IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CALIFORNIA ASSOCIATION OF PRIVATE POSTSECONDARY SCHOOLS, **Plaintiff,** **v.** **ELISABETH DeVOS, Secretary, U.S. Department of Education, *et al.*,** **Defendants.**	**Civil Action No. 17-999 (RDM)**

CALIFORNIA ASSOCIATION OF PRIVATE POSTSECONDARY SCHOOLS' MOTION FOR A PRELIMINARY INJUNCTION

Plaintiff California Association of Private Postsecondary Schools ("CAPPS") hereby moves for a preliminary injunction restraining the Department of Education ("Department"), its officers, employees, and agents from effectuating, implementing, applying, or taking any action to enforce the ban on arbitration and class-action-waiver provisions ("Arbitration and Class Action Waiver Ban") during the pendency of this litigation. The Arbitration and Class Action Waiver Ban constitutes a portion of the Final Rule challenged in this action. *See* 81 Fed. Reg. 75,926 (Nov. 1, 2016) ("Final Rule").

As detailed in the attached memorandum of law, the Arbitration and Class Action Waiver Ban contravenes the Federal Arbitration Act, exceeds the Department's statutory authority, runs afoul of the Administrative Procedure Act, and violates the Constitution. CAPPS is thus likely to succeed on the merits; its members will be irreparably harmed in the absence of injunctive relief; the balance of equities tips in its favor; and an injunction would be in the public interest.

WHEREFORE, CAPPS respectfully requests that the Court grant CAPPS's Motion for a Preliminary Injunction and enjoin the Department from enforcing the Arbitration and Class Action Waiver Ban.

Dated: June 2, 2017

Respectfully submitted,

/s/ Clifford M. Sloan
CLIFFORD M. SLOAN, DC Bar No. 417339
CAROLINE S. VAN ZILE, DC Bar No. 1017942
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
1440 New York Avenue, NW
Washington, DC 20005
T: 202/371-7000
F: 202/661-8340
Email: cliff.sloan@skadden.com
Email: caroline.vanzile@skadden.com

BORIS BERSHTEYN
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
4 Times Square
New York, NY 10036
T: 212/735-3834

GREGORY BAILEY
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
155 N Upper Wacker Dr. #2700
Chicago, IL 60606
T: 312/407-0739
F: 312/407-8604

ROBERT L. SHAPIRO, DC Bar No. 415854
Duane Morris LLP
505 Ninth Street, NW
Washington, DC 20004
T: 202/776-7867
F: 202/330-5290

Attorneys for CAPPS

CERTIFICATE OF SERVICE

I hereby certify that the foregoing Motion for a Preliminary Injunction, Memorandum in Support, and the relevant Declarations and Attachments, were sent via Federal Express to the following parties:

Elisabeth DeVos, in her official capacity as Secretary of Education
United States Department of Education
400 Maryland Avenue, S.W.
Washington, DC 20202

Jefferson B. Sessions III
United States Office of the Attorney General
950 Pennsylvania Avenue, N.W.
Washington, DC 20530

Channing D. Phillips
United States Attorney's Office for the District of Columbia
555 4th Street, N.W.
Washington, DC 20530

The Motion, Memorandum, Declarations, and Attachments were also sent via email to Sheila Lieber (Sheila.Lieber@usdoj.gov) and Thomas Zimpleman (Thomas.D.Zimpleman@usdoj.gov) at the Department of Justice, who have indicated that they will be acting as counsel for Defendants Elisabeth DeVos and the Department of Education.

Dated: June 2, 2017

Respectfully submitted,

/s/ Clifford M. Sloan
CLIFFORD M. SLOAN, DC Bar No. 417339
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
1440 New York Avenue, NW
Washington, DC 20005
T: 202/371-7000
F: 202/661-8340
Email: cliff.sloan@skadden.com

Attorney for CAPPS

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CALIFORNIA ASSOCIATION OF PRIVATE POSTSECONDARY SCHOOLS' MEMORANDUM IN SUPPORT OF ITS MOTION FOR A PRELIMINARY INJUNCTION

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INTRODUCTION

On November 1, 2016, the Department of Education ("Department") published a Final Rule adopting a series of far-reaching and unprecedented changes in its approach to student borrower defenses under the Higher Education Act. *See* 81 Fed. Reg. 75,926 (Nov. 1, 2016) ("Final Rule" or "Borrower Defense Regulations"). It provided that these changes would go into effect on July 1, 2017, the earliest possible date they could be imposed under the governing statute. The Secretary of Education has publicly stated that she is reviewing the new regulatory regime set forth in the Borrower Defense Regulations. The Department, however, has not yet modified the rules or their effective date. Accordingly, with the July 1 effective date approaching, plaintiff California Association of Private Postsecondary Schools ("CAPPS") filed suit on May 24, 2017, challenging the new rules as exceeding the Department's statutory authority, violating the Administrative Procedure Act, and flouting the Constitution.

Although CAPPS plans to ask for a briefing schedule that would expeditiously resolve the legal issues with the broader regulations, one aspect of the Final Rule will lead to immediate chaos and disruption if it goes into effect on July 1, 2017. The Final Rule bars the enforcement of arbitration provisions and class action waivers in existing agreements with students, and it further prohibits schools from entering into new agreements with arbitration provisions and class action waivers. This ban on arbitration and class-action-waiver provisions ("Arbitration and Class Action Waiver Ban") will immediately and irreparably harm CAPPS schools. Accordingly, CAPPS respectfully moves for the entry of a preliminary injunction to preserve the status quo and prevent the implementation of the Arbitration and Class Action Waiver Ban while the Court considers the merits of the challenge to the Final Rule.

Many CAPPS schools have arbitration clauses and class action waivers in their existing enrollment agreements with students to promote cost-effective and swift dispute resolution for

both the school and its students. *See* Declaration of Robert Johnson ("Johnson Decl.") ¶ 9 (June 1, 2017). In the Federal Arbitration Act ("FAA"), Congress recognized the many benefits of arbitration and enacted a broad federal pro-arbitration policy – a principle that the Supreme Court has repeatedly emphasized and upheld. Without relief from this Court, however, beginning on July 1, those well-established benefits will be unavailable to CAPPS schools: their current arbitration provisions and class action waivers will immediately become unenforceable. CAPPS schools, moreover, will immediately be prohibited from entering into such agreements with any future students.

Attempting to justify this wholesale rejection of the arbitration and class-action-waiver benefits recognized by Congress and the Supreme Court, the Department stated that it is merely making its ban a condition of receiving Title IV funding, not enacting a flat prohibition. But the elimination of Title IV funds would be the death knell for CAPPS institutions, as it would be for nearly all postsecondary institutions. Fully 80% of postsecondary students rely on Title IV funds to pay their tuition; thus, the loss of such funds would cripple any school. *See* Nat'l Ctr. For Educ. Statistics, Digest of Educ. Statistics, Table 331.20 (Nov. 2016), https://nces.ed.gov/programs/digest/d16/tables/dt16_331.20.asp (outlining financial aid statistics for 2014-15 school year). As a result, the ban is an impermissibly coercive *de facto* mandate – as other courts have recognized in similar circumstances.

The four-part test for obtaining a preliminary injunction is met here:

- **First**, CAPPS is likely to succeed on the merits with regard to the Department's regulatory overreach in enacting the Arbitration and Class Action Waiver Ban. The Department's new Arbitration and Class Action Waiver Ban conflicts with the Federal Arbitration Act; exceeds the Department's authority under the Higher

Education Act ("HEA"); violates the Administrative Procedure Act ("APA"); and contravenes the Constitution.

- **Second**, CAPPS schools will be irreparably harmed in the absence of an injunction. Schools will immediately be stripped of the benefits of arbitration and class-action waivers in their enrollment agreements for all new enrollments; chaos will ensue as schools, arbitrators, and courts debate how existing arbitrations may proceed, assuming they may proceed at all; schools that lose Title IV funding will quickly collapse; and funds lost will not be recoverable due to the Department's sovereign immunity.
- **Third**, the balance of the equities tips in CAPPS's favor. There will be no harm to the Department or students if this aspect of the Final Rule's implementation is delayed pending full consideration of the merits; in contrast, severe harm to CAPPS schools and students will flow from allowing the ban to remain in place. That is particularly true given that the Secretary is currently reconsidering the Final Rule in any event, and its fate in the long term remains uncertain.
- **Finally**, an injunction is in the public interest. In the absence of an injunction, the sound and orderly continuation of existing arbitration proceedings will be unnecessarily disrupted. Moreover, resources will be needlessly diverted away from classes and students, particularly students from underserved populations that enroll in proprietary schools like many CAPPS constituents.

For all of these reasons, CAPPS respectfully requests that this Court enter a preliminary injunction enjoining enforcement of the Arbitration and Class Action Waiver Ban by July 1, 2017.

FACTUAL BACKGROUND

CAPPS

CAPPS is a California state association of schools representing a diverse range of private postsecondary institutions in California. *See* Johnson Decl. ¶ 2. It has a membership of approximately 150 institutions, which includes proprietary (for-profit) and non-profit schools. *Id.* ¶ 4. Many CAPPS schools are technical or vocational colleges that prepare workers for occupations necessary to a thriving economy. *Id.* ¶ 7. CAPPS schools train future nurses, dialysis technicians, ultrasound technicians, home health aides, emergency medical technicians, information technology specialists, cyber-security specialists, HVAC and refrigeration technicians, electricians, paralegals, chefs, line cooks, and cosmetologists. *Id.* ¶ 8. The economy would not function without workers in these fields. Local hospitals, labs, repair companies, and restaurants depend on a reliable stream of well-trained workers. And students rely on CAPPS schools for access to skilled jobs and upward mobility.

Most CAPPS members are proprietary institutions, which serve a student population that has a high percentage of low-income and minority individuals who are otherwise not well served by traditional institutions. *See* Comments of CAPPS, ED-2015-OPE-0103, Attach. 1, Declaration of Jonathan Guryan, Ph.D. (Aug. 1, 2016). Students at proprietary schools are likely to be the first in their family to graduate from college. *Id.* ¶ 14. They are also more likely to be single parents, financially independent, and over the age of 25. *Id.* ¶ 7, 12. These students are often drawn to proprietary schools based on the schools' flexible schedules and career-focused instruction. Johnson Decl. ¶ 5-6. Proprietary schools have established a record of successful efforts to help these students, whom other schools might label "at risk," actually graduate. *See*, *e.g.*, Henry Bienen, *In Defense of For-Profit Colleges*, Wall St. J. (July 24, 2010), http://www.wsj.com/articles/SB10001424052748703724104575378933954267308. As the

Department itself acknowledged, "there are many proprietary career schools and colleges that play a vital role in the country's higher education system." 81 Fed. Reg. at 75,934.

Final Rule

The Final Rule is a sprawling mass of loosely related regulations. One of those regulatory interventions is central here: the Arbitration and Class Action Waiver Ban. Under the Final Rule, institutions that participate in the Direct Loan Program are prohibited from using or obtaining pre-dispute agreements to arbitrate borrower defense claims and from using or obtaining a waiver of a borrower's right to initiate or participate in a class action lawsuit related to those claims. *See* 81 Fed. Reg. at 76,087-88; 34 C.F.R. §§ 685.300(e)-(f). The borrower defense claims encompassed by the Final Rule include actions related to student loans, the provision of educational services, or a school's marketing – in other words, a wide variety of lawsuits a student might initiate against a school.

The Final Rule explicitly bars institutions from enforcing existing arbitration provisions or class action waivers. 81 Fed. Reg. at 76,087-88; 34 C.F.R. §§ 685.300(e)(3)(ii), 685.300(f)(3)(ii). The ban takes effect immediately on July 1, 2017. Schools must either notify borrowers of this change or amend their agreements. 81 Fed. Reg. at 76,067; 34 C.F.R. §§ 685.300(e)(3)(ii), 685.300(f)(3)(ii). The Department imposed this ban despite Congress's explicit pro-arbitration stance in the Federal Arbitration Act, despite Supreme Court decisions emphasizing the benefits of arbitration and class-action-waiver provisions in contractual agreements, and despite data in the record demonstrating the benefits of bilateral arbitration.

STANDARD OF REVIEW

To obtain a preliminary injunction, a plaintiff must establish that (i) it is "likely to succeed on the merits," (ii) "it is likely to suffer irreparable harm in the absence of preliminary

relief," (iii) "the balance of equities tips in [its] favor," and (iv) "an injunction is in the public interest." *Winter v. Nat. Res. Def. Council*, 555 U.S. 7, 20 (2008).

ARGUMENT

I. CAPPS IS LIKELY TO SUCCEED ON THE MERITS

CAPPS is likely to succeed on the merits because the Rule's Arbitration and Class Action Waiver Ban contravenes the FAA, exceeds the Department's statutory authority, runs afoul of the APA, and violates the Constitution.

A. The Arbitration and Class Action Waiver Ban Contravenes the Federal Arbitration Act

The Department's Final Rule would retroactively invalidate arbitration clauses in thousands of contracts and prohibit arbitration clauses in thousands of prospective contracts. That is exactly what Congress sought to prevent in the FAA. *See* H.R. Rep. No. 68-96, 68th Cong., 1st Sess., at 1 (1924) ("The purpose of this bill is to make valid and enforc[ea]ble agreements for arbitration contained in contracts involving interstate commerce or within the jurisdiction of admiralty, or which may be the subject of litigation in the Federal courts.").

The FAA forbids such agency action. The Federal Arbitration Act provides that arbitration agreements in contracts "*shall be* valid, irrevocable, and enforceable." 9 U.S.C. § 2 (emphasis added). Congress intended the Act to replace "indisposition to arbitration with a 'national policy favoring [it] and plac[ing] arbitration agreements on equal footing with all other contracts.'" *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 581 (2008) (quoting *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006)). As the Supreme Court has observed, the FAA embodies a "liberal federal policy favoring arbitration." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983); *see also Marmet Health Care*

Ctr., Inc. v. Brown, 132 S. Ct. 1201, 1203 (2012) (per curiam) (The FAA "reflects an emphatic federal policy in favor of arbitral dispute resolution.").

In a wide-ranging series of cases enforcing the FAA, the Supreme Court has invalidated state laws and policies that abridge the right to enforce arbitration provisions in contracts. *See, e.g.*, *DIRECTV, Inc. v. Imburgia*, 136 S. Ct. 463, 471 (2015) (holding that "California['s] . . . interpretation does not place arbitration contracts 'on equal footing with all other contracts'" and "does not give 'due regard . . . to the federal policy favoring arbitration.'" (internal citations omitted)); *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 341 (2011) ("When state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA."); *see also Marmet Health Care Ctr., Inc.*, 132 S. Ct. at 1203.

As the Supreme Court emphasized only weeks ago, the FAA "establishes an equal-treatment principle" and invalidates "any state rule discriminating on its face against arbitration." *Kindred Nursing Ctrs., L. P. v. Clark*, No. 16-32, slip op. at 4 (May 15, 2017).

In addition, the Supreme Court has made clear that the FAA protects the formation of contracts providing for arbitration just as it does the enforcement of arbitration provisions in existing contracts. *Id.* at 7-9 (rejecting the contention that the FAA is inapplicable to rules that "address only formation" of contracts); *see also, e.g.*, *Saturn Distrib. Corp. v. Williams*, 905 F.2d 719, 723 (4th Cir. 1990) ("To restrict the FAA to existing agreements would be to allow states to 'wholly eviscerate Congressional intent to place arbitration agreements upon the same footing as other contracts.'" (citing *Sec. Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1123-24 (1st Cir. 1989))).

The Supreme Court has also held that the FAA's protection of arbitration provisions fully applies to class action waivers that are part of arbitration provisions. *See AT&T Mobility LLC*,

563 U.S. 333. A prohibition against contractual provisions that specify bilateral arbitration, like the Department's class-action-waiver ban here, "sacrifices the principal advantage of arbitration – its informality – and makes the process slower, more costly, and more likely to generate procedural morass than final judgment." *Id.* at 348. The "principal purpose" of the FAA is not only to ensure that arbitration agreements are treated equally, but to "ensur[e] that private arbitration agreements are enforced *according to their terms*." *Volt Info. Servs., Inc. v. Board of Trs. of Leland Stanford Jr. Univ.*, 489 U.S. 468, 478 (1989) (emphasis added). Those terms, as the Supreme Court has recognized, certainly may include a preference for bilateral over class-wide arbitration. *AT&T Mobility LLC*, 563 U.S. at 344-52; *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 681-87 (2010).

The FAA likewise prohibits federal agencies from invalidating or otherwise discriminating against arbitration agreements or class action waivers. A federal court recently held that plaintiffs were likely to prevail in a suit against the Department of Health and Human Services, which sought to bar arbitration agreements between nursing homes and their patients. *See Am. Health Care Ass'n. v. Burwell*, No. 16-233, 2016 WL 6585295 (N.D. Miss. Nov. 7, 2016) (to be published at 217 F. Supp. 3d 921). The court noted the vast array of Supreme Court decisions striking down state laws "that stand as an obstacle to the accomplishment of the FAA's objectives." *Id.* at *6 (quoting *AT&T Mobility LLC*, 563 U.S. at 343). The court also deferred to the Supreme Court's holding that the FAA's preference for arbitration can be displaced only by a "contrary *congressional command*." *CompuCredit Corp. v. Greenwood*, 565 U.S. 95, 99 (2012) (emphasis added). As the court recognized, "Congress did not enact the Rule in this case; a federal agency did, and therein lies the rub." *Am. Health Care Ass'n.*, 2016 WL 6585295, at *19. Because of the FAA, the "burden is on the party opposing arbitration" – here, the

Department – "to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue." *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 227 (1987). In the present case, the Department of Education has not suggested that Congress intended to preclude arbitration agreements in the higher education context; therefore, the Department's rule barring arbitration agreements between schools and students is unlawful.

The Department's principal argument as to why the Arbitration and Class Action Waiver Ban does not violate the FAA is an assertion that "the HEA gives the Department the authority to impose conditions on schools that wish to participate in a Federal benefit program." 81 Fed. Reg. at 76,022. In other words, the Department contends that it is not imposing an impermissible ban on arbitration or class-action waivers because schools can always choose not to accept Title IV funds. That argument fails for two reasons. First, an agency may not use its spending power to engage in "economic dragooning" that leaves parties with "no real option but to acquiesce" to otherwise unlawful requirements. *Nat'l Fed. of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566, 2605 (2012). A threat to withdraw all Title IV funding, which 80% or more of students rely on, is a "gun to the head" that goes well beyond "the point at which pressure turns into compulsion." *Id.* at 2604 (citing *South Dakota v. Dole*, 483 U.S. 203, 211 (1987)).[1] Second, pursuant to the FAA the Supreme Court has frequently vacated provisions that merely have a disproportionate impact on arbitration clauses without imposing a flat ban. *See*, *e.g.*, *DIRECTV, Inc.*, 136 S. Ct. at 471. The Department's Final Rule certainly constitutes such unequal treatment of arbitration

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[1] At the very least, this Court should reject the Department's interpretation of its statutory authority as encompassing the authority to impose such a coercive condition (which would raise deeply problematic issues under the Spending Clause) to avoid having to confront a constitutional question. *See Solid Waste Agency of N. Cook Cty. v. U.S. Army Corps of Eng'rs*, 531 U.S. 159, 174 (2001).

contracts, which is in and of itself prohibited by the FAA. *See Kindred Nursing Centers, L. P.*, No. 16-32, slip op. at 4.[2]

Based on the text of the statute and Supreme Court precedent, the FAA bars the Department from prohibiting and rendering unenforceable arbitration agreements and class action waivers.

B. The Department Lacks the Authority to Promulgate the Ban Under the HEA

CAPPS is also likely to succeed on the merits because the Secretary lacks the authority to promulgate the Arbitration and Class Action Waiver Ban under the HEA. The Department purports to find authority for the ban in Section 454(a)(6) of the HEA, a catch-all provision codified at 20 U.S.C. § 1087d(a)(6). Under Section 454(a)(6), the Secretary may "include such . . . provisions as the Secretary determines are necessary to protect the interests of the United States and to promote the purposes of" the Direct Loan Program in program participation agreements with educational institutions. 20 U.S.C. § 1087d(a)(6). This vague catch-all provision is too thin a reed on which to hang a regulation that conflicts with the express statutory mandate of the FAA.

To begin with, in the rare circumstances in which Congress has given an agency the authority to abrogate arbitration provisions, it has done so clearly and unambiguously. For

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[2] The federal court considering a similar ban in the Medicare/Medicaid context agreed:

> [N]ursing homes are so dependent upon Medicare and Medicaid funding that the Rule in this case effectively amounts to a ban on pre-dispute nursing home arbitration contracts. This court believes that the Rule should, and likely will be, treated as what it effectively is (*i.e.*, a de facto ban), in determining whether it conflicts with the FAA. Moreover, it should be noted that, even if the Rule in this case is interpreted as a mere "incentive" against arbitration, this does not necessarily mean that singling out a form of arbitration for such disincentives allows it to survive FAA scrutiny.

Am. Health Care Ass'n, 2016 WL 6585295, at *5.

example, the Consumer Financial Protection Bureau ("CFPB") was given explicit authority by Congress to study the issue of mandatory arbitration and then to promulgate a rule regarding mandatory arbitration *if* the CFPB believed such a rule to be necessary.[3] Without such explicit congressional authorization, the FAA prohibits an agency from altering arbitration agreements. The fact that Congress plainly thought it necessary to give such explicit authority to the CFPB, and even then only after a careful study of the issue, supports the conclusion that the Department does not have the authority, under a vague catch-all provision of the HEA, to abrogate arbitration or class-action-waiver agreements.[4]

In addition, the text and structure of the HEA establish that Section 454(a)(6) does not authorize such aggressive interference with private contracts or such a massive expansion of agency authority. Section 454(a)(6) is a catch-all phrase that comes at the end of a series of

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[3] In sharp contrast to the catch-all in the HEA, the CFPB statute provides that:

> (a) The Bureau shall conduct a study of, and shall provide a report to Congress concerning, the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services.
>
> (b) The Bureau, by regulation, ***may prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties***, if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers. The findings in such rule shall be consistent with the study conducted under subsection (a).

12 U.S.C. § 5518 (emphasis added).

[4] Indeed, as the Department acknowledged (81 Fed. Reg. at 76,023), other agencies in addition to the CFPB have also been given specific, limited statutory authority to regulate arbitration provisions – unlike the Department. *See, e.g.*, 10 U.S.C. 987(f)(4), (h) (concerning the Department of Defense and regulation of the use of mandatory arbitration in extensions of credit to service members); 15 U.S.C. 78o (authorizing the SEC to regulate the use of mandatory arbitration in certain investment relationships).

ministerial requirements for loan administration under program participation agreements. And when general provisions "'follow specific words in a statutory enumeration, the general words are construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words.'" *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 114-15 (2001) (quoting 2A N. Singer, *Sutherland on Statutes and Statutory Construction* § 47.17 (1991)). For example, under Subsections (1)-(5) of Section 454(a), an institution must agree to "provide a statement that certifies the eligibility of any student to receive a loan." 20 U.S.C. § 1087d(a)(1)(C). The institution must also "set forth a schedule for disbursement of the proceeds of the loan in installments." *Id.* § 1087d(a)(1)(D). And the school may "not charge any fees of any kind, however described, to student or parent borrowers for origination activities." *Id.* § 1087d(a)(5). Under the precept of *ejusdem generis*, any provision promulgated under Section 454(a)(6) – the catch-all provision at the end of this long list – should likewise deal with the calculating, tracking, and disbursement of loan funds, or at least a similar ministerial function.

The Department seeks to use this limited catch-all requirement to override the FAA and to give the Department unbounded authority to regulate agreements between students and their schools. But as the Supreme Court has held, Congress "does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions – it does not, one might say, hide elephants in mouseholes." *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 468 (2001); *see FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 159-161 (2000) (refusing to approve the FDA's assertion of authority to regulate tobacco based on generic statutory language); *Comcast Corp. v. FCC*, 600 F.3d 642, 661 (D.C. Cir. 2010) (refusing to allow the FCC to use its ancillary authority to enact massive new regulations otherwise outside its statutory reach).

Put simply, Section 454(a)(6) is not a blank check for the Department to enact any policy it sees fit, no matter how attenuated the connection might be to loan administration. Section 454(a) does not deal with arbitration provisions or class action waivers – and neither, for that matter, does *any* provision of the HEA. The Department cannot read into 454(a)(6) authority that Congress clearly did not intend to confer.[5]

C. The Arbitration and Class Action Waiver Ban Is Arbitrary and Capricious

The Department's Arbitration and Class Action Waiver Ban is also arbitrary and capricious under the tenets of reasoned decision-making. Section 706 of the APA requires an agency to:

> examine the relevant data and articulate a satisfactory explanation for its action including a "rational connection between the facts found and the choice made." . . . Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.

Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) ("*State Farm*") (quoting *Burlington Truck Lines v. United States*, 371 U.S. 156, 168 (1962)). When engaging in notice-and-comment rulemaking, the agency also has the obligation to respond to significant comments on the record. The D.C. Circuit has held that "the opportunity

[5] Further, the Department's foray into arbitration and class action waivers is novel and unprecedented. This, too, supports the conclusion that the Arbitration and Class Action Waiver Ban exceeds the agency's authority. *See*, *e.g.*, *Util. Air Regulatory Grp. v. EPA*, 134 S. Ct. 2427, 2446 (2014) (refusing to approve the EPA's assertion of "newfound authority" to regulate energy sources that it had not attempted to regulate previously); *Brown & Williamson Tobacco Corp.*, 529 U.S. at 159-161 (refusing to approve the FDA's assertion of authority to regulate tobacco, a product that it had not attempted to regulate previously).

to comment is meaningless unless the agency responds to significant points raised by the public." *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35-36 (D.C. Cir. 1977) (citation omitted).

First, the Department violated the APA because the agency failed to adequately consider extensive data in the record demonstrating the benefits of arbitration. As discussed in the legislative history compiled to support the FAA and in Supreme Court case law interpreting the Act, the benefits of arbitration are substantial to *all* parties involved. The Supreme Court has emphasized the significant "benefits [to] private dispute resolution: lower costs, greater efficiency and speed, and the ability to choose expert adjudicators to resolve specialized disputes." *Stolt-Nielsen S.A.*, 559 U.S. at 685. CAPPS cited not only those court opinions in its comments – opinions that themselves contain references to numerous studies on arbitration – but also several published studies confirming the advantages of arbitration. *See, e.g.*, Comments of CAPPS, ED-2015-OPE-0103, at 64 ("The average time from filing to final award for the consumer arbitrations studied was 6.9 months[,] . . . [i]n cases with claims seeking less than $10,000, consumer claimants paid an average of $96[,] and . . .[c]onsumers won some relief in 53.3% of the cases they filed and recovered an average of $19,255[.]" (citing Searle Civil Justice Institute, Consumer Arbitration Before the American Arbitration Association, Preliminary Report xiii (Mar. 2009), http://www.masonlec.org/site/rte_uploads/files/Consumer %20Arbitration%20 Before%20the%20AAA%20-%20Preliminary%20Rpt.pdf)); *id.* ("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% said it was faster, 63% said it was simpler, and 51% said it was cheaper than litigation." (citing Brief of the Ctr. for Class Action Fairness as Amicus Curiae in Supp. of Pet'r at 25, *AT&T Mobility LLC. v. Concepcion*, 563 U.S. 333 (2011) (No. 09-893))); *see also* S. Rep. No. 536, 68th Cong., 1st

Sess., at 3 (1924) (the Act, by avoiding "the delay and expense of litigation," will appeal "to big business and little business alike, . . . corporate interests [and] . . . individuals"); H.R. Rep. No. 97-542, 97th Cong. 2d Sess., at 13 (1982) ("The advantages of arbitration are many: it is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is often more flexible in regard to scheduling of times and places of hearings and discovery devices . . ."). The Department, however, failed to address the substance of these submissions.[6] Because the Department failed to meaningfully consider the benefits of arbitration, it violated cardinal principles of the APA by "entirely fail[ing] to consider an important aspect of the problem"; failing to address substantial comments in the record; and "offer[ing] an explanation for its decision that runs counter to the evidence before the agency." *State Farm*, 463 U.S. at 43; *see also Home Box Office, Inc.*, 567 F.2d at 35-36.[7]

Second, in adopting the class action waiver ban, the Department likewise failed to adequately consider the serious drawbacks of class actions for students. It is well documented that class actions are often an ineffective means of obtaining relief for consumers, as CAPPS

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[6] The Department purports to be remedying "widespread abuse" by schools "aggressively us[ing] waivers and arbitration agreements to thwart" student actions over the years. 81 Fed. Reg. at 76,025. However, the Department does not acknowledge that students already have a means to combat this alleged abuse. Arbitration provisions that do not comport with the evenhanded legal principles that apply to all contracts may be voided by courts, even under the FAA. *See Marmet*, 132 S. Ct. at 1203-04. Banning arbitration agreements altogether only prevents students and institutions from being able to contract freely. Moreover, if the Department is worried about private arbitration being used to avoid publicity, the Department already proposed a separate solution: Under the Final Rule, schools must notify the Department when an arbitration or lawsuit is initiated.

[7] These benefits are confirmed by the Department, which itself requires arbitration with institutions disputing accreditation decisions. See 34 C.F.R. §§ 600.4(c), 600.5(d) (requiring an institution to "agree[] to submit any dispute involving the final denial, withdrawal, or termination of accreditation to initial arbitration before initiating any other legal action.").

noted in its comments. As practitioners and scholars have found, the incentive to litigate a class action – including compensation – is higher for attorneys than it is for individual consumers. *See, e.g.*, Deborah Platt Majoras, Chairwoman, FTC, Comments at the FTC Workshop: Protecting Consumer Interests in Class Actions (Sept. 13, 2004), 18 Geo. J. Legal Ethics 1161, 1162-63 (2005) (cited by CAPPS in the record, Comments of CAPPS, ED-2015-OPE-0103, at 66); *see also* Jill E. Fisch, *Class Action Reform, Qui Tam, and the Role of the Plaintiff*, 60 Law & Contemp. Probs. 167, 168 (1997) (discussing situation in which class members receive little or nothing but counsel are compensated generously) (cited by CAPPS in the record, Comments of CAPPS, ED-2015-OPE-0103, at 66 n.15); Susan P. Koniak & George M. Cohen, *Under Cloak of Settlement*, 82 Va. L. Rev. 1051, 1053-54 (1996) (discussing class action settlements in which class lawyers negotiated or requested multimillion dollar fees while class members received minimal in-kind compensation) (cited by CAPPS in the record, Comments of CAPPS, ED-2015-OPE-0103, at 66 n.15). For example, as CAPPS noted in its comments, even where students can overcome the high hurdle of class certification, it is statistically unlikely they will prevail. *See* Comments of CAPPS, ED-2015-OPE-0103, at 66-67. One study of consumer and employee class actions filed or removed in 2009 found that not a single class action ended in a final judgment on the merits for plaintiff: 14% remained pending four years after filing; of those resolved, 35% were voluntarily dismissed; 31% were dismissed on the merits; and 33% achieved a classwide settlement – half the settlement rate of general federal court litigation. *See* U.S. Chamber Institute for Legal Reform, *Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions* 1-2 (Dec. 11, 2013), http://www.instituteforlegalreform.com/uploads/sites/1/Class-Action-Study.pdf. Given the well-documented drawbacks of class litigation, the Department should have, at the very least, considered and addressed whether class

action waivers might ultimately hold benefits for borrowers. *See Home Box Office, Inc.*, 567 F.2d at 35-36. Once again, however, the Department failed to adequately address this important aspect of the problem.

Third, the Department relies heavily on a CFPB study on arbitration agreements and class action provisions. But that study is plainly inapposite to the public student loan context at issue in the Final Rule. The CFPB study concerned six financial products including credit cards, checking accounts, general purpose reloadable prepaid cards, payday loans, private student loans, and mobile wireless contracts governing third-party billing services. *See* 81 Fed. Reg. 32,830, 32,840 (May 24, 2016). The CFPB *itself*, however, acknowledges that federal loans fundamentally differ from private loans (let alone mobile wireless contracts): The CFPB points out that the "interest rate for a federal student loan is generally fixed"; "[f]ederal student loans allow [students] to limit the amount [they] must repay each month based on [their] income"; and there are "[o]ptions to delay or temporarily forgo payments (like deferment and forbearance)[.]" *See* Consumer Financial Protection Bureau, *What Are the Main Differences Between Federal Student Loans and Private Student Loans?*, http://www.consumerfinance.gov/askcfpb/545/what-are-main-differences-between-federal-student-loans-and-private-student-loans.html (last visited May 30, 2017). The Department may not, consistent with the mandates of reasoned decision-making, simply cut and paste findings from an entirely separate legal and factual setting, made by a separate agency with an entirely distinct statutory charter and mission.[8] Given the massive

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[8] In responding to comments raising the issue of the dissimilarity between the loans in the CFPB study and federal student loans, the Department stated that the study looked at the prevalence of arbitration agreements for private student loans, which may "share characteristics" with Direct Loan borrowers. However, the Final Rule applies to educational institutions, not private student loan lenders. If the Department was concerned with arbitration and class actions provisions offered by private student loan lenders, that concern

(cont'd)

and disruptive nature of the Final Rule, the Department's failure to undertake its own consideration of relevant data is fatal.[9] The CFPB's study is an obviously insufficient basis to sustain the Arbitration and Class Action Waiver Ban, and the Department's failure to even *consider* these differences demonstrates a failure of reasoned decision-making. *See State Farm*, 463 U.S. at 43; *see also Home Box Office, Inc*., 567 F.2d at 35-36. It also emphasizes the fact that the agency's decision runs counter to the evidence in the record. *See State Farm*, 463 U.S. at 43.

Finally, the Department failed to consider the extent to which institutions have relied on the current regulatory framework. Recently, the Supreme Court acknowledged that "an agency must . . . be cognizant that longstanding policies may have engendered serious reliance interests that must be taken into account." *Encino Motorcars, LLC v. Navarro, No*. 15-415, 579 U.S. ___, slip op. at 9 (June 20, 2016) (citations omitted). Here, institutions have relied on arbitration provisions and class action waivers, at least in part, in determining the cost of tuition, obtaining insurance, and otherwise ordering their affairs. To upend those relationships without even considering reliance interests is textbook arbitrary and capricious decision-making. *See Home Box Office, Inc*., 567 F.2d at 35-36. As a result, CAPPS is likely to prevail on the independent ground that the Final Rule violates the APA.

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did not provide justification for banning provisions by separate, unrelated educational institutions. 81 Fed. Reg. at 76,025.

[9] "[T]his court believes that CMS would be required to actually prove that [a] negative impact is occurring, with proof considerably more reliable than comments received from the public. Empirical evidence, rather than anecdotes, may (or may not) establish that a greater good is served by arbitration in most cases. The record established by CMS in this case may well be sufficient for ordinary agency business, but the agency is seeking to engage in a rather unprecedented exercise of agency power in this case. This court believes that more is required to justify the Rule in this case." *Am. Health Care Ass'n*, 2016 WL 6585295, at *12.

D. <u>The Arbitration and Class Action Waiver Ban Violates the Constitution</u>

The Final Rule also violates the Constitution because the Arbitration and Class Action Waiver Ban will be applied to contracts that currently exist between students and former students and institutions. To the extent that the provisions are applied to contracts already in existence, or retroactively, the provisions contravene the Due Process Clause. *See generally, e.g., Pension Benefit Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717 (1984) (discussing Due Process Clause problems with retroactive changes to economic contracts); *E. Enters. v. Apfel*, 524 U.S. 498, 547-50 (1998) (Kennedy, J. concurring) (citing cases). For that independent reason, CAPPS is likely to prevail on the merits.

II. SCHOOLS WILL SUFFER IRREPARABLE HARM ABSENT AN INJUNCTION

When the Arbitration and Class Action Waiver Ban goes into effect on July 1, CAPPS schools – and their students – will suffer immediate and irreparable harm.

Schools that comply with the Final Rule will be faced with irreparable harm. As of July 1, schools can no longer include arbitration or class action provisions in their enrollment agreements, and schools will be immediately unable to enforce existing arbitration or class action waiver provisions. Schools will also have to send notices to borrowers indicating that they will not enforce existing agreements. 81 Fed. Reg. at 76,067; 34 C.F.R. §§ 685.300(e)(3)(ii), 685.300(f)(3)(ii). This will lead to considerable turmoil that cannot be undone even if the ban is later invalidated.

Once a school sends notices to students as required by the rule, the added confusion caused by rescinding them when the rule is invalidated would be severe. Also, for CAPPS members, the enrollment agreement is the basis of the relationship between a school and its students. In fact, under California law, an enrollment agreement is the sole means by which a student can enroll at a school approved by the California Bureau of Private Postsecondary

Education. *See* Cal. Educ. Code § 94902(a). Once students have signed the agreement, it will be virtually impossible to retroactively adopt pre-dispute arbitration and class-action-waiver provisions. *See* Johnson Decl. ¶ 13; Declaration of Stanbridge University ("Stanbridge Decl.") ¶ 11 (June 1, 2017); Declaration of Gurnick Academy of Medical Arts ("AMA Decl.") ¶ 11 (June 1, 2017); Declaration of Institute of Technology ("IT Decl.") ¶ 11 (June 2, 2017); Declaration of West Coast University ("West Coast Decl.") ¶ 12 (June 2, 2017); Declaration of American Career College ("ACA Decl.") ¶ 12 (June 2, 2017). In similar circumstances, courts have held that the harm to institutions was irreparable. *See Am. Health Care Assn.* 2016 WL 6585295, at *15 (Irreparable harm would take place where "nursing homes will lose signatures on arbitration contracts which they will likely never regain. Moreover, this court agrees with plaintiffs that 'provider Plaintiffs and other SNFs/NFs would incur immediate, substantial administrative expenses. Admission agreements would need to be revised, and staff would require retraining on admissions and dispute-resolution procedures.'"); *Am. Fin. Servs. Ass'n. v. Burke*, 169 F. Supp. 2d 62, 70-71 (D. Conn. 2001) ("No later relief can reform the contracts that AFSA members entered into without mandatory arbitration clauses or restore to AFSA members the negotiating position they would have occupied had section 5(7) not been in effect.").

Temporary implementation of the Final Rule also will cause chaos for schools and their students. Cases that are currently proceeding in arbitration and may be near final disposition could be halted in their tracks, as the Final Rule creates deep uncertainty for schools surrounding what actions (if any) they may undertake in ongoing proceedings without losing their Title IV funding. West Coast Decl. ¶ 11; ACA Declaration ¶ 11. The Final Rule will also cause disarray and disorder for courts and schools faced with new cases: A school will not be able to request removal to arbitration without risking its funding, although it would later be able to do so –

potentially upending a court case that has been proceeding – if the Final Rule were invalidated. In the interim, schools will need to amend their agreements; retrain their admissions staffs; and actually litigate cases, including class actions, in federal and state court. *See* Johnson Decl. ¶ 12; Stanbridge Decl. ¶¶ 12-13; AMA Decl. ¶¶ 12-13; IT Decl. ¶¶ 13-14; West Coast Decl. ¶¶ 13-14; ACA Decl. ¶¶ 13-14; *see generally Sec. Indus. Ass'n v. Connolly*, 703 F. Supp. 146, 157-58 (D. Mass. 1988), *aff'd*, 883 F.2d 1114 (1st Cir. 1989) ("The harm to the plaintiffs is irreparable if enforcement of the regulations is not enjoined. The patterns and practices of contract formation regarding securities arbitration will, of course, need costly revision during the pendency of the litigation in the absence of an injunction.").

The Department's only response – that a school could completely forego Title IV funding if it would like to continue using its arbitration and class-action-waiver provisions – severely exacerbates the prospect of irreparable injury. Cutting off a school from Title IV funding based on its adherence to contractual arbitration and class-action provisions would bankrupt any school and leave its students stranded. *See* Johnson Decl. ¶¶ 15-16; Stanbridge Decl. ¶¶ 3-4; AMA Decl. ¶¶ 3-4; IT Decl. ¶¶ 3-4; West Coast Decl. ¶¶ 3-4; ACA Decl. ¶¶ 3-4. Although monetary harm is not typically irreparable, economic harm is irreparable where "the loss threatens the very existence of the movant's business." *Wis. Gas Co. v. FERC*, 758 F.2d 669, 674 (D.C. Cir. 1985); *see*, *e.g.*, *Semmes Motors, Inc. v. Ford Motor Co.*, 429 F.2d 1197, 1205 (2d Cir. 1970) (Friendly, J.) ("[T]he right to continue a business . . . is not measurable entirely in monetary terms."); *TD Int'l, LLC v. Fleischmann*, 639 F. Supp. 2d 46, 48 (D.D.C. 2009); 11A Wright & Miller, Fed. Prac. & Proc. Civ. § 2948.1 (3d ed. 2013) ("[W]hen the potential economic loss is so great as to threaten the existence of the moving party's business, then a preliminary injunction may be granted, even though the amount of direct financial harm is readily ascertainable.").

Even if the Final Rule were eventually vacated, moreover, and even if the disruption caused by the ban could be ameliorated, schools *cannot recover funds from the Department* because of sovereign immunity. Their losses would be permanent. Losses that cannot be recovered due to sovereign immunity constitute irreparable harm. *See*, *e.g.*, *Enter. Int'l, Inc. v. Corporation Estatal Petrolera Ecuatoriana*, 762 F.2d 464, 473 (5th Cir. 1985) ("The absence of an available remedy by which the movant can later recover monetary damages" can constitute "irreparable injury"); *Texas Children's Hospital v. Burwell*, 76 F. Supp. 3d 224, 241-45 (D.D.C. 2014) (finding irreparable harm where the states did not have a procedure for recovering supplemental payments once they had been recouped, and the loss of funds would mean reducing the hospitals' service); *Am. Fin. Servs. Assn.*, 169 F. Supp. 2d at 70-71 ("Where pecuniary losses cannot later be recovered because the defendant enjoys Eleventh Amendment immunity (as the State of Connecticut does here), such losses are irreparable for purposes of preliminary injunctive relief.").

Since the Final Rule violates the Due Process Clause, that harm is irreparable as well. Deprivation of such a fundamental constitutional right is *de facto* irreparable. "[S]uits for declaratory and injunctive relief against the threatened invasion of a constitutional right do not ordinarily require proof of any injury other than the threatened constitutional deprivation itself." *Davis v. District of Columbia*, 158 F.3d 1342, 1346 (D.C. Cir. 1998). Thus, "a prospective violation of a constitutional right constitutes irreparable injury for [preliminary injunction] purposes." *Id.* (internal citation omitted); *see also Gordon v. Holder*, 721 F.3d 638, 653 (D.C. Cir. 2013) (finding irreparable harm in the context of a Due Process Clause violation).

CAPPS is filing this request for a preliminary injunction approximately one month before the Final Rule takes effect. The federal government has indicated that the Rule may be

significantly modified at some indeterminate date. The Secretary of Education, for example, recently testified to Congress that changes may be forthcoming in the next few weeks. *See*, *e.g.*, Michael Stratford, *DeVos Says She'll Process Already-Approved Student Debt Relief Claims*, PoliticoPro.com (May 24, 2017, 2:16 PM), https://www.politicopro.com/education/whiteboard/2017/05/devos-says-shell-process-already-approved-student-debt-relief-claims-088261 (Secretary DeVos testimony: The Borrower Defense Regulations are "something that we are studying carefully and looking at and we will have something further to say on that within the next few weeks."). But the implementation of the Final Rule is imminent, and CAPPS schools cannot wait any longer. The harm that will be imposed on July 1 will be impossible to repair. For the reasons set forth, CAPPS has demonstrated that its schools will suffer irreparably if the Final Rule goes into effect.

III. THE BALANCE OF EQUITIES TILTS IN CAPPS'S FAVOR

The balance of equities tips in CAPPS's favor. An injunction would merely maintain the status quo, which has been satisfactory to the Department and schools for decades. *See George Wash. Univ. v. Dist. of Columbia*, 148 F. Supp. 2d 15, 19 (D.D.C. 2001) (injunction warranted where it merely preserved the status quo and the only harm to the district would be delay); *Carey v. Fed. Election Comm'n*, 791 F. Supp. 2d 121, 134-35 (D.D.C. 2011) (harm to individual rights outweighed agency's interest in enforcing its regulation). The only harm the Department would suffer if it ultimately prevails would be delayed implementation of its regulations. Courts often grant equitable relief in similar circumstances. *See*, *e.g.*, *Professional Massage Training Ctr, Inc. v. Accreditation All. of Career Sch. and Colls.*, 951 F. Supp. 2d 851, 854 (E.D. Va. 2012) (harm caused by delay was outweighed by damage to school); *see also Bayou Lawn & Landscape Servs. v. Sec'y of Labor*, 713 F.3d 1080, 1085 (11th Cir. 2013) ("DOL argues that it is harmed by having 'its entire regulatory program called into question.' This is not an appealing

argument. If the 'entire regulatory program' is *ultra vires*, then it should be called into question."). In fact, because the Secretary has already announced her intention to revisit and perhaps revise the Borrower Defense Regulations, the Department has little interest in temporarily implementing the Final Rule, creating chaos for schools, and ultimately repealing the Rule in any event. By contrast, implementation of the Arbitration and Class Action Waiver Provisions would seriously and irreparably injure schools.

IV. AN INJUNCTION WOULD SERVE THE PUBLIC INTEREST

A preliminary injunction is in the public interest. *See*, *e.g.*, *George Washington Univ.*, 148 F. Supp. 2d at 19; *Prof'l Massage Training Ctr., Inc.*, 951 F. Supp. 2d at 854-55. Creating chaos and disruption in arbitral tribunals and courts is contrary to the public interest. It is in the public interest, meanwhile, for schools to be able to focus on their educational mission and devote their resources to serving their students without suffering from the disorder that will follow the imposition of the Final Rule. When, for example, the arbitration and class action provisions go into effect, massive litigation costs (and insurance premiums) will be imposed on schools with no corresponding benefit to students. *See* Johnson Decl. ¶ 12; Stanbridge Decl. ¶¶ 12-14; AMA Decl. ¶¶ 12-14; IT Decl. ¶¶ 12-14; West Coast Decl. ¶¶ 13-15; ACA Decl. ¶¶ 13-15. This would cause tuition to rise or services to decline. *Id*; Because proprietary schools disproportionately serve underserved populations, the negative impact of the rules would also disproportionately harm those groups. Preventing that harm is in the public interest. This is particularly true here because individuals always retain the right to challenge particular arbitration agreements on a case-by-case basis on well-established grounds. *See Marmet*, 132 S. Ct. at 1203.

CONCLUSION

For the foregoing reasons, the Court should grant CAPPS's Motion for a Preliminary Injunction and enjoin the Department from enforcing the Arbitration and Class Action Waiver Ban.

Dated: June 2, 2017

Respectfully submitted,

/s/ Clifford M. Sloan

CLIFFORD M. SLOAN, DC Bar No. 417339
CAROLINE S. VAN ZILE, DC Bar No. 1017942
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
1440 New York Avenue, NW
Washington, DC 20005
T: 202/371-7000
F: 202/661-8340
Email: cliff.sloan@skadden.com
Email: caroline.vanzile@skadden.com

BORIS BERSHTEYN
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
4 Times Square
New York, NY 10036
T: 212/735-3834

GREGORY BAILEY
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
155 N Upper Wacker Dr. #2700
Chicago, IL 60606
T: 312/407-0739
F: 312/407-8604

ROBERT L. SHAPIRO, DC Bar No. 415854
Duane Morris LLP
505 Ninth Street, NW
Washington, DC 20004
T: 202/776-7867
F: 202/330-5290

Attorneys for CAPPS

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CALIFORNIA ASSOCIATION OF PRIVATE POSTSECONDARY SCHOOLS, *Plaintiff*, v. ELISABETH DeVOS, Secretary, U.S. Department of Education, *et al.*, *Defendants*.	Civil Action No. 17-0999 (RDM)

[PROPOSED] ORDER GRANTING
MOTION FOR PRELIMINARY INJUNCTION

UPON CONSIDERATION of Plaintiff's Motion for a Preliminary Injunction, the declarations attached thereto, and the other filings and records in this case, and for good cause shown, it is hereby

ORDERED that the Motion is GRANTED and the Department of Education, its officers, employees, and agents are preliminarily ENJOINED from effectuating, implementing, applying, or taking any action whatsoever to enforce the Arbitration and Class Action Waiver Ban during the pendency of this litigation.

Signed this ____ day of June, 2017.

____
RANDOLPH D. MOSS
United States District Judge

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CALIFORNIA ASSOCIATION OF PRIVATE POSTSECONDARY SCHOOLS,

Plaintiff,

v.

ELISABETH DeVOS, Secretary, U.S. Department of Education, *et al.*,

Defendants.

Civil Action No. 17-999 (RDM)

DECLARATION OF ROBERT JOHNSON

I, Robert Johnson, submit this declaration in support of the California Association of Private Postsecondary Schools ("CAPPS")'s Motion for a Preliminary Injunction. I have personal knowledge of the facts stated herein.

1. I am the Executive Director of CAPPS. I have held this position since 1998. Working with the CAPPS Board of Directors, my responsibilities include representing the CAPPS membership and private postsecondary institutions in matters before the Governor, State Legislature, and various regulatory bodies. I routinely assist CAPPS schools in complying with regulatory mandates. One area in which CAPPS provides its members with assistance is in the drafting of enrollment agreements and arbitration provisions. Before joining CAPPS, I managed public sector programs in California at the city and county level.
2. Plaintiff CAPPS is a non-profit association of California private postsecondary schools.
3. CAPPS's principal place of business is located in Sacramento, California.
4. CAPPS has a membership of approximately 150 educational institutions, including proprietary (*i.e.*, for-profit) and non-profit schools, most of which are eligible for Title IV funding.
5. CAPPS members serve many students who are non-traditional, including students

who did not attend college immediately after graduating from high school, part-time students, students with full-time jobs, students who are financially independent, students who have dependents, and students who have earned a GED.

6. These students are often drawn to proprietary schools based on the schools' flexible schedules and career-focused instruction.
7. Many CAPPS schools are technical or vocational colleges that prepare workers for occupations necessary to a thriving economy.
8. CAPPS schools train future nurses, dialysis technicians, ultrasound technicians, home health aides, emergency medical technicians, information technology specialists, hardware and software experts, cyber-security specialists, HVAC and refrigeration technicians, heavy equipment specialists, electricians, paralegals, chefs, line cooks, and cosmetologists.
9. Based on in-person surveys conducted at annual meetings, virtually all CAPPS schools utilize arbitration agreements with their students. For example, CAPPS members Colleen O'Hara's Beauty Academy and Pima Medical Institute use arbitration agreements. These schools also participate in Title IV of the Higher Education Act.
10. Under the Department of Education's Final Rule, on July 1, 2017, Title IV schools, including CAPPS members, will be banned from enforcing their current arbitration agreements, including class-action waivers. Title IV schools, including CAPPS members, will also be required to send notices to their students advising them that the arbitration provisions in their agreements are no longer enforceable.
11. Implementation of the Final Rule's ban on arbitration and class-action-waivers, including the mandatory notice to students and the effect on current and pending arbitrations, will cause immediate chaos and disruption for CAPPS schools and their students. This chaos and disruption will occur even if the implementation

of the Final Rule's arbitration and class-action-waiver ban is only temporary.

12. To comply with the Final Rule, CAPPS schools will need to amend their agreements; retrain their admissions staffs; and actually litigate new cases, including class actions, in federal and state court. This will come at an enormous cost to CAPPS schools.

13. A school's enrollment agreement is the basis of the relationship between a school and its students. Once the parties have signed the enrollment agreement, it will not be feasible to retroactively impose an arbitration provision.

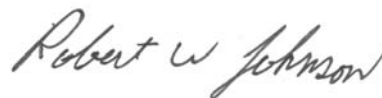
14. If schools do not comply with the Final Rule's ban on arbitration and class-action-waivers, they will lose their Title IV funding.

15. Most CAPPS schools rely on Title IV for the large majority of their students' tuition payments.

16. Accordingly, if any CAPPS school were to lose its Title IV funding, it would go out of business. As proprietary institutions, CAPPS schools rely on tuition for almost all of their revenues. No school could withstand the loss of such a large percentage of its revenue for even a single academic term.

I declare under penalty of perjury that the foregoing is true and correct.

Executed this 1st day of June, 2017 in Sacramento, CA.



Robert Johnson

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CALIFORNIA ASSOCIATION OF PRIVATE POSTSECONDARY SCHOOLS,

Plaintiff,

v.

ELISABETH DeVOS, Secretary, U.S. Department of Education, *et al.*,

Defendants.

Civil Action No. 17-999 (RDM)

DECLARATION OF AMERICAN CAREER COLLEGE

I, D. Scott Casanover, submit this declaration in support of the California Association of Private Postsecondary Schools ("CAPPS")'s Motion for a Preliminary Injunction. I have personal knowledge of the facts stated herein.

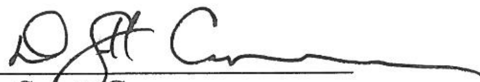
1. I am the General Counsel for American Career College. American Career College prepares students for careers in nursing and healthcare.
2. Our school is a member of CAPPS.
3. Our school and its students rely on Title IV loans to continue providing a high-quality education. Without Title IV loans, the school would not be able to continue operating.
4. Over 80% of our students rely on Title IV loans. They enable us to serve students who do not come from a wealthy background.
5. Our school, like many institutions, uses arbitration provisions in our enrollment agreements. These provisions provide that disputes arising from the agreement brought by either party should be resolved in arbitration conducted by the American Arbitration Association.
6. Our school uses arbitration because it is efficient at resolving disputes.
7. Our enrollment agreements provide that challenges should be brought only in an

individual capacity, not as a group.

8. Our school has relied on the availability of arbitration as a means to fairly resolve disputes without the expense and time of civil litigation.
9. We would be harmed by the absence of arbitration and class action provisions in our enrollment agreements.
10. We are a relatively small school and it would be extremely burdensome to be required to litigate numerous time-intensive and funding-intensive cases in court.
11. We currently have disputes in arbitration and are not certain how we could proceed with those disputes if the Final Rule goes into effect.
12. If we cannot include arbitration provisions in our enrollment agreements, the agreements will be difficult if not impossible to amend at a future date.
13. When the arbitration and class action provisions go into effect, the resulting litigation will divert school resources from education, to the detriment of our school and its students.
14. The Department of Education's new ban on arbitration and class action waiver provisions will require changing multiple policies, procedures, current and past enrollment agreements, and future enrollment agreements. These changes will be enormously burdensome and disruptive to our educational mission.
15. This expansive change will also require a time-intensive assessment of financial impact, both to our students and our institution, before it can be implemented.
16. It will be a significant hardship to implement such sweeping changes to current, past, and future agreements on July 1, 2017.

I declare under penalty of perjury that the foregoing is true and correct.

Executed this 2nd day of June, 2017 in Irvine, California.



D. Scott Casanover
General Counsel
American Career College

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CALIFORNIA ASSOCIATION OF PRIVATE POSTSECONDARY SCHOOLS, *Plaintiff*, v. ELISABETH DeVOS, Secretary, U.S. Department of Education, *et al.*, *Defendants*.	Civil Action No. 17-999 (RDM)

DECLARATION OF GURNICK ACADEMY OF MEDICAL ARTS

I, KONSTANTIN GOURJI, submit this declaration in support of the California Association of Private Postsecondary Schools ("CAPPS")'s Motion for a Preliminary Injunction. I have personal knowledge of the facts stated herein.

1. I have been the Chief Executive Officer since 02/28/2004. Gurnick Academy of Medical Arts prepares students for careers in Nursing and Allied Health.
2. Our school is a member of CAPPS.
3. Our school and its students rely on Title IV loans to continue providing a high-quality education. Without Title IV loans, the school would not be able to continue operating.
4. Over 80% of our students rely on Title IV loans, and those loans account for over 65% of our tuition payments each year. They enable us to serve students who do not come from a wealthy background.
5. Our school, like many institutions, uses arbitration provisions in our enrollment agreements. These provisions provide that disputes arising from the agreement brought by either party should be resolved in arbitration conducted by the American Arbitration Association.
6. Our school uses arbitration because it is efficient at resolving disputes.

7. Our enrollment agreements provide that challenges should be brought only in an individual capacity, not as a group.
8. Our school has relied on the availability of arbitration as a means to fairly resolve disputes without the expense and time of civil litigation.
9. We would be harmed by the absence of arbitration and class action provisions in our enrollment agreements.
10. We are a relatively small school and it would be extremely burdensome to be required to litigate numerous time-intensive and funding-intensive cases in court.
11. If we cannot include arbitration provisions in our enrollment agreements, the agreements will be difficult if not impossible to amend at a future date.
12. When the arbitration and class action provisions go into effect, the resulting litigation will divert school resources from education, to the detriment of our school and its students.
13. The Department of Education's new ban on arbitration and class action waiver provisions will require changing multiple policies, procedures, current and past enrollment agreements, and future enrollment agreements. These changes will be enormously burdensome and disruptive to our educational mission.
14. This expansive change will also require a time-intensive assessment of financial impact, both to our students and our institution, before it can be implemented.
15. It will be a significant hardship to implement such sweeping changes to current, past, and future agreements on July 1, 2017.

I declare under penalty of perjury that the foregoing is true and correct.

Executed this 1st day of June, 2017 in San Mateo, CA.

Konstantin Gourji

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CALIFORNIA ASSOCIATION OF PRIVATE POSTSECONDARY SCHOOLS,

Plaintiff,

v.

ELISABETH DeVOS, Secretary, U.S. Department of Education, *et al.*,

Defendants.

Civil Action No. 17-999 (RDM)

DECLARATION OF INSTITUTE OF TECHNOLOGY

I, Rick Wood, submit this declaration in support of the California Association of Private Postsecondary Schools ("CAPPS")'s Motion for a Preliminary Injunction. I have personal knowledge of the facts stated herein.

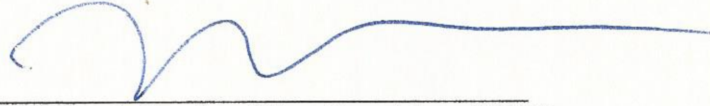
1. I have been the Senior Vice President and Chief Compliance Officer since 2007. The Institute of Technology prepares students for careers in medical, technical, culinary, business and other specialized careers like nursing and physical threrapy.
2. Our school is a member of CAPPS.
3. Our school and its students rely on Title IV loans to continue providing a high-quality education. Without Title IV loans, the school would not be able to continue operating.
4. Over 80% of our students rely on Title IV loans, and those loans account for over 80% of our tuition payments each year. They enable us to serve students who do not come from a wealthy background.
5. Our school, like many institutions, uses arbitration provisions in our enrollment agreements. These provisions provide that disputes arising from the agreement brought by either party should be resolved in arbitration conducted by the

American Arbitration Association.

6. Our school uses arbitration because it is efficient at resolving disputes.
7. Our enrollment agreements provide that challenges should be brought only in an individual capacity, not as a group.
8. Our school has relied on the availability of arbitration as a means to fairly resolve disputes without the expense and time of civil litigation.
9. We would be harmed by the absence of arbitration and class action provisions in our enrollment agreements.
10. We are a relatively small school and it would be extremely burdensome to be required to litigate numerous time-intensive and funding-intensive cases in court.
11. If we cannot include arbitration provisions in our enrollment agreements, the agreements will be difficult if not impossible to amend at a future date.
12. When the arbitration and class action provisions go into effect, the resulting litigation will divert school resources from education, to the detriment of our school and its students.
13. The Department of Education's new ban on arbitration and class action waiver provisions will require changing multiple policies, procedures, current and past enrollment agreements, and future enrollment agreements. These changes will be enormously burdensome and disruptive to our educational mission.
14. This expansive change will also require a time-intensive assessment of financial impact, both to our students and our institution, before it can be implemented.
15. It will be a significant hardship to implement such sweeping changes to current, past, and future agreements on July 1, 2017.

I declare under penalty of perjury that the foregoing is true and correct.

Executed this 2nd day of June, 2017 in Clovis, California.



Rick Wood, Senior Vice President/CCO

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CALIFORNIA ASSOCIATION OF PRIVATE POSTSECONDARY SCHOOLS,

Plaintiff,

v.

ELISABETH DeVOS, Secretary, U.S. Department of Education, *et al.*,

Defendants.

Civil Action No. 17-999 (RDM)

DECLARATION OF STANBRIDGE UNIVERSITY

I, Yasith Weerasuriya, submit this declaration in support of the California Association of Private Postsecondary Schools ("CAPPS")'s Motion for a Preliminary Injunction. I have personal knowledge of the facts stated herein.

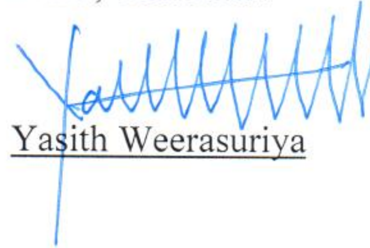
1. I have been the President at Stanbridge University since June 1, 1996. Stanbridge University prepares students for a variety of careers in Nursing, Physical therapy, Occupational Therapy and Veterinary Science at the Masters, Bachelors, Associates and diploma level.
2. Our school is a member of CAPPS.
3. Our school and its students rely on Title IV loans to continue providing a high-quality education. Without Title IV loans, the school would not be able to continue operating.
4. Over 90% of our students rely on Title IV loans, and those loans account for over 69% of our tuition payments each year. They enable us to serve students who do not come from a wealthy background.
5. Our school, like many institutions, uses arbitration provisions in our enrollment agreements. These provisions provide that disputes arising from the agreement brought by either party should be resolved in arbitration conducted by the

American Arbitration Association.

6. Our school uses arbitration because it is efficient at resolving disputes.
7. Our school has relied on the availability of arbitration as a means to fairly resolve disputes without the expense and time of civil litigation.
8. We would be harmed by the absence of arbitration and class action provisions in our enrollment agreements.
9. We are a relatively small school and it would be extremely burdensome to be required to litigate numerous time-intensive and funding-intensive cases in court.
10. We currently have disputes in arbitration and are not certain how we could proceed with those disputes if the Final Rule goes into effect.
11. If we cannot include arbitration provisions in our enrollment agreements, the agreements will be difficult if not impossible to amend at a future date.
12. When the arbitration and class action provisions go into effect, the resulting litigation will divert school resources from education, to the detriment of our school and its students.
13. The Department of Education's new ban on arbitration and class action waiver provisions will require changing multiple policies, procedures, current and past enrollment agreements, and future enrollment agreements. These changes will be enormously burdensome and disruptive to our educational mission.
14. This expansive change will also require a time-intensive assessment of financial impact, both to our students and our institution, before it can be implemented.
15. It will be a significant hardship to implement such sweeping changes to current, past, and future agreements on July 1, 2017.

I declare under penalty of perjury that the foregoing is true and correct.

Executed this 1st day of June, 2017 in Irvine, California.



Yasith Weerasuriya

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CALIFORNIA ASSOCIATION OF PRIVATE POSTSECONDARY SCHOOLS,

Plaintiff,

v.

ELISABETH DeVOS, Secretary, U.S. Department of Education, *et al.*,

Defendants.

Civil Action No. 17-999 (RDM)

DECLARATION OF WEST COAST UNIVERSITY

I, D. Scott Casanover, submit this declaration in support of the California Association of Private Postsecondary Schools ("CAPPS")'s Motion for a Preliminary Injunction. I have personal knowledge of the facts stated herein.

1. I am the General Counsel for West Coast University. West Coast University prepares students for careers in nursing and prepares 19% of all BSN-RNs and 9% of all new RNs for the State of California.
2. Our school is a member of CAPPS.
3. Our school and its students rely on Title IV loans to continue providing a high-quality education. Without Title IV loans, the school would not be able to continue operating.
4. Over 80% of our students rely on Title IV loans. They enable us to serve students who do not come from a wealthy background.
5. Our school, like many institutions, uses arbitration provisions in our enrollment agreements. These provisions provide that disputes arising from the agreement brought by either party should be resolved in arbitration conducted by the American Arbitration Association.
6. Our school uses arbitration because it is efficient at resolving disputes.

7. Our enrollment agreements provide that challenges should be brought only in an individual capacity, not as a group.
8. Our school has relied on the availability of arbitration as a means to fairly resolve disputes without the expense and time of civil litigation.
9. We would be harmed by the absence of arbitration and class action provisions in our enrollment agreements.
10. We are a relatively small school and it would be extremely burdensome to be required to litigate numerous time-intensive and funding-intensive cases in court.
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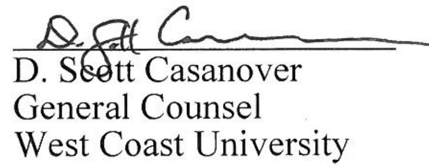
13. When the arbitration and class action provisions go into effect, the resulting litigation will divert school resources from education, to the detriment of our school and its students.
14. The Department of Education's new ban on arbitration and class action waiver provisions will require changing multiple policies, procedures, current and past enrollment agreements, and future enrollment agreements. These changes will be enormously burdensome and disruptive to our educational mission.
15. This expansive change will also require a time-intensive assessment of financial impact, both to our students and our institution, before it can be implemented.
16. It will be a significant hardship to implement such sweeping changes to current, past, and future agreements on July 1, 2017.

I declare under penalty of perjury that the foregoing is true and correct.

Executed this 2nd day of June, 2017 in Irvine, California.



D. Scott Casanover
General Counsel
West Coast University

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CALIFORNIA ASSOCIATION OF PRIVATE POSTSECONDARY SCHOOLS, *Plaintiff*, v. ELISABETH DeVOS, Secretary, U.S. Department of Education, *et al.*, *Defendants*.	Civil Action No. 17-999 (RDM)

DECLARATION OF CAROLINE S. VAN ZILE

I am an attorney admitted to practice before the courts of the District of Columbia and before this Court. I am an attorney in the law firm of Skadden, Arps, Slate, Meagher & Flom LLP, which is counsel of record for Plaintiff California Association of Private Postsecondary Schools ("CAPPS") in the above-captioned matter. I submit this declaration in support of CAPPS's Motion for a Preliminary Injunction. I have personal knowledge of the facts stated herein.

1. Attached as **Exhibit A** is a true and correct copy of the table found in the National Center For Education Statistics' Digest of Education Statistics, Table 331.20 (Nov. 2016), https://nces.ed.gov/programs/digest/d16/tables/dt16_331.20.asp.
2. Attached as **Exhibit B** is a true and correct copy of Johnathan Guryan's declaration, which was filed in the administrative record under the Comments of CAPPS, ED-2015-OPE-0103, Attach. 1, Declaration of Jonathan Guryan, Ph.D. (Aug. 1, 2016).
3. Attached as **Exhibit C** is a true and correct copy of an article cited in the brief and administrative record as Henry Bienen, *In Defense of For-Profit Colleges*, Wall St. J. (July 24, 2010).
4. Attached as **Exhibit D** is a true and correct copy of an article cited in the brief and administrative record as Searle Civil Justice Institute, Consumer Arbitration Before the American Arbitration Association, Preliminary Report (Mar. 2009).

5. Attached as **Exhibit E** is a true and correct copy of an article cited in the brief and administrative record as Deborah Platt Majoras, Chairwoman, FTC, Comments at the FTC Workshop: Protecting Consumer Interests in Class Actions (Sept. 13, 2004), 18 Geo. J. Legal Ethics 1161 (2005).
6. Attached as **Exhibit F** is a true and correct copy of an article cited in the brief and administrative record as Jill E. Fisch, *Class Action Reform, Qui Tam, and the Role of the Plaintiff,* 60 Law & Contemp. Probs. 167 (1997).
7. Attached as **Exhibit G** is a true and correct copy of an article cited in the brief and administrative record as Susan P. Koniak & George M. Cohen, *Under Cloak of Settlement,* 82 Va. L. Rev. 1051 (1996).
8. Attached as **Exhibit H** is a true and correct copy of an article cited in the brief and administrative record as U.S. Chamber Institute for Legal Reform, *Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions* (Dec. 11, 2013).
9. Attached as **Exhibit I** is a true and correct copy of a website cited in the brief and administrative record as Consumer Financial Protection Bureau, *What Are the Main Differences Between Federal Student Loans and Private Student Loans?,* http://www.consumerfinance.gov/askcfpb/545/what-are-main-differences-between-federal-student-loans-and-private-student-loans.html.
10. Attached as **Exhibit J** is a true and correct copy of an article cited in the brief as Michael Stratford, *DeVos Says She'll Process Already-Approved Student Debt Relief Claims*, PoliticoPro.com (May 24, 2017, 2:16 PM).

I declare under penalty of perjury that the foregoing is true and correct.

Executed on June 2, 2017, in Washington, DC.

/s/ Caroline S. Van Zile
Caroline S. Van Zile

EXHIBIT A

2016 Tables and Figures All Years of Tables and Figures Most Recent Full Issue of the Digest

Table 331.20. Full-time, first-time degree/certificate-seeking undergraduate students enrolled in degree-granting postsecondary institutions, by participation and average amount awarded in financial aid programs, and control and level of institution: 2000-01 through 2014-15

				Percent of enrolled students awarded aid				Average award for students in aid programs[1]							
								Current dollars				Constant 2015-16 dollars[2]			
Control and level of institution, and year	Number enrolled	Number awarded financial aid	Percent awarded aid	Federal grants	State/ local grants	Institutional grants	Student loans[3]	Federal grants	State/ local grants	Institutional grants	Student loans[3]	Federal grants	State/ local grants	Institutional grants	Student loans[3]
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
All institutions															
2000-01	1,976,600	1,390,527	70.3	31.6	31.2	31.1	40.1	$2,486	$2,039	$4,740	$3,764	$3,384	$2,775	$6,450	$5,123
2001-02	2,050,016	1,481,592	72.3	33.3	32.5	31.5	40.7	2,739	2,057	4,918	3,970	3,663	2,751	6,576	5,309
2002-03	2,135,613	1,553,024	72.7	34.1	30.9	31.5	41.4	2,947	2,189	5,267	4,331	3,856	2,864	6,892	5,666
2003-04	2,178,517	1,610,967	73.9	34.6	31.2	31.9	43.1	2,934	2,226	5,648	4,193	3,756	2,850	7,232	5,369
2004-05	2,260,590	1,689,910	74.8	35.2	31.3	31.7	44.0	2,939	2,343	5,958	4,463	3,653	2,913	7,406	5,547
2005-06	2,309,543	1,731,315	75.0	33.7	30.8	32.7	44.6	2,959	2,441	6,213	4,831	3,543	2,923	7,440	5,785
2006-07	2,427,043	1,766,257	72.8	32.1	30.0	32.2	43.5	3,125	2,526	6,593	5,014	3,648	2,948	7,695	5,853
2007-08	2,532,955	1,914,567	75.6	35.4	30.6	33.6	45.6	3,376	2,580	6,791	6,009	3,800	2,904	7,644	6,763
2008-09	2,542,748	1,974,063	77.6	36.4	31.7	34.6	46.6	3,927	2,706	7,518	6,723	4,359	3,004	8,346	7,463
2009-10	2,855,241	2,323,706	81.4	46.2	28.6	33.3	51.2	4,693	2,771	7,693	7,019	5,160	3,047	8,457	7,716
2010-11	2,648,101	2,179,582	82.3	47.8	31.0	35.8	50.1	4,758	2,843	8,393	6,624	5,128	3,064	9,046	7,139
2011-12	2,571,120	2,140,556	83.3	47.6	30.8	37.9	51.2	4,424	2,912	8,767	6,641	4,632	3,050	9,180	6,953
2012-13	2,510,994	2,077,909	82.8	45.5	31.2	39.8	49.4	4,452	3,051	9,223	6,896	4,585	3,142	9,499	7,102
2013-14	2,504,847	2,076,901	82.9	45.3	32.2	41.3	47.4	4,531	3,102	9,606	7,012	4,595	3,146	9,742	7,110
2014-15	2,470,124	2,060,944	83.4	44.5	32.9	42.8	47.0	4,598	3,215	10,068	6,931	4,629	3,237	10,136	6,977
Public															
2000-01	1,333,236	872,109	65.4	30.0	33.5	22.7	30.7	2,408	1,707	2,275	3,050	3,277	2,323	3,095	4,151
2005-06	1,510,268	1,066,041	70.6	31.1	34.8	25.1	34.2	2,926	2,226	3,162	3,866	3,503	2,666	3,786	4,630
2009-10	1,804,745	1,383,660	76.7	41.1	35.6	26.3	38.6	4,698	2,555	3,903	5,682	5,165	2,809	4,290	6,247
2010-11	1,802,335	1,421,369	78.9	46.0	35.9	27.2	40.2	4,765	2,676	4,160	5,780	5,135	2,885	4,484	6,229
2011-12	1,766,428	1,418,651	80.3	46.8	35.7	29.6	42.5	4,400	2,772	4,439	5,909	4,607	2,903	4,648	6,187
2012-13	1,736,339	1,391,643	80.1	45.1	36.2	31.2	41.4	4,427	2,915	4,696	6,123	4,560	3,002	4,837	6,306
2013-14	1,751,924	1,409,393	80.4	44.9	37.3	32.4	39.9	4,517	2,962	4,951	6,206	4,580	3,003	5,021	6,294
2014-15	1,742,518	1,411,546	81.0	44.2	38.1	34.3	39.6	4,592	3,081	5,162	6,248	4,623	3,102	5,197	6,290
4-year															
2000-01	804,793	573,430	71.3	26.6	36.5	29.6	40.7	2,569	2,068	2,616	3,212	3,496	2,814	3,560	4,371
2005-06	906,948	695,017	76.6	26.6	36.8	34.2	44.4	3,071	2,752	3,573	4,166	3,677	3,296	4,279	4,988
2009-10	1,021,273	833,194	81.6	34.4	37.4	38.9	50.1	4,966	3,302	4,345	6,065	5,460	3,630	4,776	6,668
2010-11	1,039,126	858,424	82.6	38.9	38.2	39.6	51.5	4,983	3,469	4,634	6,127	5,371	3,738	4,995	6,603
2011-12	1,059,837	878,933	82.9	39.1	37.1	42.1	52.6	4,472	3,531	4,895	6,326	4,682	3,698	5,126	6,624
2012-13	1,056,119	872,932	82.7	37.8	37.3	43.8	50.8	4,506	3,665	5,168	6,576	4,641	3,775	5,323	6,773
2013-14	1,076,346	892,158	82.9	38.0	37.4	45.3	49.6	4,596	3,725	5,437	6,652	4,660	3,778	5,513	6,746
2014-15	1,095,340	914,837	83.5	37.5	37.6	47.2	49.5	4,669	3,842	5,648	6,698	4,700	3,868	5,686	6,743
2-year															
2000-01	528,443	298,679	56.5	35.2	28.8	12.1	15.3	2,222	1,009	1,004	2,396	3,024	1,374	1,366	3,260
2005-06	603,320	371,024	61.5	38.0	31.9	11.3	19.0	2,774	1,314	1,297	2,812	3,321	1,574	1,553	3,368
2009-10	783,472	550,466	70.3	49.7	33.3	9.9	23.7	4,455	1,461	1,647	4,629	4,898	1,606	1,810	5,089
2010-11	763,209	562,945	73.8	55.7	32.8	10.3	24.9	4,557	1,418	1,677	4,802	4,912	1,529	1,807	5,175
2011-12	706,591	539,718	76.4	58.2	33.4	10.9	27.5	4,327	1,508	1,789	4,711	4,530	1,579	1,874	4,932
2012-13	680,220	518,711	76.3	56.3	34.5	11.5	26.9	4,345	1,653	1,891	4,792	4,475	1,702	1,947	4,935
2013-14	675,578	517,235	76.6	56.0	37.2	11.8	24.4	4,431	1,736	1,977	4,763	4,494	1,761	2,005	4,830
2014-15	647,178	496,709	76.7	55.6	39.0	12.4	22.9	4,505	1,840	2,031	4,603	4,535	1,853	2,045	4,634
Private nonprofit															
2000-01	439,369	363,044	82.6	28.4	31.8	68.1	57.7	2,879	2,998	7,368	4,019	3,918	4,080	10,026	5,470
2005-06	471,069	401,908	85.3	26.5	31.3	73.8	59.8	3,426	3,117	9,932	5,270	4,103	3,732	11,893	6,310
2009-10	501,227	445,500	88.9	33.1	27.8	78.4	63.0	5,059	3,642	13,642	7,445	5,562	4,004	14,998	8,185
2010-11	517,831	462,840	89.4	36.4	27.7	78.4	64.3	5,076	3,556	14,324	7,296	5,471	3,832	15,438	7,863
2011-12	512,754	457,227	89.2	34.9	27.0	79.4	63.3	4,656	3,538	15,067	7,480	4,875	3,704	15,776	7,832
2012-13	515,385	458,633	89.0	33.8	26.1	79.9	61.9	4,663	3,673	15,960	7,886	4,803	3,783	16,437	8,122
2013-14	513,574	458,513	89.3	33.7	26.1	81.1	61.1	4,733	3,762	16,830	8,064	4,800	3,815	17,067	8,178
2014-15	534,717	479,029	89.6	35.0	24.8	78.4	60.2	4,758	3,842	17,712	7,948	4,790	3,868	17,831	8,002
4-year															
2000-01	419,499	347,638	82.9	27.4	32.2	70.1	58.1	2,930	3,001	7,458	4,000	3,988	4,085	10,149	5,443
2005-06	460,832	393,429	85.4	26.0	31.2	74.6	59.8	3,437	3,121	10,002	5,264	4,116	3,737	11,977	6,304
2009-10	491,140	436,485	88.9	32.4	27.8	79.2	63.1	5,092	3,656	13,737	7,471	5,598	4,020	15,103	8,214
2010-11	504,715	451,012	89.4	35.4	27.7	79.6	64.3	5,105	3,574	14,414	7,305	5,501	3,852	15,535	7,873
2011-12	499,901	445,144	89.0	33.9	27.0	80.6	63.2	4,683	3,554	15,178	7,493	4,904	3,721	15,893	7,845
2012-13	505,079	449,337	89.0	33.1	26.0	80.7	61.9	4,692	3,680	16,070	7,904	4,833	3,791	16,551	8,141
2013-14	504,584	450,215	89.2	33.1	26.1	81.6	61.0	4,753	3,764	16,964	8,069	4,820	3,817	17,203	8,183

Control and level of institution, and year	Number enrolled	Number awarded financial aid	Percent awarded aid	Percent of enrolled students awarded aid				Average award for students in aid programs[1]							
								Current dollars				Constant 2015-16 dollars[2]			
				Federal grants	State/ local grants	Institu- tional grants	Student loans[3]	Federal grants	State/ local grants	Institu- tional grants	Student loans[3]	Federal grants	State/ local grants	Institu- tional grants	Student loans[3]
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
2014-15	503,208	450,460	89.5	32.6	25.9	82.4	60.9	4,826	3,842	17,845	8,003	4,858	3,867	17,965	8,057
2-year															
2000-01	19,870	15,406	77.5	49.2	23.9	25.7	49.5	2,269	2,892	2,168	4,509	3,088	3,936	2,950	6,136
2005-06	10,237	8,479	82.8	51.6	36.1	38.5	55.9	3,176	2,974	3,799	5,531	3,803	3,561	4,549	6,623
2009-10	10,087	9,015	89.4	66.9	29.1	41.5	58.6	4,294	3,000	4,798	6,078	4,721	3,298	5,274	6,682
2010-11	13,116	11,828	90.2	73.3	26.8	29.8	64.3	4,553	2,835	5,059	6,944	4,907	3,055	5,453	7,484
2011-12	12,853	12,083	94.0	76.3	24.3	31.8	65.5	4,180	2,830	4,075	7,014	4,377	2,963	4,267	7,344
2012-13	10,306	9,296	90.2	67.1	30.3	37.7	60.6	3,962	3,373	4,347	6,960	4,080	3,474	4,478	7,168
2013-14	8,990	8,298	92.3	70.6	27.3	49.5	65.5	4,216	3,618	4,346	7,818	4,275	3,669	4,408	7,928
2014-15	31,509	28,569	90.7	74.2	8.4	14.5	48.4	4,281	3,851	5,636	6,839	4,309	3,877	5,674	6,886
Private for-profit															
2000-01	203,995	155,374	76.2	49.3	15.2	6.2	63.5	2,312	2,494	1,540	5,517	3,147	3,393	2,095	7,508
2005-06	328,206	263,366	80.2	55.6	11.4	8.8	70.4	2,725	2,796	1,423	6,454	3,263	3,347	1,704	7,728
2009-10	549,269	494,546	90.0	74.8	6.3	15.2	81.5	4,538	3,275	1,218	8,800	4,989	3,600	1,339	9,674
2010-11	327,935	295,373	90.1	75.7	9.0	15.5	82.0	4,494	3,028	1,884	8,064	4,843	3,264	2,031	8,691
2011-12	291,938	264,678	90.7	75.3	8.4	15.3	82.3	4,327	2,992	2,102	7,797	4,531	3,133	2,201	8,164
2012-13	259,270	227,633	87.8	71.9	7.8	18.2	77.3	4,360	3,159	2,343	8,095	4,490	3,253	2,413	8,338
2013-14	239,349	208,995	87.3	72.8	8.1	21.5	73.2	4,395	3,277	2,499	8,336	4,457	3,323	2,534	8,454
2014-15	192,889	170,369	88.3	73.1	8.7	20.6	76.6	4,420	3,558	3,192	7,907	4,450	3,582	3,213	7,960
4-year															
2000-01	81,075	51,739	63.8	36.1	11.9	8.3	57.7	2,295	2,889	1,616	5,749	3,124	3,931	2,199	7,823
2005-06	157,705	116,237	73.7	46.8	8.9	10.9	67.2	2,490	2,945	1,641	7,046	2,982	3,526	1,965	8,437
2009-10	241,369	222,795	92.3	75.9	6.6	23.7	86.6	4,578	2,899	1,379	9,667	5,033	3,187	1,516	10,628
2010-11	112,706	102,000	90.5	73.6	11.3	23.6	82.9	4,733	2,950	2,805	8,561	5,101	3,179	3,023	9,227
2011-12	112,969	102,357	90.6	75.5	10.7	22.4	82.7	4,692	2,994	2,860	8,231	4,913	3,135	2,995	8,619
2012-13	100,555	89,424	88.9	73.5	9.7	26.9	79.1	4,663	2,941	3,028	8,300	4,802	3,029	3,118	8,548
2013-14	90,408	80,758	89.3	72.4	10.5	34.4	78.0	4,628	3,023	3,082	8,585	4,693	3,066	3,125	8,706
2014-15	81,791	73,040	89.3	71.9	9.8	30.9	75.7	4,677	3,262	4,137	8,237	4,708	3,284	4,165	8,293
2-year															
2000-01	122,920	103,635	84.3	58.0	17.3	4.8	67.3	2,319	2,314	1,453	5,387	3,156	3,149	1,977	7,330
2005-06	170,501	147,129	86.3	63.6	13.7	6.8	73.4	2,885	2,706	1,098	5,951	3,454	3,240	1,315	7,126
2009-10	307,900	271,751	88.3	74.0	6.1	8.5	77.5	4,506	3,596	865	8,040	4,954	3,953	951	8,840
2010-11	215,229	193,373	89.8	76.8	7.8	11.3	81.5	4,374	3,088	875	7,799	4,714	3,328	943	8,406
2011-12	178,969	162,321	90.7	75.2	6.9	10.8	82.0	4,095	2,990	1,108	7,521	4,288	3,131	1,161	7,875
2012-13	158,715	138,209	87.1	70.9	6.6	12.6	76.2	4,160	3,361	1,417	7,961	4,285	3,461	1,460	8,199
2013-14	148,941	128,237	86.1	73.0	6.7	13.6	70.3	4,254	3,517	1,602	8,168	4,314	3,567	1,625	8,283
2014-15	111,098	97,329	87.6	73.9	7.9	13.1	77.2	4,236	3,829	1,555	7,669	4,265	3,855	1,566	7,721

[1] Average amounts for students participating in indicated programs.

[2] Constant dollars based on the Consumer Price Index, prepared by the Bureau of Labor Statistics, U.S. Department of Labor, adjusted to an academic-year basis.

[3] Includes only loans made directly to students. Does not include Parent Loans for Undergraduate Students (PLUS) and other loans made directly to parents.

NOTE: Degree-granting institutions grant associate's or higher degrees and participate in Title IV federal financial aid programs. Data through 2009-10 are for students receiving aid, while later data are for students awarded aid. Students receiving aid are those who were not only awarded aid, but also accepted it. Some data have been revised from previously published figures.

SOURCE: U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System (IPEDS), Spring 2002 through Spring 2011 and Winter 2011-12 through Winter 2015-16, Student Financial Aid component. (This table was prepared November 2016.)

EXHIBIT B

DECLARATION OF JONATHAN GURYAN

I, Jonathan Guryan, do hereby swear, affirm and attest as follows, based upon my personal knowledge of the matters contained herein:

1. My name is Jonathan Guryan. I graduated from Princeton University with a B.A. in Economics in 1996, and from the Massachusetts Institute of Technology ("MIT") with a Ph.D. in Economics in 2000. I am currently tenured Associate Professor of Human Development and Social Policy and of Economics in the School of Education and Social Policy at Northwestern University. In addition, I am a Faculty Fellow at the Institute for Policy Research and a member by courtesy of the Economics Department and the Kellogg School of Management at Northwestern University. I am a labor economist who conducts research primarily on the causes and consequences of racial inequality in labor markets and in education, on the economics of discrimination, and on the economics of education and human capital. In this role I commonly work with individual-level data to conduct statistical analyses in which I measure outcomes from samples to draw inferences about populations. For example, I have collected and analyzed student-level data to study of the effectiveness of programs in the Chicago Public Schools. For these studies, I use professionally-accepted sampling methods and perform calculations to choose the sample size necessary to allow me to test statistically whether the program was effective.
2. I also serve as an editor of the Journal of Labor Economics (the leading field journal in labor economics), as an associate editor of Labour Economics, and as a reviewer for leading academic economic journals such as the American Economic Review, the Quarterly Journal of Economics, the Journal of Political Economy, the Review of Economics and Statistics and the Review of Economic Studies. In my role as editor, I assess the scientific

quality of academic studies, I choose peer reviewers for studies, and based on the advice of these peer reviewers and on my own assessment I provide editorial guidance to authors and make decisions about whether submitted manuscripts are published. My own research has been published in leading journals such as the American Economic Review, the Journal of Political Economy, Developmental Psychology, the Journal of Educational Psychology, the Review of Economics and Statistics, and the Annual Review of Economics.

3. I have taught a Ph.D. level course called “Quantitative Methods” on statistical methods and regression analysis, and an undergraduate level course, called “The Economics of Inequality and Discrimination,” both at Northwestern University. In previous years, I have taught graduate-level courses on microeconomics and labor economics at the University of Chicago Booth School of Business.

4. I am a Research Associate at the National Bureau of Economic Research, and a Research Consultant at the Federal Reserve Bank of Chicago. In 2009, I was awarded the John T. Dunlop Outstanding Scholar Award, given each year for the best research on domestic labor economics by a scholar within 10 years of completing a Ph.D. A copy of my current CV is attached to this declaration as Appendix A.

5. I was asked by the California Association of Private Postsecondary Schools (CAPPS) to provide information regarding comparative student characteristics in different sectors of higher education (public, not-for-profit, for-profit) for purposes of assisting CAPPS in commenting on the proposed Borrower Defense to Repayment rule. Students who attend for-profit colleges and universities have substantially different demographic and socioeconomic backgrounds than students who attend public or private not-for-profit colleges and universities. I demonstrate these differences with a series of figures that show

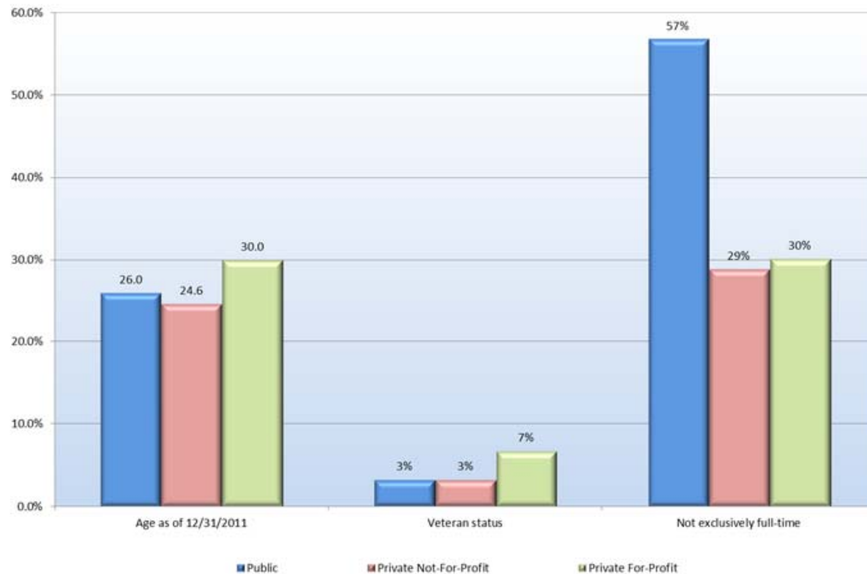
statistics I calculated using the 2011-2012 National Postsecondary Student Aid Study (NPSAS:12).

6. The NPSAS:12 is a "large, nationally representative sample of institutions and students" (https://nces.ed.gov/surveys/npsas/about.asp) administered by the U.S. Department of Education's (ED) National Center for Education Statistics (NCES). The NPSAS:12 includes a sample of approximately 95,000 undergraduates who, between July 1, 2011 and June 30, 2012, attended approximately 1,500 postsecondary institutions that were eligible to receive Title IV funding (http://nces.ed.gov/pubs2013/2013165.pdf). ED administers a similar survey approximately every four years and, according to the NCES website, is scheduled to administer a new one in 2016. According to ED, "NPSAS:12 features a nationally representative sample of both aided and nonaided students in postsecondary institutions in the United States" (http://nces.ed.gov/pubs2013/2013165.pdf, p. B-1). To my knowledge, the NPSAS:12 is the most recent nationally-representative source of publicly-available data on the demographic and socioeconomic characteristics of undergraduate students in the U.S. Unless otherwise noted, all statistics presented in this declaration were calculated using the NPSAS:12 data.

7. Figure 1 below shows selected student characteristics of students enrolled in postsecondary institutions in 2011-12, by sector. The first set of bars shows that students at for-profit colleges are older on average than students in other sectors of higher education. Students at for-profit schools were on average 30.0 years old. In contrast, students enrolled at private not-for-profit or public colleges were younger, 24.6 and 26.0 years old, respectively, on average.

8. Figure 1 also shows that for-profit schools are much more likely to serve veterans. In 2011-12, seven percent of their students were veterans, compared to just three percent of students at public or private not-for-profit institutions. About 30 percent of for-profit student students were not exclusively full-time students (meaning they were either part-time students or full-time students for only part of the year). This was similar to the 29 percent of not exclusively full-time students at private not-for-profit institutions, but just over half the 57 percent rate at public institutions.

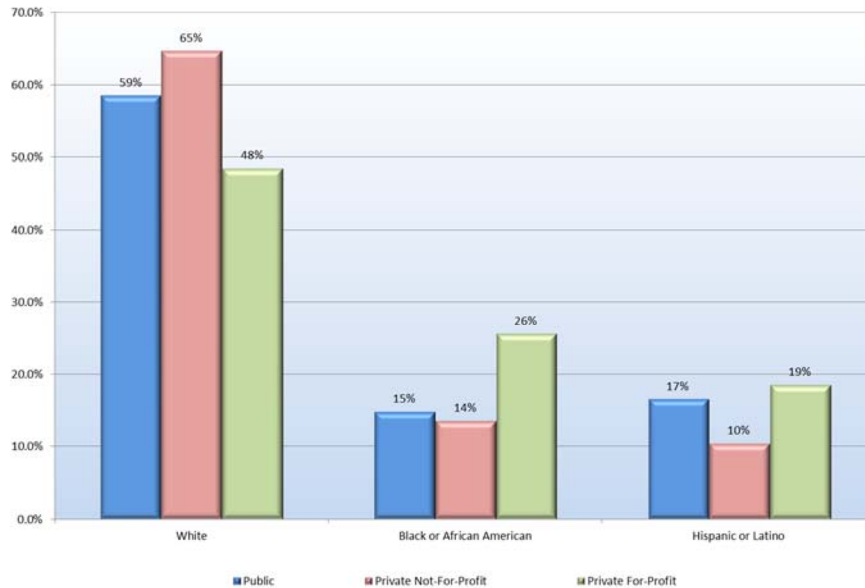
9. Figure 1: Selected Student Characteristics by Sector, 2011-2012



10. Figure 2 shows that for-profit institutions are much more likely to serve students from racial or ethnic minorities than public or private not-for-profit institutions. In 2011-12, the fraction of students at for-profit schools who were African-American was 26 percent, compared to only 15 percent at public schools and 14 percent at private not-for-profit schools. The fraction of students who were Hispanic at for-profit schools was 19 percent,

similar to the 17 percent at public schools, but greater than the 10 percent at private not-for-profit schools.

11. Figure 2: Student Racial Composition by Sector, 2011-2012

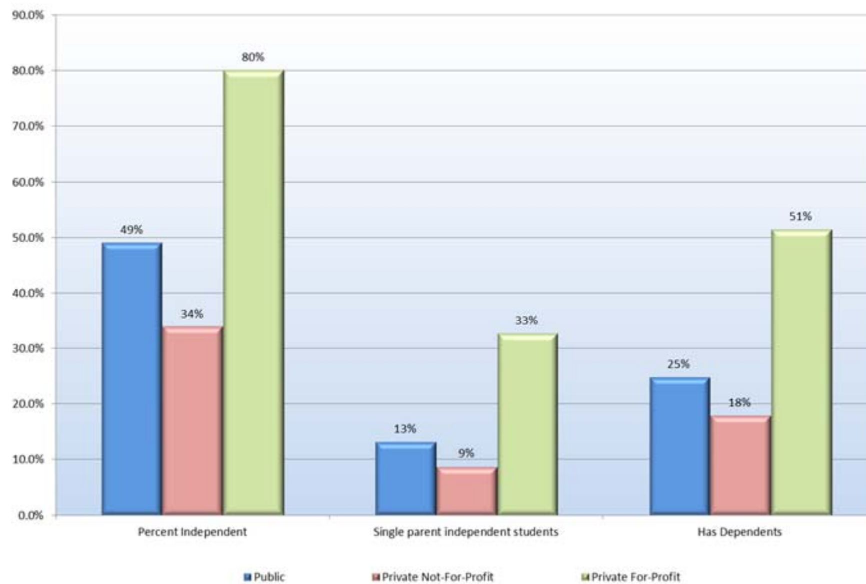


Source: 2011-12 National Postsecondary Student Aid Study (NPSAS:12).

12. Next, I turn to the economic situations of students and/or their parents. Figure 3 considers the percent of students who are financially independent from their parents, according to the federal criteria for independence used to determine financial aid awards by ED. In 2011-12, most students at for-profit schools were financially independent, 80 percent, the highest of any group. In contrast, less than half of public and private not-for-profit students were financially independent, 49 and 34 percent respectively. Of the independent students, 33 percent of those at for-profit schools were single parents, compared to just 13 percent of those at public schools and 9 percent of those at private not-for-profit schools. The third set of bars show the percent of students who had dependents. 51 percent of for-profit students had dependents, which is more than twice the 25 percent rate at public colleges

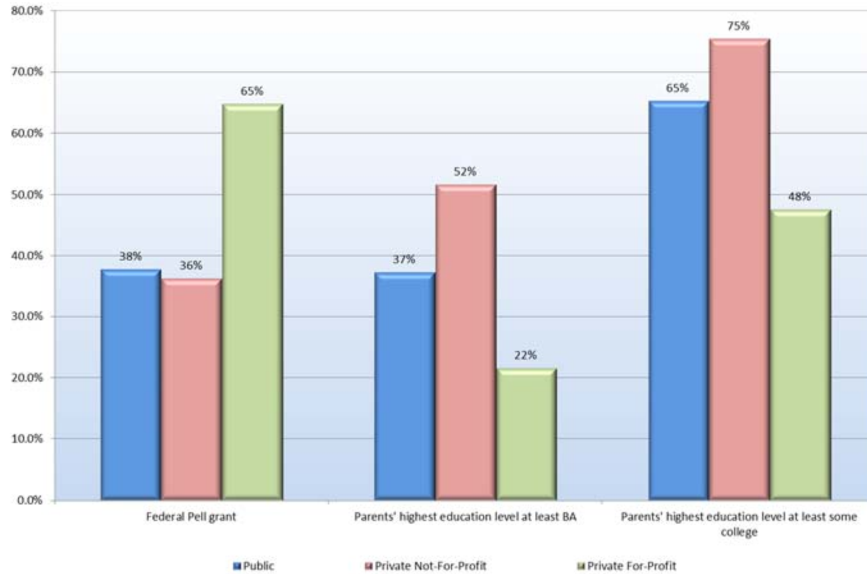
and universities and almost three times the 18 percent rate at private not-for-profit colleges and universities.

13. Figure 3: Student Dependency Status by Sector, 2011-2012



14. Figure 4 shows that for-profit students are also more likely to receive Pell grants (financial aid for low-income students): 65 percent of students at for-profit schools received a Pell grant in the 2011-12 school year. At public and private not-for-profit institutions the corresponding rates were 38 and 36 percent. Students at for-profit schools are also less likely to have a parent with a bachelor degree: only 22 percent of students at for-profit colleges come from a household in which at least one parent had a bachelor degree, compared to 37 percent of public students and 52 percent of private not-for-profit students.

15. Figure 4: Selected Student Background Characteristics by Sector, 2011-2012



16. These data indicate that students at for-profit colleges, as compared to students in other sectors of higher education, are older on average and more likely to be veterans, from a racial or ethnic minority, financially independent, with dependents, and eligible for Pell Grants.

PURSUANT TO 28 U.S.C. § 1746, I VERIFY UNDER PENALTY OF PERJURY UNDER THE LAWS OF THE UNITED STATES OF AMERICA THAT THE FOREGOING IS TRUE AND CORRECT.

Executed on this 1st of August, 2016.

JONATHAN GURYAN

Appendix A

Jonathan Guryan

Institute for Policy Research
Northwestern University
2040 Sheridan Road
Evanston, IL 60208
(o) 847-467-7144
(c) 773-848-9408
E-mail: j-guryan@northwestern.edu
jguryan@gmail.com

Employment

Northwestern University, Evanston, IL, Associate Professor of Human Development and Social Policy and Economics, School of Education and Social Policy, July 2010 – Present.

Northwestern University, Evanston, IL, Faculty Fellow, Institute for Policy Research, July 2010 – Present.

Northwestern University, Evanston, IL, Member by courtesy, Department of Economics and Kellogg School of Management, July 2010 – Present.

Urban Education Lab, University of Chicago Urban Labs, Co-Director and Co-Founder, September 2011 – Present.

University of Chicago Booth School of Business, Associate Professor of Economics, July 2004 – 2010.

Princeton University, Industrial Relations / Education Research Sections Visiting Fellow, September 2006 – June 2007.

University of Chicago Booth School of Business, Assistant Professor of Economics, July 2000 – July 2004.

Education

Massachusetts Institute of Technology, Cambridge, MA, 1996-2000
Ph. D. in Economics.

Princeton University, Princeton, NJ, 1992-1996
A.B. in Economics, Cum Laude.

Journal Articles

"Thinking Fast and Slow? Some Field Experiments to Reduce Crime and Dropout in Chicago," *Quarterly Journal of Economics*, Forthcoming (joint with Sarah B. Heller, Anuj K. Shah, Jens Ludwig, Sendhil Mullainathan and Harold A. Pollack).

"Long-term Cognitive and Health Outcomes of School-Aged Children Who Were Born Late-Term vs Full-Term," *JAMA Pediatrics*, published online June 6, 2016 (joint with David N. Figlio, Krzysztof Karbownik and Jeffrey Roth).

"Delayed Effects of a Low-Cost and Large-Scale Summer Reading Intervention on Elementary School Children's Reading Comprehension," *Journal of Research on Educational Effectiveness*, Forthcoming (joint with James S. Kim and David M. Quinn).

"Do Lottery Payments Induce Savings Behavior: Evidence From the Lab," *Journal of Public Economics*, June 2015, 126: 1-24 (joint with Emel Filiz-Ozbay, Kyle Hyndman, Melissa Schettini Kearney, and Erkut Y. Ozbay).

"The Effects of Poor Neonatal Health on Children's Cognitive Development," *American Economic Review*, December 2014, 104(12): 3921-3955 (joint with David N. Figlio, Krzysztof Karbownik, and Jeffrey Roth).

"Taste-Based or Statistical Discrimination: The Economics of Discrimination Returns to its Roots," *Economic Journal*, November 2013, 123(572): F417-F432, (joint with Kerwin Charles).

"Studying Discrimination: Fundamental Challenges and Recent Progress," *Annual Review of Economics*, Volume 3, 2011 (joint with Kerwin Charles).

Reprinted as chapter 3 in *Law and Economics of Discrimination*, John Donohue III, ed. Edward Elgar Publishing, 2014.

"Is Lottery Gambling Addictive?" *American Economic Journal: Economic Policy* August 2010, 2(3): 90-110 (joint with Melissa S. Kearney).

"The Race Between Education and Technology: A Review Article," *Journal of Human Capital* Summer 2009, 3(2): 177-196.

"The Efficacy of a Voluntary Summer Book Reading Intervention for Low-Income Latino Children from Language Minority Families: A Replication Experiment," *Journal of Educational Psychology* 102(1): 21-31, 2009 (joint with James S. Kim).

"Peer Effects in the Workplace: Evidence from Random Groupings in Professional Golf Tournaments," *American Economic Journal: Applied Economics,* October 2009, 1(4): 34-68 (joint with Matt Notowidigdo and Kory Kroft).

"Climate Change and Birth Weight," *American Economic Review Papers and Proceedings*, May 2009, 99(2): 211-217 (joint with Olivier Deschenes and Michael Greenstone).

"Prejudice and Wages: An Empirical Assessment of Becker's *The Economics of Discrimination,*" *Journal of Political Economy*, October 2008, 116(5): 773-809 (joint with Kerwin Charles). Lead article.

Reprinted as chapter 2 in *Law and Economics of Discrimination*, John Donohue III, ed. Edward Elgar Publishing, 2014.

"Does Teacher Testing Raise Teacher Quality? Evidence from Teacher Certification Requirements," *Economics of Education Review*, October 2008, 27(5),: 483-503 (joint with Joshua D. Angrist).

"Parental Education and Parental Time with Children," *Journal of Economic Perspectives*, Summer 2008, 22(3) (joint with Erik Hurst and Melissa S. Kearney).

"Gambling at Lucky Stores: Empirical Evidence from State Lottery Sales," *American Economic Review*, March 2008, 98(1): 458-473 (joint with Melissa S. Kearney).

"Using Technology to Describe Social Networks and Test Mechanisms Underlying Peer Effects in Classrooms," *Developmental Psychology*, March 2008, 44(2): 355-364 (joint with Eric Klopfer, Brian Jacob and Jennifer Groff).

"The Impact of Internet Subsidies in Public Schools," *The Review of Economics and Statistics,* May 2006, 88(2): 336-347, (joint with Austan Goolsbee).

"Desegregation and Black Dropout Rates," *American Economic Review*, September 2004, 94(4): 919-943.

"Teacher Testing, Teacher Education, and Teacher Characteristics," *American Economic Review*, *Papers and Proceedings*, May 2004, 94(2): 241-246. (joint with Joshua D. Angrist).

Grants

NICHD (1P01HD076816-01A1): "Remediating Academic and Non-Academic Skill Deficits among Disadvantaged Youth" (Guryan: Core Lead) 2014-2019. $5,893,752

W.T. Grant Foundation (180140): "The Causes of Truancy and Dropout: A Mixed-Methods Experimental Study in the Chicago Public Schools" (Guryan:PI) 2011-2014. $597,811.

NICHD (1R01HD067500-01): "A Randomized Study to Abate Truancy and Violence in Grades 3-9" (Guryan:PI) 2010-2015. $3,024,515.

Institute for Education Sciences, U.S. Department of Education: "Preventing truancy in urban schools through provision of social services by truancy officers: A Goal 3 randomized efficacy trial (Chicago Public Schools)" (Guryan:PI) 2010-2014. $3,177,638.

Smith Richardson Foundation: "Reducing Juvenile Delinquency by Building Non-Cognitive Skills: Experimental Evidence" (Guryan:PI) 2010-2012. $296,039.

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Awards and Honors

John T. Dunlop Outstanding Scholar Award, awarded by the Labor and Employment Relations Association, 2010.

Centel Foundation/Robert P. Reuss Scholar, Booth School of Business, University of Chicago, 2002-2003.

National Science Foundation, Graduate Research Fellow, 1996-1999.

Professional Activities

Editor, *Journal of Labor Economics*, December 2011 – present.

Research Associate, National Bureau of Economic Research. September 2010 – present.

Faculty research fellow, National Bureau of Economic Research, September 2000 – September 2010.

Co-Chair, J-PAL State and Local Innovation Initiative. 2015 – present.

Faculty Affiliate, Population Research Center, NORC, December 2000 – present.

Associate Editor, *Labour Economics.*

Research Consultant, Federal Reserve Bank of Chicago.

University of Chicago Crime Lab, Faculty Affiliate.

Invited Participant, Young Faculty Leaders Forum, Harvard University.

Referee: *American Economic Review, Quarterly Journal of Economics, Journal of Political Economy, Review of Economic Studies, Journal of Public Economics, Journal of Labor Economics, Review of Economics and Statistics, American Economic Journal: Applied Economics, American Economic Journal: Economic Policy, Journal of Policy Analysis and Management, National Tax Journal, Economics of Education Review, European Economic Review, Journal of Human Resources, Regulation and Governance, Education Next, Education Finance and Policy, British Journal of Industrial Relations, Journal of Law and Economics*.

Teaching

Northwestern University, School of Education and Social Policy:
Quantitative Methods II. The Economics of Inequality and Discrimination.
University of Chicago Booth School of Business:
The Employment Relationship, Microeconomics.

EXHIBIT C

THE WALL STREET JOURNAL.

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COMMENTARY

In Defense of For-Profit Colleges

They provide valuable training even as public university systems are slashing their budgets.

By Henry Bienen

Updated July 24, 2010 12:01 a.m. ET

A diverse group of critics has recently been sounding alarms about for-profit colleges. The naysayers assert that for-profits have low graduation rates, poor career placement, excessive profit margins, and high default rates on loans. Sen. Tom Harkin (D., Iowa) and financier Steven Eisman have even compared the growth of for-profits to the subprime mortgage bubble.

What are the facts?

As of 2008, the for-profit sector, which has grown rapidly over the last decade, included 9% of students enrolled in American colleges and universities. For-profit colleges run the gamut from vocational schools that give certificates for culinary or beautician training to schools that grant bachelor's, nursing, medical and master of business degrees. Some of these schools have regional accreditation (the highest type) from the same organizations that accredit elite public and private universities.

The graduation rates of some for-profit institutions are well above 50%—as high or higher than those of many four-year public colleges, let alone community colleges and nonselective public and private colleges (which often have rates below 50%).

All schools' graduation rates are driven by selectivity and demographics (including the income, age, race and prior education of students and the education level of their parents). Students who attend for-profits typically work during the day and go to school at night. Often they matriculate online. They may be single mothers. They borrow not just for tuition but for general expenses. And they do have relatively high default rates. Their average two-year default rate is 11%. For public nonprofits the rate is 5.7% and for private nonprofits it is 3.7%.

Like graduation rates, default rates are driven by demographics. At for-profit colleges, 39% of degrees are conferred to minorities who tend to be, on average, in tougher financial shape and more likely to be the first in their families to attend college. At public nonprofits, 20% of graduates are minorities. In addition, 76% of students at for-profit colleges are financially independent, meaning their parents do not support them. But colleges don't control student borrowing, so they don't control how much debt students accrue.

As for career placement, more than 90% of graduates of Rasmussen College, with which I am associated, are currently employed, despite the recession. Across for-profits, placement rates for students who get degrees in medical technology, business administration, information technology and design are all high.

Many students at for-profits are indeed at risk of not completing their degrees, as increasing access and opportunity do not always lead to high graduation rates. Education officials and critics should realize that increased access is likely to mean strains on graduation rates. But that is not an argument against offering nontraditional students an education that would otherwise be beyond reach.

For-profit colleges are also leaders in online education, which President Barack Obama and the Department of Education have correctly said will be critical in the 21st century. Many nonprofits still do not have the expertise or financial resources to develop, deploy and support effective online programs. This has led some to establish online-education partnerships with for-profit institutions.

It is true that students at for-profits use federal Pell Grants and Title IV loans to help pay tuition. But for-profits—which don't have access to endowments built up by decades of private donations—use private capital for construction, don't use state or federal funds for their operating budgets, and don't use taxpayer funds to hold down tuition rates (as every state university does). Those who argue that for-profits drain public resources are ignoring parts of the story.

Of course, state and federal governments should insist that for-profits and nonprofits alike be transparent with regard to student debt, graduation rates and job placement. At present, the data are incomplete and imperfect. They can also be misleading.

For example, when parents and students decide to pay or borrow for education, they weigh the cost against a lifetime of future earnings. But snapshots of earnings immediately after graduation are poor predictors of lifetime earnings, especially in the present labor market. It is hard enough to know the income of graduates of elite universities, and all the more difficult to get such information from students who study online. Both sectors should do better at reporting.

Nonprofit public universities such as the University of California are cutting access because of cost pressures, and many students are now failing to find suitable places in state and community colleges. For-profit colleges offer these students paths to better careers and higher earnings. It is to no one's advantage to thwart a growing sector that is training underserved people.

Mr. Bienen is vice chairman of the board of Rasmussen Inc., a for-profit college, and president emeritus of Northwestern University.

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EXHIBIT D

Searle Civil Justice Institute

CONSUMER ARBITRATION
Before the American Arbitration Association

Preliminary Report

March 2009

Searle Center on Law, Regulation, and Economic Growth

Northwestern University School of Law

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SEARLE CIVIL JUSTICE INSTITUTE

Founded in early 2008 as a division of the Searle Center on Law, Regulation, and Economic Growth, the Searle Civil Justice Institute (SCJI) aims to become the preeminent national source of large scale, empirical studies on public policy issues related to our nation's civil justice system. An operating premise of the Searle Civil Justice Institute is that hard data is a powerful and necessary tool in public policy debates.

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Northwestern University School of Law
375 East Chicago Avenue
Chicago, IL 60611-3069
312-503-3100

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CONSUMER ARBITRATION TASK FORCE

Christopher R. Drahozal
Consumer Arbitration Task Force Chair
John M. Rounds Professor of Law
University of Kansas School of Law

Henry N. Butler
Executive Director, Searle Center on Law, Regulation, and Economic Growth
Northwestern University School of Law

Judyth W. Pendell
Senior Advisor for Research and Strategic Initiatives
Searle Civil Justice Institute

Samantha Zyontz
Research Associate
Searle Civil Justice Institute

Foreword

Arbitrations between businesses and consumers arising out of pre-dispute arbitration agreements have increasingly come under attack. Proposed federal legislation, the Arbitration Fairness Act of 2009, would make pre-dispute arbitration clauses unenforceable in consumer, employment, and franchise contracts. Critics assert that arbitration providers do not adequately enforce minimum procedural safeguards, or Due Process Protocols, to ensure the fairness of arbitration. Moreover, critics question the impact of cost on access to arbitration, the speed of the process, and how well consumers fare relative to businesses in such proceedings. In contrast, supporters of consumer arbitration maintain that such proceedings actually increase access to justice and are conducted in a fair, timely, and cost-effective manner.

An operating premise of the Searle Civil Justice Institute (SCJI) is that public policy debates should be informed by systematically collected and rigorously analyzed empirical data. Despite the importance of empirical evidence to discussions of the Arbitration Fairness Act, the record as it relates to consumer arbitration is limited in important respects. To begin with, arbitrations are privately managed procedures for which data are generally not available. In addition, while a number of studies have examined other types of arbitration, far fewer studies have examined consumer arbitration in any systematic way. Finally, there is no empirical evidence examining enforcement of Due Process Protocols by arbitration providers.

To better understand the issues surrounding consumer arbitration and to begin developing a factual record for policy discussion, SCJI commissioned a Task Force on Consumer Arbitration. Christopher R. Drahozal, John M. Rounds Professor of Law at the University of Kansas, was asked to chair this ongoing initiative for SCJI. SCJI approached the AAA requesting access to its case files and related data for research purposes. This request was conditioned on the requirement that SCJI be able to conduct its research and analysis in a manner that was independent and impartial. The results contained in this Preliminary Report fully and accurately reflect the results of SCJI's data collection and analysis.

This report is denoted as preliminary for two reasons. First, SCJI intends to continue its empirical work on consumer arbitration by developing a comparison with similar claims brought in traditional court proceedings. Second, SCJI is prepared to refine its work based on future studies, critiques, and ongoing debate.

Henry N. Butler, Executive Director
Searle Center on Law, Regulation, and Economic Growth

Geoffrey J. Lysaught, Director
Searle Civil Justice Institute

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Executive Summary

Issues and Background

Empirical evidence has become a central focus of the policy debate over consumer and employment arbitration. Both supporters and opponents of the proposed Arbitration Fairness Act, which would make pre-dispute arbitration clauses unenforceable in consumer and employment (and franchise) agreements, have recognized that empirical evidence on the fairness and integrity of consumer and employment arbitration proceedings is essential to making an informed decision on the bill. Yet the empirical record, particularly on consumer arbitration, has critical gaps.

One set of issues on which further empirical research would be helpful is the costs, speed, and outcomes of consumer arbitrations. How much do consumers pay to bring claims in arbitration? How long do consumer arbitrations take to resolve? How do consumers fare in arbitration, particularly against businesses that are repeat users of arbitrators and arbitration providers? While a number of important studies on employment arbitration have been provided, the empirical record on these issues in consumer arbitrations is sparse.

A second set of issues of interest involves the enforcement of arbitration due process protocols -- privately created standards setting out minimum requirements of procedural fairness for consumer and employment arbitrations. Due process protocols commonly require independent and impartial arbitrators, reasonable costs, convenient hearing locations, and remedies comparable to those available in court. Leading arbitration providers have pledged not to administer arbitrations arising out of arbitration clauses that violate the protocols. But empirical evidence on the effectiveness of these private enforcement efforts is lacking.

Searle Civil Justice Institute Task Force on Consumer Arbitration

To shed light on these issues, the Searle Civil Justice Institute (SCJI) undertook a large-scale study of consumer arbitrations administered by the American Arbitration Association (AAA). The AAA is a leading provider of arbitration services, including arbitrations between consumers and businesses. SCJI commissioned a Task Force to advise and lead this study of consumer arbitrations. Although the study will ultimately examine many aspects of AAA consumer arbitrations, the initial research inquiries were directed at two topics:

1. *Costs, Speed, and Outcomes of AAA Consumer Arbitrations.* This aspect of the Preliminary Report assesses key characteristics of the AAA consumer arbitration process. In particular, it examines the following research questions:

    - General characteristics of AAA consumer arbitration cases including claimant type (i.e., consumer or business), types of businesses involved, and amounts claimed.

- Costs of consumer arbitration (arbitrator fees plus AAA administrative fees), including the impact of the arbitrator's power to reallocate such fees in the award.
- Speed of the arbitration process from filing to award, in the aggregate and by claimant type (i.e., consumer or business).
- Various measures of outcomes such as win-rates, damages awarded, and evidence of as well as possible explanations for any repeat-player effects.

In addition to these broad research questions, SCJI also examined the extent to which consumer arbitrations are resolved ex parte; the frequency with which arbitrators award attorneys' fees, punitive damages, and interest; and results for consumers proceeding pro se.

2. *AAA Enforcement of the Consumer Due Process Protocol.* This aspect of the Preliminary Report provides an empirical analysis of how effectively the AAA enforces compliance with the Consumer Due Process Protocol. It considers a number of key research questions including:

- To what extent do the consumer arbitration clauses comply, in their own right, with the Due Process Protocol?
- How effective is AAA review of arbitration clauses for compliance with the Due Process Protocol?
- To what extent does the AAA refuse to administer consumer cases because of the failure of businesses to comply with the Due Process Protocol?
- How do businesses respond to AAA enforcement of the Protocol?

In addition to these research questions, SCJI examined several other issues that arise in connection with the Due Process Protocols.

Data and Methodology

SCJI reviewed a sample of AAA case files involving consumer arbitrations. The primary dataset consists of 301 AAA consumer arbitrations that were closed by an award between April and December of 2007. (The focus on cases closed by an award during this particular timeframe is based on the availability of the original case files.) This sample of cases was then coded for approximately 200 variables describing various aspects of the arbitration process, including a review of the arbitration clause in the file. In addition, when possible a broader AAA dataset comprising all consumer cases closed between 2005 and 2007 was utilized. The AAA maintains this dataset in the ordinary course of its business, collecting data for internal purposes but not recording all variables of interest to SCJI. The data were analyzed using standard statistical methods in order to describe and evaluate consumer arbitrations as administered by the AAA.

Key Findings – Costs, Speed, and Outcomes of AAA Consumer Arbitrations

The upfront cost of arbitration for consumer claimants in cases administered by the AAA appears to be quite low.

In cases with claims seeking less than $10,000, consumer claimants paid an average of $96 ($1 administrative fees + $95 arbitrator fees). This amount increases to $219 ($15 administrative fees + $204 arbitrator fees) for claims between $10,000 and $75,000. These amounts fall below levels specified in the AAA fee schedule for low-cost arbitrations, and are a result of arbitrators reallocating consumer costs to businesses.

AAA consumer arbitration seems to be an expeditious way to resolve disputes.

The average time from filing to final award for the consumer arbitrations studied was 6.9 months. Cases with business claimants were resolved on average in 6.6 months and cases with consumer claimants were resolved on average in 7.0 months.

Consumers won some relief in 53.3% of the cases they filed and recovered an average of $19,255; business claimants won some relief in 83.6% of their cases and recovered an average of $20,648.

The average award to a successful consumer claimant in the sample was 52.1% of the amount claimed and to a successful business claimant was 93.0% of the amount claimed. This result appears to be driven by differences in types of claims initiated by consumers and business. Business claims are almost exclusively for payment of goods and services while consumer claims are seeking recovery for non-delivery, breach of warranty, and consumer protection violations.

No statistically significant repeat-player effect was identified using a traditional definition of repeat-player business.

Consumer claimants won some relief in 51.8% of cases against repeat businesses under a traditional definition (i.e., businesses who appear more than once in the AAA dataset) and 55.3% against non-repeat businesses – a difference that is not statistically significant.

Utilizing an alternative definition of repeat player, some evidence of a repeat-player effect was identified; the data suggests this result may be due to better case screening by repeat players.

Consumer claimants won some relief in 43.4% of cases against repeat businesses and 56.1% against non-repeat businesses under an alternative definition (based on the AAA's categorization of businesses in enforcing the Consumer Due Process Protocol) – a difference that is statistically significant at the 10% level. However, 71.1% of consumer claims against repeat businesses so defined were resolved prior to an award, while only 54.6% of claims against non-repeat businesses were resolved prior to an award. This suggests that such effect is attributable to better

case screening by repeat players (i.e., settling stronger consumer claims and arbitrating weaker claims).

Arbitrators awarded attorneys' fees to prevailing consumer claimants in 63.1% of cases in which the consumer sought such an award.

Consumer claimants sought to recover attorneys' fees in over 50% of the cases in which they were awarded damages and were awarded attorneys' fees in 63.1% of those cases. In those cases in which the award of attorneys' fees specified a dollar amount, the average attorneys' fee award was $14,574.

Key Findings – AAA Enforcement of the Due Process Protocol

A substantial majority of consumer arbitration clauses in the sample (76.6%) fully complied with the Due Process Protocol when the case was filed.

Most arbitration clauses in consumer contracts that come before the AAA are consistent with the Consumer Due Process Protocol as applied by the AAA. The same is true for cases in which protocol compliance was a matter for the arbitrator to enforce.

AAA's review of arbitration clauses for protocol compliance was effective at identifying and responding to clauses with protocol violations.

In 98.2% of cases in the sample subject to AAA protocol compliance review, the arbitration clause either complied with the Due Process Protocol or the non-compliance was properly identified and responded to by the AAA.

The AAA refused to administer a significant number of consumer cases because of Protocol violations by businesses.

In 2007, the AAA refused to administer at least 85 consumer cases, and likely at least 129 consumer cases (9.4% of its consumer case load), because the business failed to comply with the Consumer Due Process Protocol. The most common reason for refusing to administer a case (55 of 129 cases, or 42.6%) was the business's failure to pay its share of the costs of arbitration rather than any problematic provision in the arbitration clause.

As a result of AAA's protocol compliance review, some businesses modify their arbitration clauses to make them consistent with the Consumer Due Process Protocol.

In response to AAA review, more than 150 businesses have either waived problematic provisions on an ongoing basis or revised arbitration clauses to remove provisions that violated the Consumer Due Process Protocol. This is in addition to the more than 1550 businesses identified by the AAA as having arbitration clauses that comply with the Protocol. By comparison, AAA has identified 647 businesses for which it will not administer arbitrations because of Protocol violations.

Policy Implications and Next Steps

The empirical findings in the SCJI Preliminary Report on AAA consumer arbitrations have important implications for those interested in discussing and formulating public policy regarding arbitration.

1. Not all consumer arbitrations, arbitration providers, or arbitration clauses are alike. Differing results from empirical studies of arbitration may reflect variations associated with case mix, type of claimant, or provider review processes. This suggests the need for a nuanced approach to pubic policy concerning arbitration.

2. Private regulation complements existing public regulation of the fairness of consumer arbitration clauses. Policy makers should not ignore the role that arbitration providers can play in promoting fairness on behalf of consumers.

3. Courts could usefully reinforce the AAA's enforcement of the Consumer Due Process Protocol by declining to enforce an arbitration clause when the AAA has refused to administer an arbitration arising out of the clause or by otherwise reinforcing the role of the Due Process Protocol.

4. Arbitration may be less expensive for consumers than sometimes believed. For many consumers, the AAA arbitration process costs less than the amount specified in the AAA rules because arbitrators often shift some portion of the costs to businesses. Moreover, arbitrators award attorneys' fees to a substantial proportion of prevailing consumers in AAA consumer arbitrations.

5. Empirical studies have tended to find that repeat players fare better in arbitration than non-repeat players. To the extent such a repeat-player effect exists in arbitration, the critical policy question is what causes it. Our findings are consistent with prior studies in suggesting that any repeat-player effect is likely caused by better case screening by repeat players rather than arbitrator (or other) bias in favor of repeat players. A further as yet unresolved question is whether a repeat-player effect exists in litigation, and, if so, how litigation compares to arbitration in this regard.

While the empirical results presented in the SCJI Preliminary Report on Consumer Arbitration may usefully inform the policy debate on consumer arbitration, the Report nonetheless has limitations. First, its findings are limited to AAA consumer arbitrations. Empirical results from studying AAA consumer arbitration do not necessarily apply to other arbitration providers. Second, its findings on the costs, speed, and outcomes of AAA consumer arbitrations are difficult to interpret without a baseline for comparison, such as the procedures and practices in traditional court proceedings. A future phase of this research project by the Searle Civil Justice Institute's Task Force on Consumer Arbitration will undertake that comparison. It will seek to compare the procedures in AAA consumer arbitration with procedures available for consumers in court as well as comparing empirically key process characteristics of courts and arbitration.

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Christopher R. Drahozal
John M. Rounds Professor of Law
University of Kansas School of Law

CONSUMER ARBITRATION BEFORE THE AMERICAN ARBITRATION ASSOCIATION

Preliminary Report

Consumer Arbitration Task Force
Searle Civil Justice Institute

INTRODUCTION

Empirical research has become a central focus of the policy debate over consumer and employment arbitration. The congressional hearings on the proposed Arbitration Fairness Act[1] ("Act") are replete with empirical assertions about the conduct of consumer and employment arbitrations.[2] Both supporters and opponents of the proposed Act raised empirical issues and analyzed empirical studies in their testimony before Congress, on topics such as the cost of arbitration,[3] the speed of the process,[4] and the outcomes for consumers and employees.[5] Other issues involved in the debate, such as how effectively arbitration providers enforce due process protocols[6] – privately developed fairness standards for consumer and employment arbitrations[7] – likewise raise important empirical questions. Indeed, the disagreement over the state of the empirical record has continued outside of the congressional forum,[8] with both sides recognizing the importance of relying on sound empirical research rather than anecdotal evidence.[9]

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[1] Arbitration Fairness Act, H.R. 1020, 111th Cong. § 4 (2009) (making predispute arbitration agreements unenforceable if they require arbitration of any "employment, consumer, or franchise dispute," or "a dispute arising under any statute intended to protect civil rights"); *see also* Consumer Fairness Act of 2009, H.R. 991, 111th Cong. § 2 (2009) (making predispute arbitration agreements in consumer contracts unenforceable and "an unfair and deceptive trade act or practice").

[2] *See* S. 1782, The Arbitration Fairness Act of 2007: Hearing Before the Constitution Subcomm. of the Senate Comm. on the Judiciary, 110th Cong., 1st Sess. (Dec. 12, 2007) [hereinafter Senate Hearings]; H.R. 3010, the Arbitration Fairness Act of 2007, Hearing Before the Comm'l and Admin. Law Subcomm. of the House Comm. on the Judiciary, 110th Cong., 1st Sess. (Oct. 25, 2007) [hereinafter House Hearings], *available at* http://judiciary.house.gov/hearings/hear_102507.html.

[3] Senate Hearings, *supra* note 2, at 4 (Statement of Sen. Sam Brownback); Senate Hearings, *supra* note 2, at 2 (Statement of Sen. Russell Feingold).

[4] Senate Hearings, *supra* note 2, at 8 (Statement of Professor Peter B. Rutledge).

[5] Senate Hearings, *supra* note 2, at 17-18 (Statement of F. Paul Bland, Jr.); Senate Hearings, *supra* note 2, at 15 (Statement of Mark A. de Bernardo); Senate Hearings, *supra* note 2, at 4 (Statement of Sen. Sam Brownback); Senate Hearings, *supra* note 2, at 26 (Testimony of Tanya Solov); House Hearings, *supra* note 2, at __ (Testimony of Laura MacCleery) (ms. at 2-6).

[6] House Hearings, *supra* note 2, at __ (Testimony of Laura MacCleery) (ms. at 5).

[7] *E.g.*, National Consumer Disputes Advisory Committee, Consumer Due Process Protocol (April 17, 1998), *available at* www.adr.org/sp.asp?id=22019; *see* Paul R. Verkuil, *Privatizing Due Process*, 57 ADMIN. L. REV. 963, 985 (2005) ("The Consumer Due Process Protocol, for example, calls for a 'fundamentally fair process' in arbitration that stipulates adequate notice, an opportunity to be heard, and an independent decisionmaker. These procedural ingredients are comparable to those that would be provided pursuant to the informal due process requirements of the Constitution or under the fair procedure requirements of private associations like the NCAA or universities.").

[8] In particular, see the exchange between Public Citizen and Professor Peter B. Rutledge. *Compare* Public Citizen, The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on

But despite the importance of systematic empirical evidence to Congress's (and other policymakers') consideration of consumer and employment arbitration, the available empirical evidence is limited in important respects. A number of studies have analyzed employment arbitration (particularly as administered by the American Arbitration Association ("AAA")) and securities arbitration.[10] But far fewer studies have examined consumer arbitration in any detail.[11] Moreover, data are wholly lacking on "how consistently the AAA or other providers enforce their due process protocols,"[12] which, as one scholar concludes, "is an area worthy of further study."[13]

This Report extends our knowledge of consumer arbitration by presenting results from the first detailed empirical study of consumer arbitration as administered by the AAA. It first looks at key characteristics of the AAA consumer arbitration process. Primarily using a sample of 301 AAA consumer arbitrations that resulted in an award between April and December 2007, it considers such issues as the costs incurred by consumers in arbitration, the speed of the arbitral process, and the outcomes of the cases – the very topics of most interest in the policy debate. It then examines in detail the AAA's enforcement of the Consumer Due Process Protocol, using the same sample of AAA consumer arbitrations and a variety of other data sources.

Our focus on AAA consumer arbitration is both a benefit of and a limitation on our study. The AAA is a well-known and widely-used provider of arbitration services, for consumers and others. Our findings thus provide insights into consumer arbitrations administered by an important provider of such services. Conversely, our findings necessarily are limited to consumer arbitrations administered by the AAA. Other arbitration providers may administer cases differently. They may attract different types of cases and different types of businesses. Accordingly, one cannot assume that our results are representative of all consumer arbitrations, just as one cannot assume that results from studies of other providers are representative of all

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Arbitration (2008), *available* at http://www.citizen.org/documents/ArbitrationDebateTrap(Final).pdf [hereinafter Public Citizen, Arbitration Debate Trap] *and* Public Citizen, The Arbitration Trap: How Credit Card Companies Ensnare Consumers (2007), *available at* http://www.citizen.org/documents/ArbitrationTrap.pdf *with* Peter B. Rutledge, Arbitration -- A Good Deal for Consumers: A Response to Public Citizen (April 2008) (report prepared for and released by the U.S. Chamber Institute for Legal Reform), *available at* http://www.instituteforlegalreform.com/issues/docload.cfm?docId=1091. *See also* Peter B. Rutledge, *Whither Arbitration?*, 6 GEO. J.L. PUB. POL'Y 549 (2008) [hereinafter Rutledge, *Whither Arbitration?*]; Peter B. Rutledge, *Who Can Be Against Fairness? The Case Against the Arbitration Fairness Act*, 9 CARDOZO J. CONFLICT RESOL. 267 (2008).

[9] *See* Rutledge, *Whither Arbitration?*, *supra* note 8, at 589 (concluding that "[i]ncreased congressional attention" to consumer and employment arbitration "can be valuable, for it promotes discussion and study about this valuable dispute resolution tool" but also "can be dangerous if the terms of the debate focus too much on anecdote and too little on systematic study"); Public Citizen, Arbitration Debate Trap, *supra* note 8, at 2 ("Rutledge concludes *Whither* with the warning that congressional scrutiny of arbitration 'can be dangerous if the terms of the debate focus too much on anecdote and too little on systematic study.' We agree.")

[10] *See infra* Appendix 2.

[11] *See infra* Appendix 1.

[12] W. Mark C. Weidemaier, *Arbitration and the Individuation Critique*, 49 ARIZ. L. REV. 69, 107 (2007); *see also id.* at 93 n.138.

[13] *Id.* at 107.

consumer arbitrations. To the extent policy makers are deciding whether and how to regulate consumer arbitration, however, additional empirical information on the consumer arbitration process will enable them to make more informed decisions.

Part I of this Report provides background on prior empirical studies of consumer arbitration and on the development and criticisms of arbitration due process protocols. Part II describes the AAA's consumer arbitration rules and its practices and procedures in administering the Consumer Due Process Protocol. Part III sets out the research questions we analyze and describes in detail our datasets and research methodologies. Finally, Part IV presents our research results on two topics: (1) the costs, speed, and outcomes of AAA consumer arbitrations; and (2) AAA enforcement of the Consumer Due Process Protocol. As this research project is ongoing, we hope to have additional results to report in the future.

I. BACKGROUND

This Part provides general background material on each of the empirical research topics addressed later in this Report. It first summarizes prior empirical research on consumer arbitration, focusing on the cost and speed of the process as well as the outcomes for consumers and businesses. It then provides an overview of arbitration due process protocols, private initiatives that regulate the terms of arbitration agreements and the procedures in arbitration.

A. Prior Empirical Research on Consumer Arbitration – Cost, Speed, and Outcomes

In this Part, we summarize the current empirical literature on consumer arbitration.[1] Because our focus in this Report is on consumer arbitration, we do not discuss empirical studies on securities arbitration or employment arbitration (with one exception).[2] We focus on studies of the arbitration process itself, which address issues such as the cost, speed, and outcome of the arbitration proceeding.[3] To the extent those studies seek to compare arbitration to litigation, we focus only on the arbitration portion of the study, deferring comparison to the litigation process for the future.[4]

[1] For a more detailed description of the empirical studies of consumer arbitration discussed in this part, see Appendix 1.

[2] For surveys of empirical research on consumer and employment arbitration, see Sarah Rudolph Cole & Theodore H. Frank, *The Current State of Consumer Arbitration*, DISP. RESOL. MAG., Fall 2008, at 31; Alexander J.S. Colvin, *Empirical Research on Employment Arbitration: Clarity Amidst the Sound and Fury?*, 11 EMPL. RTS. & EMPLOY. POL'Y J. 405, 412-37 (2007); Kirk D. Jensen, *Summaries of Empirical Studies and Surveys Regarding How Individuals Fare in Arbitration*, 60 CONSUMER FIN. L.Q. REP. 631 (2006); Peter B. Rutledge, *Whither Arbitration?*, 6 GEO. J.L. PUB. POL'Y 549, 556-86 (2008) [hereinafter Rutledge, *Whither Arbitration?*]; David Sherwyn, Samuel Estreicher, & Michael Heise, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1563-78 (2005); *see also* Christopher R. Drahozal, *Arbitration Costs and Forum Accessibility: Empirical Evidence*, 41 U. MICH. J.L. REF. 813 (2008) (surveying empirical studies of arbitration costs). For a list of empirical studies of employment and securities arbitration, see Appendix 2. For an empirical study of franchise arbitration (and litigation) outcomes, based on disclosures in franchise disclosure documents, see Edward Wood Dunham & David Geronemus, *Lessons from the Resolution of Franchise Disputes*, JAMS DISP. RESOL. ALERT, Summer 2003, *available at* http://www.wiggin.com/db30/cgi-bin/pubs/JAMS%20article%20J%20Dunham.pdf.

[3] We do not consider studies of the provisions of consumer or employment arbitration clauses; *e.g.*, Linda J. Demaine & Deborah R. Hensler, *"Volunteering" to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer Experience*, 67 LAW & CONTEMP. PROBS. 55, 73-74 (2004); Theodore Eisenberg, Geoffrey Miller, & Emily Sherwin, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REF. 871 (2008); studies of outcomes of court cases involving challenges to arbitration agreements; *e.g.*, Christopher R. Drahozal, *Arbitration Costs and Contingent Fee Contracts*, 59 VAND. L. REV. 729, 752-59 (2006); or studies of outcomes of court cases involving challenges to arbitration awards, *e.g.*, Michael H. LeRoy, *Crowning the New King: The Statutory Arbitrator and the Demise of Judicial Review*, 29 J. DISP. RESOL. ___ (forthcoming 2009).

[4] A future phase of this research project will seek to compare the characteristics of the consumer arbitration cases described in this Report to characteristics of comparable court cases.

1. Cost

Commentators express conflicting views about the costs of arbitration. A commonly stated view is that arbitration is cheaper than litigation.[5] Arbitration often is less formal than litigation, with less discovery and less motions practice.[6] Awards are subject to limited court review, which may reduce the likelihood of a challenge to an award.[7] On this view, the costs of arbitrating a dispute may be lower than the costs of litigating a comparable dispute. If so, arbitration may be a more accessible forum for consumers to resolve disputes.[8]

An alternative view is that arbitration is too expensive – that the high costs of arbitration preclude consumers from bringing claims.[9] A report from Public Citizen issued in 2000 asserted that arbitration is substantially more expensive than litigation, citing the need to pay the arbitrator and any provider of administrative services for the arbitration.[10] By comparison, of course, parties do not pay judges (except through their tax dollars) and pay solely a flat, low filing fee to file suit in court.[11] Under this view, the high upfront costs make arbitration a less accessible forum for consumers.[12]

Most of the empirical evidence on arbitration costs addresses the upfront costs of arbitration and does not consider costs such as attorneys' fees, internal expenses, and opportunity costs associated with resolving the dispute itself.[13] The Public Citizen report on the *Costs of*

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[5] 153 CONG. REC. S4614 (daily ed. Apr. 17, 2007) (statement of Sen. Sessions) ("Arbitration is one of the most cost-effective means of resolving disputes."); Lewis L. Maltby, *The Myth of Second-Class Justice: Resolving Employment Disputes in Arbitration*, *in* HOW ADR WORKS 915, 926 (Norman Brand ed. 2002) ("The greatest strength of arbitration is that the average person can afford it.").

[6] Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISP. RESOL. 89, 90.

[7] *Id.*

[8] *See* Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 280 (1995) ("arbitration's advantages often would seem helpful to individuals, say, complaining about a product, who need a less expensive alternative to litigation"); Circuit City Stores, Inc. v. Adams, 532 U.S. 105, 123 (2001) ("Arbitration agreements allow parties to avoid the costs of litigation, a benefit that may be of particular importance in employment litigation, which often involves smaller sums of money than disputes concerning commercial contracts.").

[9] Public Citizen, Arbitration More Expensive than Court (May 1, 2002), http://www.citizen.org/pressroom/print_release.cfm?ID=1098 (statement of Joan Claybrook) ("[F]or people who are victims of consumer rip-offs and workplace injustices, arbitration costs much more than litigation – so much more that it becomes impossible to vindicate your rights."); *see also* Reginald Alleyne, *Arbitrator's Fees: The Dagger in the Heart of Mandatory Arbitration for Statutory Discrimination Claims*, 6 U PA. J. LAB. & EMPL. L. 1, 30 (2003); Mark E. Budnitz, *The High Cost of Mandatory Consumer Arbitration*, 67 LAW & CONTEMP. PROBS. 133, 161 (2004); Charles L. Knapp, *Taking Contracts Private: The Quiet Revolution in Contract Law*, 71 FORDHAM L. REV. 761, 781 (2002).

[10] *E.g.*, Public Citizen, Costs of Arbitration 1 (2002) ("The cost to a plaintiff of initiating an arbitration is almost always higher than the cost of instituting a lawsuit. Our comparison of court fees to the fees charged by the three primary arbitration provider organizations demonstrates that *forum costs*—the costs charged by the tribunal that will decide the dispute—can be up to five thousand percent higher in arbitration than in court litigation.").

[11] Christopher R. *Drahozal, Arbitration Costs and Contingent Fee Contracts*, 59 VAND. L. REV. 729, 736-37 (2006).

[12] For a reconciliation of these competing views about arbitration costs, see *id.* at 734-35.

[13] For empirical evidence on business cost savings from arbitration (including attorneys' fees in handling the

Arbitration presented a series of case studies together with an analysis of the costs of arbitrating and litigating four hypothetical cases, in reaching its conclusion that arbitration costs "have a deterrent effect, often preventing a claimant from even filing a case."[14]

By comparison, Mark Fellows reported that consumer claimants in National Arbitration Forum ("NAF") arbitrations in 2003-2004 paid arbitration fees averaging $46.63 while business claimants paid arbitration fees averaging $149.50.[15] Similarly, Navigant Consulting, relying on NAF data from January 2003 through March 2007, concluded that consumers paid no fee in 99.3% of the cases (presumably those brought by businesses) and a median fee of $75 in the remaining 246 cases.[16] Ernst & Young reported in 2004 that the average fee paid in consumer "banking" arbitrations administered by the American Arbitration Association ("AAA") was $1935, but the data were incomplete as to how the fees were allocated between consumers and businesses.[17] A study by the California Dispute Resolution Institute ("CDRI"), looking at data disclosed by six arbitration providers from January 2003 to February 2004, found a mean arbitrator's fee of $2256 and a median arbitration fee of $870.[18] But the data used by the CDRI were incomplete, did not separate out the fees paid by consumers from the fees paid by businesses,[19] and included both consumer and employment cases.[20]

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cases), see the studies discussed in Drahozal, *supra* note 2, at 829-30; *see also* Herbert M. Kritzer & Jill K. Anderson, *The Arbitration Alternative: A Comparative Analysis of Case Processing Time, Disposition Mode, and Cost in the American Arbitration Association and the Courts*, 8 JUSTICE SYS. J. 6, 17 (1983) (studying fees received by attorneys in sample of AAA commercial arbitrations and uninsured motorist arbitrations, state court cases, and federal court cases) ("The AAA is the least expensive for small cases, and most expensive for the remaining three categories.... At the same time, in a sense, one gets 'more' for the money in terms of the amount of institutional processing, with the AAA, because a much larger proportion of cases go through the 'complete process,' including a hearing and an award.").

[14] Public Citizen, *supra* note 10, at 1, 6-51.

[15] Mark Fellows, *The Same Result as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes*, METRO. CORP. COUNSEL, July 2006, at 32.

[16] Jeff Nielsen et al., Navigant Consulting, National Arbitration Forum: California Consumer Arbitration Data 3 (July 11, 2008), *available at* http://www.instituteforlegalreform.com/index.php?option=com_ilr_docs&issue_code=ADR&doc_type=STU.

[17] Ernst & Young, Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases 16-17, App. A (2004), *available at* http://www.adrforum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005ErnstAndYoung.pdf.

[18] California Dispute Resolution Institute, Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure 21 (Aug. 2004), *available at* http://www.mediate.com/cdri/cdri_print_aug_6.pdf. The six providers were the AAA, ADR Services, Arbitration Works, ARC Consumer Arbitrations, JAMS, and Judicate West. *Id.* at 14.

[19] *Id.* at 18 ("In general, inconsistencies, ambiguities and the lack of reported data limit this study's utility for the purposes of informing policy."); *see also* Lisa Blomgren Bingham et al., Arbitration Data Disclosure in California: What We Have and What We Need 20 (Apr. 15, 2005) (concluding that "the private arbitration service providers in question are not providing the information that is critical to an analysis of how the consumer party fare[s] in commercial arbitration.").

[20] California Dispute Resolution Institute, *supra* note 18, at 17, 22 Figure 1.

2. Speed

Arbitration also is commonly perceived to be a faster dispute resolution process than litigation.[21] The reasons are at least twofold. First, again, arbitration is less formal than litigation, with less discovery and fewer motions, and appellate review of awards is limited.[22] Second, arbitration may have less of a queue than litigation – parties can choose an arbitrator who does not have a backlog of cases, and so they may not have to wait behind other parties to have their dispute resolved.[23]

The empirical evidence shows consumer arbitration to be an expeditious process.[24] In 2007, the AAA reported that on average its consumer cases took four months to resolve on the basis of documents and six months to resolve on the basis of in-person hearings.[25] For 2006, the numbers were similar: an average of 3.8 months for document only cases and 7.4 months for cases decided after in-person hearings.[26] Mark Fellows found that the NAF's average disposition time in 2003-2004 for consumer claimants was 4.35 months and for business claimants was 5.60 months.[27] The CDRI study of six arbitration providers from January 2003 to February 2004 found a mean disposition time of 116 days and a median disposition time of 104 days,[28] although as noted above the data are incomplete and problematic.[29]

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[21] H.R. Rep. No. 97-542, at 13 (1982) ("The advantages of arbitration are many: it is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules ...."), *quoted in* Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 280 (1995).

[22] *Id.*

[23] Diane P. Wood, *Snapshots from the Seventh Circuit: Continuity and Change, 1966-2007*, 2008 WIS. L. REV. 1, 6 ("to the extent that litigants wish to avoid these queues, they are opting out of the judicial system altogether and turning to arbitration and mediation"); Richard A. Posner, *The Cost of Rights: Implications for Central and Eastern Europe – And for the United States*, 32 TULSA L.J. 1, 15 (1996) ("The longer the queue, the greater the incentive of the parties to a dispute to substitute arbitration or other nonjudicial methods of dispute resolution for the courts.").

[24] *See* Kritzer & Anderson, *supra* note 13, at 17 (finding that "the American Arbitration Association offers the possibility of *relatively* fast *adjudication* (compared to the relatively slow nonadjudication in the courts)").

[25] American Arbitration Association, Analysis of the American Arbitration Association's Consumer Arbitration Caseload: Based on Consumer Cases Awarded Between January and August 2007, *available at* http://www.adr.org/si.asp?id=5027 [hereinafter AAA, 2007 Caseload Analysis].

[26] Statement of the American Arbitration Association, Annex D, *in* S. 1782, The Arbitration Fairness Act of 2007: Hearing Before the Constitution Subcomm. of the Senate Comm. on the Judiciary, 110th Cong., 1st Sess., at 135 (Dec. 12, 2007) [hereinafter, AAA, 2006 Caseload Analysis].

[27] Fellows, *supra* note 15, at 32.

[28] California Dispute Resolution Institute, *supra* note 18, at 19. Actually, the CDRI data on time of disposition is more complete than on many other variables, covering 1559 of 2175 cases. *Id.*

[29] *See supra* text accompanying notes 19-20.

3. Outcomes

An important subject of empirical research is how consumers fare in arbitration. Several ways to measure outcomes have been used – the win-rate; the amount of damages recovered; and the amount of damages recovered as a percentage of the amount claimed. Two points of particular interest are how arbitration outcomes compare to outcomes in court, which is beyond the scope of this Report; and whether outcomes are biased in favor of repeat players.

Win-Rates. Studies have most commonly looked at the win-rate in arbitration – i.e., the percentage of cases won by the consumer or the business. But the absolute win-rate itself is not a particularly meaningful number. Instead, the absolute win-rate must be compared to some sort of baseline. Some commentators have focused on fifty percent as that baseline;[30] others have suggested that an extremely high business win-rate shows a process that is unfair to consumers.[31] Neither view necessarily is correct.

At least two possible approaches are available for coming up with a baseline for comparison. One possible approach is to use a theoretical model of case settlement, which generates predictions about expected outcomes.[32] Some models lead to predictions of a fifty percent win-rate, providing some support for using that figure as a baseline.[33] Other models, based on different assumptions, lead to predictions of extremely high (or low, depending on the perspective) win-rates.[34]

A second approach is to compare outcomes in arbitration to outcomes in litigation. A business win-rate of over ninety percent in arbitration does not show arbitration is unfair if the win-rate for comparable cases in court is similar.[35] But doing a proper comparison can be

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[30] Rutledge, *Whither Arbitration?*, *supra* note 2, at 559-60 ("the only reported data showing a win-rate of less than 50 percent is William Howard's study of securities arbitration"); Public Citizen, The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration 16 (2008), *available* at http://www.citizen.org/documents/ArbitrationDebateTrap(Final).pdf [hereinafter Public Citizen, Arbitration Debate Trap] ("In fact, at least five other studies have found win rates of less than 50 percent for individual claimants").

[31] Public Citizen, The Arbitration Trap: How Credit Card Companies Ensnare Consumers 13 (2007), *available at* http://www.citizen.org/documents/ArbitrationTrap.pdf [hereinafter Public Citizen, Arbitration Trap] (referring to "truly staggering success rate" of businesses in NAF arbitrations).

[32] Joel Waldfogel, *Selection of Cases for Trial*, in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 419, 419 (Peter Newman ed., 1998) ("any model of the settlement decision is also at least implicitly a model of the selection of cases for trial").

[33] *E.g.*, George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1, 17-20 (1984).

[34] *Id.* at 24-29; *see also, e.g.*, Keith N. Hylton, *Asymmetric Information and the Selection of Disputes for Litigation*, 22 J. LEGAL STUD. 187 (1993); Luke Froeb, *Adverse Selection of Cases for Trial*, 13 INT'L REV. L. & ECON. 317 (1993).

[35] *See* Peter B. Rutledge, Arbitration -- A Good Deal for Consumers: A Response to Public Citizen 11 (April 2008) (report prepared for and released by the U.S. Chamber Institute for Legal Reform), *available at* http://www.instituteforlegalreform.com/issues/docload.cfm?docId=1091 ("Studies of debt collection actions in major cities reveal that the lender typically wins between 96% and 99% of the time, right in line with the lender win-rate data cited in the Public Citizen Report.").

difficult.[36] Certainly, care must be taken to ensure that the types of cases are reasonably comparable, as well as to control for other differences between arbitration and litigation, such as the much greater use of summary judgment and other dispositive motions in litigation.[37] (In this Report, we will be presenting the raw win-rate and other outcome numbers, reserving the comparison to litigation for a future Report.)

Studies of win-rates in consumer arbitrations show various degrees of consumer and business success. Two studies by the AAA of its consumer arbitration caseload in 2006 and 2007 found that consumer plaintiffs won 48% of awarded cases they brought.[38] The 2007 study found that business claimants won 74% of awarded cases they brought.[39]

Most of the data on outcomes in consumer arbitration have come from studies of the caseload of the NAF. Unusual among the leading arbitration providers,[40] NAF's consumer caseload consists almost exclusively of debt collection actions, the majority brought by a single credit card company.[41] Although there is some disagreement on how properly to treat cases dismissed before an award,[42] studies consistently show a high win-rate for business claimants in NAF arbitrations, ranging from 67.9% to over 99%.[43] By comparison, the win-rate for consumer claimants before the NAF is much higher than the win-rate for consumer respondents, although

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[36] *E.g.*, W. Mark C. Weidemaier, *From Court Surrogate to Regulatory Tool: Re-Framing the Empirical Study of Employment Arbitration*, 41 U. MICH. J.L. REF. 843, 852-56 (2008); Stephen J. Ware, *The Effects of* Gilmer*: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. ON DISP. RESOL. 735, 755-56 (2001).

[37] Lewis Maltby, *Employment Arbitration: Is It Really Second Class Justice?*, DISP. RESOL. MAG., Fall 1999, at 23, 24; Weidemaier*, supra* note 36, at 853.

[38] AAA, 2007 Caseload Analysis, *supra* note 25, at 1; AAA, 2006 Caseload Analysis, *supra* note 26, at 135.

[39] AAA, 2007 Caseload Analysis, *supra* note 25, at 1.

[40] By comparison, see the AAA consumer caseload described *infra* Part IV(1).A.1. *See also* W. Mark C. Weidemaier, *The Arbitration Clause in Context: How Contract Terms Do (and Do Not) Define the Process*, 40 CREIGHTON L. REV. 655, 674 (2007) (reporting that 98.7% of JAMS consumer arbitrations from 2003-2006 were brought by the consumer as claimant, as compared to 0.4% of NAF consumer arbitrations during the same period).

[41] Public Citizen, Arbitration Trap, *supra* note 31, at 15 ("all but 15 of the 33,948 cases are labeled 'collection' cases"); *id*. at 17 ("MBNA's NAF arbitration cases, including those filed by debt buyers who purchased MBNA accounts, totaled 18,101 and represented 53.3 percent of the NAF California cases.").

[42] *Compare* Nielsen et al., *supra* note 16, at 1 (including dismissals with cases in which consumers prevailed outright) *with* Public Citizen, Arbitration Debate Trap, *supra* note 30, at 10 (arguing that dismissals before an arbitrator is appointed "can hardly be used as evidence of the fairness of NAF arbitration," and that dismissals after an arbitrator is appointed might have resulted from "any number of manipulative practices" and should not be counted as consumer wins).

[43] Fellows, *supra* note 15, at 32 (business claimants "prevail in 77.7% of the cases that reach a decision"); Nielsen et al., *supra* note 16, at 1 (businesses prevailed in 67.9% of NAF arbitrations either heard by an arbitrator or dismissed); Public Citizen, Arbitration Trap, *supra* note 31, at 15 ("In 19,294 cases in which an arbitrator was appointed, the business won in 18,091 (or 93.8%)"); Answers and Objections of First USA Bank, N.A. to Plaintiff's Second Set of Interrogatories, Ex. 1, Bownes v. First U.S.A. Bank, N.A. et al., Civ. Action No. 99-2479-PR (Ala. Circuit Ct. 2000), *available* at http://www.tlpj.org/briefs/McQuillan%20exhibits%2016-19%20(300dpi).pdf (last visited Dec. 10, 2008) [hereinafter First USA Interrogatory Answers] (bank prevailed in 19,618 NAF arbitrations, while credit cardholder prevailed in 87).

again there is disagreement over the actual win-rate (with reports ranging from 37.2% to 65.5%).[44] Moreover, consumers bring only a handful of NAF arbitrations each year.[45]

Monetary Recoveries. A frequent criticism of studies of win-rates in arbitration (and litigation) is that the usual measure of party wins is too simplistic. In many studies, a claimant "win" is defined to include any case in which the claimant was awarded some amount of money, while a respondent "win" is defined to include only cases in which the respondent is held liable for zero damages.[46] Such an approach may understate the number of respondent wins and overstate the number of claimant wins because a claimant with a strong claim for a large amount is treated as "winning" even when it is awarded an amount that is far less than its claim is worth.[47]

But it is difficult to value claims for purposes of empirical research. Ordinarily, researchers do not have complete information about the claims, and, even if they did, it would be extremely difficult to evaluate objectively how much a claim is worth at the time it is brought. As a result, some studies have used the amount sought by the claimant as a proxy for the value of the claim, calculating the amount recovered as a percentage of the amount claimed.[48]

Even that approach is difficult to implement. First, plaintiffs in court often do not demand a specific amount in any court filing; they may simply plead that the minimum jurisdictional amount is satisfied. Arbitration would seem to be less subject to this problem because arbitration fees typically are based on the amount of compensatory damages sought.[49] But even in arbitration, as discussed below, determining a single dollar amount claimed can be difficult.[50]

Second, in both settings, merely because a party claims an amount does not mean that the claim is worth that amount. Plaintiffs may seek amounts of damages that they have only a small likelihood of recovering.[51] The fact that they do not recover such amounts thus can mean the process is working properly, not that the process failed.

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[44] Ernst & Young, *supra* note 17, at 8 (win-rate for consumer claimants of 54.6%); Fellows, *supra* note 15, at 32 (win-rate for consumer claimants of 65.5%); Public Citizen, Arbitration Debate Trap, *supra* note 30, at 10 (win-rate for consumer claimants of 37.2%).

[45] Public Citizen, Arbitration Trap, *supra* note 31, at 15 (reporting that 0.35% of all NAF arbitrations involved consumer claimants).

[46] *E.g.*, AAA, 2006 Caseload Analysis, *supra* note 26, at 135.

[47] Rutledge, *Whither Arbitration?*, *supra* note 2, at 557. That said, as discussed *infra* text accompanying notes 49-56, the fact that the claimant recovered a small percentage of the amount claimed does not necessarily mean that the outcome was somehow incorrect. *See* Public Citizen, Arbitration Debate Trap, *supra* note 30, at 12 (asserting that definition of claimant "win" is "unreliable" when it classifies a "claimant who sought $50,000 and received only $5" as a win for claimant). Whether that is so depends not merely on the amount of the claim, but also on the strength of the claim.

[48] *E.g.*, Lewis L. Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29 (1998).

[49] *See infra* Part II.A.

[50] *See infra* Part IV(1).A.2.

[51] This is the case even if the plaintiff has a meritorious claim because some elements of the plaintiff's damages recovery may be highly uncertain.

Third, the incentives of the parties to claim damages differ between courts and arbitration. In court, subject to credibility constraints, the plaintiff's incentive is to claim higher rather than lower damages amounts. Court filing fees are a flat amount that do not increase with the amount claimed.[52] Meanwhile, claiming higher damages amounts may increase the amount the plaintiff recovers. Laboratory studies have found that the amount sought by a plaintiff – even if ridiculously large – can act as an anchor and increase the amount of damages awarded by a mock jury.[53] By comparison, because of the way arbitration fees are structured, the claimant in arbitration often has to pay more to claim more.[54] As a result, amounts claimed in arbitration may be more realistic than amounts claimed in court.[55] If so, this complicates comparisons between arbitration and litigation, because a higher percentage recovery in arbitration may be due to more realistic amounts claimed rather than any difference in the amount awarded.[56]

A few studies have examined amounts awarded in consumer arbitrations.[57] The CDRI found that the mean amount awarded in a sample of California cases administered by six different providers (including the AAA) was $33,112, while the median award was $7615.[58] But data were available on the amount awarded in only 540 of the 2175 cases in the sample, "limit[ing] this study's utility for purposes of informing policy."[59]

Navigant Consulting found that the arbitrator reduced the amount of the business's claim in 16.4% of the NAF arbitrations studied, with a median reduction of $636 and a median percentage reduction of 8.6%.[60] In the remaining 83.6% of the cases, presumably the business was awarded the full amount claimed. According to data presented by Public Citizen, NAF arbitrators who decided more than 100 cases in California awarded businesses 92.4% of the total amount they sought.[61] Note that Public Citizen apparently included amounts sought in cases in which the consumer prevailed outright in the total amount sought.[62]

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[52] Drahozal, *supra* note 11, at 736-37.

[53] *E.g.*, Gretchen B. Chapman & Brian H. Bornstein, *The More You Ask For, the More You Get: Anchoring in Personal Injury Verdicts*, 10 APPLIED COGNITIVE PSYCHOL. 519, 526-27 (1996). *See generally* Christopher R. Drahozal, *A Behavioral Analysis of Private Judging*, 67 LAW & CONTEMP. PROBS. 105, 110-11 & n.28 (2004) (describing studies).

[54] Drahozal, *supra* note 53, at 129.

[55] *Id*. In addition, parties may be subject to countervailing (or reinforcing) incentives to the extent the success rate in arbitration varies depending on the amount sought.

[56] *See* CHRISTOPHER R. DRAHOZAL, COMMERCIAL ARBITRATION: CASES AND PROBLEMS 7 (2d ed. 2006).

[57] By comparison, many more studies of employment arbitration report the amounts of awards, including some that report the amount awarded as a percentage of the amount claimed. *See infra* Appendix 2.

[58] California Dispute Resolution Institute, *supra* note 18, at 20.

[59] *Id.* at 18.

[60] Nielsen et al., *supra* note 16, at 3.

[61] Public Citizen, Arbitration Trap, *supra* note 31, at 16 (those arbitrators awarded businesses $185,479,341 of $200,736,495 sought).

[62] Navigant used the same dataset as Public Citizen, *see* Nielsen et al., *supra* note 16, at 1, and its reported reductions otherwise would be much too small relative to the amounts of the awards.

Repeat-Player Effect. Unlike judges, arbitrators get paid only when selected to serve on a case. This economic reality of arbitration has given rise to fears of "repeat-arbitrator bias" – that arbitrators will decide cases in favor of the repeat player in arbitration, which is the party more likely to be in a position to appoint the arbitrator to serve again.[63] In consumer arbitration, consumers are unlikely to be repeat players (although their attorneys may be).[64] Thus, the fear is that arbitrators will tend to favor businesses in the hopes of being appointed more often in future cases. More broadly, commentators have expressed concerns about what might be called "repeat-player bias" (rather than repeat-arbitrator bias) – that businesses, through their control of process of dispute system design, will structure the dispute resolution process in their favor.[65]

Several factors may reduce the likelihood or consequences of repeat-arbitrator or repeat-player bias. First, arbitration providers, as well as individual arbitrators, may seek to maintain a reputation for fair and unbiased decision making.[66] Such reputational constraints may reduce the risk that repeat-arbitrator or repeat-player bias will occur. Second, even if arbitrators (and arbitration providers) have an incentive to make decisions that businesses want, it is not necessarily the case that those decisions will be unfavorable to consumers. As Gordon Tullock explains, while "a bias toward the retailer might be the arbitrator's profit-maximizing course of action," it might not be. Instead, "the retailer might be interested in his general reputation and want an arbitrator who was either impartial or, for that matter, actually procustomer."[67] Tullock cites return desks at retailers, which seek to help resolve disputes between businesses and their customers, as an illustration. Even though the workers at return desks are employed by the business, "their usual reaction is not one of making a fair judicial decision between themselves and [the customer] but of giving [the customer] every benefit of the doubt."[68]

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[63] *E.g.*, Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 HOUS. L. REV. 1237, 1256 (2001); David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33, 60-61; *see also* Public Citizen, Arbitration Debate Trap, *supra* note 30, at 24-26. In addition to concerns that arbitrators might be biased in favor of repeat businesses, the same argument is directed at arbitration providers. *E.g.*, Arbitration Fairness Act, H.R. 1020, 111th Cong. § 2(4) (2009) (finding that "[p]rivate arbitration companies are sometimes under great pressure to devise systems that favor the corporate repeat players who decide whether those companies will receive their lucrative business").

[64] Budnitz, *supra* note 9, at 138 n.22; Carrie Menkel-Meadow, *Ethical Issues in Arbitration and Related Dispute Resolution Processes: What's Happening and What's Not*, 56 U. MIAMI L. REV. 949, 956 (2002). *Compare* Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RESOL. 559, 566 (2001) ("[T]he real repeat players in arbitration are not the parties themselves but the lawyers involved.") *with* Lisa B. Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 EMPL. RTS. & EMPLOY. POL'Y J. 189, 198-99 (1997) ("There is reason to believe that most individual members of the plaintiffs' bar may never successfully emerge as repeat players in employment arbitration.").

[65] Lisa B. Bingham, *Control Over Dispute-System Design and Mandatory Commercial Arbitration*, 67 LAW & CONTEMP. PROBS. 221, 231-39 (2004); Lisa B. Bingham, *Self-Determination in Dispute System Design and Employment Arbitration*, 56 U. MIAMI L. REV. 873, 889-92 (2002) [hereinafter Bingham, *Self-Determination*].

[66] Christopher R. Drahozal, *"Unfair" Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 769-70; *see also* Weidemaier, *supra* note 40, at 661-62 (arguing that arbitration providers may "confer legitimacy" by "adopt[ing] or enforc[ing] due process or 'fairness' rules").

[67] GORDON TULLOCK, TRIALS ON TRIAL: THE PURE THEORY OF LEGAL PROCEDURE 127-128 (1980).

[68] *Id.*

In the consumer context, Public Citizen has argued that debt collection arbitration before the NAF is affected by repeat-arbitrator bias. It cites both anecdotal reports[69] and evidence that the arbitrators most commonly appointed by the NAF are more likely to rule in favor of business claimants than other arbitrators.[70]

Other studies, examining outcomes of employment arbitration (the one exception where this Report discusses such studies), have not found evidence of repeat-player bias, although several have identified a "repeat-player effect": consumers win less often against repeat businesses – businesses that arbitrate on a repeat basis – than against non-repeat businesses. This repeat-player effect might be due to repeat-arbitrator or repeat-player bias, but it might also be due to better screening of cases by repeat businesses, who are more used to dealing with disputes than non-repeat businesses.

In a study of 270 AAA employment arbitration awards from 1993 and 1994, Lisa Bingham found that employees won in 63% of all awards but only 16% of awards against repeat employers.[71] Similarly, employees recovered 48% of their amount claimed against non-repeat employers but only 11% of their amount claimed against repeat employers.[72] Bingham's results from a subsequent study of 203 AAA employment awards from 1993 to 1995 were similar.[73] But Bingham's evidence indicated that the repeat-player effect was a result, not of repeat-arbitrator or repeat-player bias, but of differences in the cases arbitrated.[74] The same is true of yet another study by Bingham, this one co-authored with Shimon Sarraf, which examined AAA employment awards from 1996 and 1997.[75] Bingham and Sarraf found an employee win-rate of 29% against repeat employers as compared to an employee win-rate of 62% against non-repeat employers. But they found no evidence this was due to repeat-arbitrator or repeat-player bias; rather, the repeat-player effect was likely the result of case screening by employers with in-house dispute

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[69] Public Citizen, Arbitration Trap, *supra* note 31, at 30-32; Public Citizen, Arbitration Debate Trap, *supra* note 30, at 24-25.

[70] Public Citizen, Arbitration Trap, *supra* note 31, at 16.

[71] Bingham, *supra* note 64, at 189-90 (defining repeat employer as one involved in more than one case in her sample).

[72] *Id.* at 213. For discussions of methodological issues in Bingham's studies, see Sherwyn et al., *supra* note 2, at 1570.

[73] Lisa B. Bingham, *Unequal Bargaining Power: An Alternative Account for the Repeat Player Effect in Employment Arbitration*, IRRA 50TH ANN. PROC. 33, 38-39 (1998) [hereinafter Bingham, *Unequal Bargaining Power*]; Lisa B. Bingham, *On Repeat Players, Adhesive Contracts, and the Use of Statistics in Judicial Review of Arbitration Awards*, 29 MCGEORGE L. REV. 223, 223 (1998); *see also* Lisa B. Bingham, *An Overview of Employment Arbitration in the United States: Law, Public Policy and Data*, N.Z. J. INDUS. REL., June 1998, at 5, 15 (reporting an employee win-rate of 25.0% in cases with a repeat arbitrator as compared to an employee win-rate of 55.5% in cases with a non-repeat arbitrator).

[74] Bingham, *Unequal Bargaining Power*, *supra* note 73, at 39-40. Bingham found that "repeat player employers get to arbitration based on an implied contract stemming from a personnel manual or employee handbook," cases in which the employee "may have a substantively weaker legal claim." *Id.*

[75] Lisa B. Bingham & Shimon Sarraf, *Employment Arbitration Before and After the Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of Employment: Preliminary Evidence that Self-Regulation Makes a Difference*, *in* ALTERNATE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NEW YORK UNIVERSITY 53RD ANNUAL CONFERENCE ON LABOR 303, 320-28 (Samuel Estreicher & David Sherwyn eds. 2004); *see also* Bingham, *Self-Determination*, *supra* note 65, at 899-901.

resolution programs.[76] Nonetheless, Bingham's studies continue (incorrectly) to be cited as evidence of repeat-arbitrator bias.[77]

Elizabeth Hill found what she described as an "appellate effect" in her study of 200 AAA employment awards from 1999 to 2000.[78] Of the 34 cases with repeat employers in her sample, 25 (or 74%) involved employers with an in-house dispute resolution program. The employee win-rate in those cases was substantially below the employee win-rate in the other cases in the sample, and, indeed, substantially below the win-rate in cases involving the other repeat employers.[79] (The differences were not statistically significant, but her sample size was too small for reliable statistical testing.[80]) Based on her data, Hill attributes the repeat-player effect to "the selection processes of larger employers' in-house dispute resolution programs," rather than "merely the by-product of larger employers' repeat appearances at arbitration."[81] Hill found no evidence of repeat-arbitrator bias, as there were only two cases in her sample involving the same arbitrator and employer.[82]

Most recently, Colvin examined a sample of 836 awards in employment arbitrations administered by the AAA from January 1, 2003 to September 30, 2006.[83] Because the data were from the AAA's disclosures as required by California law, the cases involved arbitrations "based

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[76] Bingham & Sarraf, *supra* note 75, at 323 tbl. 2; *see* Sherwyn et al., *supra* note 2, at 1571 (describing Bingham & Sarraf's results and concluding that "[t]hese results suggest that the availability of an internal review process and the employer's experience with employment cases likely explains the repeat player effect. Bingham found no support for arbitrator bias.").

[77] David S. Udell & Rebekah Diller, *Access to the Courts: An Essay for the Georgetown University Law Center Conference on the Independence of the Courts*, 95 GEO. L.J. 1127, 1152 (2007) ("in many contexts, arbitrators have been shown to develop a bias in favor of so-called repeat players") (citing Lisa B. Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 EMPL. RTS. & EMPLOY. POL'Y J. 189 (1997)).

[78] Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO ST. J. ON DISP. RESOL. 777, 807-808 (2003) [hereinafter Hill, *Due Process*]; Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at Low Cost*, DISP. RESOL. J., May/July 2003, at 9 [hereinafter Hill, *Fair Forum*].

[79] Hill, *Due Process*, *supra* note 78, at 817; Hill, *Fair Forum*, *supra* note 78, at 15. Rather than reporting an employee win-rate, Hill reports an employer win-loss ratio – dividing the number of employer wins by the number of employer losses. For repeat employers with an in-house dispute resolution program, the employer win-loss ratio was 3.2; for repeat employers without an in-house dispute resolution program, the employer win-loss ratio was 1.25. For all employers, the employer win-loss ratio was 1.3. Hill, *Due Process*, *supra* note 78, at 817; Hill, *Fair Forum*, *supra* note 78, at 15.

[80] Colvin, *supra* note 2, at 428-29 ("Hill did not provide any tests of the statistical significance of the difference between the in-house program and no in-house program groups; however a simple chi-squared test on the results presented indicates that the difference is not statistically significant."); *see also* Sherwyn et al., *supra* note 2, at 1572 ("Of course, samples of thirty-four, twenty-five, and nine are too small to yield reliable conclusions.").

[81] Hill, *Fair Forum*, *supra* note 78, at 15; *see also* Hill, *Due Process*, *supra* note 78, at 817 (same).

[82] Hill, *Due Process*, *supra* note 78, at 814-15; Hill, *Fair Forum*, *supra* note 78, at 15. Hill also argues that "the total number of arbitrators on the AAA panel in contrast to the annual number of arbitrations shows that it is unlikely that any individual arbitrator would have appeared with sufficient frequency to seek to reward 'repeat player' employers," pointing out that "[t]here were 560 arbitrators on the AAA's employment arbitration panel in 1999-2000" and "only 432 awards rendered in 1999 and 410 rendered in 2000." Hill, *Due Process*, *supra* note 78, at 815.

[83] Colvin, *supra* note 2, at 408.

on employer promulgated agreements," rather than "individually negotiated contracts."[84] Colvin found an employee win-rate of 13.9% in cases against repeat employers as compared to an employee win-rate of 32.0% in cases against non-repeat employers, a statistically significant difference.[85] The employee win-rate in cases involving a repeat employer appearing before the same arbitrator (a "repeat employer-arbitrator pair" was 11.3% as compared to an employee win-rate of 21.2% in cases not involving a repeat employer-arbitrator pair.[86] Colvin then limited the sample to cases with repeat employers. In those cases, the employee win-rate was 11.3% in cases with a repeat-employer arbitrator pair and 14.7% in the rest of the cases. But the difference was not statistically significant.[87]

Overall, then, the empirical evidence tends to support the existence of a repeat-player effect, but suggests that the effect may be due to case screening by repeat businesses rather than repeat-arbitrator or repeat-player bias.

B. Overview of Arbitration Due Process Protocols

Each of the major arbitration providers has its own due process protocol or protocols.[88] The AAA adheres to the Employment Due Process Protocol, the Consumer Due Process Protocol, and the Health Care Due Process Protocol. JAMS has set out Minimum Standards of Procedural Fairness for both employment arbitration and consumer arbitration. NAF has promulgated an Arbitration Bill of Rights. This Part describes the history of due process protocols, summarizes their contents, and discusses several criticisms of the protocols.

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[84] *Id.* at 419.
[85] *Id.* at 430.
[86] *Id.*
[87] *Id.* at 430-31.
[88] National Consumer Disputes Advisory Committee, Consumer Due Process Protocol (April 17, 1998), *available at* www.adr.org/sp.asp?id=22019 [hereinafter Consumer Due Process Protocol]; *see also* Task Force on Alternative Dispute Resolution in Employment, Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship (May 9, 1995), *available at* www.adr.org/sp.asp?id=28535 [hereinafter Employment Due Process Protocol]; Commission on Health Care Dispute Resolution, Health Care Due Process Protocol (July 27, 1998), *available at* www.adr.org/sp.asp?id=28633 [hereinafter Health Care Due Process Protocol]; JAMS, JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses: Minimum Standards of Procedural Fairness (revised Jan. 1, 2007), *available at* www.jamsadr.com/rules/consumer_min_std.asp [hereinafter JAMS Consumer Minimum Standards]; JAMS, JAMS Policy on Employment Arbitration, Minimum Standards of Procedural Fairness (revised Feb. 19, 2005), *available at* www.jamsadr.com/rules/employment_Arbitration_min_stds.asp [hereinafter JAMS Employment Minimum Standards]; National Arbitration Forum, Arbitration Bill of Rights (2007), *available at* www.adrforum.com/users/naf/resources/ArbitrationBillOfRights3.pdf [hereinafter NAF Arbitration Bill of Rights].

1. History of Due Process Protocols

The origins of the due process protocols have been described in detail by other authors.[89] This Section summarizes those origins briefly, focusing on the Employment Due Process Protocol and the Consumer Due Process Protocol and their implementation by the AAA.

The due process protocols trace back to the work of the "Dunlop Commission," which was established in 1993 to "investigate the current state of worker-management relations in the United States."[90] Among the issues considered by the Commission was whether to enhance the ability of the parties themselves to resolve workplace disputes, rather than relying on the courts and regulators.[91] Accordingly, the Commission examined the use of employment arbitration, finding that while some employers adopted "serious and fair" arbitration programs,[92] others established programs that did not meet accepted standards of "fairness."[93]

Thereafter, the Chair of the Commission, John T. Dunlop, requested Arnold M. Zack, president of the National Academy of Arbitrators, to develop a list of private due process standards that would "extend the negotiated due process protections of union management arbitration to this expanding non-union setting."[94] Zack ended up as co-chair of the Task Force on Alternative Dispute Resolution in Employment, which drafted the Employment Due Process Protocol.[95] The members of the Task Force included representatives of an array of interest groups involved in employee-employer relations,[96] although the members made clear that "the protocol reflects their personal views and should not be construed as representing the policy of the designating organizations."[97] The Task Force issued the Employment Protocol in May 1995. Zack summarized the Task Force's view of its work as follows: "All the Task Force members will acknowledge that the Protocol does not contain all the protections and assurances that each of us as individuals would have liked to include, but the achievement of agreement on the components of the document did mark a substantial step forward in providing due process protections in procedures where many such protections had been lacking."[98]

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89 In particular, see Margaret M. Harding, *The Limits of Due Process Protocols*, 19 OHIO ST. J. ON DISP. RESOL. 369, 373-416 (2004). For a personal account of the origins of the Employment Due Process Protocol, see Arnold M. Zack, *The Due Process Protocol: Getting There and Getting Over It*, 11 EMPL. RTS. & EMPLOY. POL'Y J. 257, 257-59 (2007).

90 COMMISSION ON THE FUTURE OF WORKER-MANAGEMENT RELATIONS, FACT-FINDING REPORT xi (1994).

91 *Id.*

92 THE DUNLOP COMMISSION ON THE FUTURE OF WORKER-MANAGEMENT RELATIONS, FINAL REPORT 51 (1995).

93 *Id.* at 73.

94 Zack, *supra* note 89, at 258.

95 Employment Due Process Protocol, *supra* note 88.

96 The Task Force included representatives of the AAA, several committees of the American Bar Association, the National Academy of Arbitrators, the Society of Professionals in Dispute Resolution, the National Employment Lawyers Association, Federal Mediation & Conciliation, and the Workplace Rights Project of the American Civil Liberties Union. *Id.*

97 *Id.*

98 Zack, *supra* note 89, at 260. For example, the Task Force members agreed to disagree on whether pre-

In July 1995, the AAA established a pilot program in California to administer arbitrations using new rules incorporating the Employment Due Process Protocol.[99] Based on its experience in California, and drawing on a national Employment Conclave it sponsored in September 1995,[100] the AAA promulgated new Employment Arbitration Rules (effective June 1996) reflecting the principles of the Employment Protocol.[101] The AAA later announced that it would refuse to administer employment arbitrations if the plan failed materially to comply with the Protocol; the AAA also established a process by which employers could obtain advance review of their dispute resolution programs for protocol compliance.[102]

The Employment Due Process Protocol in turn served as the "primary model" for the Consumer Due Process Protocol.[103] In 1997, the AAA established the National Consumer Disputes Advisory Committee, which like the Employment Task Force consisted of an array of individuals from interested groups.[104] In May 1998, the Committee issued the Consumer Due Process Protocol, which is described in more detail below.[105] Thomas J. Stipanowich, the Academic Reporter for the Protocol, explained that although the AAA established the Advisory Committee, its "representatives did not play an active role in the Committee's deliberations or drafting process."[106] The AAA thereafter incorporated the principles of the Consumer Protocol into its Consumer Arbitration Rules, as well as announcing (as with the Employment Protocol) that it would refuse to administer cases that materially failed to comply.[107]

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dispute arbitration clauses should be enforceable in employment contracts. *See infra* text accompanying note 120.

[99] American Arbitration Association, Fair Play: Perspectives from American Arbitration Association on Consumer and Employment Arbitration 12 (Jan. 2003) [hereinafter AAA, Fair Play].

[100] Zack, *supra* note 89, at 260-61 ("The critical first step in the effort toward recognition of the validity of the proposals inherent in the Protocol was the decision of William Slate, President of AAA, to convene a Conclave on Employment Arbitration in Washington, D.C., on September 22-23, 1995.").

[101] AAA, Fair Play, *supra* note 99, at 13. JAMS likewise adopted the Employment Protocol. *JAMS/Endispute Issues Minimum Standards for Employment Arbitration*, 6 WORLD ARB. & MED. REP. 50, 50 (1995).

Some have suggested that another factor playing a role in both providers' adoption of the Employment Due Process Protocol was a threatened boycott by the National Employment Lawyers Association. *E.g.*, Harding, *supra* note 89, at 403 n.193; Richard C. Reuben, *Mandatory Arbitration Clauses Under Fire*, A.B.A. J., Aug. 1996, at 58, 58-59 ("[The Employment Protocol] largely languished until NELA issued an ultimatum to AAA and JAMS."); *see National Employment Lawyers Association Will Boycott ADR Providers*, 6 WORLD ARB. & MED. REP. 240, 240 (1995); *JAMS/Endispute Clarifies Position on Mandatory Employment Arbitration*, 7 WORLD ARB. & MED. REP. 512, 512 (1996).

[102] AAA, Fair Play, *supra* note 99, at 13; *see also infra* Part II.B.

[103] Thomas J. Stipanowich, *Contract and Conflict Management*, 2001 WIS. L. REV. 831, 907.

[104] The Task Force included representatives of the AAA, the Federal Trade Commission, Freddie Mac, Fannie Mae, the American Association of Retired Persons, Consumer Action, Consumers Union, the American Council on Consumer Interests, the National Association of Consumer Agency Administrators, the National Association of Attorneys General, Duke University, two lawyers in private practice who formerly were attorneys for large corporations, as well as academics and a retired judge. National Consumer Disputes Advisory Committee, *Introduction: Genesis of the Advisory Committee*, *in* Consumer Due Process Protocol, *supra* note 88, at 46.

[105] *Id.*; *see infra* Part I.B.2.

[106] Stipanowich, *supra* note 103, at 896 n.383.

[107] AAA, Fair Play, *supra* note 99, at 14. The protocols have influenced the arbitration of consumer and employee disputes in other ways as well. Businesses have incorporated the provisions of the Protocols into their

Shortly after the Consumer Due Process Protocol was issued, the Commission on Health Care Dispute Resolution issued a Health Care Due Process Protocol as well.[108] As discussed below, the Health Care Due Process Protocol differs from the Employment and Consumer Protocols because it requires a post-dispute agreement to arbitrate health care disputes involving patients.[109] The AAA likewise has announced that it will follow the Health Care Protocol and refuse to administer cases arising out of pre-dispute agreements to arbitrate disputes within its scope.[110]

2. Content of the Protocols

The due process protocols of the leading arbitration providers are broadly consistent in content. This Section describes key features the protocols have in common as well as highlighting some important differences.[111]

First, several of the protocols set out an overarching principle of "fundamental fairness."[112] The protocols do not make clear whether "fundamental fairness" is an independent requirement that must be satisfied or whether complying with the other requirements of the protocols constitutes fundamental fairness. The Commentary to the Consumer Due Process Protocol suggests the latter, explaining that the other principles in the Protocol "identify specific minimum due process standards which embody the concept of fundamental fairness."[113] Likewise, the Commentary to the NAF Arbitration Bill of Rights explains how the NAF's process and outcomes are fair to all parties.[114] Nonetheless, the requirement of fundamental

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arbitration clauses. *E.g.*, First Victoria, TIB – The Independent Bankersbank Visa Gift Card Terms and Conditions (Associate Program) (2005), *available at* www.firstvictoria.com/PDFs/VISAGiftCard Terms.pdf ("All disputes between you and the Bank in connection with your Gift Card and these Terms and Conditions will be resolved by BINDING ARBITRATION in accordance with the Consumer Due Process Protocol ...."); AT&T, BellSouth Service Agreement for Residential Services in Alabama (2006), *available at* http://cpr.bellsouth.com/pdf/al/al_res_sa.pdf ("[I]n the event that the AAA determines that any provision of this Agreement does not comply with applicable standards stated in the AAA's Consumer Due Process Protocol, the standards in the protocol shall control."). Courts have relied on the protocols in evaluating the fairness of an arbitration clause. *See* Richard A. Bales, *The Employment Due Process Protocol at Ten: Twenty Unresolved Issues, and a Focus on Conflicts of Interest*, 21 OHIO ST. J. ON DISP. RESOL. 165, 178-84 (2005) (discussing cases). Proposed federal legislation (not the Arbitration Fairness Act) has been modeled on the protocols. Fair Arbitration Act, S.1135, 110th Cong. (2007).

[108] The Commission was comprised of representatives of the AAA, ABA, and the American Medical Association. Health Care Due Process Protocol, *supra* note 88, at 3-4.

[109] *Id.* princ. 3.

[110] *See infra* Part IV(2).E.3.

[111] Appendix 3 contains excerpts from the Employment Due Process Protocol, the Consumer Due Process Protocol, the Health Care Due Process Protocol, as well as the JAMS Minimum Standards of Procedural Fairness for employment arbitration and for consumer arbitration, and the Arbitration Bill of Rights of the National Arbitration Forum. *See infra* Appendix 3.

[112] *E.g.*, Consumer Due Process Protocol, *supra* note 88, princ. 1.

[113] *Id.* Reporter's Comments to princ. 1.

[114] Commentary to NAF Arbitration Bill of Rights, *supra* note 88, princ. 1 ("Fairness for various classes of

fairness might be construed to have independent force as a constraint on procedures in consumer arbitrations.[115]

Second, several of the protocols address the contract formation process. The Consumer Due Process Protocol and the JAMS Minimum Standards for consumer arbitrations require businesses to provide consumers with "full and accurate information" on the arbitration program.[116] The NAF Arbitration Bill of Rights provides that "[i]nformation about arbitration should be reasonably accessible" to consumers "before they commit to an arbitration contract."[117] It adds that arbitration agreements "should conform to the legal principles of contract and applicable statutory law."[118]

As noted above, one important difference between the Health Care Due Process Protocol and the other due process protocols is that the Health Care Protocol precludes enforcement of pre-dispute arbitration agreements.[119] By comparison, the drafters of the Employment Due Process Protocol agreed to disagree on whether pre-dispute arbitration clauses should be enforceable; the drafters of the Consumer Due Process Protocol did likewise.[120] The effect of the disagreement was that both of those protocols permit enforcement of predispute arbitration agreements. The same is true for the JAMS Minimum Standards and the NAF Arbitration Bill of Rights.[121]

Third, the Consumer Due Process Protocol and the JAMS Minimum Standards of Procedural Fairness for consumer arbitrations permit claimants to bring claims in small claims court rather than arbitration, even if the claims are subject to a pre-dispute arbitration agreement.[122] The NAF Arbitration Bill of Rights contains no comparable provision, even though it applies to consumer arbitrations.[123] Neither the Employment Due Process Protocol nor the JAMS Minimum Standards for employment arbitrations contain opt outs for small claims court,[124] presumably due to the sorts of claims that typically arise out of the employment relationship.

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litigants can be evaluated by the standards of the process, and examined by its results.").

[115] And, in fact, the AAA does so in examining arbitration clauses for protocol compliance. *See infra* Part II.C.

[116] Consumer Due Process Protocol, *supra* note 88, princs. 2 & 11; JAMS Consumer Minimum Standards, *supra* note 88.

[117] NAF Arbitration Bill of Rights, *supra* note 88, princ.2.

[118] *Id.* princ. 5.

[119] Health Care Due Process Protocol, *supra* note 88, princ. 3.

[120] Consumer Due Process Protocol, *supra* note 88, Scope ("As was the case with the task force which developed the *Employment Due Process Protocol*, opinions regarding the appropriateness of binding pre-dispute arbitration agreements in consumer contracts were never fully reconciled.").

[121] JAMS Employment Minimum Standards, *supra* note 88, Introduction ("JAMS does not take a position on the enforceability of condition-of-employment arbitration clauses").

[122] Consumer Due Process Protocol, *supra* note 88, princ. 5; JAMS Consumer Minimum Standards, *supra* note 88, Standard 1(B).

[123] NAF Arbitration Bill of Rights, *supra* note 88.

[124] Employment Due Process Protocol, *supra* note 88; JAMS Employment Minimum Standards, *supra* note 88.

The JAMS Minimum Standards (for both consumer arbitrations and employment arbitrations) contain an additional limitation on the scope of arbitration agreements -- that arbitration agreements must be "reciprocally binding."[125] Under the JAMS Minimum Standards, an arbitration clause is "reciprocally binding" when a business is bound to arbitrate to the same extent as the consumer or employee.[126] None of the other protocols has a similar requirement.[127]

Fourth, the bulk of protocol provisions address procedural aspects of arbitration. Here, the requirements of the protocols are broadly similar. The protocols typically require: (1) independent and impartial arbitrators; (2) reasonable arbitration costs; (3) a reasonably convenient hearing location; (4) reasonable time limits for the proceeding; (5) the right to representation; (6) adequate discovery; and (7) a fair hearing.[128] Not all of the provisions of the protocols on these topics are identical, but they are broadly consistent.

Fifth, the protocols all address the remedies available in arbitration and the arbitration award itself. Every protocol requires that all remedies available in court also be available in arbitration.[129] In addition, the protocols typically require the arbitrator to follow the law in making a decision and to issue a written award (with reasons on request).[130]

3. Criticisms of the Protocols

A common criticism of the due process protocols is that they lack a mechanism for ensuring compliance with their provisions.[131] While the protocols set out minimum standards for consumer and employment arbitrations, they do not specify how the standards are to be enforced. Arbitration providers like the AAA and JAMS state that they will refuse to administer a case when the arbitration clause materially fails to comply with the relevant protocol. But the private nature of arbitral dispute resolution makes it difficult to verify whether providers in fact refuse to administer such cases.

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[125] JAMS Consumer Minimum Standards, *supra* note 88, Standard 1(A); JAMS Employment Minimum Standards, *supra* note 88, Standard 7 ("Both the employer and the employee must have the same obligation (either to arbitrate or go to court) with respect to the same kinds of claims.").

[126] JAMS Consumer Minimum Standards, *supra* note 88, Standard 1(A) (defining an arbitration clause as "reciprocally binding" when if a consumer or employee is "required to arbitrate his or her claims or all claims of a certain type, the company is so bound" as well).

[127] Courts likewise are split on whether nonmutual arbitration clauses are enforceable. Christopher R. Drahozal, *Non-Mutual Arbitration Clauses*, 27 J. CORP. L. 537, 542-52 (2002).

[128] *See, e.g.*, Consumer Due Process Protocol, *supra* note 88, princs. 3, 6-9, 12 & 13.

[129] *See, e.g.*, *id.* princ. 14.

[130] *See, e.g.*, *id.* princ. 15.

[131] Harding, *supra* note 89, at 372 ("The lack of [monitoring and enforcement] provisions makes it impossible to determine if the due process protocols are in fact being followed by individual arbitrators and arbitration service providers in actual cases."); Jean R. Sternlight, *Consumer Arbitration*, *in* ARBITRATION LAW IN AMERICA: A CRITICAL ASSESSMENT 174 (Edward Brunet et al. eds. 2006) ("Because the protocols are simply policies adopted by arbitration providers, there is no clear enforcement mechanism.")

Some critics allege that the AAA fails to ensure compliance with the protocols. For example, Laura MacCleery, Director of Public Citizen's Congress Watch Division, testified before Congress that "[w]hile AAA touts its internal protocols, it does not pledge to always follow them."[132] The plaintiffs in *Ting v. AT&T* alleged in their complaint in California federal court that "despite its representations to the contrary, AAA regularly administers arbitrations or otherwise endorses the validity of mandatory pre-dispute arbitration clauses that do not comply with its Due Process Protocol."[133]

To evaluate the criticisms requires empirical evidence on AAA protocol compliance review. But no direct evidence of the nature and extent of protocol compliance review by the AAA is yet available.[134] As Mark Weidemaier states: "With respect to the AAA, for example, we do not know whether it routinely conducts an adequate, independent review of the governing agreement before accepting a case for arbitration."[135] Without systematic empirical study, the only evidence consists of occasional anecdotal reports of alleged violations of the protocols.[136]

An additional criticism of the protocols is that they are incomplete.[137] As Rick Bales puts it (in the context of the Employment Due Process Protocol), the protocols have "largely been left behind by ongoing legal developments" -- that is, they "no longer provide[] the kind of

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[132] H.R. 3010, the Arbitration Fairness Act of 2007, Hearing Before the Comm'l and Admin. Law Subcomm. of the House Comm. on the Judiciary, 110th Cong., 1st Sess. (Oct. 25, 2007) [hereinafter House Hearings], *available at* http://judiciary.house.gov/hearings/hear_102507.html (Testimony of Laura MacCleery) (ms. at 5) (*citing* Declaration of Robert E. Meade, senior vice president, American Arbitration Association *in* Stahle v. Blue Cross of California, Case No. BC 218082 (Cal. Super. Ct. Feb. 17, 2000) ("[Health Care Due Process Protocol] consists of recommended procedures and compliance with the procedures is voluntary.")).

[133] Class Action Complaint ¶ 59, Ting v. AT&T (Cal. Super. Ct. July 31, 2001), *available at* www.consumer-action.org/press/articles/ting_consumer_action_sues_atampt_over_binding_arbitration_clause/. Some of these criticisms are misdirected, however. For example, Public Citizen cites evidence that many franchise agreements include remedy limitations as showing the ineffectiveness of the Consumer Due Process Protocol. Public Citizen, The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration 33 (2008), *available* at http://www.citizen.org/documents/ArbitrationDebateTrap(Final).
pdf. But the Consumer Protocol does not apply to franchise agreements, so the comparison misses the mark.

[134] There is indirect evidence of compliance with the Employment Due Process Protocol, in the form of a study by Lisa Bingham and Shimon Sarraf finding that employee win-rates in AAA employment arbitration increased after adoption of the Protocol. Bingham & Sarraf, *supra* note 75.

[135] W. Mark C. Weidemaier, *Arbitration and the Individuation Critique*, 49 ARIZ. L. REV. 69, 93 n.138 (2007); *see also* Weidemaier, *supra* note 40, at 659 ("Another possibility is that the company knows that JAMS and AAA often do not enforce their rules. This cannot be ruled out, in part because providers are reluctant to provide the data needed to evaluate this possibility. There have been allegations that actual practices sometimes conflict with providers' public stances. Providers, however, are under no small amount of scrutiny, and I am not aware of supported allegations of under- or non-enforcement of these providers' due process rules.").

[136] *See* Paul Bland, CL&P Blog, AAA Breaks Its Promise Not to Hear Pre-Dispute Arbitrations in Health Care Cases (Feb. 22, 2007), http://pubcit.typepad.com/clpblog/2007/02/aaa_breaks_its.html.

[137] Bales, *supra* note 107, at 185 (identifying "twenty unresolved issues" in the Employment Due Process Protocol, which "may be broadly divided into six major categories: contract formation issues, barriers to access, remedies issues, FAA issues, and conflicts of interest"). We do not address all the asserted substantive shortcomings of the protocols in this study.

prospective guidance that [they] did a decade ago."[138] The most frequently litigated provision that the protocols do not address is the class arbitration waiver.[139]

Arbitration clauses themselves prevent a case from proceeding as a class action in court.[140] Because the parties' contract includes an arbitration clause, the case instead goes to arbitration.[141] Following the Supreme Court's decision in *Green Tree Financial Corp. v. Bazzle*,[142] the AAA promulgated rules for the administration of class arbitrations -- cases that proceed on a class basis in arbitration.[143] In response to the availability of class arbitration, some or many businesses (depending on the type of business) now include "class arbitration waivers" -- clauses that preclude arbitration from proceeding on a class basis -- in their arbitration clause.[144] The combined effect of an arbitration clause and an enforceable class arbitration waiver -- precluding the availability of class relief altogether -- might prevent claimants with

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138 *Id.* at 184.

139 *Id.* at 188 ("[One] issue is the enforceability of arbitration clauses that forbid employees from bringing claims as an arbitral class action."); Martin H. Malin, *Due Process in Employment Arbitration: The State of the Law and the Need for Self-Regulation*, 11 EMPLOYEE RTS. & EMPL. POL'Y J. 363, 402 (2007) ("[T]he neutral community has failed to address the common practice in employer-imposed arbitration systems that prohibit not only class actions but also joinder of claims of even two individuals."); Jeffrey W. Stempel, *Mandating Minimum Quality in Mass Arbitration*, 76 U. CINN. L. REV. 383, 424 (2008) ("A more substantive failing of the Employment Protocol and similar ventures is that they either do not address remedial issues such as the availability of class actions or expressly exclude standard litigation remedies from mass arbitration."); Sternlight, *supra* note 131, at 175 ("By contrast [to the Health Care Protocol], the Consumer Protocol neither bans mandatory arbitration nor clauses that would eliminate consumers' rights to proceed in class actions.").

140 Christopher R. Drahozal & Quentin R. Wittrock, *Franchising, Arbitration, and the Future of the Class Action*, 3 ENTREPRENEURIAL BUS. L.J. __, __ (forthcoming 2008).

141 John F. Dienelt & Margaret E.K. Middleton, *Settling Franchise Class Actions*, 21 FRANCH. L.J. 113, 158-59 (2002) (describing series of cases that "illustrate how arbitration clauses may be used to diminish drastically the size of the class, and, in some instances, to block class litigation altogether"); Kevin M. Kennedy & Bethany Appleby, Green Tree Financial Corp. v. Bazzle*: A New Day for Class Actions?*, 23 FRANCH. L.J. 84, 84 (2003) ("[D]uring the past decade, arbitration clauses have repeatedly enabled franchisors to 'break up' attempts by franchisees to assert class or consolidated claims."); Robert S. Safi, Note, *Beyond Unconscionability: Preserving the Class Mechanism Under State Law in the Era of Consumer Arbitration*, 83 TEX. L. REV. 1715, 1724 (2005) ("The CAP [class arbitration preclusion clause] is an invention of fairly recent vintage, born of necessity. Historically, defendants could rest assured that a binding arbitration clause buried within the terms of a contract of adhesion would foreclose the possibility of classwide exposure, because courts perceived the class mechanism and arbitration as incompatible.")

142 539 U.S. 444 (2003) (plurality opinion) (deciding that arbitrator is to determine whether arbitration clause that is silent on class relief in arbitration permits class arbitration).

143 American Arbitration Association, Supplementary Rules for Class Arbitrations (effective Oct. 8, 2003), *available at* www.adr.org/sp.asp?id=21936. Under its current policy, the AAA will administer arbitrations on a class basis "if (1) the underlying agreement specifies that disputes arising out of the parties' agreement shall be resolved by arbitration in accordance with any of the Association's rules, and (2) the agreement is silent with respect to class claims, consolidation or joinder of claims." American Arbitration Association, AAA Policy on Class Arbitrations (July 14, 2005), *available at* www.adr.org/sp.asp?id= 28779. If, however, the arbitration agreement "prohibits class claims, consolidation or joinder," the AAA will not administer a class arbitration "unless an order of a court directs the parties to the underlying dispute to submit any aspect of their dispute involving class claims, consolidation, joinder or the enforceability of such provisions, to an arbitrator or to the Association." *Id.*

144 *See infra* Part IV(2).E.2.

small claims from bringing an action, and is frequently cited as a reason for making pre-dispute arbitration agreements unenforceable in consumer and employment contracts.[145]

Again, empirical evidence would be valuable in evaluating this criticism. While several empirical studies have examined the use of class arbitration waivers, most have focused on a narrow class or classes of consumer contracts.[146] Timely data on the use of class arbitration waivers in a range of consumer contracts could usefully inform consideration of this issue as well.

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[145] Drahozal & Wittrock, *supra* note 140, at __. For a discussion of the case law, see *id.* at ___-___.
[146] *See infra* Part IV(2).E.2.

II. AAA CONSUMER ARBITRATION PROCEDURES

For consumer arbitrations administered by the American Arbitration Association ("AAA"), the starting point for understanding the arbitration process is the AAA's Supplementary Procedures for Resolution of Consumer-Related Disputes.[1] Accordingly, this Part first describes briefly key features of those procedures. It then discusses in detail the AAA's review of consumer arbitration clauses for compliance with the Consumer Due Process Protocol, beginning with the review process and then addressing the substance of the AAA's review. Throughout this Part, we describe the AAA's procedures as set out in its rules and other publications, or as explained to us in discussions with knowledgeable AAA personnel. The extent to which the AAA's actual practices are consistent with this description is a subject of our empirical findings in Part IV.

A. AAA Procedures for Consumer Arbitration

Under the AAA's rules, a case is classified as a consumer case when it meets three requirements. First, it must arise out of "an agreement between a consumer and a business where the business has a standardized, systematic application of arbitration clauses with customers."[2] Second, "the terms and conditions of the purchase of standardized, consumable goods or services [must be] non-negotiable or primarily non-negotiable in most or all of its terms, conditions, features, or choices."[3] Third, "[t]he product or service must be for personal or household use."[4] The AAA makes the initial determination whether a case is a consumer case, subject to redetermination by the arbitrator.[5]

When a case is designated as a consumer case, the AAA's Supplementary Procedures for Resolution of Consumer-Related Disputes generally will apply.[6] A central feature of those procedures is their discounted fee schedule, designed to satisfy the requirement of the Consumer Due Process Protocol that arbitration be available to consumers at a reasonable cost.[7] For consumer claims administered by the AAA, fees are based on a three-tiered structure. For claims

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[1] American Arbitration Association, Supplementary Procedures for the Resolution of Consumer-Related Disputes (effective Sept. 15, 2005), *available at* http://www.adr.org/sp.asp?id=22014 [hereinafter AAA, Consumer Rules].

[2] *Id.*

[3] *Id.*

[4] *Id.*; *see also* JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses: Minimum Standards of Procedural Fairness n.1 (revised Jan. 1, 2007) [hereinafter JAMS Consumer Minimum Standards] ("These standards are applicable where a company systematically places an arbitration clause in its agreements with individual consumers and there is minimal, if any, negotiation between the parties as to the procedures or other terms of the arbitration clause. A consumer is defined as an individual who seeks or acquires any goods or services, including financial services, primarily for personal family or household purposes.").

[5] AAA, Consumer Rules, *supra* note 1, Rule C-1(a) ("The AAA will have the discretion to apply or not to apply the Supplementary Procedures and the parties will be able to bring any disputes concerning the application or non-application to the attention of the arbitrator.").

[6] *Id.*

[7] National Consumer Disputes Advisory Committee, Consumer Due Process Protocol, princ. 6 (April 17, 1998) [hereinafter Consumer Due Process Protocol].

seeking less than $10,000, the consumer must pay $125.[8] The full amount is applied toward the arbitrator's fees and none to the AAA's administrative fees. For claims seeking between $10,000 and $75,000, the consumer must pay $375.[9] Again, the AAA pays the full amount toward the arbitrator's fees and none to its administrative fees. For claims over $75,000, the consumer pays administrative fees based on the regular fee schedule in the AAA Commercial Rules, and arbitrator's fees based on the arbitrator's usual rates (with a deposit of one-half the arbitrator's fee due on filing).[10] The consumer may seek a deferral or waiver of the administrative fees on a showing of financial hardship and request an arbitrator willing to serve pro bono.[11]

Under the AAA's rules, the business respondent pays all the administrative fees and the remaining arbitrator's fees for small consumer claims, both for claims brought by the consumer as well as claims brought by the business. For claims of $10,000 or less, the business pays $750 in administrative fees and an additional $200 if a hearing is held.[12] In addition, the business is responsible for the remaining $125 in arbitrator's fees.[13] For claims seeking between $10,000 and $75,000, the business pays $950 in administrative fees and $300 if a hearing is held.[14] In addition, the business is responsible for the remaining $375 in arbitrator's fees.[15] For business claims seeking over $75,000, the business pays administrative fees based on the regular fee schedule in the AAA Commercial Rules, and arbitrator's fees based on the arbitrator's usual rates.[16]

Beyond the fee structure, a number of other features of the AAA Consumer Rules also are worth noting. Even though the parties have agreed to arbitrate, a party retains the right to seek relief in small claims court instead.[17] In most cases, the entire proceeding is to be conducted on an expedited basis.[18] The AAA appoints the arbitrator from its consumer panel, subject to the

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[8] AAA, Consumer Rules, *supra* note 1, Rule C-8 ("Fees and Deposits to be Paid by the Consumer").

[9] *Id.*

[10] *Id.* If, however, the arbitration agreement provides for the consumer to pay a lower share of the costs than otherwise would be applicable, the lower contractual amount controls.

[11] American Arbitration Association, Administrative Fee Waivers and Pro Bono Arbitrators ("Pro Bono Service by Arbitrators"), *available at* www.adr.org/si.asp?id=22040 ("A number of arbitrators on the AAA panel have volunteered to serve pro bono for one hearing day on cases where an individual might otherwise be financially unable to pursue his or her rights in the arbitral forum.").

[12] AAA, Consumer Rules, *supra* note 1, Rule C-8 ("Fees and Deposits to be Paid by the Business: *Administrative Fees*").

[13] *Id.* Rule C-8 ("Fees and Deposits to be Paid by the Business: *Arbitrator Fees*").

[14] *Id.* Rule C-8 ("Fees and Deposits to be Paid by the Business: *Administrative Fees*").

[15] *Id.* Rule C-8 ("Fees and Deposits to be Paid by the Business: *Arbitrator Fees*").

[16] *Id.* Rule C-8 ("Fees and Deposits to be Paid by the Business: *Administrative Fees*"); *see* American Arbitration Association, Commercial Arbitration Rules, Rules R-49 and R-51 (amended and effective Sept. 1, 2007) [hereinafter AAA, Commercial Rules].

[17] AAA, Consumer Rules, *supra* note 1, Rule C-1(d); *see* Consumer Due Process Protocol, *supra* note 7, princ. 5.

[18] *E.g.*, AAA, Consumer Rules, *supra* note 1, Rules C-1(b) ("The Expedited Procedures will be used unless there are three arbitrators."), C-2(b), C-4, C-6, & C-7(a); *see* Consumer Due Process Protocol, *supra* note 7, princ. 8 ("Reasonable Time Limits").

parties' right "to submit any factual objections to that arbitrator's service."[19] For claims seeking $10,000 or less, the default rule is that the case will be resolved on the basis of documents only.[20] Either party may request a telephone or in-person hearing, however.[21] Likewise, the arbitrator may hold a telephone or in-person hearing if he or she decides one is necessary. For claims seeking over $10,000, the default rule is that the arbitrator will hold either a telephone or in-person hearing unless the parties agree otherwise.[22] The arbitrator's award "shall be in writing,"[23] and in making the award "[t]he arbitrator may grant any remedy, relief or outcome that the parties could have received in court."[24]

B. Process of AAA Protocol Compliance Review

If a consumer case involves a claim for compensatory damages of $75,000 or less, the AAA's procedure is for the AAA itself to review the arbitration clause for compliance with the Consumer Due Process Protocol.[25] After undertaking this review, "[i]f the Association determines that ... a dispute resolution clause on its face, substantially and materially deviates from the minimum due process standards of this Protocol, the Association may decline to administer cases arising under this clause."[26] If the claim is seeking over $75,000, issues of protocol compliance are for the arbitrator.[27]

AAA review of consumer arbitration clauses for protocol compliance can take place both before and after a dispute arises. Before a dispute arises, the AAA has set up an "advance review" procedure similar to the procedure under its Employment Arbitration Rules.[28]

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[19] AAA, Consumer Rules, *supra* note 1, Rule C-4; *see* Consumer Due Process Protocol, *supra* note 7, princ. 3 ("Independent and Impartial Neutral") and princ. 4 ("Quality and Competence of Neutrals").

[20] AAA, Consumer Rules, *supra* note 1, Rule C-5.

[21] Consumer Due Process Protocol, *supra* note 7, princ. 12 ("Arbitration Hearings").

[22] AAA, Consumer Rules, *supra* note 1, Rule C-6.

[23] *Id.* Rule C-7(b); *see* Consumer Due Process Protocol, *supra* note 7, princ. 15 ("Arbitration Awards").

[24] AAA, Consumer Rules, *supra* note 1, Rule C-7(c); *see* Consumer Due Process Protocol, *supra* note 7, princ. 14 ("Arbitral Remedies").

[25] American Arbitration Association, Rules Updates, Consumer Arbitrations: Notice to Consumers and Businesses, *available at* http://www.adr.org/sp.asp?id=24714&printable=true (last visited Aug. 13, 2008) [hereinafter AAA Rules Updates].

[26] *Id.*

[27] American Arbitration Association, Fair Play: Perspectives from American Arbitration Association on Consumer and Employment Arbitration 33 (Jan. 2003) [hereinafter AAA, Fair Play]. Likewise, "issues that are not clearly substantial and material deviations will be presented to the arbitrator for determination." AAA Rules Updates, *supra* note 25.

[28] AAA, Fair Play, *supra* note 27, at 33 ("[B]usinesses] are asked to obtain advance review by AAA of the program to determine compliance with the protocols."); AAA Rules Updates, *supra* note 25 (describing advance review process); *see* American Arbitration Association, Employment Arbitration Rules, Rule 2 (amended and effective July 1, 2006), *available at* http://www.adr.org/sp.asp?id=32904 [hereinafter AAA, Employment Rules] ("An employer intending to incorporate these rules or to refer to the dispute resolution services of the AAA in an employment ADR plan, shall, at least 30 days prior to the planned effective date of the program: (i) notify the Association of its intention to do so and, (ii) provide the Association with a copy of the employment dispute resolution plan.").

According to the AAA, "[i]f a business intends to use the arbitration services of the Association in a predispute arbitration clause that involves consumers, it shall, at least thirty (30) days before the planned effective date of the clause (1) notify the Association of its intention to do so; and (2) provide the Association with a copy of the clause."[29] If the business does not do so, the AAA "reserves the right to decline its administrative services."[30] The description of the AAA's process for advance review of consumer arbitration clauses, while available on the AAA web site,[31] is not included in either the AAA's Commercial Arbitration Rules[32] or its Supplementary Procedures for Resolution of Consumer-Related Disputes.[33] By comparison, the provision providing for advance review of employment arbitration clauses is set out in the AAA's Employment Arbitration Rules.[34]

The potential benefits of advance review are at least twofold. First, advance review permits the business and the AAA to resolve any issues of protocol compliance before a dispute arises, so that the compliance review process does not interfere with resolution of the dispute between the business and a consumer. Second, advance review extends the benefits of the Protocol to all consumers who agree to a form contract with the business, not just those who are party to an arbitration before the AAA.

Post-dispute protocol review is to occur once a claimant files a demand for arbitration with the AAA. Under the AAA's arbitration rules, the demand must include a copy of the arbitration clause.[35] The parties need not attach the entire contract. Accordingly, in conducting its review for protocol compliance, the "AAA reviews the parties' arbitration clause only, and not the entire contract."[36]

Before undertaking administration of the case, the AAA case intake staff is to review the arbitration clause for compliance with the Consumer Due Process Protocol[37] (the substance of that review is described in the next section).[38] The case intake staff also is to check the name of the business against the AAA "business list" ("AAA business list") – a list of all businesses of

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29 AAA, Rules Updates, *supra* note 25.
30 *Id.*
31 *Id.*
32 AAA, Commercial Arbitration Rules, *supra* note 16.
33 AAA, Consumer Rules, *supra* note 1.
34 AAA, Employment Rules, *supra* note 28, Rule 2.
35 AAA, Consumer Rules, *supra* note 1, Rule C-2(a).
36 American Arbitration Association, AAA Review of Consumer Clauses 1, *available at* http://www.adr.org/si.asp?id=4453 (last visited Sept. 9, 2008); *see also* JAMS, JAMS Policy on Employment Arbitration, Minimum Standards of Procedural Fairness (revised Feb. 19, 2005), *available at* www.jamsadr.com/rules/employment_Arbitration_min_stds.asp [hereinafter JAMS Employment Minimum Standards] ("In assessing whether the standards are met and whether to accept the arbitration agreement, JAMS, as the ADR Provider, will limit its inquiry to a facial review of the clause or procedure. If a factual inquiry is required, for example, to determine compliance with the Minimum Standards, it must be conducted by an arbitrator or court.").
37 AAA Fair Play, *supra* note 27, at 33-34 ("[S]pecially designated AAA staff members review clauses submitted in consumer cases ... to check protocol compliance.").
38 *See infra* Part II.C.

which the AAA is aware that mention (or at least at some point mentioned) the AAA in their consumer arbitration clauses. If the business is one that has refused either to waive an objectionable provision or to pay its share of arbitration costs in a prior consumer case, it should be classified as "unacceptable" on the AAA business list so that the AAA will refuse to administer future cases involving the business.[39] Otherwise, the business should be classified as "acceptable."

If the clause complies with the Protocol, the business is to be classified as "acceptable" on the AAA business list. Provided that the business pays its share of the arbitration fees, the case will proceed to arbitration.[40] If the clause does not comply, the AAA's procedure is to contact the business to determine whether the business will waive the offending provision or provisions -- not only for this dispute, but for future disputes.[41] Moreover, the AAA will advise the business regarding the changes that can be made to bring the clause into compliance with the Protocol. If the business does not waive the provision, AAA policy is to refuse to administer the case.[42] If the company is listed as "unacceptable" on the AAA business list, or if the business fails to pay the required fees, the AAA likewise should refuse to administer the case.

If questions arise, the case intake staff can consult with a designated AAA employee who maintains the AAA business list. Note that protocol review in consumer cases differs from protocol review in employment cases, in which review is handled centrally by a single AAA employee.[43] In the consumer setting, by comparison, the case intake staff conduct the review,

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[39] The list is described in more detail *infra* Part III.B. Note that review of the AAA business list is not to replace reviewing the arbitration clause itself, as the clause may have changed since the most recent entry on the AAA business list.

[40] Assuming, of course, that the other requirements for AAA administration are met, such as that the consumer paid his or her share of the arbitrator's fees.

[41] *See* Ragan v. AT&T Corp., 824 N.E. 2d 1183, 1194 (Ill. Ct. App. 2005) (quoting letter from AAA employee to AT&T dated Oct. 29, 2002) ("The AAA's willingness to administer disputes under AT&T's arbitration agreement is contingent upon AT&T's continued willingness to have all past, present[,] and future consumer-related disputes administered in accordance with the Consumer Rules and the Protocol."). For a sample letter that is in the public domain, see Letter from Molly A. Bargenquest to Melissa Hoag Sherman & Kevin Mason dated Dec. 19, 2003, included in CD-ROM Appendix to NATIONAL CONSUMER LAW CENTER, CONSUMER ARBITRATION AGREEMENTS: ENFORCEABILITY AND OTHER TOPICS (5th ed. 2007).

[42] AAA, Rules Updates, *supra* note 25; *see also* JAMS Employment Minimum Standards, *supra* note 36 ("If JAMS becomes aware that an arbitration clause or procedure does not comply with the Minimum Standards, it will notify the employer of the Minimum Standards and inform the employer that the arbitration demand will not be accepted unless there is full compliance with those standards."); JAMS Consumer Minimum Standards, *supra* note 4 ("JAMS will administer arbitrations pursuant to mandatory pre-dispute arbitration clauses between companies and consumers only if the contract arbitration clause and specified applicable rules comply with the following minimum standards of fairness.").

[43] Lisa B. Bingham & Shimon Sarraf, *Employment Arbitration Before and After the Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of Employment: Preliminary Evidence that Self-Regulation Makes a Difference*, *in* ALTERNATE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NEW YORK UNIVERSITY 53RD ANNUAL CONFERENCE ON LABOR 303, 321 (Samuel Estreicher & David Sherwyn eds. 2004) ("The internal mechanism the AAA uses to enforce the Protocol is for a single employee to review each and every employer arbitration plan in which the AAA is named as third-party administrator. If the plan does not comport with the Protocol, the AAA advises the employer to revise it, and the AAA refuses to administer any arbitration under the plan until it comports with the Protocol. The fact that a single employee centrally reviews

with the employee who maintains the AAA business list available for consultation in individual cases.

C. Substance of AAA Protocol Compliance Review

The Consumer Due Process Protocol sets out fifteen principles it describes as "embodiments of fundamental fairness" in dispute resolution.[44] In deciding whether to administer a consumer case, the AAA reviews the arbitration clause submitted with the arbitration demand for compliance with the Due Process Protocol. This review is subject to several important constraints.

First, as noted above, the AAA reviews the text of the arbitration clause, not the entire contract, to determine protocol compliance.[45] To the extent a problematic provision is not located in the arbitration clause but rather is located elsewhere in the contract, the provision is not subject to the AAA's review.[46]

Second, evaluating compliance with some principles of the Due Process Protocol may require factual determinations rather than simply a review of the text of the arbitration clause. To the extent factual inquiries are necessary in a particular case, the matter becomes one for the arbitrator rather than for the AAA's review process.[47]

Third, it has been the longstanding policy of the AAA to comply with any court order directing that the administration of an arbitration proceed in a particular manner.[48] Typically, the AAA is not a party to such a court proceeding; rather, only the parties to the arbitration clause are parties to the court order. Nonetheless, the AAA's policy is to defer to the court order compelling arbitration and to administer the case, even if the clause includes provisions that are inconsistent with the Consumer Due Process Protocol. However, AAA policy is to administer the case consistently with the Protocol, unless the court order directs otherwise.

Fourth, administrative review is limited to cases seeking $75,000 or less – the same cutoff the AAA uses for the reduced fee schedule in its Consumer Arbitration Rules.[49] In determining the amount of the claim, the AAA's rules provide for it to consider only compensatory damages.[50] Amounts sought as punitive damages, interest, or attorneys' fees are

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all plans ensures a certain consistency in internal administration.").

[44] Consumer Due Process Protocol, *supra* note 7, princ. 1.

[45] *See supra* Part II.B.

[46] Presumably challenges to such a provision could still be made to the arbitrator.

[47] *Cf.* JAMS, Employment Minimum Standards, *supra* note 36.

[48] The description in this paragraph is based on discussions with AAA personnel knowledgeable of its policies and practices in administering consumer cases.

[49] *See supra* Part II.A.

[50] AAA, Consumer Rules, *supra* note 1, Rule C-8 ("Administrative Fees").

not to be considered. The Protocol still applies in cases in which the claimant seeks more than $75,000, but in those cases decisions on application of the Protocol are for the arbitrator.[51]

In our empirical analysis below,[52] we evaluate the effectiveness of the AAA's review for protocol compliance. To do so, we examine the arbitration clauses in the cases in the case file sample under the same standards the AAA seeks to apply in its review. The rest of this Section describes our understanding of those standards.[53]

- Principle 1. Fundamentally-Fair Process: As discussed above, the text of the Protocol is not clear whether Principle 1 states a separate requirement of fundamental fairness or whether it merely indicates that the remaining principles of the Protocol protect fundamental fairness.[54] Nonetheless, in reviewing clauses, the AAA is to consider whether the procedures set out in the arbitration clause are unduly one-sided – that is, whether they unduly favor the business in ways not addressed in other principles of the Protocol.

- Principle 2. Access to Information: The AAA's review is limited to the arbitration clause itself; it does not examine the surrounding circumstances to evaluate whether the consumer was able to obtain "full and accurate information" regarding the ADR program.[55] As a result, the AAA's protocol compliance review does not consider this Principle. Presumably, the consumer could raise the issue of compliance before the arbitrator.

- Principle 3. Independent and Impartial Neutral: Various contract provisions might violate the requirement that the arbitrator be independent and impartial. Certainly a provision permitting the business to select the arbitrator unilaterally, or to control the list of prospective arbitrators, would violate this Principle.[56] In addition, provisions setting out required qualifications for arbitrators likewise might be problematic. For example, a requirement that the arbitrator work at a company that sells the good or service at issue would be objectionable under this Principle.[57]

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[51] *See supra* Part II.B.

[52] *See infra* Part IV(2).B.

[53] The description below is based on discussions with AAA personnel knowledgeable about its protocol compliance review and on guidance given to case intake staff who conduct that review.

[54] *See supra* Part I.B.2.

[55] Consumer Due Process Protocol, *supra* note 7, princ. 2.

[56] *E.g.* Hooters of Am., Inc. v. Phillips, 173 F.3d 933, 938-39 (4th Cir. 1999) ("The Hooters rules also provide a mechanism for selecting a panel of three arbitrators that is crafted to ensure a biased decisionmaker. The employee and Hooters each select an arbitrator, and the two arbitrators in turn select a third. Good enough, except that the employee's arbitrator and the third arbitrator must be selected from a list of arbitrators created exclusively by Hooters.").

[57] *Cf.* Christopher R. Drahozal, *"Unfair" Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 733 (provision in franchise agreement).

- Principle 4. Quality and Competence of Neutrals: This Principle focuses on the quality of the arbitrators named by the AAA. The AAA views it as directed at the AAA's screening and training of potential arbitrators (so that the AAA's policy is to appoint only attorney arbitrators for consumer arbitrations, for example), rather than at the parties' arbitration clause. On this view, there is nothing for the AAA to review in the arbitration clause with respect to this Principle.

- Principle 5. Small Claims: This Principle requires that the arbitration agreement "should make it clear that all parties retain the right to seek relief in a small claims court for disputes or claims within the scope of its jurisdiction."[58] The AAA's Supplementary Procedures for Resolution of Consumer-Related Disputes provide that "[p]arties can still take their claims to a small claims court."[59] As such, unless the arbitration clause expressly precludes the consumer from going to small claims court, the AAA treats this Principle as satisfied.

- Principle 6. Reasonable Cost: The AAA addresses the Principle in part through its arbitration rules, which provide for the business to pay all administrative costs for claims of $75,000 or less, and the parties to share equally the arbitrator's fees, capped at $125 or $375 for consumers.[60] In addition, the AAA reviews clauses for provisions that would increase arbitration costs above the amounts provided under its rules. Thus, a clause that requires the parties to share equally all arbitration costs (not just the arbitrator's fees) would be objectionable under this Principle. Similarly, a clause that requires three arbitrators rather than one likewise would be objectionable because it would increase (potentially triple) the consumer's costs.

- Principle 7. Reasonably Convenient Location: This Principle addresses clauses that would require the consumer to travel unreasonably long distances to attend an in-person arbitration hearing.[61] A clause that requires arbitration to take place at the business's location would be problematic for a business that provides goods or services nationally. For businesses that typically sell locally, however, the AAA will not find such a clause to violate the Protocol because the location of the business would be convenient for most consumers, although the arbitrator may find a violation in a particular case, based on the particular circumstances of that case.

- Principle 8. Reasonable Time Limits: This Principle requires that arbitration take place "without undue delay."[62] The AAA interprets this Principle as primarily applicable to its rules and procedures, which set out the time limits for the arbitration process. Only if the

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[58] Consumer Due Process Protocol, *supra* note 7, princ. 5.
[59] AAA, Consumer Rules, *supra* note 1, Rule C-1(d).
[60] *See supra* Part II.A.
[61] *See also* American Arbitration Association, Locale Determinations: AAA (2007), *available at* www.adr.org/sp.asp?id=22025 ("For consumer disputes, if the claim is under $75,000 then AAA will require the business to waive the locale if the locale is not reasonably convenient for the consumer.").
[62] Consumer Due Process Protocol, *supra* note 7, princ. 8.

arbitration clause unduly lengthens those time limits so as to unreasonably delay the arbitration proceeding would there be an issue for the AAA's review.[63]

- Principle 9. Right to Representation: This Principle provides that the consumer has the right to the representative of his or her choice. An arbitration clause that precluded the consumer from being represented by counsel (or other representative) would violate this Principle.

- Principle 10. Mediation: This Principle encourages but does not require the use of mediation. As a result, in the AAA's view there is nothing for it to review.

- Principle 11. Agreements to Arbitrate: See discussion above of Principle 2.[64]

- Principle 12. Arbitration Hearings: The sorts of provisions that would violate this Principle include a provision that requires the arbitrator to decide on the basis of documents only (i.e., bars an in-person hearing) or otherwise restricts the arbitrator's discretion as to how to resolve the case.

- Principle 13. Access to Information: By "Access to Information," the Protocol means discovery. Thus, contract provisions that unduly restrict the amount of discovery in the arbitration would violate this Principle.

- Principle 14. Arbitral Remedies: This Principle requires that the same remedies be available in arbitration as are available in court. This Principle can be interpreted in two ways. The broader interpretation is that the remedies generally available in court -- such as punitive damages and injunctive relief -- also must be available in arbitration. Under that interpretation, contractual limitations on remedies would not be permitted. The narrower interpretation is that a contractual limitations on remedies would be permissible in a particular case so long as the limitation was enforceable under the applicable state law. In applying this principle, the AAA has adopted the broader interpretation.[65] As

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[63] Interestingly, in Martinez v. Master Protection Corp., 12 Cal. Rptr. 3d 663 (Cal. Ct. App. 2004) (alternate holding), the AAA evidently applied the comparable principle of the Employment Due Process Protocol in refusing to enforce a provision that shortened the statute of limitations for bringing a claim. *Id.* at 667 ("AAA's policy was against conducting arbitrations on employment plans such as [the employer's], which gave parties less time to assert claims than would otherwise be available by statute."); *see* Task Force on Alternative Dispute Resolution in Employment, Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship (May 9, 1995), *available at* www.adr.org/sp.asp?id=28535. By contrast, Principle 8 of the Consumer Due Process Protocol focuses solely on eliminating delays in the arbitration process, rather than on provisions that reduce the time for bringing a claim. Consumer Due Process Protocol, *supra* note 7, Reporter's Comments to princ. 8 ("[I]t is not enough that the agreement places strict time limitations on procedural steps if these limitations are not effectively enforced.").

[64] *See supra* text accompanying note 55.

[65] W. Mark C. Weidemaier, *Arbitration and the Individuation Critique*, 49 ARIZ. L. REV. 69, 90 (2007) ("[O]n one occasion, the AAA asserted that an agreement violated the Consumer Protocol by allowing only recovery of direct damages in most cases and barring recovery of punitive and other damages in all cases, without suggesting

interpreted by the AAA, clauses that preclude the recovery of punitive damages or consequential damages violate this Principle. In addition, clauses that cap the amount of damages to something less than full compensatory damages or preclude any award of attorneys' fees would be objectionable.

- Principle 15. Arbitration Awards: The AAA interprets this Principle as generally addressing (and dealt with by) its rules on the making of an award, although a provision that bars written awards, for example, presumably would violate this Principle.[66]

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that its decision depended on whether a court would enforce a similar limitation.") (*citing* Affidavit of Neil B. Currie on Behalf of the American Arbitration Association in Response and Objection to a Subpoena for Documents Issued by Plaintiff, Ragan v. AT&T Corp., No. 92-L-168 (Ill. Cir. Ct. July 15, 2002)); *see also* Ragan v. AT&T Corp., 824 N.E. 2d 1183, 1194 (Ill. Ct. App. 2005) (quoting Currie affidavit).

[66] Weidemaier, *supra* note 65, at 89 ("To be sure, businesses might forbid reasoned, written awards in the arbitration agreement itself; it is unclear whether providers like the AAA would view such contract terms as consistent with the due process protocols").

III. Research Methodology

This Part describes our research methodology in this study. It begins by outlining the research questions of interest, and then describes the case file sample and other data sources.

A. Research Questions

1. Costs, Speed, and Outcomes of AAA Consumer Arbitrations

We examine a variety of aspects of the American Arbitration Association's ("AAA's") consumer arbitration caseload in this Report. Our focus is on the AAA arbitration process itself, rather than on comparing arbitration to litigation.

First, we describe the general characteristics of AAA consumer arbitration cases, as reflected in the case file sample. Which are more common, cases brought by consumers or cases brought by businesses? How much do claimants seek? What types of businesses are claimants or respondents in consumer arbitrations? To what extent are cases resolved ex parte – i.e., without one party (presumably the consumer) participating? What proportion of arbitration cases are resolved by an award?

Second, we consider the costs of consumer arbitration, in particular the arbitrator's fees and the AAA's administrative fees. The AAA's arbitration rules set out the basic framework, subject to the arbitrator's power to reallocate fees in the award.[1] To what extent do arbitrators use that power, and how does it affect the amount of arbitrator's fees and administrative costs assessed to consumers? Moreover, how does the amount of arbitration fees compare to the amounts sought in arbitration?

Third, we look at the speed of the arbitration process – how long does a case take to resolve from filing to award? How does the speed of the process compare for consumer claimants and business claimants? For cases resolved on the basis of documents as opposed to telephone and in-person hearings?

Fourth, we examine various measures of outcomes in arbitration – in particular, consumer and business win-rates, compensatory damage awards, and compensatory damage awards as a percentage of the amount claimed. How do consumers and businesses fare in arbitration under each of these measures? To what extent do arbitrators also award attorneys' fees, punitive damages, and interest to prevailing parties? Do outcomes differ in cases in which consumers are represented by an attorney as compared to cases in which they proceed pro se? Is there any evidence of a repeat-player effect, with repeat businesses faring better in arbitration than non-repeat businesses? If so, is the repeat-player effect due to arbitrator (or other) bias in favor of repeat businesses or is it due to case screening by repeat businesses?

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[1] *See supra* Part II.A.

2. AAA Enforcement of the Due Process Protocol

We also are interested in how effectively the AAA enforces compliance with the Consumer Due Process Protocol. In answering that question, we consider a series of subsidiary questions.

First, to what extent do arbitration clauses giving rise to AAA consumer arbitrations comply with the Due Process Protocol of their own right? The greater the extent to which clauses comply on their own, the less need for the AAA to enforce compliance.[2] Conversely, if many arbitration clauses are problematic under the Protocol, effective AAA compliance review becomes even more important.

Second, how effective is AAA review of arbitration clauses for compliance with the Consumer Due Process Protocol? Does the AAA identify and respond appropriately to problematic provisions? Or are there systematic gaps in the AAA's review efforts?

Third, to what extent does the AAA refuse to administer consumer cases because of Protocol issues? The AAA has indicated that when it identifies an issue of protocol compliance, it will refuse to administer the case unless the business waives the objectionable provision.[3] How often does the AAA refuse to administer a case and under what circumstances?

Fourth, how do businesses respond to AAA enforcement of protocol compliance? A business might respond in several ways. First, the business might waive the objectionable provision and/or change its arbitration clause to remove the objectionable provision. Second, the business might refuse to waive or change the provision, resulting in the AAA declining to administer the case and future cases involving the business. Third, the business might obtain a court order compelling arbitration of the dispute. Fourth, the business might modify its arbitration clause for future disputes, either by switching to another arbitration provider (that perhaps will administer cases under the objectionable provision) or by removing the pre-dispute arbitration clause altogether.[4]

These varying responses have different implications for the need for public (rather than private) regulation of consumer arbitration. To the extent businesses respond to AAA compliance review by removing objectionable provisions, AAA review benefits not only the parties to the immediate dispute but also future consumers who deal with the business under the revised clause. Conversely, to the extent businesses respond to AAA protocol review by

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[2] Of course, the fact that a clause currently complies with the Protocol does not mean that it always did so. Its current compliance may be due to prior AAA enforcement actions. Thus, an additional question we consider is the extent to which the AAA's protocol compliance efforts have resulted in changes to the terms of consumer arbitration agreements.

[3] *See supra* Part II.B.

[4] *See* W. Mark C. Weidemaier, *The Arbitration Clause in Context: How Contract Terms Do (and Do Not) Define the Process*, 40 CREIGHTON L. REV. 655, 670 (2007) ("I have heard anecdotally from provider employees that businesses and employers often waive terms that conflict with the due process protocols. I know of no other evidence to support this assertion.").

switching to other arbitration providers, or by avoiding the AAA altogether, the Consumer Due Process Protocol becomes less effective as a means of private regulation.[5]

In addition to these research questions, we examine several other issues that arise in connection with the due process protocols. In particular, we look at how frequently parties arbitrate their disputes based on post-dispute (rather than pre-dispute) arbitration agreements; how often businesses include class arbitration waivers in their consumer arbitration clauses; and how the AAA administers disputes arising out of the health care industry in its consumer caseload.

B. Data & Methodology

1. Our primary data set consists of 301 AAA consumer arbitration cases closed by an award between April 2007 and December 2007 ("the case file sample"). The cases in the case file sample were drawn from a broader AAA dataset consisting of all consumer arbitration cases coded as closed from 2005 through 2007. We reviewed all 313 consumer cases that were awarded from April through December 2007,[6] the period for which files were still available under AAA file retention policies.[7] We excluded from the case file sample two cases from April 2007 for which the files had by accident been destroyed prematurely, one case for which the case file could not be located, two cases that had been reopened, and seven cases that were improperly labeled as closed, awarded consumer cases in the original AAA dataset. The case file sample consists of the remaining 301 cases.

We then coded those cases for approximately 200 variables that describe various aspects of the arbitration process, including: the identity and characteristics of the parties; the identity of

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[5] This possibility has been described as a "race to the bottom" in consumer and employment arbitration. Jean R. Sternlight, *Is the U.S. Out on a Limb? Comparing the U.S. Approach to Mandatory Consumer and Employment Arbitration to that of the Rest of the World*, 56 U. MIAMI L. REV. 831, 842-43 (2002) ("Moreover, not all arbitrators and arbitral organizations have signed on to the Due Process Protocols, so there is some risk that arbitrators will engage in a race to the bottom in order to secure large numbers of arbitration contracts."); Jean R. Sternlight, *Consumer Arbitration*, *in* ARBITRATION LAW IN AMERICA: A CRITICAL ASSESSMENT 174 (Edward Brunet et al. eds. 2006) ("[M]any have raised concerns that if major and reputable arbitration providers all choose to adopt fairness protocols, other less reputable providers may enter the field, offering companies an alternative that is beneficial to the company, but not its opponents. That is, the Protocols could prompt a classic 'race to the bottom.'").

[6] In addition to these 313 consumer case files, the AAA included in its broader dataset thirty-two cases in which students challenged the cancellation of test scores. Because those cases were different in kind from the other consumer cases in the case file sample, in that they revolved around the cancellation of test scores and involved no claim for damages, we excluded those cases from the case file sample.

[7] Under AAA file retention policies, awarded case files are retained for fifteen months after the date the filed is closed, and all other case files (e.g., files for settled cases and cases dismissed by the parties) are retained for six months after the closed date. The AAA informs parties of these document retention policies in its correspondence notifying them of the closing of the case file. *See*, *e.g.*, Letter from Elizabeth Cominole to Richard E. Molan & Mark T. Broth dated May 20, 2008, *available at* http://www.aaup-unh.org/docs/AAA_AAUP.pdf ("[I]t is the AAA's policy to retain awarded cases for a maximum period of fifteen (15) months from the date of the transmittal letter. Therefore, please take note that the above referenced case file will be destroyed 15 months from the date of this letter.").

the parties' representatives, if any; the AAA office and case manager that administered the case; the type of case and amounts claimed; key dates in the arbitration process; information on arbitrator selection; hearing information (including the type and location of the hearing); amounts awarded, if any; and fees paid to the AAA and the arbitrator. We also examined the arbitration clause giving rise to the case as part of a review of the AAA's enforcement of the Consumer Due Process Protocol, as discussed in more detail below.[8] The variables coded and the coding instructions can be found in Appendix 4.

The Task Force members double checked each other's work using the original case files. Finally, we corrected any inconsistencies across and within variables. Once the data was cleaned, we aggregated variables for multiple parties into single claimant and respondent variables to use in the data analysis below.

2. The case file sample is subject to several possible selection biases. First, the case file sample is limited to consumer arbitrations administered by the AAA. Arbitrations arising out of clauses that specify other arbitration providers are not included in the case file sample. To the extent providers differ in how they administer cases, or in the types of cases or businesses they attract, the case file sample will not be representative of all consumer arbitrations. In particular, businesses that seek to avoid application of the Consumer Due Process Protocol would presumably be less likely to provide for AAA arbitration. Arbitrations arising out of clauses drafted by such businesses will accordingly be less likely to be included in the case file sample.

Second, the case file sample is limited to AAA consumer arbitrations giving rise to an award in the last nine months of 2007. For much of our data analysis, we do not include cases that were closed without an award, such as by settlement or otherwise.[9] Moreover, due to constraints on the availability of original case files and time constraints in collecting the data,[10] the time period covered by the cases is not a full calendar year. We know of no reason why awards from the nine months studied would differ from other periods of similar length, and no reason why awards from 2007 would differ from awards in nearby years. One consequence of the time period studied, of course, is that it necessarily limits the number of cases in the case file sample.

3. In addition to the case file sample, when possible we also use a larger dataset ("AAA consumer dataset") comprising all 3220 AAA consumer cases closed between 2005 and 2007.[11] The AAA maintains this dataset in the ordinary course of its business, collecting data for its internal purposes on some but not all of the variables in which we are interested. Case managers collect and enter the information in the AAA consumer dataset to track case progress and to

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[8] *See infra* text accompanying notes 14-18.

[9] For an exception, see, *e.g.*, Part IV(2).A.

[10] Our ability to examine older case files was limited by the AAA's document retention policy, described *supra* note 7. Our ability to examine newer case files was limited by time and resource constraints in completing data collection for this study.

[11] Before using the AAA consumer dataset in this study, we excluded the cases identified in the file review that were not consumer arbitrations or not currently closed, as well as the cases in which students challenged the cancellation of test scores.

make sure the parties are charged the correct fees. Because the AAA consumer dataset is used on an ongoing basis, the AAA makes updates as case information changes.[12] Moreover, case managers tend to focus on the information they need to monitor the case. As a result, data central to the AAA's operations, such as the names of the parties, the key dates in the case, and the total fees charged to all parties are more likely to be entered consistently than other data on the case.

Because the AAA consumer dataset was updated by many different case managers at different times, we expected the coding of certain variables to be somewhat inconsistent. To determine the degree of that inconsistency, we compared the data we collected for the 301 cases in the case file sample to the data the AAA maintained for those same 301 cases in the AAA consumer dataset.

Certain information was almost completely consistent between the AAA consumer dataset and the case file sample. For example, distinguishing between businesses and consumers is always possible, which made it reasonably straightforward to identify the type of business involved. Further, cases were consistently coded as either awarded or non-awarded, although it was not possible to verify whether the non-awarded cases were properly coded as settled or withdrawn.

Other information is less accurate, but is still reasonably reliable. Because of the way information was entered into the AAA consumer dataset, it was not always possible to distinguish claimants from respondents easily. However, in 295 out of the 301 cases (98.0%), the claimant was the first listed party and could be reliably identified. In 6 of 301 cases (2.0%) could we not correctly categorize the parties as claimants or respondents by using the order of appearance. Further, the key dates seem reasonably accurate as well. The AAA did not enter the date a case was filed, instead using the date the case was assigned in its system. We could not determine the assignment date in our review of the files, but instead recorded the filing dates. The differences between the filing and assignment dates averaged 5.2 days with a median of 1 day. Although we could not verify the date the AAA administratively closed a case, we were able to determine the award dates. For the cases in the case file sample, the award date entered by the AAA was different from the closed date in fourteen cases (4.7%). The differences for these fourteen cases had a mean of 17.5 days and a median of 1 day. The differences were likely due to minor typos and the fact that on occasion a case manager recorded the date of a partial award rather than the date of the final award.

We also find similar accuracy in the identification of claims $75,000 or less and claims of more than $75,000. Of the 301 cases, 13 (4.3%) differed in their categorization. Less consistent is the association of exact AAA administrative fee amounts with each party. For the first party, the AAA administrative fees recorded were different 33 out of 301 times (11.0%) and for the second party they were different 40 out of 301 times (13.3%). As mentioned above, the sums of the AAA administrative fees were consistent, however.

[12] For example, the recorded information on the case manager responsible for the case was changed whenever a new case manager was assigned to the case. Thus, the name of the case manager recorded in the dataset is the name of the case manager with responsibility for the case at the time the case was closed.

Finally, the amount claimed and the amount awarded were much less consistent than the other data we compared.[13] Specifically, the amount sought by the first party listed in the AAA consumer dataset differed in 59 out of 301 cases (19.6%) between the AAA consumer dataset and the case file sample. In many of these cases, it appeared that the parties or the AAA case managers included attorneys' fees, interest, punitive damages, or other damages together with the compensatory damages sought in a single amount claimed. Or else the case managers entered the amount claimed by a different party. The amount sought by the second party listed (the majority of which were counterclaims) was entered differently in 39 out of 301 cases (13.0%). In most of the 301 cases, however, the second party did not assert a claim. In those cases in which the second party did assert a claim, the data was entered differently in 34 out of 48 cases (70.8%).

The inconsistencies in award amounts are similar. The amount of compensatory damages awarded to the first party listed differed in 88 out of the 301 cases (29.2%) between the AAA consumer dataset and the case file sample. In many of these cases, the parties or the AAA case managers combined the compensatory damages awarded with the amount of attorneys' fees, interest, punitive damages, or other damages awarded. In other cases, the case managers entered the amount awarded to a different party or did not enter the amount awarded at all. The amounts of compensatory damages awarded to the second party listed (the majority of which were from counterclaims) were entered differently in 31 out of 301 cases (10.3%). Again, however, in most of the 301 cases the second party did not assert a claim. In those cases in which the second party did assert a claim, the data was entered differently in 30 out of 48 cases (62.5%).

4. The AAA consumer dataset does not include information on the arbitration clause or on the details of AAA protocol compliance review. To obtain that information, we reviewed the original case files for the cases in the case file sample. For each of the cases, we examined the arbitration clause attached to the arbitration demand for compliance with the Consumer Due Process Protocol.[14] In evaluating compliance, we applied the standards used by the AAA as described above. We also determined from the file whether the AAA case intake staff identified any protocol violation and, if so, whether the AAA obtained a waiver of the violation from the business.

One file was missing the arbitration clause.[15] The business in the case appeared in at least one other case in the case file sample; the clause in that case contained no provisions violating the protocol. Because we could not be certain that same clause was involved in the two cases, however, we treated the clause as missing. For another file, the arbitration clause appeared to be

[13] Since most of the cases in the case file sample only had claims from the first two parties listed, we discuss the results as they relate to the first two parties.

[14] Thus, we examined all arbitration clauses that gave rise to a consumer arbitration before the AAA that was resolved by an award from April to December 2007. The arbitration clauses in the case file sample are not a random sample of all consumer arbitration clauses, nor are they even a random sample of all consumer arbitration clauses specifying the AAA as arbitration provider.

[15] The file clearly had included the arbitration clause at one point, but by the time we obtained the case file for review the clause was no longer included.

incomplete. While the file included a lengthy portion of the arbitration clause, it appeared that the claimant may not have provided a copy of the entire clause. Although the clause had no problematic provisions in the portion we were able to review, we excluded it from the case file sample because we could not be certain what provisions were included in the rest of the clause. Accordingly, the case file sample as used to evaluate AAA protocol enforcement consists of 299 AAA consumer arbitration clauses.[16]

We used the case file sample to evaluate the extent to which arbitration clauses in the case file sample complied with the Consumer Due Process Protocol and how well the AAA applied its standards in reviewing arbitration clauses for protocol compliance. We also used it to obtain information on the relative frequency of pre-dispute and post-dispute arbitration agreements and on the use of class arbitration waivers in the clauses.[17] Finally, we looked at those cases in the case file sample involving the health care industry to evaluate AAA compliance with the Health Care Due Process Protocol.[18]

5. The case files contained no indication of whether the business had sought advance review (i.e., pre-dispute review) of its arbitration clause for protocol compliance. To obtain information on business use of advance review, we examined the AAA business list,[19] which included a notation when the business sought advance review of its arbitration clause. We verified those notations against AAA files documenting the request for advance review. We also examined a sample of other entries on the AAA business list to ensure that requests for advance review had not been misclassified.[20]

6. The AAA does not maintain a list of the cases it refuses to administer for failure to comply with the Consumer Due Process Protocol. To estimate the number of cases the AAA refused to administer during 2007, we started with a list of "pre-filing" cases provided by the AAA ("AAA pre-filing cases"). "Pre-filing" cases are cases submitted to the AAA that do not satisfy the filing requirements of the AAA Consumer Rules. Such requirements include a completed demand for arbitration, a copy of the arbitration clause, and payment of the appropriate fee,[21] as well as the business's payment of its share of the fees and waiver of any protocol violations.[22]

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[16] Because the rest of the file that was missing the arbitration clause was complete, we are able to use this case in examining other aspects of AAA consumer arbitrations.

[17] We did not review all of the provisions in the consumer arbitration clauses in the case file sample, and thus do not have comprehensive data on those provisions. But because of the high visibility of the issue of class arbitration, we did collect data on the use of class arbitration waivers in the consumer arbitration agreements in the case file sample.

[18] Commission on Health Care Dispute Resolution, Health Care Due Process Protocol (July 27, 1998), *available at* www.adr.org/sp.asp?id=28633.

[19] *See supra* Part II.B. We used the AAA business list as of April 25, 2008.

[20] We found one additional case in which the business had sought advance review.

[21] American Arbitration Association, Supplementary Procedures for the Resolution of Consumer-Related Disputes, Rule C-8 (effective Sept. 15, 2005), *available at* http://www.adr.org/sp.asp?id=22014.

[22] *See supra* Parts II.A & II.B.

Cases the AAA refused to administer because of protocol violations should be included in the AAA pre-filing cases. But also included would be cases brought by a consumer (or business, for that matter) that did not meet the requirements for filing the claim.[23] To distinguish between these types of cases, we cross-checked the AAA pre-filing cases against the AAA business list. If the business was listed as "unacceptable" on the AAA business list, we presumptively treated the case as one that the AAA refused to administer because of a protocol violation. In such cases, we further examined the AAA files documenting the business's status on the AAA business list. In a number of cases, we were able to confirm from those files that the AAA refused to administer a particular case because of protocol noncompliance.[24]

7. Finally, we obtained data on how businesses respond to AAA enforcement of the Consumer Due Process Protocol. As described above, a business might respond to AAA enforcement actions in several ways.[25] We again used the AAA business list (and supporting files) as the best available source of data on such actions.

As discussed above, the AAA classifies the businesses on the AAA business list either as "acceptable" – i.e., the AAA will administer consumer arbitrations involving the business – or "unacceptable – i.e., the AAA will not administer consumer arbitrations involving the business.[26] For each entry, the AAA business list also includes a short explanation of the businesses' current status as acceptable or unacceptable.[27] We used those explanations to provide an initial characterization of how the business responded to AAA protocol compliance review. We then sought to verify that characterization by reviewing the AAA's files supporting the AAA business list entry. For some types of entries, we examined all available supporting files. For others, time constraints limited us to examining a random sample of the supporting files.[28] We also collected data on the underlying protocol issue, if any, involved.

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[23] This may occur because the claimant decides not to pursue the case, or because the parties settle before the filing requirements are met.

[24] If the business's status on the AAA business list changed because of some action during the case we were examining, the correspondence relating to that case would be in the files. For example, if the AAA added the business to the AAA business list because it refused to waive a problematic provision or failed to pay its share of arbitration fees, that correspondence would be in the AAA business list file. If, however, the AAA declined to administer the case because the business was already listed as unacceptable because of prior events, we would find no evidence of the later refusal (only the prior one) in the AAA business list file.

[25] *See supra* Part III.A.

[26] The AAA also includes a sub-category of "acceptable businesses" on the AAA business list – typically large entities for which in the past there had been some confusion over the appropriate contact person when a consumer brought a claim against the business. For those businesses, the AAA business list typically identifies the appropriate contact person to receive the demand for arbitration.

[27] If the business's arbitration clause complied with the protocol at the time it was first reviewed, and if the business had always paid its share of the arbitration fees, the business would be listed but only with the date of the first review.

[28] For AAA business list entries indicating that the business did not respond to the initial case filing, we originally examined a random sample of supporting files. When that examination revealed that in some of the cases businesses failed to pay their share of the arbitration fees while in others they failed to waive protocol violations or update their arbitration clauses to remove protocol violations, we expanded our examination to include supporting files for all of those entries. For AAA business list entries indicating that the business did not respond to a follow-up contact by the AAA to update its arbitration clause or to waive protocol violations in all future cases, we examined a

Using this data, we sought to estimate how frequently businesses responded to AAA protocol review by: (1) waiving the objectionable provision for future cases and/or updating their clauses to eliminate problematic provisions; (2) refusing to update their clauses or simply not responding to the AAA; or (3) updating their clauses to replace the AAA with a different arbitration provider (or to remove the arbitration clause altogether).[29]

8. Our access to all of the sources of data from the AAA is subject to a non-disclosure agreement entered into with the AAA. The non-disclosure agreement protects the parties' expectation to privacy in their contractually specified dispute resolution process. As required by the non-disclosure agreement, we report aggregate results about the arbitration process; we do not include any information in this Report that might identify a particular case or party.

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random sample of supporting files. Because those files confirmed that the business failed to waive a protocol violation or update its arbitration clause, we did not expand our review. We examined a handful of files in which the AAA listed the business as acceptable with no further comment. (Our examination of the cases in the case file sample provides a more satisfactory test of the effectiveness of AAA protocol compliance review because it includes cases that might not be listed on the AAA business list.) For all other types of AAA business list entries, we examined all the supporting files.

[29] The AAA business list files contain no information on how frequently businesses seek court orders compelling arbitration of cases the AAA refuses to administer.

IV. EMPIRICAL RESULTS

TOPIC 1. COSTS, SPEED, AND OUTCOMES OF AAA CONSUMER ARBITRATIONS

This Part sets out our empirical findings, which are based on American Arbitration Association ("AAA") data from the 301 cases in the case file sample, supplemented when possible with data from the 3220 cases in the AAA consumer dataset. Our findings address the following: (1) general characteristics of the cases in the case file sample; (2) the costs incurred by the parties in arbitrating their case; (3) the speed of the arbitration process; and (4) outcomes of AAA consumer arbitrations, including data on outcomes in cases with pro se consumer claimants and repeat-player businesses.

A. General Case Characteristics

Because our purpose is to describe comprehensively the AAA's consumer arbitration caseload, this Section gives a general overview of case characteristics for the 301 cases in the case file sample, supplemented when possible with data from the AAA consumer dataset.

1. Business Claimants v. Consumer Claimants

In the substantial majority of AAA consumer arbitrations, the consumer is the claimant in the arbitration proceeding.[1] Of the cases in the case file sample, consumers were claimants in 240 of 301 (or 79.7%) of the cases, while businesses were claimants in 61 of 301 (or 20.3%) of the cases. Because we can reasonably rely on the coding accuracy of the AAA consumer dataset for business and consumer claimants, we used this dataset as a check on the case file sample for this variable. The results from the AAA consumer dataset are similar. Assuming, based on our data consistency analysis,[2] that the first named party in that dataset is the claimant, consumers were claimants in 2765 of the 3220 (or 85.9%) of the cases, while businesses were claimants in 455 of 3220 (or 14.1%) of the cases. Figure 1 shows the similarity between the two data sources.

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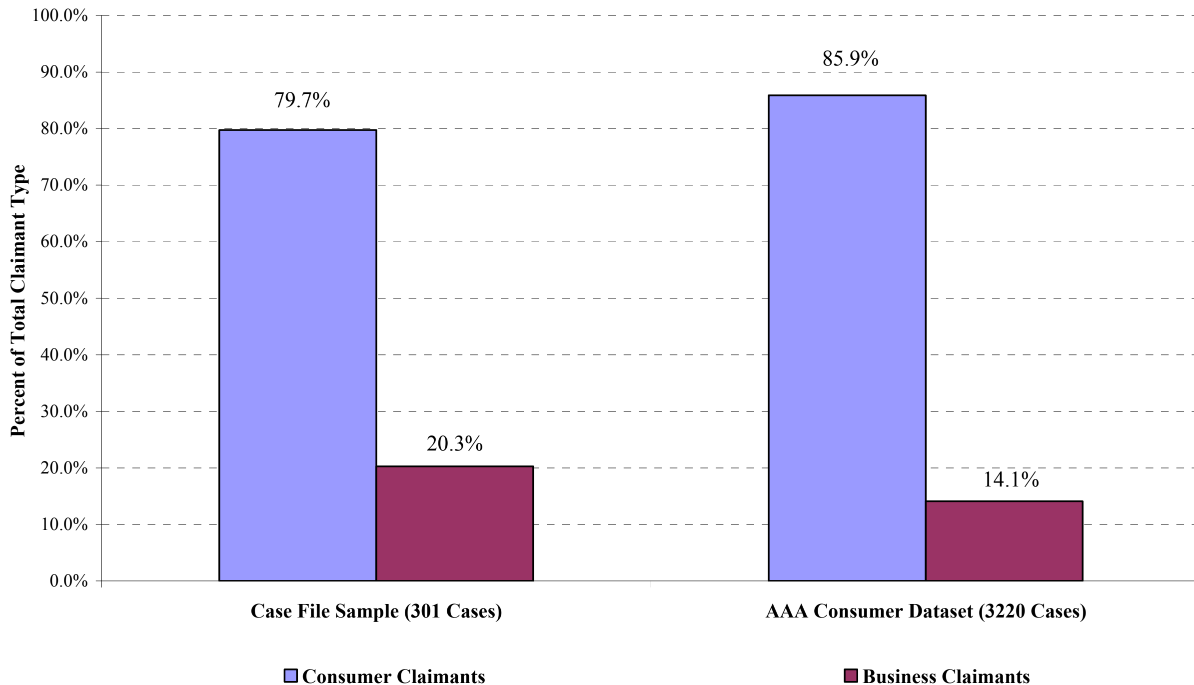
[1] Thus, the AAA's consumer caseload more closely resembles the JAMS consumer caseload than the NAF's caseload, which consists almost exclusively of arbitrations brought by businesses against consumers to collect debts. *See supra* Part I.A.3.

[2] *See supra* Part III.B.

Figure 1:
Comparison of Claimant Types



As a general matter, the types of cases brought by businesses in the case file sample differed from the types of cases brought by consumers. In most cases brought by businesses, the business claimants sought payment for goods delivered or services rendered but usually little else. In contrast, the issues raised in cases brought by consumer claimants were much more diverse, with consumers asserting claims for nondelivery of goods or services, claims for breach of warranty for defective goods or services, claims under state consumer protection acts, claims under federal consumer protection statutes, and the like. Because of these sorts of differences between the cases, we examine cases with business claimants separately from cases with consumer claimants in the rest of our data analysis.

2. Amounts Claimed

The amount sought by the claimant is an important variable for several reasons. First, arbitration fees vary depending on the amount claimed, with low-cost arbitration available under the AAA's consumer rules for claims seeking $75,000 or less. (Accordingly, in the rest of this analysis we examine cases seeking $75,000 or less separately from cases seeking more than $75,000.) Second, as discussed above,[3] the extent of the AAA's review of arbitration clauses for

[3] *See supra* Part II.B.

compliance with the Due Process Protocol depends on the amount claimed. Third, empirical studies of arbitration outcomes use the amount claimed as a rough proxy for the value of the claim.[4]

But determining the amount claimed turns out to be more difficult than sometimes assumed.[5] First, claimants sometimes combine various elements of damages into a single claim amount, which includes not only compensatory damages, but also interest, punitive damages, and attorneys' fees. Because the AAA bases its fees only on the amount of compensatory damages claimed, excluding interest, punitive damages, and attorneys' fees, we treat those individual items of damages separately as well. In this Section, we discuss only amounts of compensatory damages sought as the amount claimed.[6] Moreover, when we categorize results in this Report by the amount claimed (usually in two categories, $75,000 or less and more than $75,000), we likewise use the amount of compensatory damages sought in calculating the amount claimed.

Second, although claimants must specify a claim amount in their demand for arbitration,[7] some claimants specify the claim amount not as a single number but as a range of numbers.[8] Other claimants specify the amount claimed as an inequality, seeking less than or more than a specified amount. For example, a demand for arbitration might claim damages of between $10,000 and $75,000, or damages greater than $10,000. Specifying the amount claimed as a range or inequality ordinarily does not cause problems for the AAA in determining arbitration fees or in its enforcement of the Due Process Protocol because the ranges or inequalities typically are tied to the relevant threshold amounts.[9] For purposes of using claim amounts in our empirical analysis, however, demands specifying damages as a range or an inequality are much more problematic.

For business claimants, one case out of 61 (1.6% of cases) presented the claim amount as an inequality. Consumer claimants, however, were much more likely to use inequalities or ranges in their arbitration demand. In 22 cases out of 235[10] (9.4% of cases seeking a monetary amount), consumer claimants presented the claim amount as an inequality (16 of 22) or bounded range (6 of 22).

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[4] *See supra* Part I.A.3.

[5] *E.g.*, Public Citizen, The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration 12 (2008), *available* at http://www.citizen.org/documents/ArbitrationDebateTrap (Final).

[6] While claimants often assert a claim for interest, punitive damages, and attorneys' fees in their demand, rarely do they quantify those claims. For further discussion, see *infra* Part IV(1).D.2.

[7] American Arbitration Association, Supplementary Procedures for the Resolution of Consumer-Related Disputes, Rule C-2(a) (effective Sept. 15, 2005), *available at* http://www.adr.org/sp.asp?id=22014 [hereinafter AAA, Consumer Rules]; American Arbitration Association, Commercial Arbitration Rules, Rule R-4(a)(i) (amended and effective Sept. 1, 2007) [hereinafter AAA, Commercial Rules].

[8] We discuss here initial claims only, not counterclaims.

[9] In consumer cases, arbitration fees are a flat amount within certain ranges (less than $10,000 and between $10,000 and $75,000), and the threshold for the AAA's administrative review of clauses for protocol compliance is $75,000.

[10] We exclude the five cases seeking non-monetary remedies from these calculations.

We considered several options for dealing with demands specifying the claim amount as an inequality or a range: (1) dropping all cases specifying a claim amount as a range or inequality from the case file sample; (2) taking the mid-point of all ranges (treating inequalities as one end of a range bounded on the other end by the claim threshold); or (3) using the base number of claim amounts specified as inequalities and the mid-point for all claim amounts specified as bounded ranges.

To enhance comparability to the AAA consumer dataset, we use the third option.[11] For claim amounts given as inequalities, we simply ignore the inequality and use the base amount as the amount of the claim. For example, if the claim amount was written "greater than $10,000," we used $10,000 as the claim amount; if the claim amount was written "less than $75,000," we used $75,000 as the claim amount.[12] For claim amounts given as bounded ranges, we used the mid-point of the range as the claim amount. For example, if the claim amount was written as "$10,000 to $75,000," we used $42,500 as the claim amount. Because only sixteen cases with consumer claimants have claim amounts specified as inequalities and only six cases have claim amounts specified as bounded ranges, the choice among the options for measuring claim amount rarely affects the results.[13]

Overall, the vast majority of cases in the case file sample involved claims for $75,000 or less. For business claimants, 95.5% of cases (58 of 61) involved claims for $75,000 or less. For consumer claimants, 91.5% of cases (215 of 235) involved claims for $75,000 or less. Indeed, 39.1% of cases (92 of 235) brought by consumer claimants involved claims for less than $10,000.

Because the coding of claims as greater than $75,000 and less than or equal to $75,000 in the AAA consumer dataset is reasonably reliable, we use that dataset to check this variable in the case file sample. Again, the results are similar. In the AAA consumer dataset, excluding non-monetary and unspecified claims, 94.5% of business claimants brought claims of $75,000 or less (359 of 380 cases). By comparison, 88.5% of consumer claimants brought claims of $75,000 or less (2190 of 2475 cases).

Consumers tend to seek larger amounts than businesses in AAA consumer arbitrations. The average claim for business claimants in the case file sample was $22,037 and for consumer claimants was $46,131, a statistically significant difference.[14] There also is a statistically

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[11] The AAA uses the base amount of the inequality in its consumer dataset.

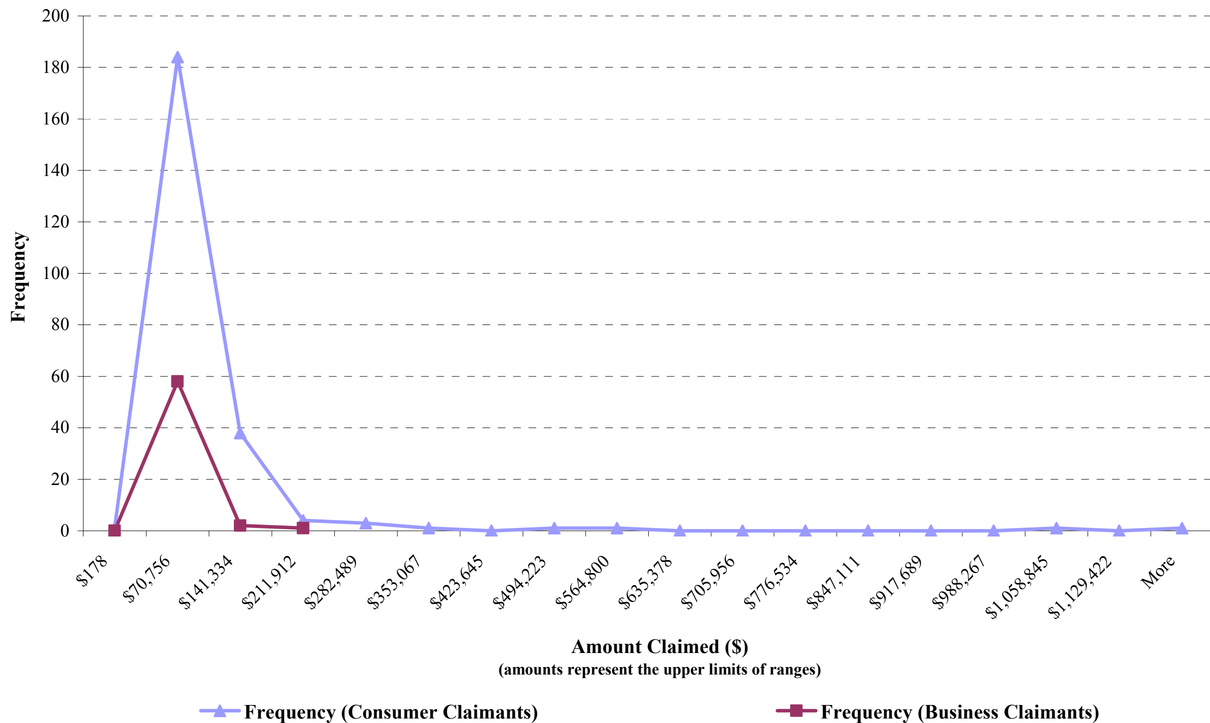
[12] Selecting the lower end of the range in cases not specifying the claim amount will increase the recovery rate discussed below, but the effect should be minimal due to the small number of cases affected by this choice.

[13] Option 1 resulted in higher average claim amounts than either option 2 or option 3. Further, using option 2 rather than option 3 resulted in an average difference of less than $100 for both business and consumer claimants. The claim amount changes for one case with a business claimant and sixteen cases with consumer claimants between options 2 and 3.

[14] We used a two-group t-test for averages in claims made by business claimants and consumer claimants excluding non-monetary claims and adjusting for unequal variances. The t-statistic was -2.9338 (DF = 290.932 and p = 0.0036), allowing us to reject the null hypothesis that the averages between the two groups were the same.

significant difference in the variance of claim amounts between the two groups.[15] Figure 2, a frequency distribution with equally distributed bins, shows that almost all business claims fall between $178 and $70,756, with a short tail. Almost all consumer claims also fall between $178 and $70,756. However, at least 12 cases fell outside that range, including one claim of $1,200,000. Thus, consumer claims have a longer tail than business claims.

Figure 2:
Frequency of Amounts Claimed by Consumer and Business Claimants
(Cases = 296)



Because the case file sample includes only awarded cases, it is possible that there are differences in claim amounts between awarded cases and other types of closed cases. In order to test whether case resolution was related to claim amounts, we truncated the AAA consumer dataset to all cases with specified monetary claims and closed in the same time frame as the case file sample, namely April 2007 through December 2007, which added 46 business cases and 345 consumer cases.[16] Because the case file sample comprised almost all of the awarded cases in this time period, the added cases were mostly settled, withdrawn, or closed in some other way.

For business claimants, the average claim was $22,037 for the awarded cases in the case file sample and $18,313 for all other cases; the means are not significantly different from one

[15] We used a two-group F-test for variances in claims made by business claimants and consumer claimants excluding non-monetary claims. The f-statistic was 0.0504 (DF = 60, 234 and p = 0.0000), allowing us to reject the null hypothesis that the variances between the two groups were the same.

[16] We note that the individual claim amounts coded in the AAA consumer dataset are less reliable than the binary coding for claims of $75,000 or less and claims greater than $75,000. *See supra* Part III.B.

another.[17] Claim amounts for consumer claimants are similar. The average claim was $46,131 for the awarded cases in the case file sample and $66,367 for all other closed cases. Although the other closed cases had a slightly higher average claim, the difference between the two groups is not statistically significant.[18]

Counterclaims were somewhat rare in the case file sample – only 57 out of 301 cases (or 18.9% of cases) involved a counterclaim at all. Eleven consumer respondents brought counterclaims: five sought compensatory damages of $75,000 or less, two sought more than $75,000, and the remaining four sought non-monetary relief or the remedy sought was unspecified. Business respondents were more likely to bring a counterclaim. The remaining forty-six counterclaims were brought by business respondents: thirty-three sought compensatory damages of $75,000 or less, one sought more than $75,000, and the remaining twelve sought non-monetary relief or the remedy sought was unspecified. Counterclaims were not recorded consistently in the AAA consumer dataset so a comparison is not possible.

3. Types of Businesses

The types of businesses involved in the cases in the case file sample included motor vehicle dealerships, credit card issuers, insurance companies, home builders, finance companies, mobile home dealers, and real estate brokers. As shown in Figure 3, different types of companies were claimants than respondents. Business claimants were mostly service providers: home builders (13 or 61, or 21.3% of the cases), real estate brokers (12 of 61, or 19.7% of the cases), and other service providers such as law and accounting firms (20 of 61, or 32.8% of the cases). In contrast, the most common business respondents were motor vehicle dealerships (66 of 240, or 27.5% of the cases) and insurance/warranty companies (44 of 240, or 18.3% of the cases). The differing types of businesses reflect the different nature of cases brought by business and consumer claimants. Businesses were mostly looking to collect fees owed for services performed while consumers were bringing claims for faulty cars and faulty products, among others.

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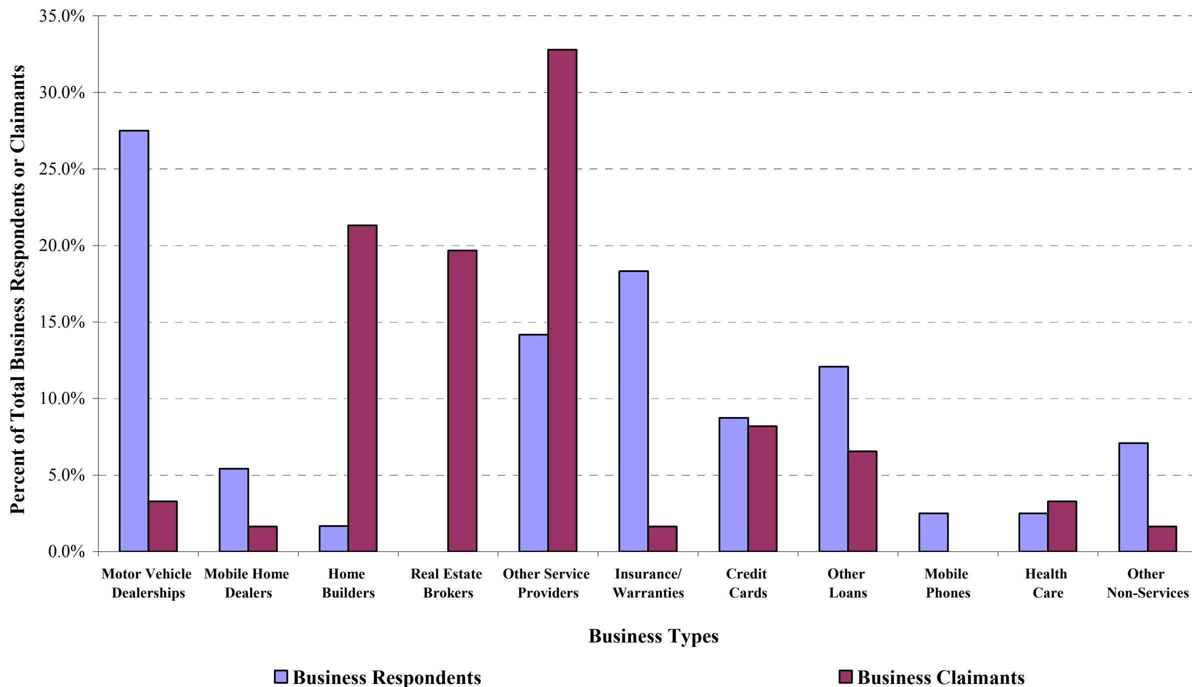
[17] The two-group t-test accounting for unequal variances resulted in $t = -0.9056$ ($DF = 102.497$ and $p = 0.3673$). The variances between the two groups are significantly different however. The f-statistic was 0.4083 ($DF = 45, 60$ and $p = 0.0021$), allowing us to reject the null hypothesis that the variances between the two groups were the same.

[18] The two-group t-test accounting for unequal variances resulted in $t = 1.0948$ ($DF = 466.817$ and $p = 0.2741$). The variances between the two groups are significantly different, however, owing to several large claims in cases that were eventually settled. The f-statistic was 7.4138 ($DF = 344, 234$ and $p = 0.0000$), allowing us to reject the null hypothesis that the variances between the two groups were the same.

Figure 3:
Business Types as a Percent of Total Business Respondents and Total Business Claimants
(Cases = 301)



The entries for business type in the AAA consumer dataset are less reliable than for the case file sample. However, we generally find the same business types for business claimants and respondents in both datasets. Business claimants were mostly service providers: home builders (59 of 455, or 13.0% of cases), real estate brokers (53 of 455, or 11.6% of cases), and other service providers such as law and accounting firms (84 of 455, or 18.5% of cases). Common types of business respondents were motor vehicle dealerships (451 of 2765, or 16.3% of cases) and insurance/warranty companies (207 of 2765, or 7.5% of cases). Note that in the AAA consumer dataset, the type of business as a percentage of the total was generally lower than in the case file sample. This is mostly due to a higher proportion of cases involving credit card issuers and other creditors in the AAA consumer dataset, most of which never went to an award.

4. Ex Parte Proceedings

Of the 301 cases in the case file sample, 26 cases (8.6%) were resolved on an ex parte basis – i.e., in the absence of one of the parties. All twenty-six cases involved claims of $75,000 or less, and in all twenty-six cases the absent party was the consumer. Interestingly, however, not all of the ex parte cases involved a business claimant. Twenty-two of the ex parte cases were brought by business claimants. The remaining four cases were brought by consumers, who then either did not appear at the hearing or submit documents. Three of the four consumers originally

were represented by counsel, who filed the claim but then withdrew from representing the consumer. Ex parte cases were not recorded in the AAA consumer dataset, so a comparison is not possible.[19]

5. Case Resolutions – Awarded Versus Non-Awarded

The case file sample is limited to awarded cases, so to examine the frequency of other case resolutions (and the relative frequency of awarded cases) we use the AAA consumer dataset. The AAA consumer dataset categorizes cases consistently into awarded and non-awarded categories.

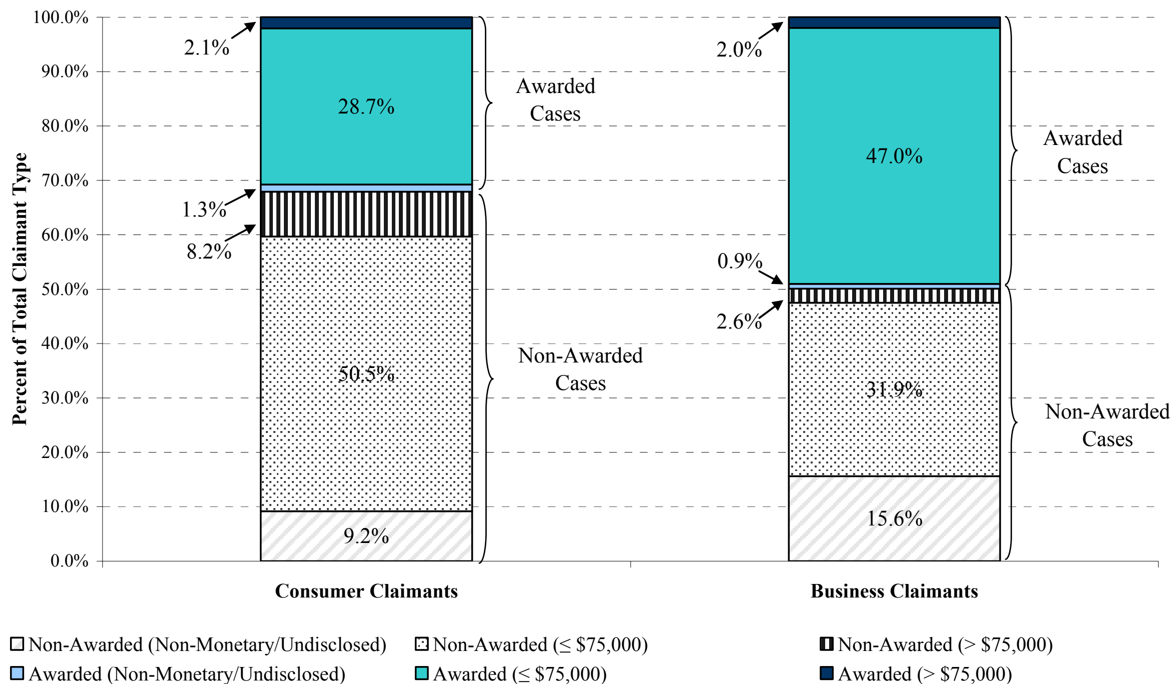
In cases involving business claimants, 227 (or 49.9%) were resolved by an award and 228 (or 50.1%) were otherwise closed.[20] Of the 227 awarded cases, 214 had claims of $75,000 or less, 9 had claims of more than $75,000, and 4 sought non-monetary relief or sought an unspecified remedy. Of the 228 non-awarded cases, 145 had claims of $75,000 or less, 12 had claims of more than $75,000, and 71 sought non-monetary relief or sought an unspecified remedy.

In cases involving consumer claimants, 887 (or 32.1%) were resolved by an award and 1878 (or 67.9%) were otherwise closed. Of the 887 awarded cases, 57 had claims of more than $75,000, 793 had claims of $75,000 or less, and 37 sought non-monetary relief or sought an unspecified remedy. Of the 1878 non-awarded cases, 228 had claims greater than $75,000, 1397 had claims of $75,000 or less, and 253 sought non-monetary relief or sought an unspecified remedy. Figure 4 below shows the relative differences between case dispositions by amount claimed.

[19] As discussed *infra* Part IV(1).D.2, the number of ex parte awards likely is related to the win-rate for business claimants.

[20] The AAA database does distinguish among withdrawn, settled, and administratively closed cases, however those distinctions are not always accurate since the AAA relies on the parties to report a settlement or withdrawal. As such, we distinguished only between awarded and non-awarded cases in our analysis.

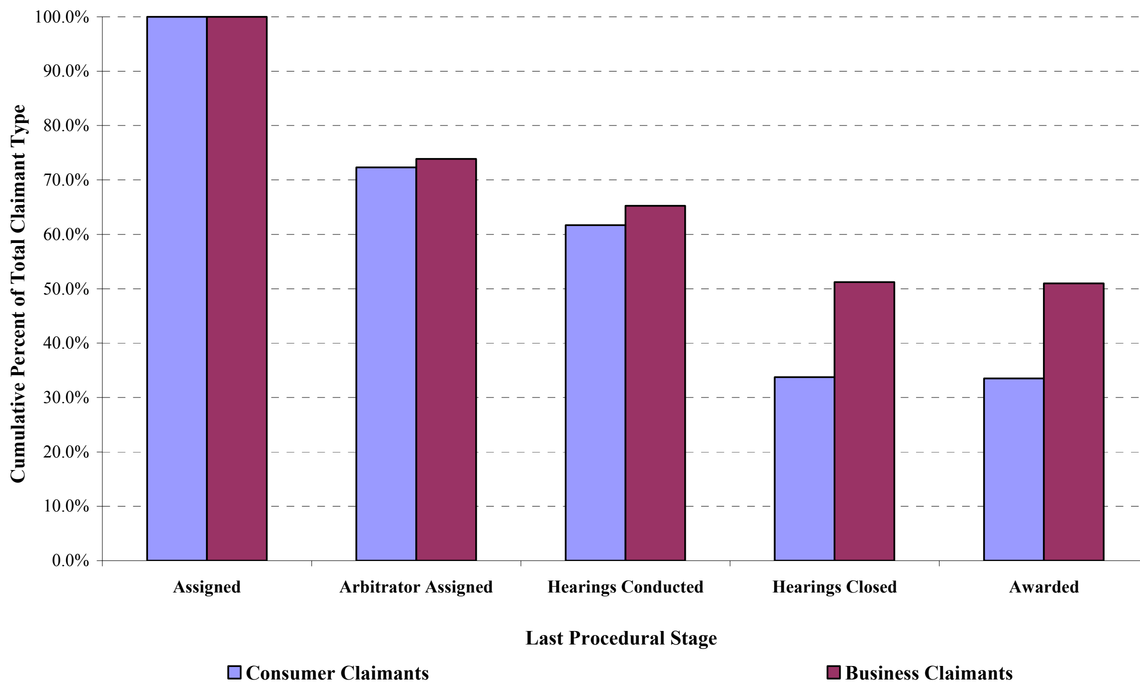
Figure 4:
Percent of Awarded and Non-Awarded Cases by Claimant Type and Amount Claimed
(Cases = 3220)



Using the key dates (which were reliably recorded in the AAA consumer dataset), we were also able to estimate how far in the arbitration process cases progressed before being resolved. We categorized the procedural stages using the Assignment Date (the date the case was entered into the AAA's system), the Arbitrator Assignment Date (the date an arbitrator was appointed), Hearing Dates (the date or dates of any hearings, including preliminary hearings), Hearing Closed Date (the date the hearing, if any, was declared closed), and Award Date (the date of the award). Cases were categorized by the last listed date in the database before the case was closed. For business claimants, 26.2% (or 119 out of 455) of the cases were closed before an arbitrator was appointed; for consumer claimants, the percentage was similar (766 out of 2765, or 27.7% of cases). But cases with consumer claimants are much less likely than cases with business claimants to be resolved by an award. Figure 5 below shows the comparison in case progression between consumer and business claimants.[21]

[21] We note that a small number of cases (1.1% of cases with business claimants and 1.4% of cases with consumer claimants) have awarded dates but are categorized in the AAA consumer dataset as settled or otherwise closed. We do not have an explanation for this seeming discrepancy. It does not, however, materially affect our findings.

Figure 5:
Cumulative Percent of All Cases by Procedural Stage by Claimant Type
(Cases = 3220)



B. Cost of AAA Consumer Arbitrations

As described above,[22] the AAA has a tiered fee structure based on the amount of compensatory damages claimed.[23] The fees are not based on other amounts such as punitive damages, interest, or attorneys' fees.[24] Table 1 summarizes the AAA's fees for consumer cases.

[22] *See supra* Part II.A.
[23] AAA, Consumer Rules, *supra* note 7, Rule C-8.
[24] *Id.* Rule C-8.

Table 1: AAA Consumer Arbitration Fees

Amount Claimed	Fees Owed By Consumer	Fees Owed By Business
< $10,000	• Half of arbitrator's fees up to $125	• $750 in AAA administrative fees • $200 in Case Service Fees if a hearing is held • Remaining arbitrator's fees (usually $125)
$10,000 - $75,000	• Half of arbitrator's fees up to $375	• $950 in AAA administrative fees • $300 in Case Service Fees if a hearing is held • Remaining arbitrator's fees (usually $375)
> $75,000 (or Non-Monetary)	• AAA administrative fees according to the Commercial Fee Schedule • Half of arbitrator's fees at usual rates	• AAA administrative fees according to the Commercial Fee Schedule • Remaining arbitrator's fees at usual rates

This Section describes the amount of arbitration costs assessed, how these arbitration costs are allocated in practice in AAA consumer arbitrations, and how arbitration costs relate to the amount sought in cases in the case file sample. We have data on arbitrators' fees and the AAA's administrative fees, but we do not have comparable data on amounts the parties paid to their own attorneys, if any.[25] We do not provide comparisons to the AAA consumer dataset in this Section because we are unable to break down the data in analogous ways.

1. Fees Assessed to Consumers and Businesses

The AAA fee schedule and fee allocations by arbitrators in awards interact to determine the total amount of fees assessed to consumers and businesses.[26] In this section, we summarize the total amounts of administrative and arbitrator's fees assessed to consumers and businesses as well as their respective shares of those fees in the case file sample.[27]

In cases with business claimants, the business is assessed an average of $958 in AAA administrative fees and $751 in arbitrator's fees, as shown in Figure 6. In these same cases, consumers are assessed an average of $215 in AAA administrative fees and $256 in arbitrator's fees. Thus, on average, consumer respondents are responsible for 18.3% of total AAA administrative fees and 25.4% of total arbitrator fees in those cases. At the tail of the distribution,

[25] Although Elizabeth Hill used awards of attorney's fees as a proxy for attorney's fees paid by the parties, *see* Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO ST. J. ON DISP. RESOL. 777, 798-99 (2003) [hereinafter Hill, *Due Process*], we do not believe we have enough data to make reliable statements regarding attorney's fees paid by the parties in the case file sample. For further discussion of attorney's fee awards, see *infra* Part IV(1).D.2.

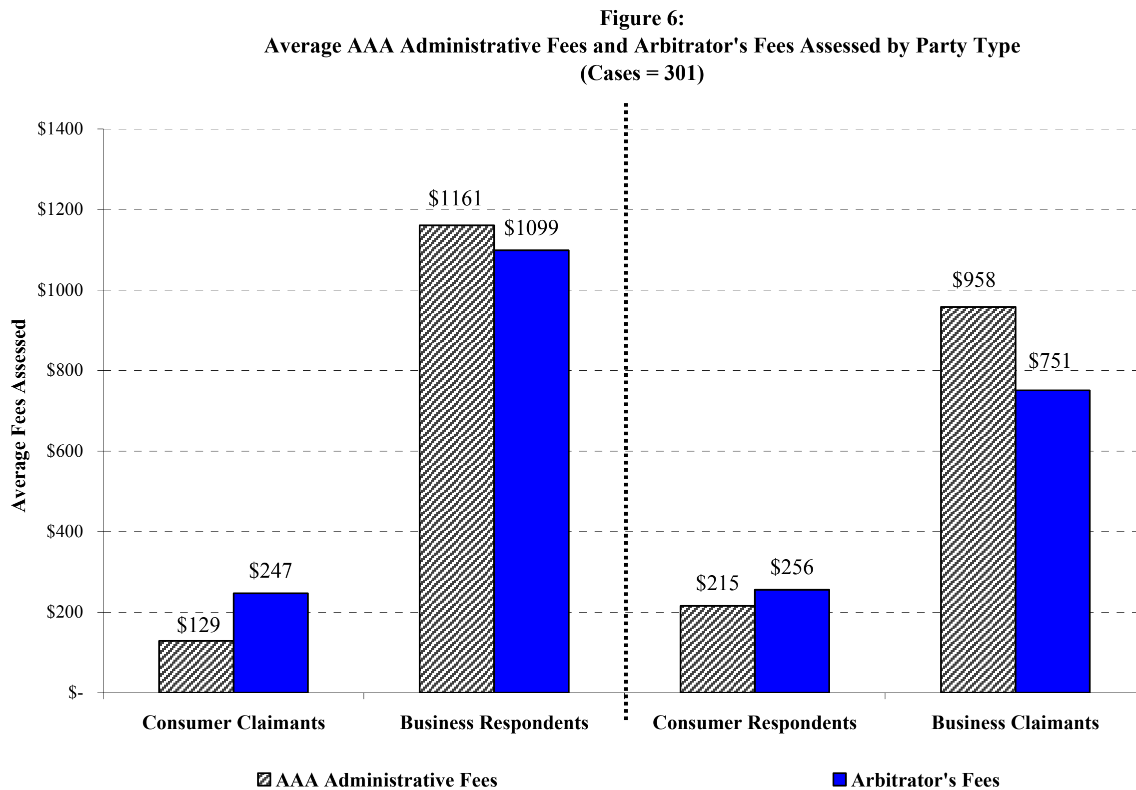
[26] In addition, on occasion contract provisions provide that consumers are to pay a lower fee than set out in the AAA fee schedule.

[27] We describe the fees as "assessed" to businesses and consumers because the parties did not necessarily pay the fees as assessed. Further, we do not have systematic data on the extent to which consumers receive fee waivers or deferrals from the AAA, and so we report no results on that issue.

three consumer respondents were assessed AAA administrative fees in excess of $1000 and/or arbitrator's fees in excess of $1000. All three brought counterclaims of $75,000 or more.

In cases with consumer claimants, the consumer is assessed an average of $129 in AAA administrative fees and $247 in arbitrator fees, as shown in Figure 6. In these same cases, businesses are assessed an average of $1161 in AAA administrative fees and $1099 in arbitrator's fees. Thus, on average consumer claimants are responsible for 10.0% of total AAA administrative fees and 18.4% of total arbitrator's fees in those cases. Note that these amounts include fees from cases with claims over $75,000, so we would expect that on average consumers pay some AAA administrative fees, even though for claims under $75,000 the business is to pay all administrative fees under the AAA consumer rules.[28] At the tail of the distribution, ten consumer claimants were assessed AAA administrative fees in excess of $1000 and/or arbitrator's fees in excess of $1000. All but one brought claims of $75,000 or more.

Overall, then, consumers are responsible for a larger share of AAA administrative and arbitrator's fees when they are respondents, but never more than approximately one-fourth of the total.



[28] *See supra* Part II.A.

If we break down the fees assessed to consumers and businesses by claim size, using the categories used by the AAA in determining fees, we find that consumer claimants on average are assessed less than the amount specified by the fee schedule. By comparison, consumer respondents are assessed more on average, but this is mostly due to the fact that in a few cases the arbitrator allocated all of the fees to the consumer respondent.[29]

In cases with claims of less than $10,000, consumer claimants are assessed on average $1 in AAA administrative fees (or 0.1% of the total, with the business assessed the rest);[30] for cases with claims between $10,000 and $75,000 they are assessed on average $15 (or 1.2% of the total);[31] and for cases with claims greater than $75,000 they are assessed on average $1,448 (or 38.6% of the total).

For arbitrator's fees, consumer claimants pay on average $95 in arbitrator's fees (or 23.4% of the total) in cases seeking less than $10,000, noticeably less than the $125 in arbitrator's fees charged under the AAA fee schedule.[32] In cases with claims between $10,000 and $75,000, consumer claimants are assessed on average $204 in arbitrator's fees (or 16.9% of the total), again, substantially below the $375 charged under the AAA fee schedule.[33] Finally, in cases with claims greater than $75,000, consumer claimants are assessed on average $1256 in arbitrators' fees (or 18.8% of the total). Figure 7 summarizes these findings.

[29] See *infra* Part IV(1).B.2.

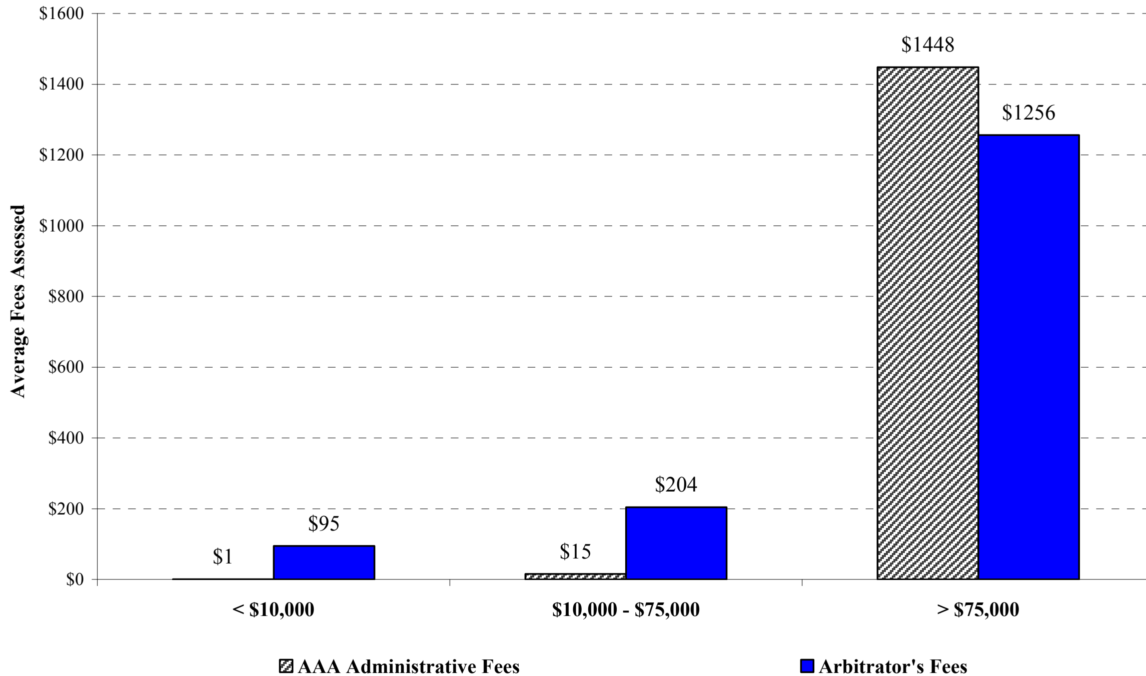
[30] There is one case with a claim under $10,000 for which a consumer was assessed any AAA administrative fees. The fees were allocated "as incurred" by the arbitrator after an in-person hearing, but it is not clear from the file why the consumer was assessed these fees.

[31] There are three cases with claims between $10,000 and $75,000 for which a consumer was assessed AAA administrative fees. In all three cases, the arbitrator allocated the AAA administrative fees equally between the parties in the award.

[32] *See supra* Part II.A. This is largely due to the fact that in 21 cases (22.8% of the time), the arbitrators allocated arbitrator's fees to the business respondent in the award.

[33] *See supra* Part II.A. This is largely due to the fact that in 47 cases (38.2% of the time), the arbitrators allocated arbitrator's fees to the business respondent in the award.

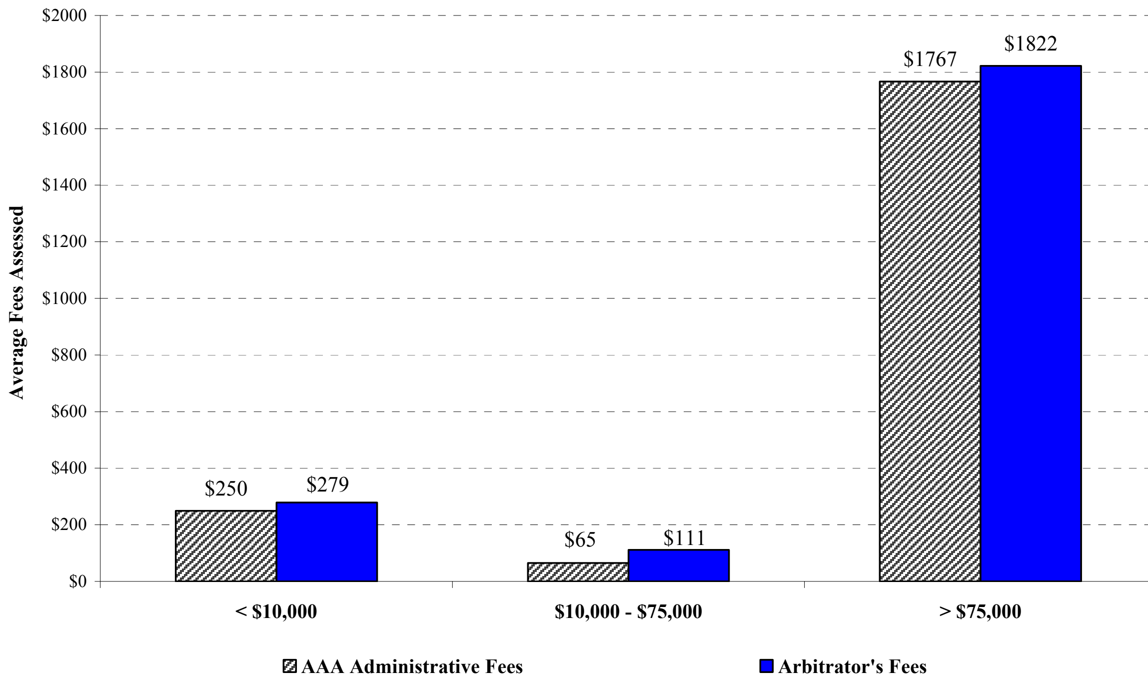
Figure 7:
Average Fees Assessed to Consumer Claimants by Amount Claimed
(Cases = 235)



Consumer respondents were generally assessed higher fees on average than consumer claimants, as shown in Figure 8. On average, consumer respondents were assessed $250 in AAA administrative fees and $279 in arbitrator's fees for cases with claims less than $10,000. These average fees are influenced by a single case in which the consumer respondent asserted a counterclaim for over $75,000, and was assessed over $8000 in total arbitration fees. Excluding that outlier, consumer respondents were assessed on average $71 in AAA administrative fees and $100 in arbitrator's fees for cases with claims less than $10,000. For cases with claims between $10,000 and $75,000, on average consumer respondents were assessed $65 in AAA administrative fees and $111 in arbitrator's fees.[34] Finally, for cases with claims greater than $75,000, on average consumer respondents were assessed $1767 in AAA administrative fees and $1822 in arbitrator's fees.

[34] In 10 cases (27.8% of the time) arbitrators allocated arbitrator's fees to consumer respondents equally, partially, or solely.

Figure 8:
Average Fees Assessed to Consumer Respondents by Amount Claimed
(Cases = 61)



Because we have no data on the financial situation of individual consumer claimants, we are unable to evaluate how affordable these costs of arbitration are to consumers. Of course, all of the cases in the case file sample are ones in which the consumer was able to bring the case, and hence cases in which arbitration costs did not preclude the consumer from asserting his or her claim.

2. Fee Allocations in Awards

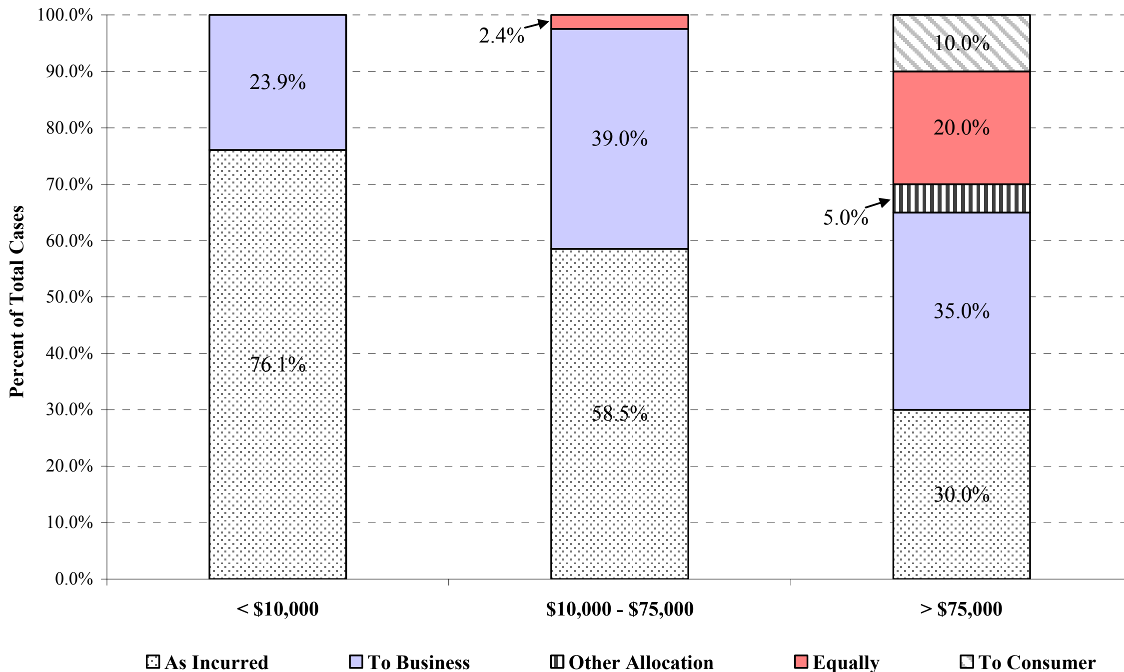
As discussed in the previous subsection, the fees assessed to a party are determined in part by how the arbitrator allocates fees in the award. Under the AAA's rules, the arbitrator has the power to apportion the AAA's administrative fees and arbitrator's fees among the parties in the award as he or she deems appropriate.[35] Arbitrators can direct that fees be borne "as incurred," specify that fees be shared equally by the parties, or require one party to bear most or all of the fees. The arbitrator can allocate administrative fees in the same or in a different manner from the arbitrator's fees.

[35] AAA, Commercial Rules, *supra* note 7, Rule R-43(c).

In the majority of the 301 cases in the case file sample, the arbitrator directed that fees be borne "as incurred." For business claimants, the award provided that AAA administrative fees be borne "as incurred" in 55.7% of the cases and that arbitrator's fees be borne "as incurred" in 42.6% of the cases. Of the remaining cases with business claimants, AAA administrative fees were allocated solely to the businesses 36.1% of the time and solely to the consumer respondents 8.2% of the time (5 cases).[36] Likewise, arbitrator's fees were allocated solely to the business 18.0% of the time, allocated equally or disproportionately to the business 31.2% of the time, and allocated solely to the consumer 8.2% of the time.[37]

For consumer claimants, fee allocations in awards varied depending on the amount sought – i.e., whether the case was subject to the AAA's low-cost arbitration procedures. Specifically, AAA administrative fees were allocated solely to consumer claimants twice, both in cases with claims seeking over $75,000. Arbitrators allocated AAA administrative fees equally or partially to consumers another eight times. Otherwise, arbitrators allocated AAA fees as incurred or solely to the business as shown in Figure 9.

Figure 9:
Percent Allocated AAA Administrative Fees in Consumer Claimant Cases by Amount Claimed
(Cases = 235)



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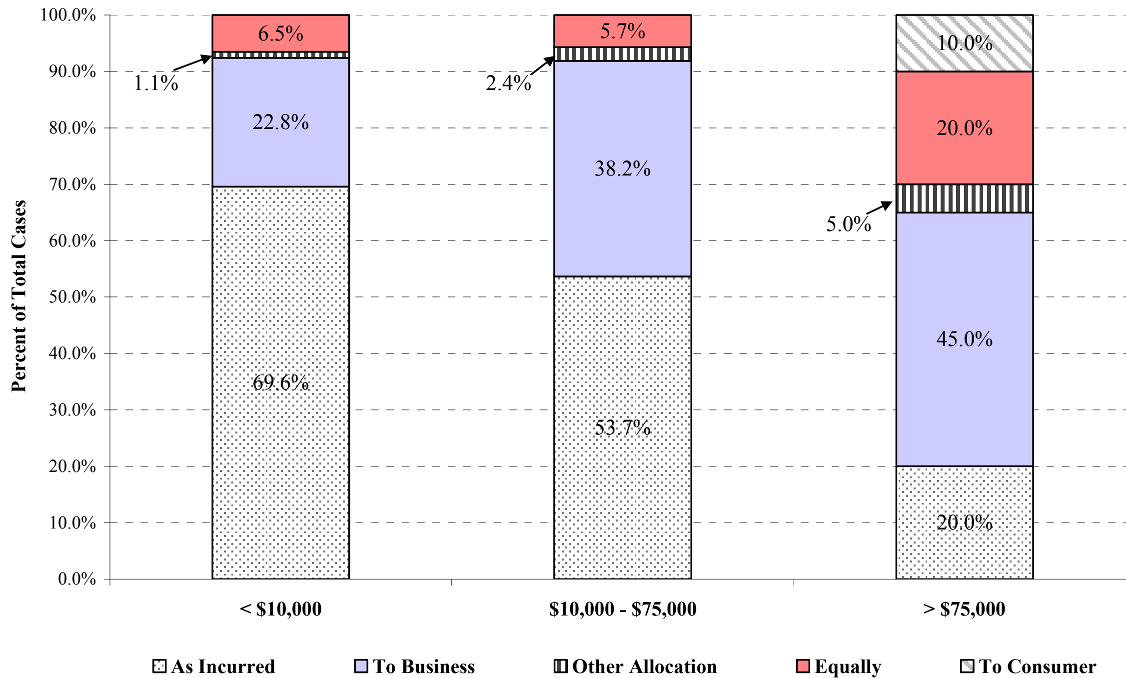
[36] It is not clear why the arbitrator allocated all AAA administrative fees to the consumer respondents in these five cases, but in two cases the consumers did bring counterclaims.

[37] The same five cases allocated both AAA administrative fees and arbitrator's fees solely to the consumers.

The allocation of arbitrator's fees for cases with consumer claimants was similar to the allocation of AAA administrative fees. In the two cases in which the arbitrator allocated AAA administrative fees to the consumer, the arbitrator also allocated arbitrator's fees to the consumer. In twenty-two cases the arbitrator allocated the arbitrator's fees equally or partially to the consumer, while in another 137 cases the arbitrator ordered the arbitrator's fees to be borne as incurred.[38] In the remaining 79 cases, the arbitrator allocated arbitrator's fees solely to the businesses. Figure 10 shows the breakdown by claim type of arbitrators' fees owed by consumer claimants.

Figure 10:
Percent Allocated Arbitrator's Fees in Consumer Claimant Cases by Amount Claimed
(Cases = 235)

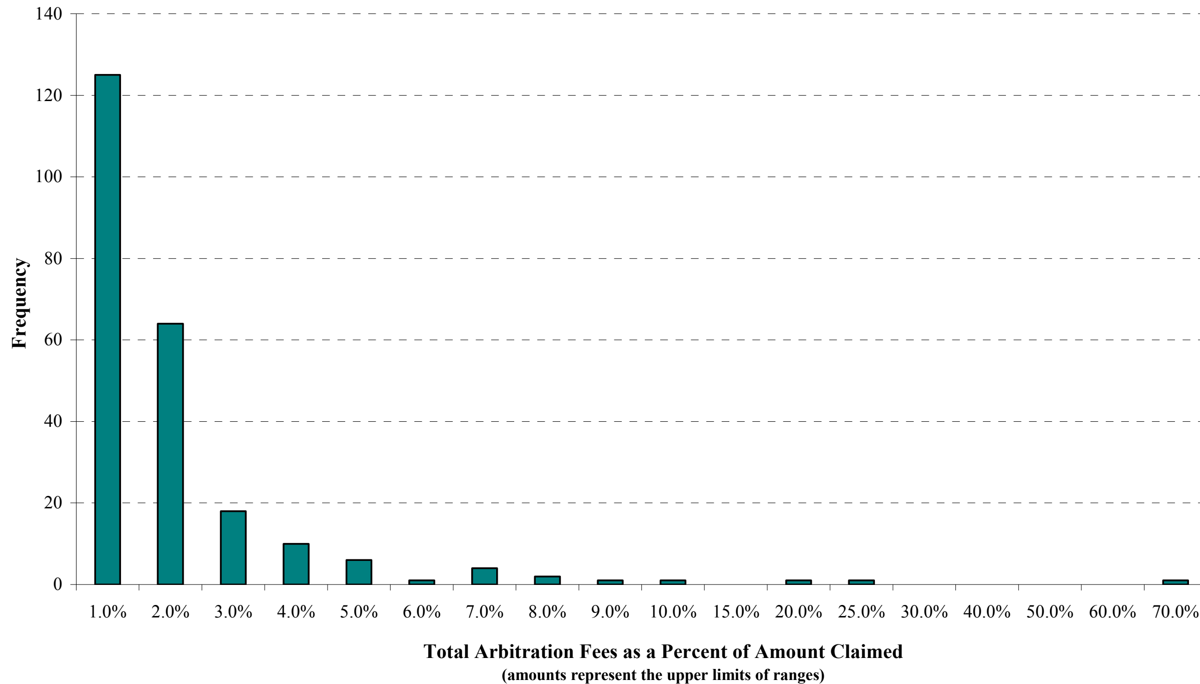


3. Fees as Percent of Amount Claimed

Finally, we calculated the total arbitration fees (i.e., AAA administrative fees and arbitrator's fees assessed to the consumer) as a percentage of the amount claimed. In the majority of the 235 cases in the case file sample with consumer claimants, total arbitration fees were one percent or less of the amount claimed, as shown in Figure 11.

[38] Consumers must pay half of the arbitrator's fees under the AAA's low-cost arbitration rules. *See supra* Part II.A. An order that arbitrator's fees be borne as incurred thus has the effect of maintaining that original allocation. An order that the consumer share the arbitrator's fees with the business equally likely has that same effect as well.

Figure 11:
Frequency of Total Arbitration Fees as a Percent of Amount Claimed in Cases with Consumer Claimants
(Cases = 235)



The range has a long tail, due largely to a single outlier: total arbitration fees (i.e., both administrative and arbitrator's fees) ranged from 0.0% of the amount claimed to 65.1% of the amount claimed. The outlier was a case in which the amount sought was less than $200. In no other case did the total arbitration costs exceed 25.0% of the amount claimed. The mean for the entire case file sample of total arbitration fees as a percent of amount claimed by consumers was 0.8%. On average, for claims of $10,000 or less, the ratio of total fees to amount claimed for consumer claimants was 1.6%;[39] for claims between $10,000 and $75,000 the average ratio was 0.6%; and for claims greater than $75,000 the average ratio was 1.0%.

Overall, then, the fees paid by consumer claimants typically constitute less than two percent of the amount claimed.

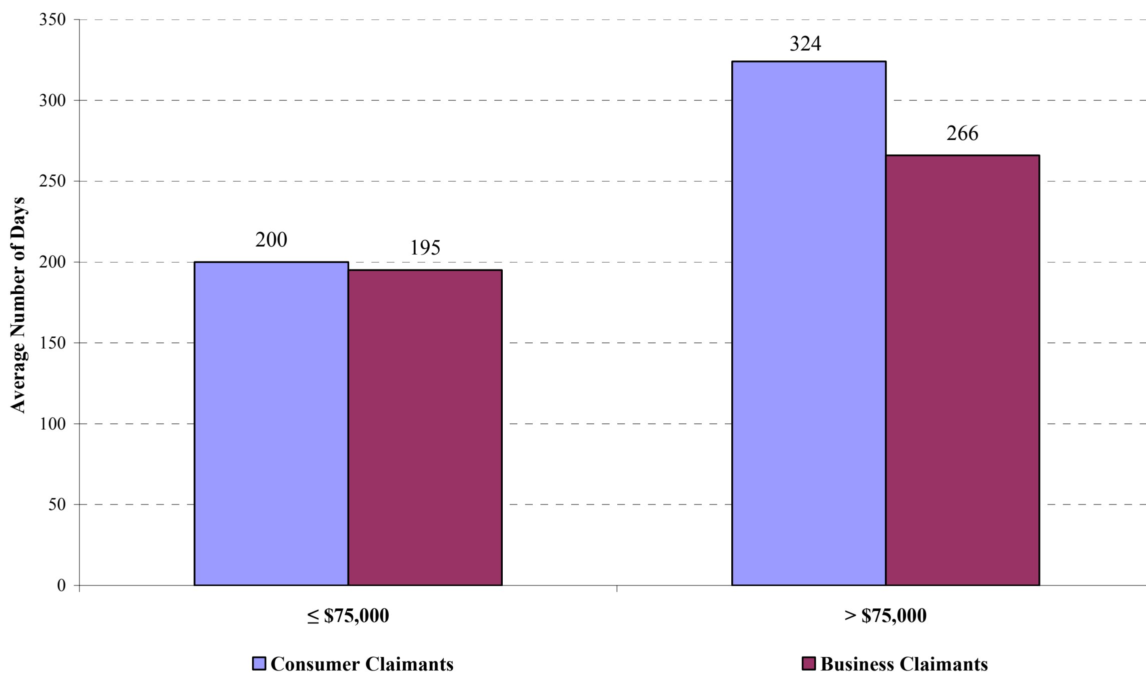
C. Speed of AAA Consumer Arbitrations

Generally arbitration is considered a relatively quick form of dispute resolution. Our results do not appear to contradict that impression, and are consistent with prior empirical studies

[39] Note that this result is due to the same outlier mentioned above.

on the issue.[40] On average, for the 301 cases in the case file sample, the time from filing to final award was 207 days (6.9 months).[41] The median time from filing to final award was 168 days (5.6 months), with a range of 64 to 992 days (2.1 months to 2.8 years). Cases with business claimants were about 10 days shorter on average than cases with consumer claimants (198 days, or 6.6 months, instead of 209 days, or 7.0 months). The median duration for cases brought by business claimants likewise was about 10 days shorter than for cases brought by consumer claimants (160 days, or 5.3 months, instead of 169 days, or 5.6 months). However, the range was greater for cases brought by business claimants (68 to 992 days, or 2.3 months to 2.8 years, as compared to 64 to 763 days, or 2.1 months to 2.1 years, for cases brought by consumer claimants). The upper tails of the ranges for business and consumer claimants were driven by a few outliers. Four cases involving consumer claimants lasted more than a year-and-a-half; and three cases involving business claimants lasted more than a year-and-a-half. Not surprisingly, cases with higher amounts claimed tended to take longer to resolve, as shown in Figure 12.

Figure 12:
Average Number of Days from Filing to Award by Amount Claimed
(Cases = 296)



The time from filing to award changes substantially depending on the type of hearing involved in the case. In the majority of cases in the case file sample (187 of 301, or 62.1%), the

[40] *See supra* Part I.A.2.
[41] We were not able to find the filing date for one of the cases so we used the assignment date as a reasonable proxy. See Part III.B for a discussion on the consistency tests of the AAA dataset.

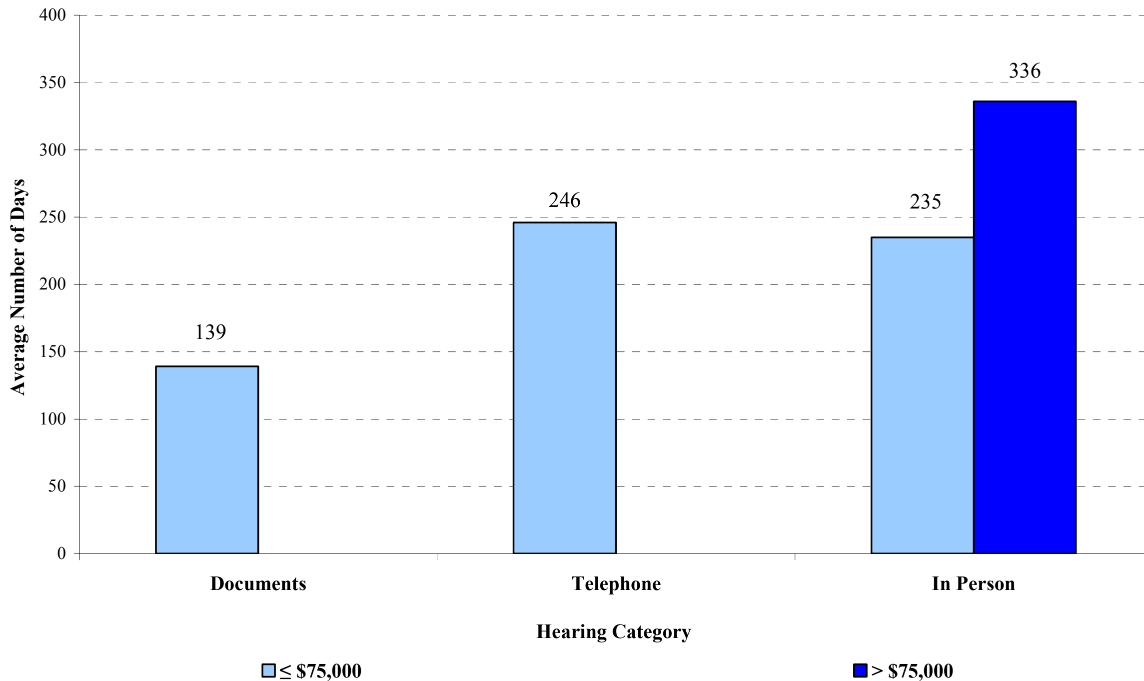
arbitrator held either an in-person or telephone hearing. The remaining cases were resolved on the basis of documents only.[42] Cases brought by consumer claimants whose claims were resolved on the basis of documents only were awarded in 139 days (4.6 months) on average, or 125 days (4.2 months) at the median. Cases brought by consumer claimants and resolved by an in-person hearing were awarded in 235 days (7.8 months) on average for claims of $75,000 or less and 336 days (11.2 months) on average for claims greater than $75,000.[43] The comparable median times to award are 188 days (6.3. months) for claims of $75,000 or less and 291 days (9.7 months) for claims greater than $75,000. For consumer claims of $75,000 or less, the difference in time from filing to award between cases resolved by documents only and cases resolved by in-person hearings is statistically significant.[44] Figure 13 below shows the relative differences in average time from filing to award for consumer claimants by claim size.

[42] In two cases, the arbitrator issued the final award pursuant to motions for summary disposition; we did not include those two cases in the results for cases resolved on the basis of documents.

[43] Clearly, it is not the time of the hearing itself that results in the greater time to an award. On average, in-person and telephone hearings lasted 1.23 days for cases with claims of $75,000 or less, 1.91 days for cases with claims of more than $75,000, and 1 day for non-monetary claims. Instead, presumably, the greater complexity of the cases and the difficulties of scheduling in-person or telephone hearings account for the added time.

[44] We used a two-group t-test for averages in number of days from filing to final award for cases resolved by documents only and for cases resolved by an in-person hearing. All cases were brought by consumer claimants seeking less than or equal to $75,000. The t-statistic was 7.1718 (DF = 200.151 and p = 0.0000 and accounting for unequal variances), which indicates that we may reject the null hypothesis that the averages between the two groups were the same.

Figure 13:
Average Number of Days from Filing to Award for Consumer Claimants by Amount Claimed and Hearing Type
(Cases = 233)



The milestone dates in the AAA consumer dataset were generally reliable, which permits us to use that dataset as a check on our findings from the case file sample.[45] On average, the cases in the AAA dataset that were closed by an award from 2005 through 2007 (1114 cases) took 219 days (7.3 months) from filing to award, with a median case length of 176 days (5.9 months). Individual cases ranged in length from 55 days to 1203 days (or 1.8 months to 3.3 years). Overall, then, the results from the AAA consumer dataset are broadly consistent with the results from the case file sample.[46]

There is some potential for selection bias in both the case file sample and the AAA consumer dataset. The case file sample is limited to cases awarded from April 2007 through December 2007, and hence does not include cases that were filed during that period but awarded after December 2007. Similarly, the AAA consumer dataset does not include cases filed from 2005 through 2007 but resolved after December 2007. Thus, it is possible that, on average, our

[45] For the AAA consumer dataset, we use the assignment date as a proxy for filing date because the filing date is not captured. As discussed in Part III.B, however, assignment date is a reasonable proxy for filing date.

[46] The AAA consumer dataset did not track consistently whether the case was decided only by a review of documents or otherwise, so we could not use that dataset to check the results on type of hearing from the case file sample.

results understate somewhat the time to award. The amount of any understatement is not likely to change our results substantially, however.[47]

As such, the average time from filing to award for AAA consumer arbitration cases is approximately seven to eight-and-a-half months. By comparison, the median time from filing to award for AAA consumer arbitration cases is approximately five-and-a-half to seven months.

D. Outcomes of AAA Consumer Arbitrations

In this Section, we present the results of our analysis on outcomes in AAA consumer arbitrations. First, we describe limitations of the data as to outcomes. Second, we present general data on outcomes – win-rates for consumer claimants and business claimants; amounts of compensatory damages, interest, punitive damages, and attorneys' fees awarded; and the amount of compensatory damages awarded as a percentage of the amount claimed. Third, we examine the relationship between outcome and whether the consumer was represented by counsel. Finally, we look at what our data suggest about the existence of a repeat-player effect and, if there is such an effect, whether it results from bias in favor of repeat businesses or from case screening by repeat businesses.

1. Limitations of the Data

We use data from the 301 cases in the case file sample in analyzing outcomes because the AAA consumer dataset does not permit reliable tracking of party wins and award amounts. The case file sample has several limitations. First, as discussed above, claimants (particularly consumer claimants) do not always specify an exact amount demanded, sometimes seeking less

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[47] Using cases filed and/or awarded in 2005 in the AAA consumer dataset as a reasonable proxy for the mix of cases filed and/or awarded in other years, we can examine the extent of any likely selection bias. Based on a review of case characteristics, we find no reason to believe that cases filed and/or awarded in 2005 would be systematically shorter or longer than cases filed and/or awarded in 2007. We also know of no exogenous event that might cause a difference in the types of cases filed in either year. We relied on the AAA consumer dataset and supplementary information from the AAA on cases still pending as of May 16, 2008, and February 18, 2009, to construct the set of cases filed and/or awarded in 2005. Specifically, we looked at (1) all cases filed in 2005 and awarded by December 2007; (2) all cases awarded in 2005; and (3) any cases filed in 2005 and listed as still pending as of May 16, 2008 and February 18, 2009. (There might be some cases that were filed in 2005 but closed between January 1, 2008 and May 15, 2008, that we may not have captured in this analysis. But the number of such cases is likely to be very small, if any exist at all.) For the resulting 520 awarded cases, the average length of time from filing to award was 252 days (8.4 months), and the median length of time from filing to award was 206 days (6.9 months). Individual cases ranged in length from 65 to 1151 days (2.2 months to 3.2 years). Additionally, according to the AAA, there were 57 cases filed in 2005 that were pending as of May 16, 2008. These same 57 cases were still pending as of February 18, 2009. Of those cases, 53 are held in abeyance due to party agreement or court order. Should any of these cases be awarded, the time to award in the case will be greater than 1000 days. However, in the AAA consumer dataset, only four cases were pending for more than 1000 days prior to an award; thus few, if any, of these 57 cases will likely be awarded. These cases are approximately five percent of the total cases filed in 2005. As such, they will not likely change the average of 252 days by a substantial amount.

than or more than a particular amount or a bounded range of amounts.[48] Our approach for dealing with this issue is described above.[49] Because only twenty-two cases with consumer claimants are affected, alternative approaches do not drastically change the results below.

Second, claimants sometimes include interest, punitive damages, attorneys' fees or other damages in the amount claimed in the demand for arbitration, instead of only including the amount of compensatory damages sought.[50] In order to mitigate this problem, when collecting the data we segregated those other damage amounts from the amount of compensatory damages when possible. However, there may be some claim amounts that include interest or other damages or were amended without evidence in the file. In the calculations below (unless otherwise noted) we report percent recoveries using claims and awards of compensatory damages. Because claimants often did not claim specific amounts for other kinds of damages, calculating those percent recoveries was not possible.

Similar issues arise on the award side as well, although not as frequently. In general, arbitrators specified in the award the types of damages being awarded, although the award was not clear as to the breakdown of the amount awarded in a few cases. Again, this could overstate the amount of compensatory damages awarded.

Third, we consider any time the arbitrator found for the claimant and awarded damages of some kind to be a win for the claimant and a loss for the respondent, regardless of the amount awarded. (We do not, however, treat the reallocation of arbitration costs alone as making the case a win for the claimant.) We use this definition of a win for both initial claims and counterclaims. We recognize, as discussed above, that this definition may overstate the extent to which the claimant truly prevails on its claim.[51] We deal with that possibility by presenting data on win-rates as well as on the amount awarded.

2. General Outcomes

Because of the differing nature of the respective claims,[52] we present win-rates for consumer claimants and business claimants separately.[53] For cases with consumer claimants, the consumer won some relief in 53.3% (128 of 240) of the cases, as shown in Table 2. By comparison, for cases with business claimants, the business won some relief in 83.6% (51 of 61)

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48 *See supra* Part IV(1).A.2.

49 *See supra* Part IV(1).A.2.

50 On some of the demand for arbitration forms used by the AAA, claimants can check a box to indicate whether they are seeking recovery of attorneys' fees, punitive damages, interest, arbitration costs, or other damages. See AAA, Form Demand for Arbitration, *available at* http://www.adr.org/si.asp?id=3807 (last visited December 31, 2008). Because it is not clear that those items of damages should not be included in the line item for "Dollar amount of claim" on the form, it is possible that some claimants included those items of damages in the amount claimed.

51 *See supra* Part I.A.3.

52 *See supra* Part IV(1).A.1.

53 Note that we do not consider settlements in our win-rates since we do not have enough data to determine whether their inclusion would be appropriate in this context.

of the cases.[54] The higher win-rate for business claimants may be due to the fact that businesses tend to bring debt collection actions and other similar cases in which the likelihood of success for the business is high.[55] Although we cannot reach any definitive conclusions about the success of consumer claimants, because we have no baseline for comparison, we can at least say that the consumer claimants won some relief more often than they lost against businesses in AAA consumer arbitrations.

Table 2: Win Rates by Case Type and Party

	Cases with Consumer Claimants Only		**Cases with Business Claimants Only**	
Party	**Consumer**	**Business**	**Consumer**	**Business**
Wins	128	112	10	51
Total Cases	240	240	61	61
Win Rate	**53.3%**	**46.7%**	**16.4%**	**83.6%**

Consumer claimants who bring large claims tend to do better than consumers who bring smaller claims, although the number of consumers bringing large claims is small. As Table 3 shows, consumer claimants won some relief in 60.0% of cases (12 of 20) seeking more than $75,000, and won some relief in 52.1% of cases (112 of 215) seeking $75,000 or less. In both types of cases, the consumer claimant won some relief against the business more than half the time.

Table 3: Consumer Claimant Win Rates by Amount Claimed

	Cases with Consumer Claimants Only	
Claim	**≤ $75,000**	**> $75,000**
Consumer Wins	112	12
Total Cases	215	20
Consumer Win Rate	**52.1%**	**60.0%**

[54] If we include the fifty-seven counterclaims in the case file sample in the above analysis, consumer claimants won some relief in 53.4% (134 of 251) of the cases and business claimants won some relief in 80.4% (86 of 107) of the cases.

[55] *See* Peter B. Rutledge, Arbitration -- A Good Deal for Consumers: A Response to Public Citizen 10-11 (April 2008) (report prepared for and released by the U.S. Chamber Institute for Legal Reform), *available at* http://www.instituteforlegalreform.com/issues/docload.cfm?docId=1091.

We also analyzed the amounts awarded to business and consumer claimants. Our results are summarized in Table 4.[56] The mean amount awarded to business claimants in the case file sample was $20,648 and the mean percent recovery was 93.0%.[57] The median amount awarded to business claimants was $11,110 and the median percent recovery was 100.0%. For consumer claimants, the mean amount awarded was $19,255 and the mean percent recovery was 52.1%, while the median amount awarded was $5000 and the median percent recovery was 41.7%.

Table 4: Compensatory Damages Recovered by Consumer Claimants and Business Claimants

	Prevailing Consumer Claimants			**Prevailing Business Claimants**		
	Compensatory Damages Awarded	**Compensatory Damages Claimed**	**% Recovery (Amt. Awarded/ Amt. Claimed)**	**Compensatory Damages Awarded**	**Compensatory Damages Claimed**	**% Recovery (Amt. Awarded/ Amt. Claimed)**
Maximum	$419,259	$500,000	**100.0%**	$156,048	$156,048	**100.0%**
Minimum	$0	$178	**0.0%**	$873	$1,215	**16.3%**
Average	$19,255	$40,955	**52.1%**	$20,648	$21,420	**93.0%**
Median	$5,000	$16,530	**41.7%**	$11,110	$12,827	**100.0%**
Std. Dev.	$50,592	$67,056	**38.9%**	$26,732	$27,138	**16.0%**
Cases	119	119	**119**	51	51	**51**

We also examined the amounts awarded to consumers based on the whether the consumer claimed more or less than $75,000, as shown in Table 5. The mean amount awarded to consumers claiming $75,000 or less in the case file sample was $8871 and the mean percent recovery was 51.6%. The median amount awarded to consumers claiming $75,000 or less was $4800 and the median percent recovery was 41.6%. For consumers claiming more than $75,000, the mean amount awarded was $111,847 and the mean percent recovery was 56.2%, while the median amount awarded was $78,062 and the median percent recovery was 72.7%. Thus, prevailing consumers who claimed amounts in excess of $75,000 tended to receive awards in excess of $75,000. The average percent recovery between the two groups is similar, however.

[56] Consumer claimants prevailed in an additional nine cases, but in those cases either the claim sought non-monetary relief or the dollar amount awarded was not available in the case file. Accordingly, we excluded those cases from our analysis. Since our definition of a win includes the claimant recovering any part of the claim, we did include two cases with consumer claimants who were awarded attorneys' fees but no compensatory damages.

[57] In this section, all average percent recoveries were calculated as the average from a distribution of each claimant's percent recovery.

Table 5: Compensatory Damages Recovered by Consumer Claimants by Amount Claimed

	Prevailing Consumer Amount Claimed ≤ $75,000			**Prevailing Consumer Amount Claimed > $75,000**		
	Compensatory Damages Awarded	**Compensatory Damages Claimed**	**% Recovery (Amt. Awarded/ Amt. Claimed)**	**Compensatory Damages Awarded**	**Compensatory Damages Claimed**	**% Recovery (Amt. Awarded/ Amt. Claimed)**
Maximum	$60,000	$75,000	**100.0%**	$419,259	$500,000	**100.0%**
Minimum	$0	$178	**0.0%**	$784	$80,000	**0.8%**
Average	$8,871	$23,816	**51.6%**	$111,847	$193,785	**56.2%**
Median	$4,800	$12,378	**41.6%**	$78,062	$150,000	**72.7%**
Std. Dev.	$12,108	$23,069	**38.7%**	$125,071	$121,527	**42.2%**
Cases	107	107	**107**	12	12	**12**

Because we have no baseline for comparison, we cannot evaluate whether these recoveries are favorable or unfavorable for consumers.[58] We can say that the differing outcomes between business claimants and consumer claimants do not necessarily show that the process is unfair to consumers. Instead, the differing outcomes appear likely to be due to the types of cases brought by business claimants and consumer claimants rather than any form of systematic bias. Business claimants usually bring claims for specific monetary amounts representing debts for goods provided or services rendered. Many of the cases are resolved ex parte, with the consumer failing to appear.[59] By comparison, cases with consumer claimants are much less likely to involve liquidated amounts and more likely to be contested by businesses.

Figure 14 further illustrates the variation in awards of compensatory damages to business claimants and consumer claimants. In 41 of the 51 cases in which a business claimant prevailed, the business recovered between 90.0% and 100.0% of the amount claimed. In contrast, the distribution of outcomes for prevailing consumer claimants is bimodal. In the 119 cases in which consumer claimants received monetary awards, the consumer recovered 20.0% or less of the amount claimed in 36 cases and between 90.0% to 100.0% of the amount claimed in 37 cases. This bimodal distribution is consistent with studies of AAA commercial arbitration awards[60] and international arbitration awards.[61] It also suggests that arbitrators do not commonly make compromise awards in AAA consumer arbitrations.[62]

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[58] Again, we hope to develop such a baseline in a future report.

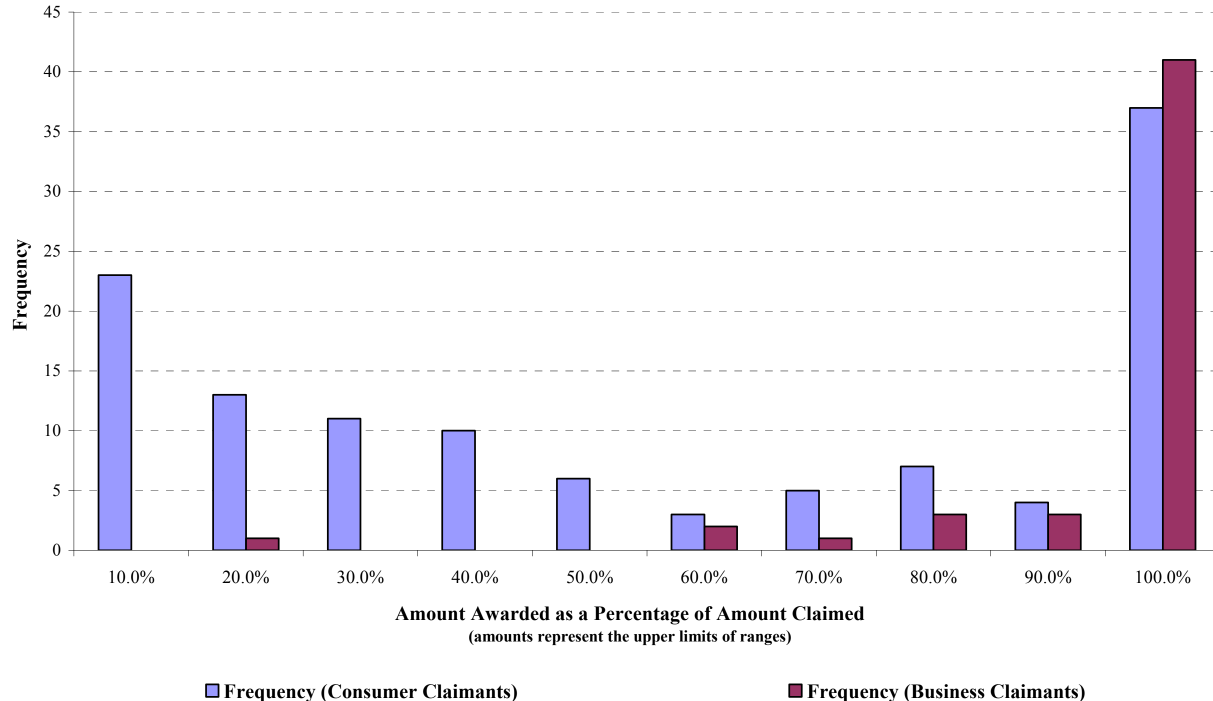
[59] Twenty-two out of the sixty-one cases (or 36.1%) brought by business claimants were resolved on an ex parte basis. The business won some relief in 100.0% of those 22 cases, and on average recovered 94.1% of the amount claimed.

[60] American Arbitration Association, *Splitting the Baby: A New AAA Study* (Mar. 9, 2007), *available at* www.adr.org/sp.asp?id=32004.

[61] Stephanie E. Keer & Richard W. Naimark, *Arbitrators Do not "Split the Baby" – Empirical Evidence from International Business Arbitration*, 18 J. INT'L ARB. 573 (2001).

[62] *See* Richard A. Posner, *Judicial Behavior and Performance: An Economic Approach*, 32 FLA. ST. U. L. REV. 1259, 1260-61 (2005); Alan Scott Rau, *Integrity in Private Judging*, 38 SO. TEX. L. REV. 485, 523 (1997).

Figure 14:
Amount Awarded as a Percent of Amount Claimed by Consumer and Business Claimants
(Cases = 170)



In addition to compensatory damages, prevailing claimants also were awarded other types of damages, including attorneys' fees, punitive damages, and interest.

In the case file sample, consumer claimants made a claim for attorneys' fees in 65 of the 128 cases (or 50.8%) in which they prevailed. In 41 of those 65 cases (or 63.1%), the arbitrator awarded attorneys' fees to the consumer.[63] In those cases in which the award of attorneys' fees specified a dollar amount (35 cases), the average attorneys' fee award was $14,574 and the median award was $9000. Of course, in 44 of 63 (or 69.8%) of the cases in which prevailing consumer claimants did not seek attorneys' fees, they were proceeding pro se and did not have to pay an attorney anything.[64]

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[63] Because claimants sometimes amended their claims without formal indication in the AAA file, there are occasions where the claimant was awarded damages they had not originally requested. Since we understand from the AAA that the arbitrators are not to award damages beyond those claimed, we assume that claims for those damages were made.

[64] There are four cases in which consumer claimants proceeded pro se but asked for attorneys' fees. In two of those cases, the arbitrator did not award attorneys' fees and the claim may have been a misunderstanding on the part of the claimant in filling out the arbitration demand form. The other two pro se consumer claimants were awarded attorneys' fees. However, both of theses cases came to arbitration from state courts, so the attorneys' fees claims may have resulted from fees incurred in state court or some other involvement of an attorney in the process.

Of the 51 cases in which the business claimant prevailed, the business made a claim for attorneys' fees in 41 cases and was awarded those fees in 16 cases (or 39.0%). The mean attorneys' fee award was $2302 and the median fee award was $1534. The data in the files were not sufficient to determine the basis on which business claimants' recovered attorneys' fees from consumers.

Awards of punitive damages were less common. Prevailing consumer claimants were awarded punitive damages in 12 of the 46 (26.1%) cases in which they were sought. The mean punitive damages award was $39,557, while the median punitive award was $2100. The higher mean is due to one case in which the consumer claimant received a punitive damages award of $427,500. In contrast, prevailing business claimants almost never sought punitive damages. Of the 51 cases in which business claimants prevailed, the business sought punitive damages in three, and was awarded punitive damages in two. The average amount of punitive damages awarded in those two cases was $10,778.

Arbitrators also awarded interest to prevailing parties that requested it in their claims. Prevailing consumer claimants were awarded interest in 19 of the 36 cases (or 52.8%) in which it was sought. Prevailing business claimants were awarded interest in 21 of the 27 cases (or 77.8%) in which it was sought. Because interest is often awarded without a specific dollar amount in the written awards, it is difficult to determine the magnitude of the amounts awarded.

3. Pro Se Consumers

In almost half (150 of 301, or 49.8%) of the cases in the case file sample, consumers arbitrated the case themselves – i.e., without an attorney. (In the other half of the cases, of course, that means that consumers were represented by attorneys in the arbitration proceeding.) As Table 6 shows, consumer claimants were far more likely to be represented by counsel than consumer respondents. This difference may be due to the different type of claim involved,[65] or to the fact that consumer claimants, unlike consumer respondents, might be represented on a contingency fee basis.

[65] For a more detailed discussion of ex parte cases, see *supra* Part IV(1).A.4.

Table 6: Consumer Representation by Case Type

	Cases with Consumer Claimants Only	Cases with Business Claimants Only*
Consumer Represented by Attorney	133 (55.4%)	18 (29.5%)
Consumer Proceeded Pro se	103 (42.9%)	22 (36.1%)
Consumer Did Not Appear (Ex Parte Case)	4 (1.7%)	22 (36.1%)
Total Cases	240	61

* Note that one consumer respondent was represented by an attorney but eventually did not appear. This case appears twice in the above table in the Business Claimants column - once in the first row and again in the third row. Accordingly, the total number of cases in which consumers proceeded pro se (150) consists of the entries in the table above for consumers proceeding pro se and consumers who did not appear, less the one case in which a consumer was represented by an attorney but did not appear.

As a general matter, pro se consumers have a lower win-rate than consumers represented by attorneys, both in cases in which the consumers are claimants and in cases in which businesses are claimants. As Table 7 shows, pro se consumer claimants won some relief in 44.9% of the cases they brought, while consumer claimants with counsel won some relief in 60.2% of the cases they brought. By comparison, pro se consumers won in 7.0% of the cases brought by businesses, while consumer respondents with counsel won in 38.9% of such cases.

Table 7: Consumer Win Rates by Case Type and Consumer Representation

	Cases with Consumer Claimants Only			Cases with Business Claimants Only		
Consumer Representation	**All**	**Attorney**	**Pro se**	**All**	**Attorney**	**Pro se**
Consumer Wins	128	80	48	10	7	3
Total Cases	240	133	107	61	18	43
Consumer Win Rate	**53.3%**	**60.2%**	**44.9%**	**16.4%**	**38.9%**	**7.0%**

The results are similar if we take into account the amount claimed. As Table 8 shows, consumer claimants fare better when represented by an attorney both for cases in which the

claimant seeks $75,000 or less and for cases in which the claimant seeks more than $75,000, although pro se claimants are much less common in the latter category.

Table 8: Consumer Claimant Win Rates by Amount Claimed and Representation

	Consumer Amount Claimed ≤ $75,000		**Consumer Amount Claimed > $75,000**	
Consumer Representation	**Attorney**	**Pro se**	**Attorney**	**Pro se**
Consumer Wins	67	45	11	1
Total Cases	115	100	16	4
Consumer Win Rate	**58.3%**	**45.0%**	**68.8%**	**25.0%**

At least two explanations are possible for the higher success rate of consumers with attorneys.[66] First, hiring an attorney may increase the consumer's likelihood of success because of the specialized advocacy skills of an attorney.[67] Second, in deciding whether to take on a client, attorneys accept only cases that are more likely to prevail, screening out less meritorious cases. From our data, we are unable to distinguish between these two explanations.

In addition to a higher win-rate, consumer claimants who are represented by attorneys also tend to receive higher damages awards. As shown in Table 9,[68] consumer claimants with attorneys received an average award of $27,233 and a median award of $6702, while pro se claimants received an average award of $5656 and a median award of $3029. [69]

Similar explanations are possible here as with win-rates – either attorneys are able to obtain higher recoveries for their clients, or attorneys screen cases for those with higher potential

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[66] Prior empirical studies on employment arbitration report mixed results on the question. *Compare* Alexander J.S. Colvin, *Empirical Research on Employment Arbitration: Clarity Amidst the Sound and Fury?*, 11 EMPL. RTS. & EMPLOY. POL'Y J. 405, 433 (2007) ("the employee win rate was 22.6 percent where represented by counsel and only 13.7 percent where the employee was self-represented, a statistically significant difference") *with* Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at Low Cost*, DISP. RESOL. J., May/July 2003, at 15 ("The win-loss ratio for both lower-income employees with representation and those who proceeded *pro se* was .50"); Hill, *Due Process*, *supra* note 25, at 819 (reporting similar results).

[67] Because of the less formal nature of arbitration, this explanation seems somewhat weaker than it would as applied to a case in court, although clearly at least some of an attorney's skills are transferable from court to arbitration.

[68] The outcomes results are only for those cases with known amounts of compensatory damages claimed and awarded.

[69] We used a two-group t-test for averages in compensatory damages awards to pro se consumer claimants and consumer claimants with counsel, excluding non-monetary claims and awards and accounting for unequal variances. The t-statistic was 2.9591 (DF = 78.6227 and p = 0.0041), which indicates that we may reject the null hypothesis that the averages between the two groups were the same.

recoveries. Our data again are unable to distinguish definitively between these two explanations, although they are suggestive. All consumer claimants who filed claims and were represented by attorneys sought an average of $57,529 in compensatory damages, while pro se claimants sought an average of $31,774, amounts that are statistically different albeit at the 10% level.[70] Likewise, median claim amounts are higher for consumer claimants with attorneys ($32,000 versus $8576 for pro se claimants). While higher claim amounts may in part reflect value added by attorneys, it seems likely that a substantial part of the difference reflects the underlying value of the claim. As such, the data at least suggest that consumer claimants are more likely to be represented by counsel in cases with higher stakes.[71]

Table 9: Compensatory Damages Recovered by Consumer Claimants by Consumer Representation

	Prevailing Consumer Claimants with Attorneys			**Prevailing Pro se Consumer Claimants**		
	Compensatory Damages Awarded	**Compensatory Damages Claimed**	**% Recovery (Amt. Awarded/ Amt. Claimed)**	**Compensatory Damages Awarded**	**Compensatory Damages Claimed**	**% Recovery (Amt. Awarded/ Amt. Claimed)**
Maximum	$419,259	$500,000	**100.0%**	$44,472	$99,898	**100.0%**
Minimum	$0	$2,770	**0.0%**	$0	$178	**0.0%**
Average	$27,233	$57,659	**44.9%**	$5,656	$12,483	**64.3%**
Median	$6,702	$33,905	**31.3%**	$3,029	$7,342	**72.8%**
Std. Dev.	$62,171	$78,760	**38.4%**	$8,472	$18,650	**37.0%**
Cases	75	75	**75**	44	44	**44**

Two additional results are worth noting. First, pro se consumer claimants recovered a higher percentage of the amount claimed than consumers who were represented by attorneys. Prevailing pro se consumer claimants averaged a 64.3% recovery of the amount claimed, while prevailing consumer claimants with attorneys averaged a 44.9% recovery of the amount claimed. We have no clear explanation for this finding.[72]

Second, consistent with findings reported in the previous section,[73] of the 80 cases in which prevailing consumer claimants were represented by attorneys, the claimant was awarded attorneys' fees in 39 of the 61 cases in which they were sought (a success rate of 63.9%). The

[70] We used a two-group t-test for averages in claims made by represented and pro se consumer claimants, excluding non-monetary claims and accounting for equal variances. The t-statistic was 1.7093 (DF = 233 and p = 0.0887), which indicates that we fail to reject the null hypothesis that the averages between the two groups were the same at higher than the 10% level.

[71] Attorneys will be more likely to accept cases with higher stakes, while cases with lower stakes may encourage consumers to minimize their costs and forego legal representation.

[72] One possibility is that attorneys are more aggressive in formulating damages claims than pro se claimants. A second possibility is that attorneys are less precise in their demands, specifying ranges rather than precise amounts of damages.

[73] *See supra* Part IV(1).D.2 & n.65.

frequency with which attorneys' fees are awarded in arbitration provides at least some incentive for attorneys to agree to represent consumers in arbitration.

4. Repeat-Player Effect

As discussed above, previous research on employment arbitration has found a "repeat-player effect," in which businesses that arbitrate on a regular basis tend to have a higher win-rate than businesses that arbitrate less often.[74] Several possible explanations for the repeat-player effect have been offered. The first is that the repeat-player effect is due to bias on the part of arbitrators and arbitration service providers, seeking to curry favor with businesses that are more likely to provide future business. The second is that businesses are able to structure the arbitration process in a favorable manner through their control of dispute systems design. The third is that the repeat-player effect is due to case selection by repeat businesses, who are more sophisticated in their case screening than non-repeat businesses. We first look at whether there is a repeat-player effect in the AAA's consumer cases. Finding some evidence of such an effect, we then test for whether the effect is likely due to bias (of arbitrators or otherwise) or case selection.

To test for the presence of a repeat-player effect, we used two different definitions of repeat business. First, we defined a business to be a repeat business when it appeared more than once in the AAA consumer dataset.[75] We refer to a business that meets this definition of a repeat business as a "repeat(1) business." Second, we used information from the AAA business list (which it maintains to help in administering the Consumer Due Process Protocol[76]) to identify a category of repeat businesses. As explained above,[77] on the AAA business list the AAA identifies a sub-category of "acceptable businesses" (businesses for which it will administer consumer arbitrations). The businesses in this sub-category typically are large entities for which in the past there had been some confusion over the appropriate contact person when a consumer brought a claim against the business. For those businesses, the AAA business list typically identifies an appropriate contact person to receive the demand for arbitration. The fact that those businesses have had additional dealings with the AAA in administering their consumer arbitrations may make it appropriate to treat them as repeat businesses. We refer to businesses that meet this definition of repeat business as "repeat(2) businesses."

Using the first definition of repeat business (businesses who appear more than once in the AAA consumer dataset), we do not find statistically significant evidence of a repeat-player effect in the cases in the case file sample. As shown in Table 10, consumer claimants won some relief in 51.8% of cases against repeat(1) businesses and 55.3% of cases against non-repeat businesses,

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[74] *See supra* Part I.A.3.

[75] This definition is similar to that used in other studies in that it focuses on the number of times the business appears in cases in the case file sample. *E.g.*, Colvin, *supra* note 66, at 430; Hill, *supra* note 66, at 15. It differs from other studies in that we are able to use a broader sample of cases in determining the number of times the business appears.

[76] *See supra* Part II.B.

[77] *See supra* Part II.B.

a difference that is not statistically significant.[78] In cases in which the business is the claimant, consumers won some relief in 13.3% of cases against repeat(1) businesses and 25.0% of cases against non-repeat businesses. But in this latter case the sample size is too small to reliably test the difference statistically. Again, using this definition of repeat business we do not find a statistically significant repeat-player effect, and consumer claimants still recover some amount against both repeat(1) and non-repeat businesses over half the time in the case file sample.

Table 10: Consumer Win Rates by Case Type and Presence of a Repeat(1) Business

	Cases with Consumer Claimants Only			Cases with Business Claimants Only		
Business Type	**All**	**Repeat(1)**	**Non-Repeat**	**All**	**Repeat(1)**	**Non-Repeat**
Consumer Wins	128	71	57	10	6	4
Total Cases	240	137	103	61	45	16
Consumer Win Rate	**53.3%**	**51.8%**	**55.3%**	**16.4%**	**13.3%**	**25.0%**

The results are similar when we categorize consumer claimants by amount claimed. The difference in Table 11 is that consumers tend to do better against repeat(1) businesses when claiming more than $75,000, although again the sample size is too small for reliable statistical analysis.

Table 11: Consumer Claimant Win Rates by Amount Claimed and Presence of a Repeat(1) Business

	Consumer Amount Claimed ≤ $75,000		Consumer Amount Claimed > $75,000	
Business Type	**Repeat(1)**	**Non-Repeat**	**Repeat(1)**	**Non-Repeat**
Consumer Wins	60	52	7	5
Total Cases	121	94	11	9
Consumer Win Rate	**49.6%**	**55.3%**	**63.6%**	**55.6%**

As shown in Table 12, consumers who prevail against a repeat(1) business recover a higher percentage of the mean (and median) amount of compensatory damages claimed than consumers who prevail against non-repeat businesses. Prevailing consumer claimants recover on average 60.9% of compensatory damages claimed against repeat(1) businesses (and 75.6% of compensatory damages claimed at the median) and on average 41.4% of the amount claimed against non-repeat businesses (and 31.4% of the amount claimed at the median), a statistically

[78] The Pearson's Chi-squared statistic is 0.2919 (DF = 1 and p = 0.589), which fails to allow us to reject the null hypothesis that consumer wins are not associated with whether the respondent is a repeat(1) business.

significant difference.[79] Although we have no clear explanation for these results, at a minimum they seem inconsistent with the existence of a repeat-player effect.[80]

Table 12: Compensatory Damages Recovered by Consumer Claimants by Presence of a Repeat(1) Business

	Prevailing Consumer Claimants Repeat(1) Business Present			**Prevailing Consumer Claimants Non-Repeat Business Present**		
	Compensatory Damages Awarded	**Compensatory Damages Claimed**	**% Recovery (Amt. Awarded/ Amt. Claimed)**	**Compensatory Damages Awarded**	**Compensatory Damages Claimed**	**% Recovery (Amt. Awarded/ Amt. Claimed)**
Maximum	$250,000	$300,000	**100.0%**	$419,259	$500,000	**100.0%**
Minimum	$1	$178	**0.0%**	$0	$538	**0.0%**
Average	$20,084	$39,467	**60.9%**	$18,256	$42,746	**41.4%**
Median	$6,000	$12,000	**75.6%**	$4,475	$22,742	**31.4%**
Std. Dev.	$43,407	$59,386	**39.4%**	$58,494	$75,805	**35.8%**
Cases	65	65	**65**	54	54	**54**

Using the second definition of repeat business (based on a sub-category of businesses on the AAA business list), we find a greater repeat-player effect, at least as to win-rates, albeit one that is weakly statistically significant. As Table 13 shows, consumer claimants won some relief in 43.4% of cases against repeat(2) businesses and 56.1% of cases against non-repeat businesses, a difference that is statistically significant at the 10% level.[81] In cases in which the business is the claimant, consumers won in none of the cases against repeat(2) businesses and 16.4% of cases against non-repeat businesses. But in this latter case the sample size is too small for reliable tests of statistical differences.

[79] We used a two-group t-test for averages in percent recoveries between consumer claimants arbitrating against repeat(1) businesses and non-repeat businesses, excluding non-monetary claims and awards and accounting for equal variances. The t-statistic was -2.7983 (DF = 117 and p = 0.0060), which indicates that we may reject null hypothesis that the averages between the two groups were the same.

[80] Some other studies include zero dollar awards (i.e., claimant losses) in calculations of the percentage recovery, which makes comparisons to those studies difficult. *See* Colvin, *supra* note 66, at 429-31. We exclude zero dollar awards from Table 12 so that we can examine percentage recovery separately from win-rate; including zero dollars awards conflates the two measures.

[81] The Pearson's Chi-squared statistic is 2.6987 (DF = 1 and p = 0.100), which fails beyond the 10% level to allow us to reject the null hypothesis that consumer wins are not associated with whether the respondent is a repeat(2) business or not.

Table 13: Consumer Win Rates by Case Type and Presence of a Repeat(2) Business

	Cases with Consumer Claimants Only			Cases with Business Claimants Only		
Business Type	**All**	**Repeat(2)**	**Non-Repeat**	**All**	**Repeat(2)**	**Non-Repeat**
Consumer Wins	128	23	105	10	0	10
Total Cases	240	53	187	61	7	54
Consumer Win Rate	**53.3%**	**43.4%**	**56.1%**	**16.4%**	**0.0%**	**18.5%**

The results are similar when we categorize consumer claimants by amount claimed, as Table 14 indicates. The win-rate for consumer claimants seeking $75,000 or less is 39.1% against repeat(2) businesses and 55.6% against non-repeat businesses, a statistically significant difference at the 5% level.[82] By comparison, consumers seeking more than $75,000 won some relief more often against repeat(2) businesses than against non-repeat businesses, but the number of such cases is too small to reliably test the results statistically.

Table 14: Consumer Claimant Win Rates by Amount Claimed and Presence of a Repeat(2) Business

	Consumer Amount Claimed ≤ $75,000		Consumer Amount Claimed > $75,000	
Business Type	**Repeat(2)**	**Non-Repeat**	**Repeat(2)**	**Non-Repeat**
Consumer Wins	18	94	4	8
Total Cases	46	169	5	15
Consumer Win Rate	**39.1%**	**55.6%**	**80.0%**	**53.3%**

Again, as Table 15 shows, if consumer claimants do prevail on their claim, they recover on average an almost identical percent of the amount claimed against repeat(2) businesses (52.4%) as against non-repeat businesses (52.0%).[83] The results are reversed for the median, with prevailing consumer claimants recovering at the median a lower percentage of the amount claimed against repeat(2) businesses (39.5%) than against non-repeat businesses (41.7%).

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[82] The Pearson's Chi-squared statistic is 3.9402 (DF = 1 and p = 0.0470), which fails beyond the 5% level to allow us to reject the null hypothesis that consumer wins for cases with claims of less than $75,000 are not associated with whether the respondent is a repeat(2) business.

[83] We used a two-group t-test for averages in percent recoveries between consumer claimants arbitrating against repeat(2) businesses and non-repeat businesses, excluding non-monetary claims and awards and accounting for equal variances. The t-statistic was -0.0485 (DF = 117 and p = 0.9614), which indicates that we fail to reject null hypothesis that the averages between the two groups were the same.

Table 15: Compensatory Damages Recovered by Consumer Claimants by Presence of a Repeat(2) Business

	Prevailing Consumer Claimants Repeat(2) Business Present			**Prevailing Consumer Claimants Non-Repeat Business Present**		
	Compensatory Damages Awarded	**Compensatory Damages Claimed**	**% Recovery (Amt. Awarded/ Amt. Claimed)**	**Compensatory Damages Awarded**	**Compensatory Damages Claimed**	**% Recovery (Amt. Awarded/ Amt. Claimed)**
Maximum	$250,000	$250,000	**100.0%**	$419,259	$500,000	**100.0%**
Minimum	$15	$178	**0.3%**	$0	$192	**0.0%**
Average	$26,693	$46,803	**52.4%**	$17,568	$39,629	**52.0%**
Median	$4,500	$23,313	**39.5%**	$5,000	$15,893	**41.7%**
Std. Dev.	$56,537	$62,958	**40.1%**	$49,309	$68,193	**38.8%**
Cases	22	22	**22**	97	97	**97**

Overall, then, we find some evidence of a repeat-player effect when using our second definition of repeat business, and even then only as to win-rates and not as to percentage recoveries. But as discussed above,[84] the existence of a repeat-player effect does not necessarily show arbitrator (or other) bias in favor of repeat businesses. Instead, a repeat-player effect also may result from case selection by repeat businesses, who settle meritorious claims and arbitrate only weaker claims, while non-repeat businesses are more likely to arbitrate all claims, even meritorious ones.

Our evidence tends not to support the hypothesis that arbitrator (or other) bias is the likely explanation for any repeat-player effect in the case file sample. First, cases with repeat player combinations of any kind make up a small portion of the case file sample. Second, and perhaps more importantly, we find that case screening by businesses may explain any repeat-player effect in the case file sample. Specifically, we find that repeat businesses are more likely to settle or otherwise close cases before an award than non-repeat businesses.

First, a small percentage of cases in the case file sample involved any combination of repeat players, such as repeat pairs of arbitrators and businesses, arbitrators and attorneys for businesses, arbitrators and consumers, arbitrators and attorneys for consumers, as well as businesses and consumers. In the case file sample, 35 of 301 cases (11.6%) involved repeat pairs of any kind (see Table 16).[85] Of those 35 cases, 7 involved business claimants and 28 involved consumer claimants.

[84] *See supra* Part I.A.3.

[85] Multiple repeat pairs were present in many of the cases. Hence, the numbers in Table 16 add to significantly more than the total thirty-five cases with repeat pairs.

Table 16: Cases with Repeat Combinations

Combination Type	Number of Cases
Arbitrator and Business	27
Arbitrator and Business Attorney	29
Arbitrator and Consumer	2
Arbitrator and Consumer Attorney	11
Business and Consumer	4

In all of the cases with repeat combinations that were brought by business claimants, the business won some relief (7 of 7, or 100.0%), which may be due to the types of cases involved. However, in two of those cases the consumers asserted counterclaims and won some relief on those counterclaims both times.

In the 28 cases with consumer claimants, consumers won some relief in 12 (or 42.9% of the cases), a slightly lower win-rate than for the entire case file sample.[86] This lower win-rate might be due to the fact that the majority of the consumers in the cases with repeat combinations were proceeding pro se (16 out of 28 cases, or 57.1%), a higher rate than for the entire case file sample.[87] Because pro se consumers tend to have a lower win-rate than consumers with attorneys,[88] it may be the lack of legal representation rather than the presence of a repeat pair that explains the lower win-rate in these cases.[89]

Second, if the repeat-player effect were due to case screening rather than arbitrator bias, one might expect that repeat businesses would be more likely to settle or otherwise resolve cases before an award than non-repeat businesses. To test for this possibility, we used the AAA consumer dataset, limited to the same period (April-December 2007) as the case file sample. Table 17 summarizes case dispositions (either as awarded or non-awarded) for cases in which consumer claimants brought claims against repeat(2) businesses.[90] Of consumer claims against repeat(2) businesses, 71.1% (133 of 187) were resolved prior to an award, while 54.6% (226 of

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[86] Thirteen of the 28 cases involved the same business respondent; consumers won some relief in roughly half of those cases (6 of 13, or 46.2%). Due to the small number of cases, we cannot reliably test this difference statistically.

[87] Due to the small number of cases, we cannot reliably test this difference statistically.

[88] *See supra* Part IV(1).D.3.

[89] The presence of a repeat business-arbitrator pair cannot explain the consumer's pro se status because the arbitrator would not be appointed until after the consumer filed the claim.

[90] We used the second definition of repeat business because only for repeat businesses so defined did we find any evidence of a repeat-player effect.

414) of consumer claims against non-repeat businesses were resolved prior to an award, a statistically significant difference.[91] Thus, consistent with the hypothesis that the repeat-player effect is due to case screening, we find that repeat businesses are much more likely to resolve cases prior to an award.

Table 17: Disposition of Cases by Consumer Claimants Against Repeat(2) and Non-Repeat Businesses

	Repeat(2) Business	Non-Repeat Business
Awarded	54 (28.9%)	188 (45.4%)
Non-Awarded	133 (71.1%)	226 (54.6%)
Total Cases	187	414

In short, while we find some indication of a repeat-player effect, the evidence seems to suggest that the repeat-player effect is more likely due to case screening by repeat businesses than arbitrator (or other) bias.

[91] The Pearson's Chi-squared statistic is 14.6401 (DF = 1 and p = 0.000), which allows us to reject the null hypothesis that whether a case is awarded is not associated with whether the respondent is a repeat(2) business.

TOPIC 2. AAA ENFORCEMENT OF THE CONSUMER DUE PROCESS PROTOCOL

This Part presents our findings on each of the research questions of interest concerning the American Arbitration Association's ("AAA's") enforcement of the Consumer Due Process Protocol: (1) to what extent do the consumer arbitration clauses in the case file sample comply with the Consumer Due Process Protocol? (2) how effective is AAA review of arbitration clauses for protocol compliance? (3) how frequently does the AAA refuse to administer consumer cases because of noncompliance with the Protocol? and (4) how do businesses respond to AAA enforcement efforts? In addition, we address several related questions: how frequent are post-dispute (as opposed to pre-dispute) agreements to arbitrate? how often do arbitration clauses contain class arbitration waivers? and how does the AAA administer cases arising out of the health care industry? Our focus is solely on the AAA. Although other providers also have promulgated due process protocols, we have no data on their enforcement practices.

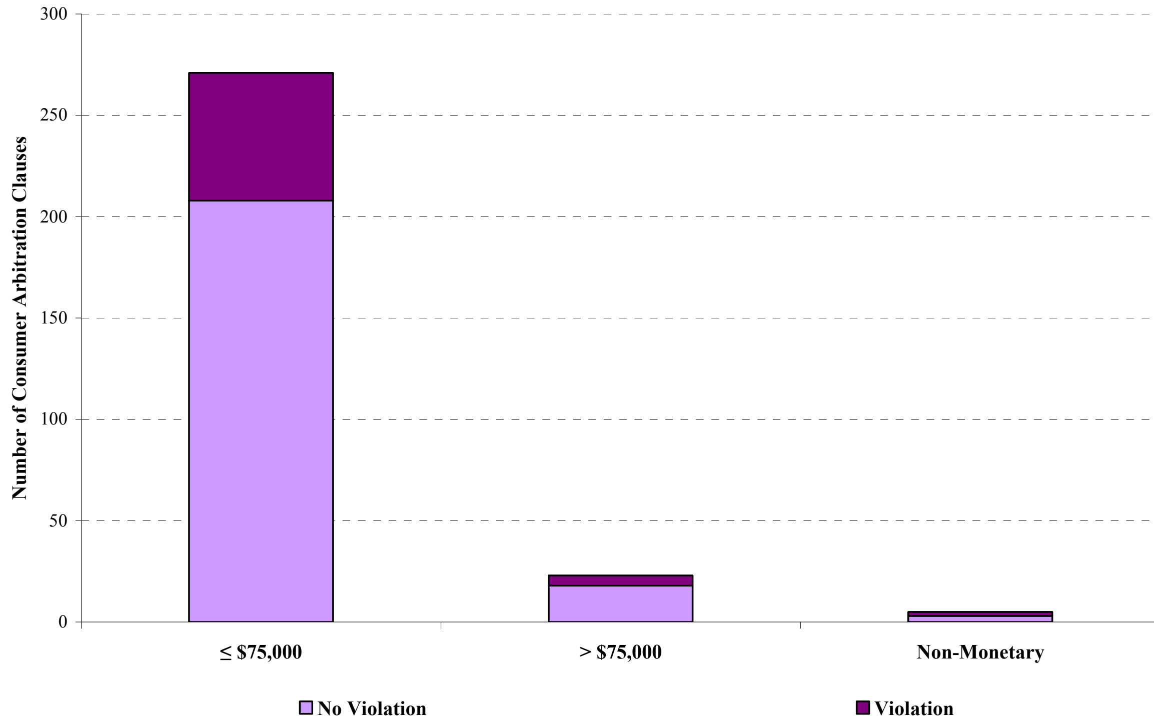
A. Problematic Clauses

The substantial majority of arbitration clauses we examined contained no provisions that violated the Consumer Due Process Protocol as applied by the AAA. Consistent with the AAA's treatment of the cases, we examined cases seeking $75,000 or less separately from cases seeking more than $75,000 (a much smaller group) and cases seeking non-monetary relief.

Of the 271 clauses in cases seeking $75,000 or less in the case file sample, 208 (or 76.8%) had no provision that violated the Protocol, as shown in Figure 1. Of the 23 clauses in cases seeking more than $75,000, 18 (or 78.3%) had no provisions that violated the Protocol. An additional five cases sought no monetary remedy; three of those five clauses (or 60.0%) had no problematic provisions. Overall, then, 229 of 299[1] clauses (or 76.6%) had no provisions that violated the Protocol.[2]

[1] As discussed above, two files for cases in the case file sample did not contain complete arbitration clauses. *See supra* Part III.B.

[2] A number of businesses appeared in the case file sample more than once, so that their arbitration clauses were counted multiple times. That may be the better approach, since it weights the clauses according to the frequency with which they gave rise to disputes that were arbitrated to an award. By comparison, 78.1% (150 of 192) of the clauses in the case file sample (counting each business's clause only once) included no problematic provisions under the Protocol.



There was no statistically significant difference in the frequency of protocol violations across categories of amount claimed[3] – even though the AAA does not review clauses for protocol compliance in cases seeking more than $75,000. This likely is true for several reasons. First, the Consumer Due Process Protocol applies to all consumer arbitrations, not just those seeking $75,000 or less. The difference is that protocol compliance is an issue for the arbitrator to decide in cases seeking more than $75,000 rather than a matter for review by the AAA. Second, businesses are unlikely to be able to differentiate in their standard form contract terms between consumers based on the amount of any likely claim. Third, to the extent businesses seek to develop a reputation for fair dealing, they will not distinguish between consumers in their contracting practices.

A total of seventy (or 23.4%) of the clauses in the case file sample contained at least one provision that violated the Consumer Due Process Protocol as applied by the AAA. Of those clauses, sixty-three (90.0%) included one problematic provision, five (7.1%) included two problematic provisions, and two (2.9%) included three problematic provisions.

[3] The Pearson's Chi-squared statistic is 0.0271 (DF = 1 and p = 0.8690), which means we fail to reject the null hypothesis that protocol violations are not associated with amount claimed if categorized into claims $75,000 or less and greater than $75,000. Including cases seeking non-monetary relief resulted in cells with a minimum expected count of less than five.

By far, the most common problematic provision was one that dealt with arbitration costs in a manner inconsistent with Principle 6 of the Protocol, which requires that arbitration be available at reasonable cost to the consumer.[4] Of the seventy clauses with at least one problematic provision, forty-eight (68.5%) contained a provision inconsistent with Principle 6. Typically, the provisions either required three arbitrators to resolve the dispute (thus increasing the cost over the cost of a single arbitrator) or specified that the consumer was to share the administrative fees with the business. (Under the AAA consumer procedures, the consumer pays a share of the arbitrator's fees but does not pay any of the AAA's administrative fees.[5]) The second most common type of problematic provision was one that limited the available remedies contrary to Principle 14,[6] usually by precluding or limiting the recovery of punitive damages. Of the seventy clauses, seventeen (or 24.3%) included such a provision. Other problematic clauses were much less common: eight clauses (or 11.4%) specified a potentially inconvenient location for the hearing contrary to Principle 7;[7] four clauses (or 5.7%) were inconsistent with the requirement of an impartial arbitrator under Principle 3;[8] and one clause (1.4%) limited discovery contrary to Principle 13.[9] Figure 2 summarizes the results. (Note that the totals here sum to more than the total number of cases because a few clauses contained more than one provision that violated the Protocol.)

[4] National Consumer Disputes Advisory Committee, Consumer Due Process Protocol princ. 6 (April 17, 1998), *available at* www.adr.org/sp.asp?id=22019 [hereinafter Consumer Due Process Protocol].

[5] *See supra* Part II.A.

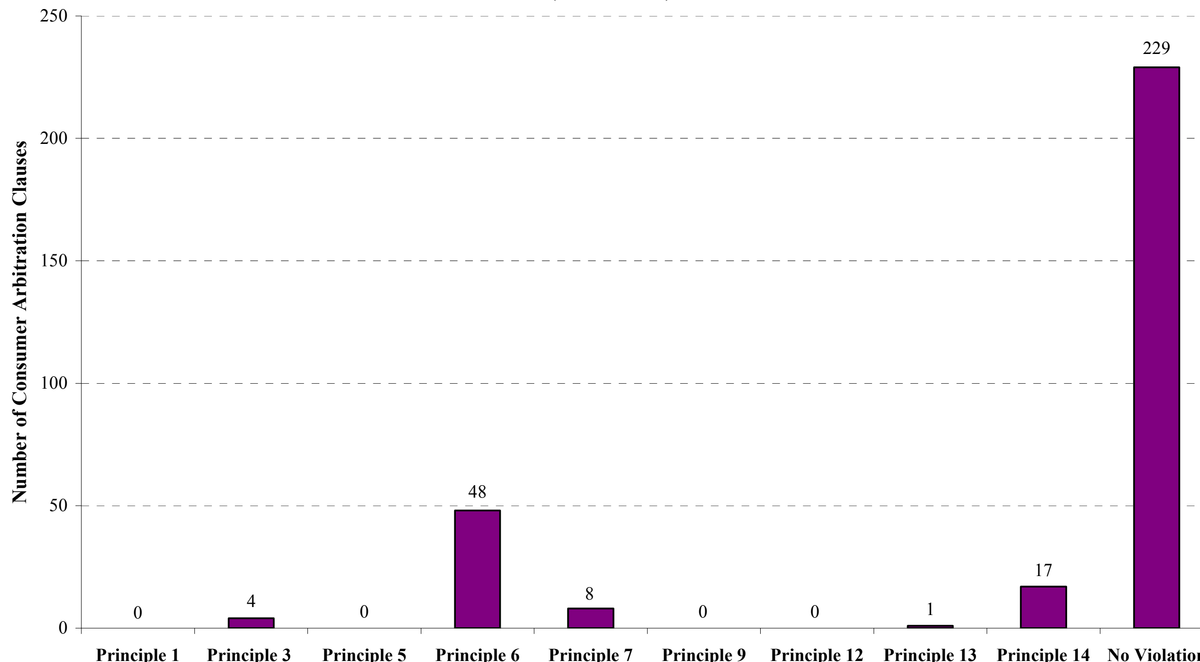
[6] Consumer Due Process Protocol, *supra* note 4, princ. 14.

[7] *Id.* princ. 7.

[8] *Id.* princ. 3.

[9] *Id.* princ. 13.

Figure 2:
Types of Protocol Violations in Consumer Arbitration Clauses
(Cases = 299)



Further description of the four clauses that were problematic under Principle 3 may be of interest, given that an impartial arbitrator is central to the fairness of an arbitration proceeding.[10] None of the clauses gave the business control over arbitrator selection or the pool of prospective arbitrators. Instead, all of the clauses were problematic because they required the arbitrator to have qualifications that might give rise to questions about the arbitrator's impartiality. Three of the clauses were in car sales contracts and required, at least under some circumstances, that the arbitrator be a certified master mechanic.[11] The other clause was in a home inspection contract and required that the arbitrator be an experienced member of one or another association of home inspectors.

Presumably, the concern is that to meet the qualification provisions would require prospective arbitrators to be employed by or engaged in the type of business involved in the arbitration. In addition, these required qualifications conflict with the AAA's policy of appointing only attorneys (with ten or more years of experience) or retired judges as arbitrators

[10] *E.g.*, Armendariz v. Foundation Health Psychcare Servs., Inc., 6 P.3d 669, 682 (Cal. 2000) (stating that the requirement of a "neutral arbitrator ... is essential to ensuring the integrity of the arbitration process") (*citing* Graham v. Scissor-Tale, Inc., 623 P.2d 165, 176 (Cal. 1981)).

[11] Two of the clauses required the presiding arbitrator to be a certified master mechanic when three arbitrators were selected; the requirement of three arbitrators itself is problematic under Principle 6 (reasonable cost) of the Protocol.

in consumer cases, unless the parties agree otherwise post-dispute. Although the AAA properly identified the provisions as ones that violated Principle 3 of the Protocol,[12] the provisions illustrate well the trade-off between expertise and impartiality that commonly arises in arbitration.[13]

Here, again, we face possible selection bias in the case file sample. Initially, clauses with provisions that violate the Consumer Due Process Protocol might discourage consumers from bringing claims (as might provisions that were waived by the business but never modified in the contract), so our results might understate the frequency of problematic provisions. We have no data on how frequently consumers fail to bring claims, so we cannot test for this possibility. As an imperfect proxy, we can examine whether damages limitations seem to deter consumers from asserting claims for punitive damages. In the case file sample, consumers sought punitive damages in 6 of 17 (or 35.3%) cases in which the arbitration clause contained a damages limitation, and in 72 of 282 (or 25.5%) cases in which the arbitration clause did not. Thus, consumers were more likely to assert a claim for punitive damages when facing a damages limitation than when not facing a damages limitation (although the number of cases with damages limitations is too small for reliable statistical testing). Certainly asserting a claim for punitive damages after having brought a claim in arbitration is a much lower cost activity than bringing a claim in the first place. Thus, as noted, this is an imperfect proxy but the results suggest at least one circumstance in which a standard form contract provision may not discourage consumers from asserting a claim.

We also considered carefully the possibility that arbitration clauses may have had more (or fewer) problematic provisions, and that AAA compliance review might have been less (or more) effective, in non-awarded cases than in awarded cases – i.e., that our results are subject to selection bias because we studied only awarded cases. Several considerations give us some degree of confidence that this source of selection bias is not a serious problem with our results.

First, using the AAA consumer dataset for all cases closed from April through December 2007, we are able to determine that the non-awarded cases appear to have been administered properly under the Protocol, at least so far as the administrative fees assessed to consumers.[14] The most common type of protocol violation in the case file sample (awarded cases) was a violation of Principle 6, which requires that the cost of arbitration to consumers be reasonable.[15] The contract provisions that violated this Principle either sought to impose on the consumer a

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[12] Consumer Due Process Protocol, *supra* note 4, princ. 3 (“Independent and Impartial Neutral”).

[13] Sphere Drake Ins., Ltd. v. All Am. Life Ins. Co., 307 F.3d 617, 620 (7th Cir. 2002) (“The more experience the panel has, and the smaller the number of repeat players, the more likely it is that the panel will contain some actual or potential friends, counselors, or business rivals of the parties. Yet all participants may think the expertise-impartiality tradeoff worthwhile.”); Stephen J. Ware, *Arbitration and Unconscionability After* Doctor’s Associates, Inc. v. Casarotto, 31 WAKE FOREST L. REV. 1001, 1022 (1996) (describing “technical areas” such as medicine in which “[t]hose who can understand the facts will be found disproportionately among specialists in the field, i.e., those with a presumed bias”).

[14] Although the AAA consumer dataset has slightly lower accuracy rates for AAA administrative fees assessed per party than other variables, it is the only data available for this purpose.

[15] Consumer Due Process Protocol, *supra* note 4, princ. 6.

greater share of costs than permitted under the AAA Consumer Rules, or required three arbitrators to resolve the dispute.[16] In 353 out of 361 (97.8%) of the non-awarded cases with claims seeking $75,000 or less, consumers paid no administrative fees (as provided in the AAA Consumer Arbitration Rules). In seven of the eight cases in which the consumer paid fees, it appears that the business may have failed to pay its share of fees and that the consumer chose to advance the fees in order to proceed with the case. In one case the consumer and the business shared the fees.[17] Moreover, in all of the non-awarded cases with claims seeking $75,000 or less, one arbitrator (rather than three) was appointed.[18] In short, the cases appear to have been administered properly under the cost provisions of the Protocol and the AAA Consumer Rules. For other principles of the Protocol, evaluating compliance is difficult, if not impossible, without examining the parties' arbitration clause.

Second, we compared the businesses involved in the non-awarded cases from the AAA consumer dataset closed from April through December 2007 to the businesses involved in the awarded cases in the case file sample, as well as to the AAA business list. Of the 361 non-awarded cases seeking $75,000 or less, 158 involved businesses that matched those in the case file sample. None of the clauses in those cases included unwaived protocol violations. Another 144 cases involved businesses that were classified as acceptable on the AAA business list. As to these 302 cases (83.7% of the 361 non-awarded cases), all indications are that the arbitration clause did not include an unwaived protocol violation. Another thirty-nine cases involved businesses that did not appear on the AAA business list.[19] For the case file sample, thirty-eight cases involved businesses that did not appear on the AAA business list, a larger percentage than for the non-awarded cases. The remaining twenty cases involved businesses that were classified as unacceptable on the AAA business list. Based on the date of their most recent status change on the AAA business list, fifteen of those businesses appear to have been added after the non-awarded case we were considering was filed. For the other five, it is possible that they could have been administered under a court order or a post-dispute arbitration agreement. But even assuming that the AAA should have refused to administer all of those cases, the percentage of unwaived violations among the non-awarded cases would have been 5 out of 361, or 1.4%.

Obviously, we cannot be certain that the frequency of protocol violations and (more importantly) unwaived protocol violations is the same in non-awarded cases as awarded cases. But we have no reason to believe that our focus on awarded cases results in any significant bias to our results.

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[16] *See supra* Part II.C.

[17] We have no data on the share of the arbitrator's fees paid by the consumer.

[18] If any; many cases were closed before any arbitrators were appointed.

[19] The businesses likely should have been reported so that they could be added to the AAA business list. But the failure to do so should not have affected parties in future cases because the case intake staff in each case is to review the arbitration clause without regard to the businesses' status on the AAA business list.

B. AAA Review of Protocol Compliance

As discussed above, AAA review for protocol compliance is limited to cases seeking $75,000 or less in compensatory damages.[20] We have 271 such cases in the case file sample, 63 of which involved an arbitration clause with a problematic provision. The next question is the extent to which the AAA properly identified and responded to those problematic provisions by requiring a waiver from the business.[21]

Initially, we examined the type of procedure by which the AAA made the determination of protocol compliance -- i.e., how often did businesses obtain advance review of their arbitration clause for compliance with the Consumer Due Process Protocol? We found that in the vast majority of cases, AAA review for protocol compliance occurs after a dispute arises. Very few businesses obtained approval of their consumer arbitration clauses before a dispute arose. Of the 1706 businesses listed as acceptable on the AAA business list,[22] 15 (or 0.9%) obtained AAA approval of their arbitration clause before a dispute arose.[23] The potential benefits of advance review were rarely obtained in consumer cases.[24]

We then evaluated the effectiveness of AAA post-dispute review for protocol compliance. Of the 271 consumer cases from the case file sample with a demand amount of $75,000 or less, five (1.8%) included an arbitration clause that violated the Consumer Due Process Protocol as applied by the AAA but had not been waived by the business.[25] Table 1 summarizes the findings. Most cases (76.8%) arose out of clauses that did not violate the Protocol, as noted above.[26] Of those cases with clauses that did violate the Protocol, the AAA obtained a waiver from the business before administering the case in 51 cases (18.8%). The

[20] In other cases, the Protocol continues to apply, but application of the Protocol is a matter for the arbitrator. *See supra* Part II.B.

[21] For discussion of the possibility of selection bias due to our focus on awarded rather than non-awarded cases, see *supra* Part IV(2).A.

[22] In our review of the documentation supporting the AAA business list, we identified a number of businesses that were on the AAA business list but for which there were no supporting files. This was either because the business was no longer treated as a consumer business (70 businesses, typically involving the home construction industry) or else because the business had been added to the AAA business list before the AAA began maintaining the supporting files (10 businesses). We excluded both types of businesses from the analysis. Because we did not perform a similar review of many of the files of businesses listed as acceptable, the number of such businesses (1706) may be slightly overstated. Any such difference is immaterial here, however.

[23] The AAA business list shows only businesses that obtained advance approval of their consumer arbitration clause. It does not show businesses that sought approval but were turned down because their clause violated the Protocol. We have no information on how many clauses the AAA refused to approve through the advance review process.

[24] We do not include as advance review cases those cases in which the party sought and obtained AAA approval of changes to its arbitration clause in response to the AAA's determination that a prior version of the clause violated the Protocol. Those types of cases are relatively common, as discussed *infra* Part IV(2).D.

[25] An alternative measurement would be to calculate a false negative rate – the number of unwaived violations (false negatives) as a percentage of all clauses with protocol violations. FEDERAL JUDICIAL CENTER, REFERENCE MANUAL ON SCIENTIFIC EVIDENCE 482 (2d ed. 2002). So calculated, the false negative rate here is 5 out of 63 cases, or 7.9%.

[26] *See supra* Part IV(2).A.

AAA handled the protocol violation in three cases (1.1%) administratively.[27] In four cases (1.5%), the AAA administered the case without a waiver because the case had been ordered to arbitration by a court.[28] Again, only five cases involved an unwaived protocol violation. Stated otherwise, in 266 out of 271 cases (98.2%), the arbitration clause either complied with the Due Process Protocol or the non-compliance was properly identified and responded to by the AAA.

Table 1: AAA Review of Protocol Compliance

	Number of Cases (% of Total Cases)
No protocol violation	208 (76.8%)
Provision waived by business	51 (18.8%)
Violation handled administratively	3 (1.1%)
Case administered per court order	4 (1.5%)
Unwaived violation	5 (1.8%)
Total Cases (seeking $75,000 or less)	**271**

We examined the case files for those five cases to determine what happened in the case.[29] Table 2 summarizes key characteristics of the cases.

[27] In all three cases, the AAA case intake staff identified the provision that violated the protocol. In two cases, the provision raised a cost issue (in one, by requiring three arbitrators for claims above $20,000, and in the other by requiring the parties to share the costs of arbitration equally). In both cases, the AAA administered the case under the Protocol and contacted the business separately to request it to update the clause. In the other case, the parties had entered into two arbitration agreements, one of which provided for AAA arbitration but included a punitive damages waiver and required the hearing to be held at the business's location. The other clause did not mention the AAA but also did not contain any provisions problematic under the Protocol. The AAA administered the case under the Protocol and contacted the business separately to address the protocol issues.

[28] The AAA's usual practice in such cases is to administer the case pursuant to the Protocol, *see supra* Part II.C, so that the unwaived violation may have had little effect on the proceedings.

[29] Mark Weidemaier raises the possibility that the consumer might waive the protections of the protocol and permit the arbitration to go forward despite the objectionable term. W. Mark C. Weidemaier, *The Arbitration Clause in Context: How Contract Terms Do (and Do Not) Define the Process*, 40 CREIGHTON L. REV. 655, 662 & n.26 (2007). He indicates that JAMS permits such waivers, and that such a waiver is equivalent to a post-dispute agreement to arbitrate, which should be permissible. *Id.*; *see also* Consumer Due Process Protocol, *supra* note 4, Reporter's Comments to princ. 1 ("Assuming they have sufficient knowledge and understanding of the rights they are waiving, however, Consumers may waive compliance with these Principles after a dispute has arisen."). We found no cases in the case file sample in which the AAA permitted a case to go forward based on a consumer waiver of the protections of the Protocol when a provision in an arbitration clause violated the Protocol. We did find seven cases in which the consumer voluntarily paid the business's share of the arbitration fees when the business failed to do so, cases in which the business's behavior rather than the arbitration clause was problematic.

Table 2: Unwaived Protocol Violations

	Type of Violation	Events in Case
Case 1	Location provision	Consumer did not respond to demand for arbitration
Case 2	Remedy limitation	No claim for punitive damages in case
Case 3	Remedy limitation	No claim for punitive damages in case
Case 4	Location provision and remedy limitation	AAA identified location provision; issue not resolved prior to hearing. AAA did not identify remedy limitation; no claim for punitive damages in case
Case 5	Remedy limitation	Arbitrator relied on consequential damages exclusion as alternative basis for award

In Case 1, the clause provided that the arbitration hearing was to be held at the business's location, which was distant from the consumer's home.[30] The consumer did not respond to the business's demand for arbitration.[31] In Cases 2 and 3, the arbitration clause contained a punitive damages waiver;[32] the claimant in the cases did not seek punitive damages.[33]

Case 4 was complicated. The arbitration clause contained two provisions that violated the Due Process Protocol: a provision limiting the recovery of punitive damages and a provision selecting the business's home as the location for the arbitration hearing. The AAA did not identify the remedy limitation. The business claimant was not seeking punitive damages and the consumer did not bring a counterclaim.

The AAA identified the location provision as a Protocol violation. The business objected, arguing that the dispute was not a consumer dispute so the Protocol did not apply. The AAA concluded that the arbitrator would have to decide whether the Protocol applied, and proceeded to appoint an arbitrator from the state in which the business was located. Meanwhile, the consumer filed suit in her home state challenging the enforceability of the arbitration agreement, resulting in the arbitration being held in abeyance for over a year. Eventually, the trial court held that the dispute had to be arbitrated, and the state appellate court affirmed. Meanwhile, the consumer changed counsel. The result was that no one raised the location issue until right before the hearing was held, at which point the arbitrator deemed it too late to reschedule the hearing.

In the award, the arbitrator did hold that the case was a consumer case and that the Protocol applied. Relying on the Protocol, the arbitrator then refused to enforce a "loser-pays" provision in the arbitration clause, which would have required the consumer (who lost in the

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[30] *See* Consumer Due Process Protocol, *supra* note 4, princ. 7.

[31] The business was the claimant in the case, and was seeking to recover the amount it allegedly was owed for its services.

[32] *See* Consumer Due Process Protocol, *supra* note 4, princ. 14.

[33] On whether consumers might be discouraged from seeking punitive damages by the presence of a punitive damages waiver, see *supra* Part IV(2).A.

arbitration) to pay all the business's attorneys' fees. In so holding, the arbitrator went beyond the AAA's administrative application of Principle 6 of the Protocol, under which the AAA does not deem loser-pays provisions to violate the Protocol.[34]

The provision in Case 5 that violated the Protocol was a remedy limitation – a provision that precluded the recovery of consequential or special damages. It appears that the AAA identified the violation and handled the issue administratively,[35] but there is no evidence that it obtained a waiver of the provision in the arbitration proceeding itself. In the award, the arbitrator relied on the remedy limitation to preclude the consumer's recovery in part, finding no gross negligence by the business that would have made the remedy limitation inapplicable. The arbitrator also concluded that the consumer had failed to establish the business's liability for damages in the first place, so that the remedy limitation was only an alternative basis for the business to prevail.

One final note: as Table 2 illustrates, the most common type of unwaived violation was a provision limiting in some way the amount of damages the consumer could recover in arbitration. Typically, but not always, these provisions preclude the award of punitive damages in arbitration. There are several possible explanations for why remedy limitations are the most commonly overlooked protocol violation. First, the provisions vary widely in language – ranging from a waiver of all punitive damages recovery to some sort of cap on (but not waiver of) damages recovery. The variations in the type of the provision may make problematic provisions more difficult to identify. Second, it may not always be clear whether the remedy limitation is in the arbitration clause (and hence subject to protocol compliance review) or merely near the arbitration clause and perhaps not subject to AAA review. Third, as discussed above, the AAA has adopted a broad interpretation of Principle 14 of the Consumer Due Process Protocol.[36] Under a narrow reading of the Protocol, a remedy limitation would be permissible so long as the limitation was lawful under the governing law. But the AAA applies the Protocol more broadly, refusing to administer arbitrations arising out of clauses with remedy limitations even if the remedy limitation would be permitted under the governing law. If consumers (or arbitrators) are not aware of the broader interpretation, they may not raise the protocol issue in cases in which the AAA does not itself raise the issue.[37]

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[34] Except in cases from California, in which AAA policy is to follow California law on loser-pays provisions. *See infra* App. 3, n.8.

[35] The AAA eventually classified the business as unacceptable on the AAA business list when it failed to respond to requests that it update its arbitration clause.

[36] *See* American Arbitration Association, Fair Play: Perspectives from American Arbitration Association on Consumer and Employment Arbitration 34 (Jan. 2003) ("There may be circumstances where AAA will not provide administration even if a provision may be legally enforceable, as the standard followed by AAA may be higher than the law allows.").

[37] That said, cases in which the consumer or the consumer's attorney assert a protocol violation appeared to be rare in the case file sample, although if the issue was raised with the arbitrator there may have been no record of it in the files we reviewed. Case 4 above, *see supra* text accompanying note 34, was unusual in this regard.

C. Refusal to Administer Cases

When a business refuses to waive a provision that violates the Consumer Due Process Protocol, or when the business fails to pay its share of the arbitration costs in an arbitration,[38] the AAA's policy is to refuse to administer the case.[39] The result is that the case filings and fee are returned to the claimant, and the business is classified as unacceptable on the AAA business list. In addition, the AAA refuses to administer future consumer cases involving the business, at least until the business provides a blanket waiver of any provisions that violate the Protocol.

From the AAA pre-filing cases[40] we identified 129 cases that likely were cases the AAA had refused to administer because of protocol violations in 2007.[41] Of those cases, we were able to confirm that eighty-five (65.9%) in fact were protocol-related refusals to administer.[42] The other forty-four cases (34.1%) likely also were protocol-related refusals to administer, but we were unable to confirm the status of the cases definitively.[43] Moreover, there may be other refusals to administer that our methods did not uncover. Accordingly, we can confidently say that in 2007 the AAA refused to administer at least 85 cases, and probably at least 129 cases, due to violations of the Consumer Due Process Protocol. We did not examine data from other years, but we have no reason to believe the results from 2007 are atypical.

Those cases constitute 9.4% of the 1378 consumer cases closed by the AAA during 2007.[44] The total consumer cases closed in 2007 consisted of 439 cases (31.9%) that resulted in an award;[45] 544 cases (39.5%) that did not result in an award; and 395 pre-filing cases (28.7%)

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[38] If the business refuses to pay its share of the arbitration fees, the consumer has the option of paying the fees and then trying to collect them later from the business. American Arbitration Association, Supplementary Procedures for the Resolution of Consumer-Related Disputes, Rule C-8 ("Arbitrator Fees") (effective Sept. 15, 2005), *available at* http://www.adr.org/sp.asp?id=22014 ("If a party fails to pay its fees and share of the administrative fee or the arbitrator compensation deposit, the other party may advance such funds. The arbitrator may assess these costs in the award.") If the consumer pays the arbitration fees, the AAA will administer the case. As noted previously, *see supra* note 29, we found seven cases in the case file sample in which the consumer paid some or all of the business's arbitration costs when the business had failed to do so. Thus, only if the business refuses to pay its share of the fees and the consumer declines to advance the amount of the fee will the case be rejected while in pre-filing status.

[39] *See supra* Part II.B.

[40] *See supra* Part III.B.

[41] We identified the cases by comparing the businesses involved in the case to those classified as unacceptable on the AAA business list. *See supra* Part III.B.

[42] We confirmed the status of the cases by examining the AAA files documenting the AAA business list.

[43] The primary distinction between the cases we could confirm and those we could not was whether the business was or was not already listed as unacceptable. For businesses that were not already on the AAA business list, the AAA created a file containing the documentation of the Protocol violation. That documentation included the name of the case, which enabled us to verify the entry on the list of AAA pre-filing cases. For businesses that already were listed as unacceptable, the AAA does not add additional documentation to the files for subsequent refusals to administer. Accordingly, for those cases we were unable to determine definitively the reason the AAA refused to administer the case. Nonetheless, it is quite likely that the cases are ones that the AAA refused to administer under the Protocol.

[44] The cases closed in 2007 consist of the cases in the AAA consumer dataset and the AAA pre-filing cases.

[45] The case file sample includes 301 of these cases, closed between April and December 2007. The number for all of 2007 is adjusted for several exclusions from the case file sample, as described *supra* Part III.B.

that never met the AAA's filing requirements, either because they settled very early on, because the claimant failed to meet the filing requirements, or because the AAA refused to administer the case due to protocol violations.

Various types of protocol violations gave rise to the refusals to administer, as shown in Table 3. The AAA refused to administer forty-four cases (of 129, or 34.1%) because the business already was classified as unacceptable on the AAA business list. The remaining cases (85 of 129, or 65.9%) involved businesses that were not already classified as unacceptable. Of those cases, the AAA refused to administer fifty-five because the business failed to pay its share of the arbitration fees and the rest (thirty cases) because the arbitration clause violated the Protocol.[46]

Table 3: AAA Refusals to Administer, 2007

Reason for Refusal to Administer	Number of Cases (% of Total Cases)
Business failed to pay fees	55 (42.6%)
Business already classified as unacceptable	44 (34.1%)
Cost issue	11 (8.5%)
Remedy limitation	8 (6.2%)
Location issue	6 (4.7%)
Multiple violations	5 (3.9%)
Total	**129**

Although we are able to estimate with some degree of confidence the number of cases that the AAA refused to administer for protocol violations, we have no information on what happened to the cases afterwards. In some cases the dispute might nonetheless end up in AAA arbitration. If a business subsequently resolves the protocol issue, the case may be refiled with the AAA. Or a party might obtain a court order requiring the case to be arbitrated, which the AAA will honor.[47] We have no evidence, however, whether any of the 2007 refusals to administer were refiled with the AAA or were administered pursuant to a court order.

Another possibility is that the case was subsequently filed with another arbitration provider. Some arbitration clauses give the claimant the choice among several alternative

[46] The provisions violated were Principle 6 ("Reasonable Cost") (11 cases); Principle 14 ("Arbitral Remedies") (8 cases); Principle 7 ("Reasonably Convenient Location") (6 cases); and multiple provisions (5 cases). A business's failure to pay its share of the arbitration fees has the same effect in that case as a contract term that imposes all costs on the consumer while permitting the consumer to recover the fees from the business. The failure to pay differs from such a contract clause, however, because it is limited to the particular consumer dispute. Accordingly, we classify the failure to pay separately from other protocol violations.

[47] *See supra* Part II.B.

arbitration providers, and specify that if one will not administer the case it should be filed instead with a different one.[48] Again, we do not know whether any of the 2007 refusals to administer were subsequently filed with another arbitration provider.

A third possibility is that the case might end up in court. A handful of reported cases have addressed whether a party can litigate when the AAA has refused to administer the arbitration, with divided results. In *Brown v. Dillard's, Inc.*[49] the Ninth Circuit held that a business that refuses to pay its share of arbitration fees materially breaches the arbitration agreement, permitting the consumer to file suit in court.[50] The facts of *Dillard's* match the most common type of case in which the AAA refuses to administer a consumer arbitration.[51] In those cases, under *Dillard's*, the consumers could assert their claim against the business in court.[52]

A more difficult question is whether a consumer can go to court when the AAA refuses to administer a case because of a provision in the arbitration clause that violates the Protocol. The courts are split. In *Martinez v. Master Protection Corp.*,[53] the AAA had refused to administer an employment arbitration agreement because of provisions inconsistent with the Employment Due Process Protocol.[54] The employee then sought to assert his claim in court, while the business sought to have the court appoint an arbitrator. The California Court of Appeal held that the trial court had erred in appointing an arbitrator, stating that California arbitration law "does not permit the trial court to choose an alternative forum when the chosen forum refuses to hear the case."[55]

Similarly, in *Mathews v. Life Care Centers of America, Inc.*,[56] the AAA relied on the Health Care Due Process Protocol to refuse to administer a negligence and elder abuse claim against a nursing home. But in this case, the Arizona Court of Appeals affirmed the trial court's order compelling arbitration. The court of appeals explained that the trial court correctly relied on Arizona arbitration law to appoint an arbitrator when the AAA would not do so because "the record contains no evidence that an AAA arbitration panel was a significant or material term to [the claimant] when she executed the Agreement."[57] If future courts were to follow the approach

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[48] Again, we have no data on the extent to which such clauses are used in consumer contracts; we only know anecdotally that they exist.

[49] 430 F.3d 1004 (9th Cir. 2005).

[50] *Id.* at 1010.

[51] *See supra* text accompanying note 46.

[52] In Cox v. Ocean View Hotel Corp., 533 F.3d 1114 (9th Cir. 2008), the Ninth Circuit distinguished *Dillard's* on the ground that the employee in *Ocean View* never filed a demand for arbitration with the AAA. *Id.* at 1123-24. Instead, the employee had merely written to the employer asserting a claim of sex discrimination and requesting the employer to "provide the date and time of the arbitration hearing" to the employee's attorney. *Id.* at 1118.

[53] 12 Cal Rptr 3d 663 (Cal. Ct. App. 2004) (alternate holding)

[54] *Id.* at 674.

[55] *Id.* at 675; *see also In re* Salomon Inc. Shareholders' Derivative Litigation, 68 F.3d 554, 561 (2d Cir. 1995) ("None of these cases, however, stands for the proposition that district courts may use § 5 to circumvent the parties' designation of an exclusive arbitral forum.").

[56] 177 P.3d 867 (Ariz. Ct. App. 2008).

[57] *Id.* at 872. *Cf.* Brown v. ITT Consumer Fin'l Corp., 211 F.3d 1217, 1222 (11th Cir. 2000) (stating that when chosen forum is unavailable, arbitration agreement is not void unless the chosen forum "was an integral part of the

of the Ninth Circuit in *Dillard's* and the California Court of Appeal in *Martinez*, rather than that of the Arizona Court of Appeals in *Mathews*, they would reinforce the AAA's enforcement of the Protocols and give businesses a greater incentive to comply.

Finally, the case may end up not being brought at all. We have no data on how frequently cases end up being dropped after the AAA refuses to administer the arbitration.[58]

Overall, then, we find that in enforcing the Consumer Due Process Protocol, the AAA refused to administer at least 85 consumer cases, and likely 129 consumer cases – amounting to 9.4% of its consumer caseload – in 2007. We have no information, however, on what happened to those cases after the AAA refused to administer them.

D. Business Responses to AAA Compliance Review

This Section addresses how businesses respond to the AAA's enforcement of the Due Process Protocol. Of course, most cases in the case file sample do not present a protocol violation in the first place; most businesses comply with the protocol in advance of AAA review. Thus, as explained above, 76.6% of the cases in the case file sample contained no provision that violated the Protocol as applied by the AAA. Similarly, the number of businesses classified as "acceptable" on the AAA business list (i.e., the 1706 businesses for which it will administer consumer arbitrations) is more than two-and-one-half times as large as the number of businesses (647) classified as "unacceptable."[59]

One possibility is that the business might respond by waiving the violation in the pending case and/or revising the clause for future cases.[60] Since the AAA began reviewing consumer clauses for protocol violations, over 150 businesses have updated their arbitration clauses to remove a protocol violation and/or have waived such provisions for future cases, as shown in Table 4.[61] In a handful of those cases (five), the business waived future violations but then

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agreement to arbitrate").

[58] The court of appeals in *Dillard's* asserted that "[m]any people in Brown's position would simply have given up." Brown v. Dillard's, Inc., 430 F.3d 1004, 1030 (9th Cir. 2005).

[59] As discussed above, while we examined occasional files of businesses classified as acceptable on the AAA business list, we did not subject those businesses to the same comprehensive review as those classified as unacceptable. As a result, there may be businesses so classified that no longer arbitrate using the AAA's consumer arbitration rules. *See supra* Part III.B. Conversely, however, AAA case intake staff may be less likely to make sure that acceptable businesses are added to the AAA business list than unacceptable businesses; clauses from acceptable businesses need to be reviewed again each time the business is involved in a consumer arbitration in any event. *See supra* Part II.B. Thus, the number of businesses that have been involved in AAA consumer arbitrations with clauses that fully comply with the protocol may be either more or less than 1706, although likely not materially so in either direction.

[60] As between the two, revising the clause would seem preferable, as it reduces the possibility consumers might not file a claim and thus not learn of the waiver.

[61] As Mark Weidemaier explains, businesses may have an incentive to waive violations and change their clause to comply with the Due Process Protocol because of the "legitimacy" provided by arbitrating with a well-respected arbitration provider. Weidemaier, *supra* note 29, at 661 ("providers may also sell legitimacy. Arbitration

indicated it would remove the AAA from its arbitration clause. In one case the business waived future violations and then informed the AAA it was eliminating its arbitration clause altogether. Those businesses are in addition to over 1550 businesses with arbitration clauses that did not violate the Protocol.

By far the most common protocol issue in these cases involved arbitration costs. Sixty of the clauses presented only cost issues and a number more raised cost issues together with other protocol violations.[62] Eliminating provisions raising cost issues (either by waiver or updating the clause) likely would benefit all consumers who arbitrate against the company under the revised clause. Otherwise the consumer would either have had to pay a larger share of the arbitration costs or else contribute toward the fees of three arbitrators instead of one. In Mark Weidemaier's words: "these are cases in which the due process rules yield a clear benefit to individual claimants."[63] By comparison, not every consumer will benefit from the elimination of a remedy limitation or a location provision (requiring the hearing to be held at a distant location); not every consumer will have a claim for punitive damages and not every consumer will want an in-person hearing. Nonetheless, for those consumers who do, the AAA's protocol review process again has clear benefits.

Table 4: Business Responses to AAA Protocol Compliance, On Business List As "Acceptable"

Business Response	Total Cases
No Response Necessary	1539
Updated Clause	95
Waived Violation for Future Cases	51
Waiver and Removed AAA	5
Waiver and Removed Arbitration	1
Sought Advance Review	15
Total "Acceptable" Businesses	**1706**

A second possibility is that the business might respond by doing nothing -- either not participating in the case or not updating its clause for future cases. A number of businesses simply fail to pay their share of arbitration fees in a case or do not respond to requests by the AAA to waive any problematic provisions under the Protocol. As shown in Table 5, 358

clauses are often challenged by parties who would prefer to litigate their disputes in court, and the designation of a recognized provider may help immunize the arbitration agreement from challenge.").

[62] *See infra* Part IV(2) Annex A.

[63] Weidemaier, *supra* note 29, at 670 (distinguishing between cases in which "the offending term serves no function" and "'meaningful' waivers" of provisions that violate the protocols).

businesses are classified as unacceptable on the AAA business list for these reasons. Most commonly, the business failed or refused to pay its share of arbitration costs even though its arbitration clause fully complied with the Protocol. Somewhat less commonly, the business failed to pay arbitration fees and to waive a problematic provision under the Protocol as well.[64]

Table 5: Business Responses to AAA Protocol Compliance, On Business List As "Unacceptable"

Business Response	Total Cases
Did Not Respond to Case Initiation	358
Did Not Respond to AAA Contact	201
Refused to Pay, Update Clause, or Waive	61
Notified Removing AAA	13
Removing Arbitration Clause	1
Out of Business	10
Unable to Locate	3
Total "Unacceptable" Businesses	**647**

Another 201 businesses are classified as unacceptable because they did not respond to a subsequent contact by the AAA seeking to have the business update its arbitration clause to remove a protocol violation. An additional 61 businesses refused to comply with the protocol, either by refusing to pay their share of arbitration fees or refusing to waive a protocol violation or update their arbitration clause.[65]

A third possibility is that the business might remove the arbitration clause altogether from its consumer contracts or replace the AAA with a different arbitration provider. We have limited ability to determine the extent to which companies in fact switched to other arbitration providers or removed arbitration clauses from their consumer contracts. A business that changes its clause in either of these ways presumably would no longer show up in the case file sample. But we would be unable to determine whether their failure to show up was due to their switching arbitration providers or whether they simply did not have any disputes with consumers go to arbitration during the period we studied.[66]

[64] The types of provisions that businesses most commonly refused to waive or change were provisions addressing arbitration costs, specifying the location of the arbitration hearing, and limiting remedies. *See infra* Part IV(2) Annex B.

[65] Although we attempted to follow the classification scheme in the AAA business list by distinguishing between cases in which the business did not respond and cases in which the business refused to comply, one should not place too much significance on these differing classifications. As a practical matter, the result is the same in both types of cases: the business does not pay its share of fees and/or the problematic provision remains.

[66] The remaining categories shown in Table 5 are that the business went "out of business" (ten cases) or that

The AAA does record on the AAA business list those businesses that inform the AAA they have removed or will be removing the AAA (or arbitration in general) from their dispute resolution clause. The number of such businesses is quite small. Of the 647 businesses listed on the AAA business list as unacceptable, thirteen (or 2.0%) informed the AAA that they had removed or would be removing the AAA from their clause, and one (or 0.15%) informed the AAA that its dispute resolution clause no longer provided for arbitration. Another five businesses (of 1706, or 0.3%) listed as acceptable waived any protocol violations but then informed the AAA they would no longer provide for AAA arbitration in their dispute resolution clause. And one business (0.05%) listed as acceptable waived any protocol violations but then removed arbitration altogether from its consumer contracts. Overall, then, eighteen businesses (0.8%) of those on the AAA business list informed the AAA that they would no longer provide for AAA arbitration, and two businesses (0.08%) removed their arbitration clause altogether.

But of course not all businesses that switch dispute resolution providers (or remove arbitration altogether from their contract) necessarily inform the AAA that they are doing so. Any number of businesses classified as unacceptable by the AAA might have changed their contracts without informing the AAA.

Another way to identify businesses that switch away from the AAA is to look at data from other arbitration providers. California law requires arbitration providers to disclose basic information about their consumer arbitration cases, including the name of the business party.[67] As others have noted, the disclosure documents are not always in the most useful format for researchers.[68] But Public Citizen has compiled data from the National Arbitration Forum's ("NAF's") California disclosures into a spreadsheet available on Public Citizen's web site.[69] We matched the businesses that brought NAF arbitrations in California against the AAA's list of unacceptable businesses to try to identify businesses that might have switched from the AAA to NAF.

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the AAA was unable to locate the business (three cases).

[67] CAL. CODE CIV. PROC. § 1281.96.

[68] California Dispute Resolution Institute, Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure 27 (Aug. 2004) ("Many providers posted required information on their websites. However, a number of data points were not provided. Some providers, however, posted data that resulted in inconsistent, incomplete and/or ambiguous data.").

[69] *See* NAF California Data Jan. 2003 to Mar. 2007, *available at* www.citizen.org/congress/civjus/arbitration/NAFCalifornia.xls. Public Citizen describes the spreadsheet as follows:

> This spreadsheet consists of the information on 33,948 National Arbitration Forum cases conducted in California between Jan. 1, 2003 and Mar. 31, 2007. It was compiled from quarterly reports that the National Arbitration Forum posted in a difficult-to-find place on its Web site in Adobe Systems' Portable Document Format (PDF). Public Citizen converted them to an Excel spreadsheet so California residents and others interested in binding mandatory arbitration may do their own analysis of NAF arbitrations in California and of the records of NAF arbitrators.

Public Citizen, Binding Mandatory Arbitration and Access to Courts, www.tradewatch.org/congress/civjus/arbitration/ (last visited Nov. 10, 2008).

Of the 647 businesses classified as unacceptable on the AAA business list, we found five (or 0.8%) that were subsequently listed as arbitrating cases using the NAF during the period covered. The combined caseload of those businesses before the NAF was small; they were not major contributors to the NAF caseload.[70] Interestingly, three of the five businesses were ones that had informed the AAA that they would no longer use AAA arbitration in future cases. Two businesses classified by the AAA as unacceptable showed up in the NAF cases that had not already informed the AAA they were switching providers. And one of those two appeared before the AAA because of a claim it had acquired from another business, arising out of a contract providing for AAA arbitration.

The NAF data have various limitations. First, obviously they only involve arbitrations administered by the NAF. If the business switched from the AAA to a provider other than the NAF, it would not show up in the NAF data. Second, the disclosures are limited to California.[71] To the extent businesses switching from AAA arbitration do not operate in California, they would not show up in the NAF data. That said, one would expect that a major business operating nationally might have at least one case in California during the period covered by the NAF disclosures. Third, we do not have access to the arbitration clause giving rise to the NAF arbitrations. Some arbitration clauses permit the claimant to choose either the AAA or the NAF (or sometimes JAMS) to administer their arbitration.[72] It might be that the arbitrations before the NAF were brought under such a clause, rather than a clause that removed the AAA as provider. Thus, the mere fact that the business appears both on the AAA business list and in the NAF spreadsheet does not necessarily mean that the business is one that switched from the AAA. Subject to those caveats, however, we find little evidence that businesses have switched from the AAA to the NAF as an alternative arbitration provider.[73]

E. Other Issues

The case file sample also permits us to address several other issues related to the Due Process Protocols. First, to what extent do consumer arbitrations arise out of post-dispute versus pre-dispute agreements? Second, how common are class arbitration waivers -- which are not addressed by the Protocols -- in consumer arbitration agreements? Third, how did the AAA

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[70] To avoid the possibility of identifying any of the businesses, we do not quantify the percentage of the NAF caseload provided by the businesses, although it was small. We can say that neither MNBA Bank nor Banc One – which with their assignees and successors accounted for a substantial majority of the NAF caseload in the Public Citizen spreadsheet – was one of the businesses that switched from the AAA to the NAF.

[71] *See supra* text accompanying note 67.

[72] *See*, *e.g*, J.P. Morgan Chase & Co. Arbitration Agreement (2005), *available at* www.citizen.org/congress/images/JPMorgan.05.jpg ("The party filing a Claim in arbitration must choose one of the following two arbitration administrators: American Arbitration Association or National Arbitration Forum.").

[73] *See* Martin H. Malin, *Due Process in Employment Arbitration: The State of the Law and the Need for Self-Regulation*, 11 EMPLOYEE RTS. & EMPL. POL'Y J. 363, 399 (2007) ("To the extent those rogue arbitration agencies and opportunistic employers represent a significant share of the market, they could place competitive pressure on AAA and JAMS to deviate from their rules and policies. There are reasons to believe that this is not a widespread problem.").

handle cases in the case file sample involving the health care industry, which might be subject to the Health Care Due Process Protocol?

1. Pre-Dispute v. Post-Dispute Agreements

The Consumer Due Process Protocol does not bar enforcement of pre-dispute arbitration agreements, although the matter was controversial among the drafters of the Protocol.[74] Thus, it is not surprising that arbitrations arising from pre-dispute clauses are common in the case file sample. Indeed, virtually all of the 301 cases in the case file sample -- 290 (or 96.3%) -- arose out of pre-dispute agreements; 11 (or 3.7%) arose out of post-dispute agreements to arbitrate.[75] These results are consistent with prior studies of employment and international arbitration.[76]

The more interesting question is what, if anything, can be learned from the dramatically greater number of arbitrations arising from pre-dispute as opposed to post-dispute agreements. A common argument by critics of pre-dispute consumer arbitration agreements is that if arbitration were fair, parties would agree to it post-dispute even if they could not agree to it pre-dispute.[77] The usual response is that parties are unlikely to agree post-dispute to arbitrate, even if arbitration would make them both better off ex ante. Once parties know of their claim, they often will be unable to agree to arbitration, either because of limitations on the bargaining process[78] or because an uncertainty that would have permitted the parties to make a beneficial bargain earlier has been resolved.[79]

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[74] *See supra* Part I.B.2. By comparison, the Health Care Due Process Protocol does preclude enforcement of pre-dispute arbitration agreements "in cases involving patients." Commission on Health Care Dispute Resolution, Health Care Due Process Protocol, princ. 3 (July 27, 1998), *available at* www.adr.org/sp.asp?id =28633 [hereinafter Health Care Due Process Protocol] ("In disputes involving patients, binding forms of dispute resolution should be used only where the parties agree to do so after a dispute arises.").

[75] Although we treated two of the clauses as missing for purposes of evaluating AAA protocol compliance review, *see supra* Part III.B, those clauses plainly were predispute clauses, and we treat them as such here, even though we could not determine all of the provisions.

[76] Stephen R. Bond, *How to Draft an Arbitration Clause (Revisited)*, 1(2) ICC INT'L CT. ARB. BULL. 14 (1990), *reprinted in* CHRISTOPHER R. DRAHOZAL & RICHARD W. NAIMARK, TOWARDS A SCIENCE OF INTERNATIONAL ARBITRATION: COLLECTED EMPIRICAL RESEARCH 65, 67 (2005) ("Of the cases submitted to the ICC Court, only four [of 237] in 1987 and six [of 215] in 1989 resulted from *a compromis*, that is, an agreement to submit an already-existing dispute to arbitration."); Lewis L. Maltby, *Out of the Frying Pan, into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313, 319 (2003) ("AAA found only 6% (69/1148) of their 2001 employment arbitrations were the result of post-dispute agreements. In 2002, the frequency of post-dispute agreements was even lower, 2.6% (29/1124).").

[77] *E.g.*, Charles Knapp, *Common Sense and Contracts Symposium: The Gateway Thread – AALS Contracts Listserv*, 16 TOURO L. REV. 1147, 1173 (2000) ("[I]f arbitration is so economically sound for everybody, then let the consumer be persuaded 'once the dispute has arisen' that arbitration is in her best interests too.").

[78] Christopher R. *Drahozal, Arbitration Costs and Contingent Fee Contracts*, 59 VAND. L. REV. 729, 747 (2006).

[79] *E.g.*, Peter B. Rutledge, *Who Can Be Against Fairness? The Case Against the Arbitration Fairness Act*, 9 CARDOZO J. CONFLICT RESOL. 267, 278-80 (2008); Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements – with Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251, 262-64 (2006).

While our results do show that arbitrations arising out of post-dispute agreements to arbitrate are rare, they do not resolve the disagreement over the implications of that rarity. If pre-dispute agreements to arbitrate consumer disputes are made unenforceable, it seems likely that the number of consumer arbitration proceedings would decline dramatically. But the data provide no evidence on the reason for that decline.

2. Use of Class Arbitration Waivers

As noted above, one criticism of the Consumer Due Process Protocol is that it is underinclusive – i.e., it does not include all provisions in arbitration clauses that some see as unfavorable to consumers.[80] The most frequently litigated such clause, and one central to the policy debate over consumer arbitration, is the class arbitration waiver.

The existing empirical evidence is mixed on how frequently consumer arbitration clauses include class arbitration waivers. Eisenberg, Miller, and Sherwin found that in a sample of contracts from consumer financial services companies and telecommunications companies,[81] twenty of twenty-six (76.9%) consumer contracts included arbitration clauses[82] and all twenty of the contracts with arbitration clauses included class arbitration waivers.[83] Based on this "fairly narrow" sample,[84] they concluded that "apart from the role of arbitration clauses in shoring up the validity of class action waivers, it is not clear why consumer arbitration would appeal to companies… [F]rom the perspective of corporate self-interest, concern over class actions remains the most likely explanation for the prevalence of arbitration clauses in consumer agreements."[85]

By contrast, in end user license agreements (EULAs) for computer software, Florencia Marotta-Wurgler found almost no use of arbitration clauses and no use of class arbitration waivers.[86] Her conclusions are in stark contrast to those of Eisenberg, Miller, and Sherwin: "Although much analysis remains to be done, these results immediately cast doubt on casual

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[80] *See supra* I.B.3.

[81] Theodore Eisenberg, Geoffrey Miller, & Emily Sherwin, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871, 881-82 (2008) (describing their sample as consisting of the following types of companies (with the number of such companies in parentheses): "Telecommunications (7); Cable services (CATV, Internet, phone) (5); Securities services (4); Commercial banks (3); Retail credit card issuers (2); and Financial credit company (1)").

[82] *Id.* at 883.

[83] *Id.* at 884.

[84] *Id.* at 891 ("Our study is limited to a fairly narrow range of industries. As described above, only six major groups appear in our sample.").

[85] *Id.* at 894. The study is unclear whether its conclusions apply to businesses generally or apply only to the types of businesses studied.

[86] Florencia Marotta-Wurgler, *"Unfair" Dispute Resolution Clauses: Much Ado about Nothing?*, *in* BOILERPLATE: THE FOUNDATION OF MARKET CONTRACTS 45, 51 (Omri Ben-Shahar ed. 2007) ("Not a single EULA out of 597 includes a class-action waiver."). Of the consumer EULAs she studied, only 15 or 259 (or 5.8%) included an arbitration clause. *Id.* at 52.

claims that sellers' rampant use of choice of forum and arbitration clauses deprive buyers of their day in court, or that sellers are shielding themselves from liability by making it impossible for buyers to aggregate low-value claims."[87]

An older study found only limited use of class arbitration waivers in a variety of consumer contracts. Linda Demaine and Deborah Hensler examined dispute resolution clauses in a sample of contracts from businesses that an average consumer "was most likely to patronize."[88] Of the 161 contracts they examined, 57 (or 35.4%) included an arbitration clause.[89] The use of arbitration clauses varied widely across their industry groups, from a high of 69.2% in financial businesses to none in food and entertainment businesses.[90] They also found that a minority (30.8%) of the arbitration clauses included class arbitration waivers, but they did not provide a breakdown by industry type.[91] Demaine and Hensler collected their data in 2001,[92] however – prior to *Bazzle* – and so their results do not provide any insight into the post-*Bazzle* use of class arbitration waivers.

We also find varied use of class arbitration waivers in consumer contracts giving rise to AAA consumer arbitrations in 2007. Overall, of the clauses we examined in the case file sample, 109 of 299 (or 36.5%) included class arbitration waivers. The use of class arbitration waivers varied widely across contract types, as shown in Figure 3. Consistent with Eisenberg, Miller, and Sherwin, we found that all cases involving cell phone companies (5 of 5, or 100.0%) and all cases involving credit card issuers (26 of 26, or 100.0%) arose out of arbitration clauses with class arbitration waivers. By comparison, just over half of cases arising out of car sale contracts (34 of 64, or 53.1%) and contracts with home builders (11 of 17, or 64.7%) included class arbitration waivers. Meanwhile, none of the cases arising out of insurance contracts or real estate brokerage agreements included class arbitration waivers.[93] Thus, while some types of consumer contracts in the case file sample commonly included class arbitration waivers, other types did not.

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[87] *Id.*

[88] Linda J. Demaine & Deborah R. Hensler, *"Volunteering" to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 LAW & CONTEMP. PROBS. 55, 59 (2004). The businesses were from the following types of industries: "housing and home services," "retail services," "transportation," "health," "food and entertainment," "travel," "financial," and "other." *Id.* For a more detailed listing of the types of businesses they studied, see *id.* tbl. 1.

[89] *Id.* at 63-64 tbl. 2.

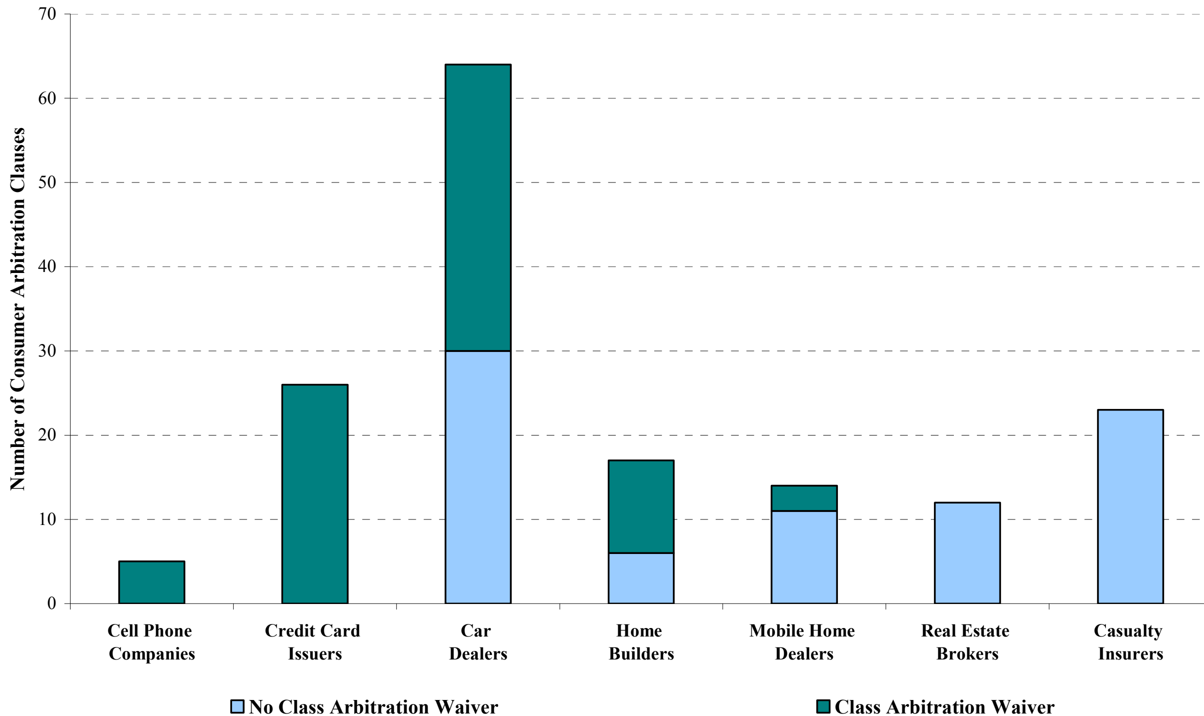
[90] *Id.*

[91] *Id.* at 65.

[92] *Id.* at 60.

[93] We should note that almost all of the insurance cases involved a single insurer.

Figure 3:
Use of Class Arbitration Waivers by Type of Contract
(Cases = 161)



One caveat to these findings: the case file sample of arbitration clauses is limited to those giving rise to AAA consumer arbitrations closed in 2007. Clauses selecting other providers may differ in how frequently they include class arbitration waivers.[94] Moreover, many of those arbitrations (180 of 301, or 59.8%) were filed in 2007, although a number were filed earlier. We do not have data on the date on which the arbitration agreements giving rise to those arbitrations were entered. For some types of contracts, such as car sales agreements, one would expect a dispute to arise relatively close in time to when the sales contract was signed. But for others, there may have been a time lag between the time the arbitration agreement was entered and when the case arising out of the arbitration agreement was closed. So we cannot exclude the possibility that the arbitration clauses we examined might have changed subsequently to include class arbitration waivers.

That said, the evidence suggests that many consumer arbitration clauses may not include class arbitration waivers. Studies that have found widespread use of class arbitration waivers focused on types of businesses that most commonly used class arbitration waivers. The evidence

[94] The AAA has promulgated rules governing the administration of class arbitrations and has a well established class arbitration docket. *See* American Arbitration Association, Supplementary Rules for Class Arbitrations (effective Oct. 8, 2003), *available at* www.adr.org/sp.asp?id=21936; *see also supra* Part I.B.3. We do not know whether the availability of class arbitration before the AAA makes it less likely or more likely that arbitration clauses specifying the AAA will include class arbitration waivers.

here suggests that those businesses may not be representative of all the businesses that include arbitration clauses in their consumer contracts.

3. Health Care Cases

Although the focus of this Report is on the Consumer Due Process Protocol, the case file sample provides a limited opportunity to consider the AAA's application of the Health Care Due Process Protocol as well. As discussed above, unlike the other due process protocols, the Health Care Due Process Protocol provides that "[i]n disputes involving patients, binding forms of dispute resolution should be used only where the parties agree to do so after a dispute arises."[95] In its Healthcare Policy Statement, the AAA has indicated that it would not administer "cases involving individual patients" unless the parties agreed to arbitrate after the dispute arose.[96] The AAA distinguishes cases involving a "patient undergoing health care treatment" from "other situations involving an individual," in which the AAA "will continue to administer pre-dispute agreements to arbitrate."[97] Thus, under the AAA's Healthcare Policy Statement, if the dispute involves treatment of the patient, a post-dispute arbitration agreement is necessary; but for other disputes, such as those involving the payment of money, the AAA will still administer pre-dispute arbitration agreements, even in the health care field.

The case file sample included seven health-care-related cases. Three of the cases were disputes between a health insurance company and its insured. In two cases, the claimant sought coverage of treatment that had not yet been provided. In both of those cases, the parties entered into a post-dispute arbitration agreement. In the other case, the claimant sought coverage for treatment that already had been provided; in other words, the dispute was over reimbursement of money to the consumer. The parties arbitrated that case pursuant to a pre-dispute arbitration agreement.

The other four health-care-related cases were brought by or against nursing homes. In one case, a consumer sought damages against the nursing home for negligence in the care it provided. In that case, the parties entered into a post-dispute arbitration agreement. One of the other claims was a claim by a consumer for overcharges against the nursing home. The other two cases were collection actions brought by the nursing home against the patient or a family member. All three of those cases were brought pursuant to pre-dispute arbitration agreements.

Overall, then, the AAA's administration of the small number health care cases in the case file sample seems to have followed the line it draws between cases involving treatment of a patient and cases involving other types of disputes (e.g., the recovery of money).

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[95] Health Care Due Process Protocol, *supra* note 74, princ. 3.

[96] American Arbitration Association, Healthcare Policy Statement (effective Jan. 1, 2003), *available at* www.adr.org/sp.asp?id=32192.

[97] *Id.*

ANNEX A. BUSINESS RESPONSES TO AAA PROTOCOL COMPLIANCE, ON THE AAA BUSINESS LIST AS "ACCEPTABLE"

Business Response	Protocol Issue	Number of Cases	Total Cases
No Response Necessary			
	No issues	1539	
	Total No Response Necessary		1539
Updated Clause			
	Cost issue	44	
	Location issue	9	
	Remedy limitation	16	
	Cost issue and location issue	3	
	Cost issue and remedy limitation	13	
	Others	9	
	Unspecified	1	
	Total Updated Clause		95
Waived Violation for Future Cases			
	Cost issue	16	
	Location issue	4	
	Remedy limitation	5	
	Cost issue and location issue	2	
	Cost issue and remedy limitation	7	
	Unpaid fees	9	
	Others	3	
	Unspecified	5	
	Total Waived Violation for Future Cases		51
Waiver and Removed AAA			
	Cost Issue	4	
	Remedy Limitation	1	
	Total Waiver and Removed AAA		5
Waiver and Removed Arbitration			
	Hearing Issue	1	
	Total Waiver and Removed Arbitration		1
Sought Advance Review			
	Approved as submitted	14	
	Approved after revision (various protocol issues)	1	
	Total Sought Advance Review		15
	Grand Total "Acceptable" Businesses		**1706**

ANNEX B. BUSINESS RESPONSES TO AAA PROTOCOL COMPLIANCE, ON THE AAA BUSINESS LIST AS "UNACCEPTABLE"

Business Response	Protocol Issue	Number of Cases	Total Cases
Did Not Respond to Case Initiation			
	Unpaid fees	252	
	Cost issue	41	
	Location issue	20	
	Remedy limitation	15	
	Cost issue and location issue	2	
	Cost issue and remedy limitation	6	
	Cost issue and arbitrator selection issue	5	
	Location issue and remedy limitation	3	
	Other	10	
	Unspecified	4	
	Total Did Not Respond to Case Initiation		358
Did Not Respond to AAA Contact			
	Cost issue	30	
	Location issue	12	
	Remedy limitation	23	
	Cost issue and location issue	1	
	Cost issue and remedy limitation	4	
	Cost issue and arbitrator selection issue	2	
	Location issue and remedy limitation	2	
	Other	5	
	Unspecified	2	
	Did not examine	120	
	Total Did Not Respond to AAA Contact		201
Refused to Pay			
	Unpaid fees	29	
	Unpaid fees and cost issue	2	
Refused to Update Clause			
	Remedy limitation	2	
Refused to Waive			
	Cost issue	9	
	Location issue	6	
	Remedy limitation	9	
	Cost issue and remedy limitation	2	
	Other	1	
	Unspecified	1	
	Total Refusals		61
Removing AAA			
	Unpaid fees	3	
	Cost issue	6	
	Remedy limitation	2	
	Cost issue and remedy limitation	1	
	Unspecified	1	
	Total Removing AAA		13
Removing Arbitration Clause			
	Remedy limitation	1	
	Total Removing Arbitration Clause		1
Out of Business			
	Unavailable	10	
	Total Out of Business		10
Unable to Locate			
	Unavailable	3	
	Total Unable to Locate		3
	Grand Total "Unacceptable" Businesses		**647**

CONCLUSIONS

A. Empirical Findings

TOPIC 1. COSTS, SPEED, AND OUTCOMES OF AAA CONSUMER ARBITRATIONS

Our central empirical findings on this topic are as follows:

- Consumer claimants brought the substantial majority (approximately 86.0%) of cases in the American Arbitration Association ("AAA") consumer dataset from 2005 through 2007. Of the cases brought by consumer claimants, 32.1% were resolved by an award, while in cases brought by business claimants, 49.9% were resolved by an award. The remaining cases typically were either settled or dismissed voluntarily by the parties.

- Overall, in the case file sample of consumer cases awarded from April 2007 through December 2007, consumer claimants were assessed an average of $129 in AAA administrative fees and $247 in arbitrator's fees. Consumer claimants seeking less than $10,000 were assessed an average of $1 in AAA administrative fees and $95 in arbitrator's fees, while consumer claimants seeking between $10,000 and $75,000 were assessed an average of $15 in AAA administrative fees and $204 in arbitrator's fees. Consumer claimants seeking more than $75,000 were assessed an average of $1448 in administrative fees and $1256 in arbitrator's fees. For cases subject to the AAA's low-cost consumer arbitration rules (i.e., with a claim amount of $75,000 or less), consumers almost never paid more than the amount specified in the rules and often paid less – as a result of the arbitrator reallocating some portion of the consumer's share of costs to the business in the award.

- The average time from filing to final award for the AAA consumer arbitration cases in the case file sample was 207 days (6.9 months), subject to some possible degree of case selection bias. Cases with business claimants were resolved in 198 days (6.6 months) on average; cases with consumer claimants were resolved in 209 days (7.0 months) on average.

- Of the cases in the case file sample, consumer claimants won some relief in 53.3% of the cases (128 of 240) they brought. On average, successful consumer claimants were awarded $19,255 in compensatory damages and recovered 52.1% of the amount they sought; the median amount awarded was $5000 and the median percent recovery was 41.7%. Business claimants won some relief in 83.6% of the cases (51 of 61) they brought. On average, successful business claimants were awarded $20,648 and recovered 93.0% of the amount they sought; the median amount awarded was $11,110 and the median percent recovery was 100.0%. We cannot evaluate whether these recoveries are favorable or unfavorable for consumers.

- Consumer claimants sought to recover attorneys' fees in 65 of the 128 cases in which they were awarded damages. In 41 of those 65 cases (or 63.1%), the arbitrator awarded attorneys' fees to the consumer. In those cases in which the award of attorneys' fees

specified a dollar amount (35 cases), the average attorneys' fee award was $14,574 and the median award was $9000.

- Under the usual definition of a repeat business, we find no statistically significant repeat-player effect: consumer claimants won some relief in 51.8% of cases against repeat businesses so defined and 55.3% of cases against non-repeat businesses, a difference that is not statistically significant.[1] Under an alternative definition of a repeat business, based on the AAA's categorization of businesses in enforcing compliance with the Consumer Due Process Protocol, we find some evidence of a repeat-player effect as to win-rate (claimants won some relief in 43.4% of cases against repeat businesses and 56.1% of cases against non-repeat businesses, a difference that is weakly statistically significant)[2] but not as to the percentage of claim amount recovered by consumer claimants (claimants actually recover a higher percentage of the amount claimed against repeat businesses than against non-repeat businesses). But the evidence suggests that any repeat-player effect is not due to arbitrator (or other) bias in favor of repeat businesses. Instead, it appears to result from case screening by repeat businesses, with those businesses resolving consumer claims prior to an award at a much higher rate than non-repeat businesses.

TOPIC 2. AAA ENFORCEMENT OF THE CONSUMER DUE PROCESS PROTOCOL

Our central empirical findings on this topic are as follows:

- In the case file sample of AAA consumer arbitrations, the majority of consumer arbitration clauses (229 of 299, or 76.6%) fully complied with the Consumer Due Process Protocol as applied by the AAA. We found no statistically significant difference in how frequently clauses violated the Protocol between cases seeking $75,000 or less (which were subject to AAA protocol compliance review) and those cases seeking over $75,000 (which were not).

- The AAA's review of arbitration clauses for protocol compliance appears to be effective at identifying and responding to those clauses with protocol violations. Of the 271 cases in the case file sample subject to the AAA's protocol compliance review, five (or 1.8%) included an arbitration clause with an unwaived violation of the Consumer Due Process Protocol. Stated otherwise, in 266 out of 271 cases (98.2%), the arbitration clause either complied with the Due Process Protocol or the non-compliance was properly identified and responded to by the AAA.

- The AAA in the time period studied refused to administer at least 85 consumer cases, and likely at least 129 consumer cases (or 9.4% of its total consumer caseload), because the business failed to comply with the Consumer Due Process Protocol. The most common

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[1] See *supra* Part IV(2).D.4.
[2] See *supra* Part IV(2).D.4.

reason for refusing to administer a case (55 of 129 cases, or 42.6%) was the business's failure to pay its share of the costs of arbitration rather than any problematic provision in the arbitration clause.

- In response to AAA protocol compliance review, over 150 businesses have either waived problematic provisions or revised arbitration clauses to remove provisions that violated the Consumer Due Process Protocol. Those businesses are in addition to over 1550 businesses with arbitration clauses that did not violate the Protocol. By comparison, the AAA has identified 647 businesses for which it will refuse to administer arbitrations. The most common reason (358 of 647, or 55.3%) for the AAA to refuse to administer consumer arbitrations for a business is the business's failure to pay its share of the arbitration costs.

- Of the clauses in cases in the case file sample, 109 (36.5%) included class arbitration waivers -- provisions that waive the availability of class relief in arbitration. The results varied significantly by industry. All arbitration clauses in cases involving cell phone companies (5 of 5, or 100%) and credit card issuers (26 of 26, or 100%) included class arbitration waivers. By comparison, no arbitration clauses in insurance contracts and real estate brokerage agreements included class arbitration waivers.

B. Policy Implications

These empirical findings have important implications for the debate over consumer arbitration – for Congress, for state legislatures, for the courts, and for others seeking to help formulate policy about consumer arbitration.

1. Not all consumer arbitrations are alike. In the case file sample of AAA consumer arbitrations, for example, the types of claims brought by consumer claimants differed from the types of claims brought by business claimants. Arbitration clauses in some types of contracts commonly included class arbitration waivers, while arbitration clauses in other types of contracts did not. Likewise, not all arbitration providers are alike. Some administer claims that are predominantly brought by businesses, while others have a higher proportion of claims brought by consumers. Policy makers should not assume that empirical findings for one type of consumer arbitration necessarily will be the same for other types. Nor should policy makers assume that empirical findings for arbitrations administered by one arbitration provider necessarily will be the same for arbitrations administered by other providers. Of course, the same holds true for the empirical findings in this Report – that they do not necessarily hold for other types of arbitration or for other arbitration providers. These variations suggest the need for a nuanced approach to pubic policy concerning arbitration.

2. Private regulation complements existing public regulation of the fairness of consumer arbitration clauses. Our evidence indicates that the AAA effectively reviews arbitration clauses for protocol compliance and appropriately responds to clauses that do not comply. A number of

businesses have responded to AAA compliance efforts by changing their arbitration clauses to comply with the Protocol. Any consideration of the need for legislative action should take into account such private regulation of consumer arbitration.

Courts and policymakers usefully could consider ways to reinforce the AAA's enforcement of the Consumer Due Process Protocol. For example, courts could give businesses additional incentive to waive violations of the Protocol (or pay their share of arbitration fees) by making clear that the consumer can bring the case in court if the business does not do so. The rationale could be that the identity of the provider was "material" to the agreement to arbitrate; hence, the inability to arbitrate before the AAA would result in invalidation of the entire arbitration clause. Congress, state legislatures, and the courts also might consider ways to extend the protections of the Consumer (or Employment) Due Process Protocols to arbitration clauses that do not provide for AAA arbitration.

Although our evidence indicates that the AAA effectively reviews clauses for protocol compliance, that review process could nonetheless be improved in several ways. First, the process of reviewing consumer clauses might be centralized in a single person, as it is for the Employment Due Process Protocol. Centralization might reduce further the number of unwaived protocol violations, although at some resource cost to the AAA. Second, the AAA might provide additional training for case intake staff, particularly on how to identify problematic remedy limitations, the most commonly overlooked type of violation. Third, the AAA might publish the standards it uses in reviewing clauses for protocol compliance. Publication would give businesses better information on what provisions are problematic, and could enlist consumer claimants and their attorneys in enforcement of the Protocol. Finally, the AAA might give more prominent notice of the availability of advance review, such as by incorporating advance review into its Consumer Arbitration Rules.

3. For several reasons, consumers may pay less to arbitrate disputes than the cost shown in arbitration rules. When arbitrators in the case file sample exercised their authority to reallocate costs in their award, they did so most often to reallocate costs from consumers to businesses – i.e., to reduce the costs of arbitration to consumers. In addition, arbitrators awarded attorneys' fees to prevailing consumer claimants in almost two-thirds of the cases in which they sought such an award (and in over half the cases in which consumer claimants were awarded any compensatory damages). The widespread availability of attorneys' fee awards in arbitration further reduces the effective cost of arbitration to consumers.

4. Empirical studies have tended to find that repeat players fare better in arbitration than non-repeat players. To the extent such a repeat-player effect exists in arbitration, the critical policy question is what causes it. Is the repeat-player effect due to arbitrator bias in favor of repeat players? Is it due to bias resulting from control by repeat players over the design of dispute resolution systems? Or is it due to better case screening by repeat players, who settle stronger cases and arbitrate weaker cases against them? Our findings are consistent with prior studies in suggesting that any repeat-player effect is likely caused by better case screening by repeat players rather than arbitrator (or other) bias in favor of repeat players. A further as yet

unresolved question is whether a repeat-player effect exists in litigation, and, if so, how litigation compares to arbitration in this regard.

5. Finally, despite the insights that empirical research can provide, it nonetheless has important limitations. First, our results are limited to AAA consumer arbitrations. Our data do not address arbitrations administered by other arbitration providers. Second, one must have a baseline for comparison to evaluate the cost, speed, and outcomes of consumer arbitrations; data on arbitration proceedings alone are not enough. Accordingly, this Report's findings are only a beginning. While they provide a look into consumer arbitrations administered by the AAA, further work remains to be done – work that we hope to undertake in a future phase of this project.

APPENDIX 1. EMPIRICAL STUDIES OF CONSUMER ARBITRATION

This appendix lists the empirical studies of consumer arbitration discussed in the body of this Report. For each study, it describes the sample and summarizes the central findings of the study. It also briefly describes criticisms of the study, if any.

A. AAA Consumer Arbitration

1. American Arbitration Association, Analysis of the American Arbitration Association's Consumer Arbitration Caseload: Based on Consumer Cases Awarded Between January and August 2007, *available at* http://www.adr.org/si.asp?id=5027

Sample: 310 AAA cases resulting in an award from January 2007 through August 2007.[1]

Findings: 41% of the cases were decided on the basis of documents only, while 59% were resolved after a telephone or in-person hearing. Cases on average took about four months to resolve on the basis of documents and about six months to resolve on the basis of an in-person hearing. Consumer claimants won 48% of awarded cases they brought; business claimants won 74% of awarded cases they brought.[2]

Criticisms: Public Citizen criticized the AAA's analysis on several grounds. First, it found the win-rate calculated by the AAA "unreliable because any arbitrator award was counted as a win, regardless of its relation to the amount sought. This means for example that AAA would deem victorious a claimant who sought $50,000 and received only $5."[3] Second, Public Citizen faulted the AAA because Public Citizen was unable to duplicate the AAA's findings from the AAA's public disclosures.[4] Third, Public Citizen pointed out that business claimants had a higher win-rate than consumer claimants.[5]

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[1] American Arbitration Association, Analysis of the American Arbitration Association's Consumer Arbitration Caseload: Based on Consumer Cases Awarded Between January and August 2007, *available at* http://www.adr.org/si.asp?id=5027.

[2] *Id.*

[3] Public Citizen, The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration 12 (2008), *available* at http://www.citizen.org/documents/ArbitrationDebateTrap(Final).pdf [hereinafter Public Citizen, Arbitration Debate Trap].

[4] *Id.* ("[W]e could discern the victorious party only in approximately 7 percent of the cases. AAA left the 'prevailing party' field – a required disclosure – blank in more than 90 percent of the cases it has reported.").

[5] *Id.*

2. Statement of the American Arbitration Association, Annex D, *in* S. 1782, The Arbitration Fairness Act of 2007: Hearing Before the Constitution Subcomm. of the Senate Comm. on the Judiciary, 110th Cong., 1st Sess. 135 (Dec. 12, 2007)

Sample: 987 cases brought by consumer claimants before the AAA that were resolved in 2006.[6]

Findings: The AAA reported that 42% of the cases were resolved by an award, while 58% were resolved prior to award. The consumer was awarded some monetary amount in 48% of the cases resolved by an award. Cases awarded on the basis of documents (34% of all awarded cases) took on average 3.8 months; cases awarded following an in-person hearing (66% of all awarded cases) took on average 7.4 months.[7]

3. Ernst & Young, Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases 16, App. A (2004), *available at* http://www.adrforum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005ErnstAndYoung.pdf

Sample: As part of its study of NAF arbitrations described below,[8] Ernst & Young examined forty-four AAA consumer cases classified as involving "banking" disputes. The cases were among those included on the AAA web site as part of its required disclosures under California law.[9]

Findings: Ernst & Young reported that: (1) the average amount claimed was $81,371; (2) the average fee paid (in the 31 cases for which such information was available) was $1935; (3) 50% of the cases settled, 11% were withdrawn by the claimant, and in the remaining 39% the arbitrator issued a decision; and (4) no information was provided for the amount awarded and rarely was the prevailing party identified.[10]

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[6] Statement of the American Arbitration Association, Annex D, *in* S. 1782, The Arbitration Fairness Act of 2007: Hearing Before the Constitution Subcomm. of the Senate Comm. on the Judiciary, 110th Cong., 1st Sess., at 135 (Dec. 12, 2007).

[7] *Id.*

[8] *See infra* text accompanying notes 30-36.

[9] Ernst & Young, Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases 16, App. A (2004), *available at* http://www.adrforum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005ErnstAndYoung.pdf.

[10] *Id.*

B. Other Consumer Arbitration

1. Jeff Nielsen et al., Navigant Consulting, National Arbitration Forum: California Consumer Arbitration Data (July 11, 2008), *available at* http://www.instituteforlegal reform.com/issues/docload.cfm?docId=1212

Sample: Same as in Public Citizen, The Arbitration Trap (see study no. 2, below).[11]

Findings: Of the 33,948 total NAF arbitrations, 26,665 were either heard by an arbitrator or dismissed (the excluded cases were settlements). Navigant concluded that "[o]f these 26,665 arbitrations, consumer parties were reported to have prevailed outright or had the case against them dismissed in 8,558 cases (32.1%). Claims against consumers were reduced by NAF in an additional 4,376 cases (16.4%)."[12] According to Navigant, "the median reduction was $636 and the median percentage reduction was 8.6%."[13] Of the 33,935 cases in which an arbitration fee was paid, the consumer paid no fee in 33,689 cases (99.3%). In the remaining 246 cases, the median fee paid by the consumer was $75.[14]

Criticisms: Public Citizen criticized the Navigant report on several grounds. First, the vast majority (8534 of 8558, or 99.6%) of the cases that Navigant treated as cases in which the consumer prevailed were dismissals, rather than awards. And of the dismissals, almost all (7783, or 91.2%) occurred before an arbitrator was appointed. According to Public Citizen: "These cases can hardly be used as evidence of the fairness of NAF arbitration. They scarcely involved arbitration at all."[15] Second, the 700 dismissals after appointment of an arbitrator, according to Public Citizen, might have occurred "for any number of manipulative reasons," such that "it is possible that the consumers who 'won' the cases ... lost the very same cases later."[16]

2. Public Citizen, The Arbitration Trap: How Credit Card Companies Ensnare Consumers (2007), *available at* http://www.citizen.org/documents/ArbitrationTrap.pdf

Sample: Relying on the National Arbitration Forum's California disclosures (which it reformatted into an Excel spreadsheet[17]), Public Citizen analyzed outcomes in 33,948 NAF

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[11] Jeff Nielsen et al., Navigant Consulting, National Arbitration Forum: California Consumer Arbitration Data 1 (July 11, 2008), *available at* http://www.instituteforlegalreform.com/index.php?option=com_ilr_docs& issue_code=ADR&doc_type=STU; *see infra* text accompanying notes 17-18.

[12] Nielsen et al., *supra* note 11, at 1.

[13] *Id.* at 3.

[14] *Id.*

[15] Public Citizen, Arbitration Debate Trap, *supra* note 3, at 10.

[16] *Id.* at 11.

[17] *See* Public Citizen, NAF California Data Jan. 2003 to Mar. 2007, *available at* http://www.citizen.org/congress/civjus/arbitration/NAFCalifornia.xls ("This spreadsheet consists of the information on 33,948 National Arbitration Forum cases conducted in California between Jan. 1, 2003 and Mar. 31, 2007. It was compiled from quarterly reports that the National Arbitration Forum posted in a difficult-to-find place on its Web site in Adobe Systems' Portable Document Format (PDF). Public Citizen converted them to an Excel spreadsheet so California residents and others interested in binding mandatory arbitration may do their own analysis of NAF

consumer arbitrations between January 1, 2003 and March 31, 2007. The vast majority of cases were filed by businesses against consumers; only 118 (0.35% of the cases) were brought by consumers against businesses.[18]

Findings: In the cases with consumer claimants, businesses prevailed in 61 cases and consumers in 30 cases; in the remaining cases the prevailing party was listed as "N/A." In 14,654 cases, no arbitrator was ever appointed and the case was either settled or dismissed. In the 19,294 cases in which an arbitrator was appointed, the business won in 18,091 (or 93.8%) – most of which were resolved on the basis of documents only with the consumer not appearing – while the consumer won in 781 (4.0%).[19] Public Citizen also provided information on the arbitrators who decided the cases: 28 arbitrators decided 89.5 percent of the cases in which an arbitrator was appointed, with the busiest according to Public Citizen deciding 68 cases in a single day.[20]

Criticisms: Professor Peter B. Rutledge criticized Public Citizen's data analysis on several grounds. First, the focus of the report was narrow, addressing a single arbitration provider (NAF) and a single type of business (consumer credit).[21] Second, the high win-rate for businesses was due to the type of claim involved – debt collection actions – which tend to have "very little to dispute."[22] He notes: "Studies of debt collection actions in major cities reveal that the lender typically wins between 96% and 99% of the time, right in line with the lender win-rate data cited in the Public Citizen Report."[23] Rutledge also states that Public Citizen misinterpreted the NAF data in estimating the number of cases decided by arbitrators in a single day.[24]

3. Mark Fellows, *The Same Result as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes*, METRO. CORP. COUNSEL, July 2006, at 32

Sample: Mark Fellows of the National Arbitration Forum reported information about NAF arbitrations from 2003-2004. The data was compiled from disclosures made by NAF as required by California law.[25]

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arbitrations in California and of the records of NAF arbitrators.").

[18] Public Citizen, The Arbitration Trap: How Credit Card Companies Ensnare Consumers 15 (2007), *available at* http://www.citizen.org/documents/ArbitrationTrap.pdf [hereinafter Public Citizen, Arbitration Trap].

[19] *Id.*

[20] *Id.* at 16.

[21] Peter B. Rutledge, Arbitration -- A Good Deal for Consumers: A Response to Public Citizen 10 (April 2008) (report prepared for and released by the U.S. Chamber Institute for Legal Reform), *available at* http://www.instituteforlegalreform.com/issues/docload.cfm?docId=1091.

[22] *Id.* at 11.

[23] *Id.*

[24] *Id.* at 11-12 ("This argument mischaracterizes the California data. Those data include a field for the date of the award. The Public Citizen Report treats this listed date as the day when the arbitrator actually rendered an award. This is incorrect. Rather, the California data reflect the date that the award was entered into NAF's system. An arbitrator may render a series of awards over several days, yet NAF enters those awards into its system in a single day.").

[25] Mark Fellows, *The Same Result as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes*, METRO. CORP. COUNSEL, July 2006, at 32.

Findings: Fellows found that consumer claimants "prevail in 65.5% of the cases that reach a decision," while business claimants "prevail in 77.7% of the cases that reach a decision." The time from filing until disposition averaged 4.35 months for consumer claimants and 5.60 months for business claimants. On average, consumer claimants paid $46.63 in arbitration fees while business claimants paid $149.50 in arbitration fees.[26]

Criticisms: Public Citizen criticized Fellows' analysis on several grounds. First, Fellows treats a business withdrawing a claim as a win for the consumer. But "[t]hese claims are not comparable to judicial decisions after bench trials.[27] When only cases decided by an arbitrator are considered, businesses prevail at a much higher rate. Second, Public Citizen was not able to duplicate Fellows' estimate of consumer claimants' win-rates, finding instead that "consumers prevailed in only 37.2 percent of consumer-initiated cases that reached a decision."[28] Regardless, cases with consumer claimants "account for a miniscule percentage of NAF arbitrations and therefore are not representative of NAF arbitrations."[29]

4. Ernst & Young, Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases 16, App. A (2004), *available at* http://www.adrforum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005ErnstAndYoung.pdf[30]

Sample: 226 NAF arbitrations brought by consumers between January 2000 and January 2004.[31] The study did not include information on arbitrations brought by businesses.

Findings: The largest category of disputes involved credit card fees and charges (38.9% of the cases), with other significant case types including disputes over credit card chargebacks (8.4%), mortgage loans (8.4%), and other loans (7.5%).[32] The substantial majority of claims (73.0%) sought $15,000 or less; only 7.0% of claims were for more than $75,000.[33] Overall, 129 of the 226 cases (or 57.1%) were dismissed before hearing, either due to settlement or on request of the plaintiff. Ernst & Young classified all but four of those cases as cases in which the consumer prevailed.[34] Of the cases that reached a decision by the arbitrator, the consumer

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26 *Id.*

27 Public Citizen, Arbitration Debate Trap, *supra* note 3, at 9.

28 *Id.* at 10.

29 *Id.*

30 *See also supra* text accompanying notes 8-10.

31 Ernst & Young, *supra* note 9, at 7. Of the 250 casefiles provided by the NAF, Ernst & Young excluded 24 employment-related cases from the study. *Id.* at 7.

32 *Id.* at 8.

33 *Id.*

34 *Id.* ("Under the first measure, a claimant is said to prevail if the arbitration decision favored the claimant, or if the case was dismissed at the claimant's request or per party agreement. This measure assumes that the consumer was sufficiently satisfied with the settlement to dismiss the arbitration proceedings."). The four dismissals in which the consumer did not prevail, according to Ernst & Young, were ones in which either the NAF dismissed the case due to some deficiency or the consumer dismissed the case because he or she could not afford to continue. *Id.* at 9 & n.11.

prevailed in 53 out of 97 cases (or 54.6%).[35] Ernst and Young concluded: "Consumers appear to be satisfied with settlements accomplished prior to hearings and if a hearing takes place, consumers are not losing a disproportionate number of cases. Therefore, the findings from this analysis do not support claims that the arbitration process is harmful to consumers."[36]

Criticisms: Bland et al. have criticized the Ernst & Young study on several grounds.[37] First, the study examined only the arbitration process and did not compare arbitration to litigation. Second, it included dismissals, whether by claimant request or party agreement, as wins by the claimant. It also included any case in which a claimant prevailed, regardless of the amount recovered, as a win. Third, the study focused only on the claims filed by consumers, "disregarding more than 100,000 filed by corporations against consumers during the same four-year period."[38]

5. California Dispute Resolution Institute, Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure (Aug. 2004), *available at* http://www.mediate.com/cdri/cdri_print_aug_6.pdf

Sample: 2175 arbitration cases from January 2003 through February 2004, posted on websites of six different arbitration providers as required by California law. The six providers were the AAA, ADR Services, Arbitration Works, ARC Consumer Arbitrations, JAMS, and Judicate West.[39] Although the study included data on both consumer and employment arbitration, the reported results did not distinguish between the two.[40]

Findings: The CDRI prefaced its findings with the statement that "[i]n general, inconsistencies, ambiguities and the lack of reported data in some areas limit this study's utility for the purposes of informing policy."[41] Data on both filing and disposition dates was available for 1559 cases. For those cases, the mean disposition time was 116 days, while the median was 104 days.[42] The amount of arbitrator's fee was available for 1404 cases; the mean fee was $2256 while the median fee was $870.[43] The prevailing party was identified for 302 cases. The consumer prevailed in 215 (or 71.2%) of those cases, while the business prevailed in the

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[35] *Id.* at 9.

[36] *Id.* at 10. In addition to its case analysis, Ernst & Young surveyed 29 of the consumers involved in the cases (25 of whom had prevailed in their cases). Of those responding, 25 (or 69%) either "were satisfied or very satisfied with the arbitration process." *Id.* at 11-12.

[37] F. PAUL BLAND, JR. ET AL., CONSUMER ARBITRATION AGREEMENTS: ENFORCEABILITY AND OTHER TOPICS 11 (5th ed. 2007); *see also* Public Citizen, Arbitration Trap, *supra* note 18, at 20.

[38] BLAND ET AL., *supra* note 37, at 11.

[39] California Dispute Resolution Institute, Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure 14 (Aug. 2004), *available at* http://www.mediate.com/cdri/cdri_print_aug_6.pdf.

[40] *Id.* at 22 fig. 1.

[41] *Id.* at 18. For a detailed description of the problems, see *id.* at 27-32.

[42] *Id.* at 19.

[43] *Id.* at 21.

remaining 87 cases (or 28.8%).[44] The amount of the award was reported for 540 cases; the mean amount awarded was $33,112 while the median amount awarded was $7615.[45]

Criticisms: Bland et al. identified the following criticisms of these results. First, as the CDRI itself recognized, the data it was reviewing were too incomplete to reach any firm conclusions.[46] Second, the study "appears to exclude collection actions brought by creditors against consumers and any arbitrations from the National Arbitration Forum, a lightning rod concerning the fairness of consumer arbitration."[47]

6. Answers and Objections of First USA Bank, N.A. to Plaintiff's Second Set of Interrogatories, Ex. 1, Bownes v. First U.S.A. Bank, N.A. et al., Civ. Action No. 99-2479-PR (Ala. Circuit Ct. 2000), *available* at http://www.tlpj.org/briefs/McQuillan%20 exhibits%2016-19%20(300dpi).pdf

Sample: Data on NAF arbitration outcomes between 1998 and 2000, produced by First USA Bank in response to interrogatories in an Alabama lawsuit.[48]

Findings: The data showed that of the 51,622 NAF arbitrations in which First USA was involved with consumers, it prevailed in 19,618 while the cardholder prevailed in 87. Of the cases in which First USA prevailed, the substantial majority (17,293 of 19,618, or 88.1%) were cases in which the consumer did not respond. Another 28,248 cases expired, typically for failure to serve the cardholder within ninety days, and another 3666 were pending at the time the discovery response was made. Consumers brought four cases against First USA, prevailing in

[44] *Id.* at 25.
[45] *Id.* at 20.
[46] BLAND ET AL., *supra* note 37, at 12; *see also* Public Citizen, Arbitration Debate Trap, *supra* note 3, at 11-12.
[47] BLAND ET AL., *supra* note 37, at 12.
[48] Answers and Objections of First USA Bank, N.A. to Plaintiff's Second Set of Interrogatories, Ex. 1, Bownes v. First U.S.A. Bank, N.A. et al., Civ. Action No. 99-2479-PR (Ala. Circuit Ct. 2000), *available* at http://www.tlpj.org/briefs/McQuillan%20exhibits%2016-19%20(300dpi).pdf (last visited Dec. 10, 2008).

two of the cases and settling a third; the fourth was still pending.[49] These results are commonly cited as showing that "First USA prevailed in an astonishing 99.6 percent of cases."[50]

Criticisms: The NAF responded that collection cases in court have a similar success rate for businesses ("creditors win about 98 percent of collection actions brought against debtors in federal courts") and that "'expired' cases should be counted as victories for consumers."[51]

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[49] *Id.* at 38 ex. 1.

[50] Public Citizen, Arbitration Trap, *supra* note 18, at 13.

[51] Caroline E. Mayer, *Win Some, Lose Rarely? Arbitration Forum's Rulings Called One-Sided*, WASH. POST, Mar. 1, 2000, at E01 (quoting Ed Anderson, NAF managing director).

APPENDIX 2. EMPIRICAL STUDIES OF EMPLOYMENT ARBITRATION AND SECURITIES ARBITRATION

This appendix lists empirical studies of employment and securities arbitration, organized by type of arbitration and author name.

A. Employment Arbitration

Lisa B. Bingham & Shimon Sarraf, *Employment Arbitration Before and After the Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of Employment: Preliminary Evidence that Self-Regulation Makes a Differenc*e, *in* ALTERNATE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NEW YORK UNIVERSITY 53RD ANNUAL CONFERENCE ON LABOR 303 (Samuel Estreicher & David Sherwyn eds. 2004)

Lisa B. Bingham, *Self-Determination in Dispute System Design and Employment Arbitration*, 56 U. MIAMI L. REV. 873 (2002)

Lisa B. Bingham, *Unequal Bargaining Power: An Alternative Account for the Repeat Player Effect in Employment Arbitration*, IRRA 50TH ANN. PROC. 33 (1998)

Lisa B. Bingham, *On Repeat Players, Adhesive Contracts, and the Use of Statistics in Judicial Review of Arbitration Awards*, 29 MCGEORGE L. REV. 223 (1998)

Lisa B. Bingham, *An Overview of Employment Arbitration in the United States: Law, Public Policy and Data*, N.Z. J. INDUS. REL., June 1998, at 5

Lisa B. Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 EMPL. RTS. & EMPLOY. POL'Y J. 189 (1997)

Lisa B. Bingham, *Emerging Due Process Concerns in Employment Arbitration: A Look at Actual Cases*, 47 LAB. L.J. 108 (1996)

Lisa B. Bingham, *Is There a Bias in Arbitration of Non-Union Employment Disputes?*, 6 INT'L J. CONFLICT MGMT. 369 (1995)

Alexander J.S. Colvin, *Empirical Research on Employment Arbitration: Clarity Amidst the Sound and Fury?*, 11 EMPL. RTS. & EMPLOY. POL'Y J. 405 (2007)

Michael Delikat & Morris M. Kleiner, *An Empirical Study of Dispute Resolution Mechanisms: Where Do Plaintiffs Better Vindicate Their Rights?*, DISP. RESOL. J., Nov. 2003/Jan. 2004, at 56

Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, DISP. RESOL. J., Nov.2003/Jan. 2004, at 44

Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RESOL. 559 (2001)

Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO ST. J. ON DISP. RESOL. 777 (2003)

Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at Low Cost*, DISP. RESOL. J., May/July 2003, at 9

William M. Howard, *Mandatory Arbitration of Employment Disputes: What Really Does Happen? What Really Should Happen?*, 50 DISP. RESOL. J. 40 (1995)

William M. Howard, Mandatory Arbitration of Employment Arbitration Disputes: Can Justice Be Served? (May 1995) (unpublished PhD. dissertation, Arizona State University)

Lewis L. Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. REV. 105 (2003)

Lewis L. Maltby, *The Myth of Second-Class Justice: Resolving Employment Disputes in Arbitration*, *in* HOW ADR WORKS 915 (Norman Brand ed. 2002)

Lewis L. Maltby, *Arbitrating Employment Disputes: The Promise and the Peril*, *in* ARBITRATION OF EMPLOYMENT DISPUTES 530 (Daniel P. O'Meara ed., 2002)

Lewis L. Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29 (1998)

National Workrights Institute, Employment Arbitration: What Does the Data Show?, *available at* http://www.workrights.org/current/cd_arbitration.html

HOYT N. WHEELER, WORKPLACE JUSTICE WITHOUT UNIONS 47-68 (2004)

B. Securities Arbitration

Stephen B. Choi, Jill E. Fisch, and A.C. Pritchard, Attorneys as Arbitrators (Nov. 2008), *available at* http://www.law.northwestern.edu/searlecenter/papers/Choi_attorneys_final.pdf

General Accounting Office, How Investors Fare, Rep. No. GAO/GGD-92-74 (May 1992)

General Accounting Office, Securities Arbitration: Actions Needed to Address Problem of Unpaid Awards, Rep. No. GAO/GGD/00-115 (June 2000)

Jiro E. Kondo, Self-Regulation and Enforcement in Financial Markets: Evidence from Investor-Broker Disputes at the NASD (Dec. 25, 2007)

Edward S. O'Neal & Daniel R. Solin, Mandatory Arbitration of Securities Disputes: A Statistical Analysis of How Claimants Fare (2007), *available at* http://www.slcg.com/pdf/news/Mandatory%20Arbitration%20Study.pdf

Michael A. Perino, Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations 32-33 (Nov. 4, 2002)

APPENDIX 3. SUMMARY OF DUE PROCESS PROTOCOLS[1]

PRINCIPLE 1. FUNDAMENTALLY-FAIR PROCESS

AAA Employment:[2] No provision
AAA Consumer:[3] "All parties are entitled to a fundamentally-fair ADR process."
AAA Health Care:[4] "All parties are entitled to a fundamentally-fair ADR process."
JAMS Consumer:[5] No provision
JAMS Employment:[6] No provision
NAF:[7] "All parties in an arbitration are entitled to fundamental fairness."

PRINCIPLE 2. ACCESS TO INFORMATION REGARDING ADR PROGRAM

AAA Employment: No provision
AAA Consumer: "Providers of goods or services should undertake reasonable measures to provide Consumers with full and accurate information regarding Consumer ADR Programs."
AAA Health Care: "Full and accurate information regarding the program, in writing, should be provided by the plan to patients and providers in plain, easily understood language."
JAMS Consumer: "The consumer must be given notice of the arbitration clause. Its existence, terms, conditions and implications must be clear."
JAMS Employment: No provision
NAF: "Information about arbitration should be reasonably accessible before parties commit to an arbitration contract."

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[1] The organization of this Appendix is based on the Consumer Due Process Protocol. The provisions of the other protocols are reproduced under the heading included in the Consumer Protocol, with the goal of facilitating comparison of the different protocols. Those protocols, of course, do not use the same numbering scheme, and may well not include a similar heading. Moreover, the Appendix does not reprint the complete text of the protocols, although it aims to capture the key portions of the various provisions of the protocols.

[2] Task Force on Alternative Dispute Resolution in Employment, Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship (May 9, 1995), *available at* www.adr.org/sp.asp?id=28535.

[3] National Consumer Disputes Advisory Committee, Consumer Due Process Protocol (April 17, 1998), *available at* www.adr.org/sp.asp?id=22019.

[4] Commission on Health Care Dispute Resolution, Health Care Due Process Protocol (July 27, 1998), *available at* www.adr.org/sp.asp?id=28633.

[5] JAMS, JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses: Minimum Standards of Procedural Fairness (revised Jan. 1, 2007), *available at* www.jamsadr.com/rules/consumer_min_std.asp [hereinafter JAMS Consumer Minimum Standards].

[6] JAMS, JAMS Policy on Employment Arbitration, Minimum Standards of Procedural Fairness (revised Feb. 19, 2005), *available at* www.jamsadr.com/rules/employment_Arbitration_min_stds.asp [hereinafter JAMS Employment Minimum Standards].

[7] National Arbitration Forum, Arbitration Bill of Rights (2007), *available at* www.adrforum.com/users/naf/resources/ ArbitrationBillOfRights3.pdf.

PRINCIPLE 3. INDEPENDENT AND IMPARTIAL NEUTRAL; INDEPENDENT ADMINISTRATION

AAA Employment: "Our recommendation is for selection of impartial arbitrators and mediators.... Regardless of their prior experience, mediators and arbitrators on the roster must be independent of bias toward either party."

AAA Consumer: "All parties are entitled to a Neutral who is independent and impartial.... If participation in ... arbitration is mandatory, the procedure should be administered by an Independent ADR Institution.... The Consumer and Provider should have an equal voice in the selection of Neutrals in connection with a specific dispute."

AAA Health Care: "All parties are entitled to a Neutral who is independent and impartial.... Administration of the ADR program should be neutral, and independent of the parties.... All parties should have an equal voice in the selection of neutrals in connection with a specific dispute."

JAMS Consumer: "The arbitrator(s) must be neutral and the consumer must have a reasonable opportunity to participate in the process of choosing the arbitrator(s)."

JAMS Employment: "The arbitrator(s) must be neutral, and an employee must have the right to participate in the selection of the arbitrator(s)."

NAF: "The arbitrators should be both skilled and neutral.... An arbitration should be administered by someone other than the arbitrator or the parties themselves."

PRINCIPLE 4. QUALITY AND COMPETENCE OF NEUTRALS

AAA Employment: "Mediators and arbitrators selected for such cases should have skill in the conduct of hearings, knowledge of the statutory issues at stake in the dispute, and familiarity with the workplace and employment environment."

AAA Consumer: "All parties are entitled to competent, qualified Neutrals."

AAA Health Care: "All parties are entitled to competent, qualified neutrals."

JAMS Consumer: No provision

JAMS Employment: No provision

NAF: "The arbitrators should be both skilled and neutral."

PRINCIPLE 5. SMALL CLAIMS

AAA Employment: No provision

AAA Consumer: "Consumer ADR Agreements should make it clear that all parties retain the right to seek relief in a small claims court for disputes or claims within the scope of its jurisdiction."

AAA Health Care: No provision

JAMS Consumer: "[N]o party shall be precluded from seeking remedies in small claims court for disputes or claims within the scope of its jurisdiction."

JAMS Employment: No provision
NAF: No provision

PRINCIPLE 6. REASONABLE COST[8]

AAA Employment: "We recommend ... a number of existing systems which provide employer reimbursement of at least a portion of the employee's attorney fees, especially for lower paid employees."

AAA Consumer: "Providers of goods and services should develop ADR programs which entail reasonable cost to Consumers based on the circumstances of the dispute .... In some cases, this may require the Provider to subsidize the process."

AAA Health Care: "Nonbinding arbitration may be required, as can binding arbitration in cases not involving patients, in which case the plan should pay the costs of at least one day of hearing before a single arbitrator, including the arbitrator's fees and expenses."

JAMS Consumer: "With respect to the cost of the arbitration, when a consumer initiates arbitration against the company, the only fee required to be paid by the consumer is $250, which is approximately equivalent to current Court filing fees. All other costs must be borne by the company ...."

JAMS Employment: "An employee's access to arbitration must not be precluded by the employee's inability to pay any costs or by the location of the arbitration. The only fee that an employee may be required to pay is JAMS' initial Case Management Fee. All other costs must be borne by the company ...."

NAF: "The cost of an arbitration should be proportionate to the claim and reasonably within the means of the parties, as required by applicable law."

PRINCIPLE 7. REASONABLY CONVENIENT LOCATION

AAA Employment: "The arbitrator should be bound by applicable agreements, statutes, regulations and rules of procedure of the designating authority, including the authority to determine the time and place of the hearing ...."

AAA Consumer: "In the case of face-to-face proceedings, the proceedings should be conducted at a location which is reasonably convenient to both parties with due consideration of their ability to travel and other pertinent circumstances."

AAA Health Care: "The place of the proceedings should be reasonably accessible to the parties and to the production of relevant evidence and witnesses. In cases involving a patient, the place should be in close proximity to the patient's place of residence."

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[8] In addition, the JAMS Minimum Standards for both consumer and employment arbitrations incorporate the prohibition on "loser pays" provisions of California law. *See* JAMS Employment Minimum Standards, *supra* note 6, Standard 6; JAMS Consumer Minimum Standards, *supra* note 5, ¶ 8; *see* CAL. CODE CIV. PROC. § 1284.3(a) ("No neutral arbitrator or private arbitration company shall administer a consumer arbitration under any agreement or rule requiring that a consumer who is a party to the arbitration pay the fees and costs incurred by an opposing party if the consumer does not prevail in the arbitration, including, but not limited to, the fees and costs of the arbitrator, provider, organization, attorney, or witnesses."). Not surprisingly, neither the Employment Due Process Protocol nor the Consumer Due Process Protocol refer to the California law because it had not been enacted at the time they were promulgated.

JAMS Consumer: "The consumer must have a right to an in-person hearing in his or her hometown area."
JAMS Employment: No provision
NAF: "Hearings should be convenient, efficient, and fair for all."

PRINCIPLE 8. REASONABLE TIME LIMITS

AAA Employment: "The arbitrator should be bound by applicable agreements, statutes, regulations and rules of procedure of the designating authority, including the authority to determine the time and place of the hearing ...."
AAA Consumer: "ADR proceedings should occur within a reasonable time, without undue delay. The rules governing ADR should establish specific reasonable time periods for each step in the ADR process ...."
AAA Health Care: "ADR proceedings should occur within a reasonable time, and without undue delay. The rules governing ADR should establish specific reasonable time periods for each step in the ADR process ...."
JAMS Consumer: No provision
JAMS Employment: No provision
NAF: "A dispute should be resolved with reasonable promptness."

PRINCIPLE 9. RIGHT TO REPRESENTATION

AAA Employment: "Employees considering the use of or, in fact, utilizing mediation and/or arbitration procedures should have the right to be represented by a spokesperson of their own choosing."
AAA Consumer: "All parties participating in processes in ADR Programs have the right, at their own expense, to be represented by a spokesperson of their own choosing."
AAA Health Care: "All parties participating in processes in ADR Programs have the right, at their own expense, to be represented by an attorney or other spokesperson of their own choosing."
JAMS Consumer: "The clause or procedures must not discourage the use of counsel."
JAMS Employment: "The agreement or clause must provide that an employee has the right to be represented by counsel. Nothing in the clause or procedures may discourage the use of counsel."
NAF: "All parties have the right to be represented in arbitration, if they wish, for example, by an attorney or other representative."

PRINCIPLE 10. MEDIATION

AAA Employment: "The members of the task force felt that mediation and arbitration of statutory disputes conducted under proper due process safeguards should be encouraged ...."

AAA Consumer: "The use of mediation is strongly encouraged as an informal means of assisting parties in resolving their own disputes."

AAA Health Care: No provision

JAMS Consumer: No provision

JAMS Employment: "JAMS encourages the use of mediation and of voluntary arbitration that is not a condition of initial or continued employment."

NAF: "The preferable process is for the parties themselves to resolve the dispute."

PRINCIPLE 11. AGREEMENTS TO ARBITRATE

AAA Employment: "The Task Force takes no position on the timing of agreements to mediate and/or arbitrate statutory employment disputes, though it agrees that such disputes be knowingly made."

AAA Consumer: "Consumers should be given: (a) clear and adequate notice of the arbitration provision and its consequences ...; (b) reasonable access to information regarding the arbitration process ...; (c) notice of the option to make use of applicable small claims court procedures ...; and, (d) a clear statement of the means by which the Consumer may exercise the option (if any) to submit disputes to arbitration or to court process."

AAA Health Care: "The agreement to use ADR should be knowing and voluntary.... In disputes involving patients, binding forms of dispute resolution should be used only where the parties agree to do so after a dispute arises."

JAMS Consumer: No provision

JAMS Employment: "JAMS encourages the use of mediation and voluntary arbitration that is not a condition of initial or continued employment. JAMS does not take a position on the enforceability of condition-of-employment arbitration clauses ...."

NAF: "An agreement to resolve disputes through arbitration is a contract and should conform to the legal principles of contract and applicable statutory law."

PRINCIPLE 12. ARBITRATION HEARINGS

AAA Employment: "The arbitrator should be bound by applicable agreements, statutes, regulations and rules of procedure of the designating authority, including the authority to determine the time and place of the hearing ...."

AAA Consumer: "All parties are entitled to a fundamentally-fair arbitration hearing.... [T]he Neutral should have discretionary authority to require a face-to-face hearing upon the request of a party."

AAA Health Care: "The pre-hearing and hearing should be conducted with adequate notice and with a fair opportunity to be heard and to present relevant evidence and witnesses. There should be a right to examine and cross-examine witnesses, and to argue orally and/or in writing."

JAMS Consumer: "The consumer must have a right to an in-person hearing in his or her hometown area."

JAMS Employment: "At the arbitration hearing, both the employee and the employer must have the right to (a) present proof, through testimony and documentary evidence, and (b) to cross-examine witnesses."

NAF: "Hearings should be convenient, efficient, and fair for all."

PRINCIPLE 13. ACCESS TO INFORMATION

AAA Employment: "Adequate but limited pre-trial discovery is to be encouraged and employees should have access to all information reasonably relevant to mediation and/or arbitration of their claims."

AAA Consumer: "Consumer ADR agreements which provide for binding arbitration should establish procedures for arbitrator-supervised exchange of information prior to arbitration, bearing in mind the expedited nature of arbitration."

AAA Health Care: "After a dispute arises, participants should have access to all information necessary for effective participation in ADR."

JAMS Consumer: "The arbitration provision must allow for the discovery or exchange of non-privileged information relevant to the dispute."

JAMS Employment: "The procedures must provide for an exchange of core information prior to the arbitration."

NAF: "The parties should have access to the information they need to make a reasonable presentation of their case to the arbitrator."

PRINCIPLE 14. ARBITRAL REMEDIES

AAA Employment: "The arbitrator should be empowered to award whatever relief would be available in court under the law."

AAA Consumer: "The arbitrator should be empowered to grant whatever relief would be available in court under law or in equity."

AAA Health Care: "The arbitrator should be empowered to grant whatever relief would be available in court under law or in equity."

JAMS Consumer: "Remedies that would otherwise be available to the consumer under applicable federal, state or local laws must remain available under the arbitration clause, unless the consumer retains the right to pursue the available remedies in court."

JAMS Employment: "All remedies that would be available under the applicable law in a court proceeding, including attorneys fees and exemplary damages, must remain available in the arbitration."

NAF: "The remedies resulting from an arbitration must conform to the law."

PRINCIPLE 15. ARBITRATION AWARDS

AAA Employment: "The arbitrator should issue an opinion and award setting forth a summary of the issues, including the type(s) of dispute(s), the damages and/or other relief requested and awarded, a statement of any other issues resolved, and a statement regarding the disposition of any statutory claim."

AAA Consumer: "In making the award, the arbitrator should apply any identified, pertinent contract terms, statutes, and legal precedents.... At the timely request of either party, the arbitrator should provide a brief, written explanation of the basis for the award."

AAA Health Care: "The arbitration award should be in writing, and should be accompanied by an opinion, where requested by an party."

JAMS Consumer: "An Arbitrator's Award will consist of a written statement stating the disposition of each claim. The award will also provide a concise written statement of the essential findings and conclusions on which the award is based."

JAMS Employment: "An arbitration award will consist of a written statement signed by the Arbitrator regarding the disposition of each claim and the relief, if any, awarded as to each claim. The Arbitrator will also provide a concise written statement of the reasons for the Award, stating the essential findings and conclusions on which the award is based."

NAF: No provision

OTHER PROVISIONS

JAMS Consumer: "The arbitration agreement must be reciprocally binding on all parties ...."

JAMS Employment: "JAMS will not administer arbitrations pursuant to clauses that lack mutuality. Both the employer and the employee must have the same obligation (either to arbitrate or go to court) with respect to the same kinds of claims."

APPENDIX 4. DATA CODING INSTRUCTIONS FOR THE CASE FILE SAMPLE

Variable Name	Variable Description	Coding Instructions
Case Identification		
Numb_Orig_Parties	Total number of parties originally involved in the arbitration	Enter the number of parties in the suit, even if one was dropped later.
CaseID	Internal AAA case ID number	Enter the AAA case ID number (12-digit number): first two digits are the region, sixth digit is the last digit of the filing year, and last five digits are the sequence number of the case
Party1_2	Short case identifier	Enter the information in the variables Party1 and Party 2 as "Party1_Party2"
Center	AAA Center that administered the case	Enter the location of the AAA Center that administered the case
Case_Manager	AAA Case Manager	Enter the name of the AAA Case Manager responsible for the case
Parties		
Party1	Name of first party listed	Enter the name of the first party listed on the demand for arbitration
Party_Type1	Type of Party1 involved in dispute	Enter either "consumer" or a brief description of the type of business for Party1
Party_Addr1	Address of Party1	Enter the city and state listed for Party1
Party2	Name of second party listed	Enter the name of the second party listed on the demand for arbitration
Party_Type2	Type of Party2 involved in dispute	Enter either "consumer" or a brief description of the type of business for Party2
Party_Addr2	Address of Party2	Enter the city and state listed for Party2
Party3	Name of third party listed	Enter the name of the third party listed on the demand for arbitration
Party_Type3	Type of Party3 involved in dispute	Enter either "consumer" or a brief description of the type of business for Party3
Party_Addr3	Address of Party3	Enter the city and state listed for Party3
Party4	Name of fourth party listed	Enter the name of the fourth party listed on the demand for arbitration
Party_Type4	Type of Party4 involved in dispute	Enter either "consumer" or a brief description of the type of business for Party4
Party_Addr4	Address of Party4	Enter the city and state listed for Party4
Party5	Name of fifth party listed	Enter the name of the fifth party listed on the demand for arbitration
Party_Type5	Type of Party5 involved in dispute	Enter either "consumer" or a brief description of the type of business for Party5
Party_Addr5	Address of Party5	Enter the city and state listed for Party5
Party_Numb_Claimant	Parties who are the case claimants	Enter the party number of each claimant. If there is more than one, separate with semicolons (;)
Party_Numb_Respondent	Parties who are the case respondents	Enter the party number of each respondent If there is more than one, separate with semicolons (;)

Variable Name	Variable Description	Coding Instructions
Party Representatives		
Rep_Name1	Name of representative for Party1	Enter the name of the representative, if any, listed for Party1 on the demand for arbitration. If the party is the representative enter "pro se".
Rep_Addr1	Address of representative for Party1	Enter the address (city, state) of the representative of Party1
Rep_Name2	Name of representative for Party2	Enter the name of the representative, if any, listed for Party2 on the demand for arbitration. If the party is the representative enter "pro se".
Rep_Addr2	Address of representative for Party2	Enter the address (city, state) of the representative of Party2
Rep_Name3	Name of representative for Party3	Enter the name of the representative, if any, listed for Party3 on the demand for arbitration. If the party is the representative enter "pro se".
Rep_Addr3	Address of representative for Party3	Enter the address (city, state) of the representative of Party3
Rep_Name4	Name of representative for Party4	Enter the name of the representative, if any, listed for Party4 on the demand for arbitration. If the party is the representative enter "pro se".
Rep_Addr4	Address of representative for Party4	Enter the address (city, state) of the representative of Party4
Rep_Name5	Name of representative for Party5	Enter the name of the representative, if any, listed for Party5 on the demand for arbitration. If the party is the representative enter "pro se".
Rep_Addr5	Address of representative for Party5	Enter the address (city, state) of the representative of Party5
Demand for Arbitration - Party# (1 through 5)		
Counterclaim#	Is the claim by Party# a counterclaim?	=1 if yes; 0 otherwise
Amt_Sought#	Dollar amount of damages sought in demand	Enter the dollar amount of compensatory damages sought by Party#; do not include punitive damages. If several parties made a joint claim and the amounts cannot be separated by party, enter the joint claim.
Atty_Fees#	Were attorneys' fees sought in the demand?	=1 if yes; 0 otherwise
Atty_Fees_Amt#	Dollar amount of attorneys' fees sought.	Enter amount of attorneys' fees sought in demand, if amount is specified. If several parties made a joint claim and the amounts cannot be separated by party, enter the joint claim.
Arb_Costs#	Were arbitration costs sought in the demand?	=1 if yes; 0 otherwise
Arb_Costs_Amt#	Dollar amount of arbitration costs sought.	Enter amount of arbitration costs sought in demand, if amount is specified. If several parties made a joint claim and the amounts cannot be separated by party, enter the joint claim.
Interest#	Was interest sought in the demand?	=1 if yes; 0 otherwise
Interest_Amt#	Dollar or percentage amount of interest sought.	Enter amount of interest (including percentage) sought in demand, if amount is specified. If several parties made a joint claim and the amounts cannot be separated by party, enter the joint claim.
Punitives#	Were punitive damages sought in the demand?	=1 if yes; 0 otherwise
Punitive_Amt#	Amount of punitive damages sought in demand	Enter amount of punitive damages sought in demand, if amount is specified. If several parties made a joint claim and the amounts cannot be separated by party, enter the joint claim.
Other_Relief#	Was other relief sought in the demand?	=1 if yes; 0 otherwise
Other_Relief_Des#	Other relief sought in demand	Describe any other relief sought in the demand
LocaleRqtd#	Hearing locale requested by Party# demand	Enter the location sought by Party# in the demand for any hearing to be held
Dispute Description		
Dispute_Des	Subject matter of dispute between the parties	Briefly describe the subject matter of the dispute between the parties

Variable Name	Variable Description	Coding Instructions
	Arbitration Clause	
Pre-Dispute	Was the case submitted to arbitration on the basis of a pre-dispute agreement to arbitration?	=1 if yes; 0 otherwise
Principle1	Does the clause give the business more control over arbitration process than the consumer?	=1 if yes; 0 otherwise
Principle3	Does the clause give the business more control over arbitrator selection than the consumer?	=1 if yes; 0 otherwise
Principle5	Does the clause prohibit consumers from going to small claims court?	=1 if yes; 0 otherwise
Principle6	Would the clause result in the consumer paying more than provided in the AAA consumer fee schedule?	=1 if yes; 0 otherwise
Principle7	Does the clause provide for a locale for the business's benefit?	=1 if yes; 0 otherwise
Principle9	Does the clause restrict the consumer's freedom to pick a representative?	=1 if yes; 0 otherwise
Principle12	Does the clause restrict the manner in which a consumer can provide evidence?	=1 if yes; 0 otherwise
Principle13	Does the clause restrict discovery?	=1 if yes; 0 otherwise
Principle14	Does the clause limit the remedies available to the consumer?	=1 if yes; 0 otherwise
Protocol_Waiver	Does the file contain a waiver by the business of any violation of the Due Process Protocol?	=1 if yes; 0 otherwise
ClassArb_Waiver	Does the arbitration clause contain a class arbitration waiver?	=1 if yes; 0 otherwise
Nonseverability	Does the arbitration clause contain a provision making the class arbitration waiver nonseverable?	=1 if yes; 0 otherwise
	Arbitrators	
Case_Manager_Arb	Name of the case manager who chose the arbitrator or arbitrator list.	Enter the name of the case manager appearing on the initial correspondence with the arbitrators during the arbitrator selection.
Arbitrator_Final	Name of the arbitrator used in the arbitration	Enter the name of the arbitrator used in the arbitration
Arb_Final_Notes	Any notes regarding the Final Arbitrator	Note any ground for objection to the arbitrator used in the arbitration and the resolution of the objection by the AAA. Also note any other relevant information.
Arbitrator_Choice1	Name of the first prospective arbitrator notified	Enter the name of the first prospective arbitrator
Arbitrator_Choice1_Notes	Any notes regarding the first choice arbitrator	Note any ground for objection to the first prospective arbitrator and the resolution of the objection by the AAA. Also note any other relevant information.
Arbitrator_Choice2	Name of the second prospective arbitrator notified	Enter the name of the second prospective arbitrator
Arbitrator_Choice2_Notes	Any notes regarding the second choice arbitrator	Note any ground for objection to the second prospective arbitrator and the resolution of the objection by the AAA. Also note any other relevant information.
Arbitrator_Choice3	Name of the third prospective arbitrator notified	Enter the name of the third prospective arbitrator
Arbitrator_Choice3_Notes	Any notes regarding the third choice arbitrator	Note any ground for objection to the third prospective arbitrator and the resolution of the objection by the AAA. Also note any other relevant information.
Arbitrator_Choice4	Name of the fourth prospective arbitrator notified	Enter the name of the fourth prospective arbitrator
Arbitrator_Choice4_Notes	Any notes regarding the fourth choice arbitrator	Note any ground for objection to the fourth prospective arbitrator and the resolution of the objection by the AAA. Also note any other relevant information.
Arb_Alt	Any comments on arbitrators or arbitrator selection	Note any indication in the file on how the arbitrators were selected this includes ranking information and other arbitrators considered but not necessarily notified

Variable Name	Variable Description	Coding Instructions
Proceedings		
Ex_Parte	Did the case proceed on an ex parte basis (i.e., in the absence of one of the parties?)	=1 if yes; 0 otherwise
Hearing	Was there a hearing?	=1 if yes; 0 otherwise
Hearing_Type	Type of hearing	Enter the type of hearing that occurred (if any) – phone or in-person
Hearing_Days	Number of days of hearing time	Enter the number of days of in-person hearings that were conducted
Hearing_Locale	If in person, the place where the hearing took place	Enter the location (city, state) of any in-person hearing that was conducted
Disposition	How did the case get resolved?	Enter how the case got resolved, using one of the following categories: award, settlement, mediation settlement, withdrawn, closed administratively
Awards - Party# (1 through 5)		
Prevail#	Did Party# prevail in its claim?	=1 if yes; 0 if no; "no claim" if Party# did not make a claim.
Award_Amt#	The amount of any award of compensatory damages	Enter the amount of any compensatory damages awarded to Party#. If several parties received a joint award and the amounts cannot be separated by party, either enter the joint award or enter "see PartyX" where X is the number of the party where the joint award amount was entered.
Punitive_Awd#	The amount of any award of punitive damages	Enter the amount of any punitive damages awarded to Party#. If several parties received a joint award and the amounts cannot be separated by party, either enter the joint award or enter "see PartyX" where X is the number of the party where the joint award amount was entered.
AdminFee_Awd#	The reimbursement of AAA administrative fees in the award	Describe how administrative fees were reimbursed to Party#. If several parties received a joint award and the amounts cannot be separated by party, either enter the joint award or enter "see PartyX" where X is the number of the party where the joint award amount was entered.
ArbFee_Awd#	The reimbursement of arbitrators' fees in the award	Describe how arbitrator fees were reimbursed to Party#. If several parties received a joint award and the amounts cannot be separated by party, either enter the joint award or enter "see PartyX" where X is the number of the party where the joint award amount was entered.
AttyFee_Awd#	The amount of any award of attorneys' fees	Enter the amount of any award of attorneys' fees to Party#. If several parties received a joint award and the amounts cannot be separated by party, either enter the joint award or enter "see PartyX" where X is the number of the party where the joint award amount was entered.
Interest_Awd#	The amount of any award of interest	Enter the amount of any award of interest to Party#. If several parties received a joint award and the amounts cannot be separated by party, either enter the joint award or enter "see PartyX" where X is the number of the party where the joint award amount was entered.
Other_Awd#	The amount of any other award	Enter the amount of any other award to Party#. If several parties received a joint award and the amounts cannot be separated by party, either enter the joint award or enter "see PartyX" where X is the number of the party where the joint award amount was entered.
Reason_Awd#	Did the arbitrator give reasons for his/her award to Party#?	=1 if yes; 0 otherwise
Reason_Awd#_Des	The reason given for the award and/or other relevant notes	Enter the reason given for the award or any other relevant notes to the award

Variable Name	Variable Description	Coding Instructions
	Costs	
Ruling_AdminFee	The allocation of AAA administrative fees as given in the arbitrator's ruling	Enter the arbitrator's ruling on AAA administrative fees
AdminFee_Pd1	Admin Fee paid by Party1 in accordance with the arbitrator's ruling	Enter the administrative fee paid by Party1 in accordance with the arbitrator's ruling
AdminFee_Pd2	Admin Fee paid by Party2 in accordance with the arbitrator's ruling	Enter the administrative fee paid by Party2 in accordance with the arbitrator's ruling
AdminFee_Pd3	Admin Fee paid by Party3 in accordance with the arbitrator's ruling	Enter the administrative fee paid by Party3 in accordance with the arbitrator's ruling
AdminFee_Pd4	Admin Fee paid by Party4 in accordance with the arbitrator's ruling	Enter the administrative fee paid by Party4 in accordance with the arbitrator's ruling
AdminFee_Pd5	Admin Fee paid by Party5 in accordance with the arbitrator's ruling	Enter the administrative fee paid by Party5 in accordance with the arbitrator's ruling
Ruling_ArbFee	The allocation of arbitrator fees as given in the arbitrator's ruling	Enter the arbitrator's ruling on arbitrator fees
ArbFee_Pd1	Arb Fee paid by Party1 in accordance with the arbitrator's ruling	Enter the arbitrator fee paid by Party1 in accordance with the arbitrator's ruling
ArbFee_Pd2	Arb Fee paid by Party2 in accordance with the arbitrator's ruling	Enter the arbitrator fee paid by Party2 in accordance with the arbitrator's ruling
ArbFee_Pd3	Arb Fee paid by Party3 in accordance with the arbitrator's ruling	Enter the arbitrator fee paid by Party3 in accordance with the arbitrator's ruling
ArbFee_Pd4	Arb Fee paid by Party4 in accordance with the arbitrator's ruling	Enter the arbitrator fee paid by Party4 in accordance with the arbitrator's ruling
ArbFee_Pd5	Arb Fee paid by Party5 in accordance with the arbitrator's ruling	Enter the arbitrator fee paid by Party5 in accordance with the arbitrator's ruling
Total_AdminFee	Total administrative fee paid by the parties	Enter the total amount paid by the parties for administrative fees
ArbComp	Arbitrator compensation billed by the AAA	Enter the total amount of arbitrator compensation billed by the AAA
MedComp	Mediator compensation billed by the AAA	Enter the total amount of mediator compensation billed by the AAA
	Dates	
Date_Filed	The date the claimant filed the demand for arbitration	Enter the date (mm/dd/yyyy) the claimant filed the case with the AAA (based on the date stamp on the demand for arbitration)
Date_Assigned	The date the AAA entered the case in its system	Enter the date (mm/dd/yyyy) the AAA entered the case in its system
Date_ArbList1	The date the AAA entered the first list of arbitrators in its system	Enter the date (mm/dd/yyyy) the AAA entered the first list of arbitrators in its system
Date_ArbList2	The date the AAA entered the second list of arbitrators in its system	Enter the date (mm/dd/yyyy) the AAA entered the second list of arbitrators in its system
Date_ArbList3	The date the AAA entered the third list of arbitrators in its system	Enter the date (mm/dd/yyyy) the AAA entered the third list of arbitrators in its system
Date_Arb_Apptd	The date the AAA appointed the arbitrator	Enter the date (mm/dd/yyyy) the AAA appointed the arbitrator
Date_PrelimHng	The date of the preliminary hearing	Enter the date (mm/dd/yyyy) of the preliminary hearing
Date_FirstHng	The date of the first hearing	Enter the date (mm/dd/yyyy) of the first hearing
Date_LastHng	The date of the last hearing	Enter the date (mm/dd/yyyy) of the last hearing
Date_HngClosed	The date the arbitrator closed the hearing	Enter the date (mm/dd/yyyy) the arbitrator closed the hearing
Date_Award	The date the arbitrator issued the award	Enter the date (mm/dd/yyyy) the arbitrator issued the award
Date_CaseClosed	The date the AAA administratively closed the case	Enter the date (mm/dd/yyyy) the AAA administratively closed the case
	Comments	
Database	The AAA database from which the record originated	Enter "Under $75" or "Over $75"
Comments	Any other comments about the case file	Enter any other comments about the case file not covered in one of the previous entries

EXHIBIT E

FTC WORKSHOP—PROTECTING CONSUMER INTERESTS IN CLASS ACTIONS

September 13-14, 2004

WORKSHOP TRANSCRIPTS

Panel 1: The Use of "Coupon" Compensation and Other Non-Pecuniary Redress

The following is a transcript of a panel discussion from a workshop, *Protecting Consumer Interests in Class Actions*, co-sponsored by the Federal Trade Commission and *The Georgetown Journal of Legal Ethics*.[1]

MS. KOLISH

Good morning, everyone. I'm the Associate Director for the Division of Enforcement in the Bureau of Consumer Protection. My division, along with many colleagues from other offices, have had the pleasure of putting together this event today.

. . . .

And now, I'd like to introduce the new chairman of the FTC, Deborah Platt Majoras. As you know, Chairman Majoras is a distinguished antitrust practitioner who also has experience doing class action litigation, but in the short few weeks she has been here she has demonstrated a great deal of interest in the consumer protection law that we practice here, and she's rapidly becoming a master of those issues.

Now, this comes as no surprise to me because I believe that all antitrust lawyers, whether they know it or not, secretly want to be consumer protection

1. Editor's Note: The following text was transcribed from audio tapes of the panel discussions and only lightly edited. For more information on the Workshop, please visit the web site for the event at http://www.ftc.gov/bcp/workshops/classaction.

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lawyers. And why not? After all, it's the stuff that vividly, directly, and personally affects all of us. And I think it just has to be more fun than figuring out whether paper cups or Styrofoam cups are in the same market. So that's my take on consumer protection and antitrust. And with that, Chairman Majoras.

CHAIRMAN MAJORAS

Good morning and welcome to the Federal Trade Commission's workshop on Protecting Consumer Interests in Class Actions. I'd like to extend a special welcome to our fellow enforcers with the states, and I'd also like to recognize our distinguished members of the judiciary who are here with us today.

The Honorable Diane Wood, Circuit Court of Appeals judge for the Seventh Circuit; the Honorable Brock Hornby, U.S. District Court judge for the District of Maine; the Honorable Vaughn Walker, U.S. District Court judge for the Northern District of California; the Honorable Lee Rosenthal, U.S. District Court judge for the Southern District of Texas; and the Honorable Ann Yahner, Administrative Law judge for the District of Columbia, Office of Administrative Hearings. We're very grateful for your participation in our workshop.

I'd also like thank the *Georgetown Journal of Legal Ethics*, our co-sponsor, and in particular, Jaimie Kent, the editor of the Journal. The Journal will be publishing a transcript of our proceedings, and I understand also that if you are inspired by our workshop to write, that they will, in fact, be accepting articles for publication.

I am particularly pleased to open this workshop, my first as FTC Chairman. As most of you know, and as Elaine has reminded us, I am an antitrust lawyer, and I've long understood that the goal of antitrust is to protect and enhance consumer welfare.

Since joining the FTC—Elaine is right—I have immersed myself also in the FTC's vital consumer protection mission, which has the same goal. And as I have learned in just the last month, FTC should be the acronym For The Consumer, which aptly summarizes the joint goal of both our competition and our consumer protection missions.

In holding this workshop, we continue the FTC's practice of hosting fora to discuss issues of concern to consumers. Private litigation in both the competition and consumer protection fields has always played a significant role in compensating consumers and in deterring wrongful conduct. Managed appropriately, consumer class actions can be an effective and efficient way to do both.

As consumer class actions have evolved over time however, concerns have been raised about whether some of these actions, and in particular some of the settlements of these actions, truly serve consumers' interests by providing them appropriate benefits.

Under the leadership of my predecessor, former Chairman Tim Muris, the Commission sought to address these concerns by initiating the Class Action

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Fairness Project. The goal of that project was simple: to ensure that when consumers have meritorious claims they get meaningful, not illusory, relief.

It's now time to evaluate the results of this project as well as to examine the benefits and shortcomings of the class action mechanism. As my colleague Commissioner Tom Leary has stated, the FTC is a very small agency with a very large mission. And as such, we have never been shy about asking for help.

To this end here, we have enlisted an impressive array of experts from the bench, the bar, and academia to help us explore the complex issues raised by class actions. And I know that the Commission will benefit from the expertise of our assembled panelists, and we hope those of you in the audience.

Since the FTC began the project, many observers have asked why the FTC is involved in the consumer class action area at all. Contrary to what some may have concluded, the FTC is not opposed to class actions. Rather, the FTC is interested in consumer class actions, and in particular, consumer class action settlements, because they raise issues that are at the core of the FTC's consumer protection mission.

In fact, in recent years we have seen numerous consumer class actions related to cases that the FTC has already brought, and in some instances we've worked closely with class attorneys to obtain effective relief for consumers.

Unfortunately, however, in some cases class actions may have been an impediment to truly protecting consumers. The Commission therefore has participated as an amicus in cases where it believed the interests of consumers were inadequately represented or, in some instances, not represented at all.

The FTC's primary concern has been whether coupon and other non-pecuniary redress provide adequate relief to consumers. Such settlements are notoriously difficult to value, yet their face value is typically used as a basis for setting fees.

This can pose two related problems. First, consumers may not get meaningful relief or the amount of relief claimed. And second, class counsel's compensation may be inflated due to the overly optimistic value of the coupon settlement.

In our first panel today, we'll specifically address this type of relief and provide an opportunity to discuss these issues in a broader context than an individual case may allow.

Amicus briefs are not the only activity within the Class Action Fairness Project. As the Commission has done with respect to a host of important issues, it has used its educational platform to provide helpful information to consumers.

Specifically, the Bureau of Consumer Protection has published a piece entitled, "Need a Lawyer? Judge for Yourself." And the purpose of this piece is to ensure that consumers who need a lawyer are fully informed of their rights and their options.

Among other recommendations, this piece advises 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.

And in addition to this education, the Commission has also offered the consumer perspective on the proposed amendments to Federal Rule of Civil Procedure 23 to the Federal Judicial Conference.

Our panels over the next two days will address the question of attorneys' fees and how consumer class actions can fairly compensate lawyers while protecting consumers. In other panels we'll address equally important issues such as special ethics concerns, which is particularly apt considering our co-sponsor, the *Georgetown Journal of Legal Ethics*.

Through this dialogue we hope to gain insights on a full range of issues; there are four in particular relating to the Class Action Fairness Project. First, we would like to explore strategies for making class action settlement information available in a more systematic and comprehensive way.

It may surprise you to learn that one of the greatest challenges for the project has been identifying potentially troublesome class settlement terms with sufficient lead time to permit evaluation and, if perceived necessary, action.

In some instances, interested parties, attorneys, objectors, and consumer advocacy groups have provided us with this information, but more often, settlements have come to the Commission's attention by chance—for example, through an FTC staff member reading about a particular settlement in the newspaper or actually as a member of a class receiving a notice.

Other interested parties may be also finding it difficult to obtain this information, and we would like to talk about that.

Second, we would like to solicit feedback on the amicus component of our project. To date, the FTC settlement objections have focused particularly on two issues: coupon settlements and excessive attorneys' fees. The Commission's briefs have also raised to a lesser degree such issues as insufficiently clear notices, burdensome claims procedures, and so-called piggyback class actions.

Are these the issues that raise the greatest consumer concerns? Are there other issues on which we should be focusing our attention?

Third, we'd like to solicit input on the empirical research component of our project. In addition to our capabilities in law enforcement, we have substantial policy analysis and research capabilities which we implement not only using our attorneys but also the Bureau of Economics, one of the world's preeminent teams of industrial organization economists.

The FTC strives not only to ensure that we improve the procedures directly under our control, but we also work with public bodies to promote the development of approaches that would enhance consumer welfare. And we hope that this workshop will provoke discussion about how we can use our research resources to bear on important questions.

And finally, looking beyond the limited role of our own agency, we would like the panels to explore opportunities for more effective coordination among all of the parties involved in the class action process. More participation and especially parallel participation by states and private attorneys may be helpful in some

cases. And we hope that the workshop will provide an opportunity for all entities to discuss the fundamental issue of coordination.

Before concluding I would like to acknowledge the FTC staff who has worked so diligently in planning this workshop. First, in the Bureau of Consumer Protection's Enforcement Division, Elaine Kolish from whom you've already heard this morning; Assistant Director Robert Frisby; attorneys Pat Bak, Adam Fine, and Angela Floyd, and paralegal Heather Thomas.

In the Office of Policy Planning, Maureen Ohlhausen, Acting Director; and John Delacourt, Chief Antitrust Counsel. In the Bureau of Economics, Joe Mulholland, and finally in BCP's Office of Consumer and Business Education, Erin Malick and Callie Ward.

And now I will turn this over to John Delacourt to begin our first panel. Thank you again for being here.

MR. DELACOURT

Thank you, Chairman Majoras. I think we're ready to begin. Our first panel this morning is on the use of coupon compensation and other non-pecuniary relief in class action settlements.

All of our panelists have done quite a bit of thinking on this issue and some of them have extensive experience both in court and in settlement negotiations, so rather than standing in the way of their collective wisdom I will try to keep my own initial remarks pretty brief.

To date, the FTC's Class Action Fairness Project has consisted primarily of a series of amicus objections to particularly problematic class action settlements. Even in these early stages of the project, however, the use of coupon compensation has already become a recurring target.

One reason for this is that coupons, much more so than cash compensation, are difficult to value and may offer class members only speculative relief. This was the situation that confronted the Commission in *Erikson v. Ameritech*.

In that case, the defendant was alleged to have made deceptive representations regarding its voice mail service and proposed to settle the case by offering to class members coupons for one free month of speed-dial service.

FTC staff objected to this arrangement, however, noting that among other problems, after the initial free month, class members that took advantage of this offer would be enrolled in a speed dial program on a continuing basis at the full subscription rate unless they took active steps to cancel the service. In other words, the proposed settlement was more akin to a promotional gimmick than to a genuine effort to provide injured consumers with relief.

A second reason for heightened FTC scrutiny of coupon compensation is that due to their speculative value, coupons can be used in certain situations to inflate attorney fee awards. This was the situation that confronted the Commission in *Haese v. H&R Block*.

In that case, the defendant was alleged to have made deceptive nondisclosures regarding its arrangements with other financial institutions when issuing refund anticipation loans. The defendant proposed to settle this case by offering class members coupons for a variety of products and services including H&R Block tax preparation services, do-it-yourself tax preparation software, and do-it-yourself tax preparation books and worksheets.

Though the use of many of these coupons was mutually exclusive, for example, if you're a do-it-yourselfer you don't have any need for H&R Block tax preparation services, class counsel proposed to base its fee on the total value of all of the coupons. That factor, as well as various flaws with the coupons themselves, ultimately triggered an FTC objection.

Perhaps the best example of the stark contrast between cash and non-cash compensation, however, is a case that is both more recent and likely more familiar to many of you, that is, the music CD minimum-advertised price litigation.

In order to resolve the variety of antitrust charges, the defendant music distributors in that case agreed to a hybrid settlement that included both a cash and a non-cash component. Defendants agreed to pay $67 million in cash directly to consumers. They also pledged to distribute 5.6 million CDs to governmental and nonprofit organizations such as public libraries.

While I can't claim to have any particular knowledge of an official consensus on the settlement, my own anecdotal experience was that the cash component was very well received. I spoke with a number of acquaintances just in the ordinary course of things who indicated that they thought the claims procedure was very easy. You could file online. They were happy with the fact that they received their compensation right away, and many of them were actually amazed that they received a check. That had not been their experience in other cases.

So though the checks were relatively small, in the range of $13 to $16, they were very happy to receive a check. So that was the cash component which received high marks all around.

The non-cash component, that is, the 5.6 million CDs that were distributed to public libraries, was another story. That portion of the settlement continues to be subject to criticism.

In a recent news story, for example, an official from the Milwaukee public library described some of the CDs that his institution received. Among the take for the settlement are the following: not one, but 104 copies of Will Smith's *Willennium*.

For those of you who are not Will Smith's fans, there are also 188 copies of the Michael Bolton classic, *Timeless*. And finally, there were 1,235 copies of Whitney Houston's 1991 recording of the national anthem. So I can only conclude that the defendants must have regarded this particular single as an underappreciated work.

So anyways, subsequent reporting on this portion of the settlement revealed

that in fact Milwaukee's experience was not an anomaly, that in Virginia, for example, they received 1600 copies of the Whitney Houston single, and in Maryland they received 1200 copies.

Adding insult to injury, defendants valued this non-cash component of the settlement at almost $76 million. So that was more than the $67 million in cash. Furthermore, this $76 million figure was incorporated into the total settlement value from which class counsel's attorney fee was ultimately derived.

So clearly, there is room for improvement with respect to coupon compensation in class action settlements, and for that, I will ask the assistance of the panelists.

Before I begin, however, I should raise one final issue, and that is that we will be taking questions today. I believe there are 3 x 5 index cards included in the folders that you received this morning, so if you have a question, please write it down on the card and get the attention of an FTC staff person, and they will make sure that those cards are passed to the front so that I can read and pass them on to the panelists.

So with that out of the way, I will turn to our first panelist, Professor Christopher Leslie, immediately to my left. Professor Leslie is an Associate Professor of Law at Chicago Kent College of Law. His current research focuses on antitrust and business law, as well as class actions.

In particular, I would like to commend to you his article, "A Market-based Approach to Coupon Settlements in Antitrust and Consumer Class action Litigation," which was published in the UCLA Law Review and recently, because of our program, was also added to the FTC's web site. Professor Leslie.

PROF. LESLIE

I would like to thank John and his colleagues at the FTC for holding this important workshop and for inviting me to participate.

Like most private litigation, the primary purposes of class action litigation are to compensate individuals for their injuries and to deter misconduct by disgorging ill-gotten gains. The success of any class action lawsuit should be evaluated based primarily on whether or not it achieves one or both of these goals.

Also, like most private litigation, most class action litigation settles. However, unlike private litigation, class action settlements run a significant risk of collusion between opposing counsel. This is particularly the case with coupon settlements.

When the class members are paid in coupons, each class member will have one of four outcomes. First, the class member might not use the settlement coupon at all. This nonuse outcome results in the class member receiving nothing of value from the settlement. There is no compensation. Similarly, the defendant pays out nothing to that class member, and there is no disgorgement.

Second, the class member could use the coupon because the settlement coupon

induced her to make a purchase that she otherwise would not have made. This induced purchase outcome occurs when the class member makes a purchase with her settlement coupon simply to avoid the feeling of getting nothing from the settlement.

The defendant is actually in a better position in this scenario because it makes a sale that it otherwise wouldn't have made and gets that additional marginal profit. The settlement coupon operates as a promotional coupon. This is the antithesis of disgorgement.

Third, the class member could use her coupon for a purchase that she was planning to make anyway. This non-induced purchase outcome shows that settlement coupons are not inherently worthless. The class member who uses the coupon for a planned purchase receives, in essence, a payment equivalent to the face value of the coupon. The defendant loses money if that purchase would have taken place without the settlement coupon. Thus, there is some level of both compensation and disgorgement.

Fourth and finally, the class member could transfer the settlement coupon to a third party who uses it. This transferred use outcome is a variant of the third. Only someone other than the class member is redeeming the coupon and making a non-induced purchase. The class member receives value if she sells that settlement coupon to the person who eventually uses it.

Because defendants prefer outcomes where the class member either does not use the coupon, and thus the defendant pays nothing, or the class member uses the coupon for an induced purchase, and thus the defendant earns additional revenue. Defendants often structure settlement coupons to increase the probability of one of these first two outcomes occurring.

Defendants do this by imposing often one of five common restrictions in settlement coupons. First, there are limits on transferability. Settlement coupons are sometimes nontransferable. In some cases, they limit transfers of the coupon to within households, or they limit the number of times that the coupon can be transferred. Or they reduced the value of the coupon if it is transferred to a nonclass member. All of these transfer restrictions reduce the value of the settlement coupon and reduce the probability of the settlement coupon ever being used.

Second, short settlement coupon expiration dates reduce the probability of use. Settlement expiration dates can be as short as a few months, such as the 120 days in the Cuisinart case. This is particularly a problem with durable goods where class counsel and defendants had proposed settlement coupons in heavy trucks where the consumers had to use the coupons within 15 months even though the trucks they had bought to qualify for class membership would last a lot longer than that.

Third, restrictions on coupon aggregation reduce the value of settlement coupons. Coupon aggregation would allow class members to combine settlement coupons with other available discounts or to combine multiple settlement

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coupons in a single purchase. Defendants commonly structure settlement coupons to preclude both types of aggregation. This negates the value of the settlement coupon.

For example, in the recent *Schneider v. Citicorp Mortgage* case, the proposed settlement coupon was for $100 and could not be aggregated with any other discounts. Yet, a $500 discount was widely available. Thus, any class member who actually used the coupon would be foregoing a $400 net discount available to everybody who was not a member of the class.

Fourth, redemption restrictions are common. Some class action settlements have involved class members receiving multiple coupons that can only be redeemed over time in specific intervals. For example, one settlement provided each class member with 40 coupons that could only be used once a quarter over the next ten years.

Fifth and finally, product restrictions are common. For example, in the Cuisinart settlement, the settlement coupons could be used for anything except food processors. In the much-hyped antitrust airlines litigation, the coupons to be redeemed for discounts on airlines couldn't be used during blackout dates, such as Christmas, Thanksgiving, holidays, i.e., when people would actually want to use the discounts.

The net effect of these restrictions is low redemption rates of settlement coupons, as low as 3 percent, 1 percent, and in one famous case, 0.002 percent redemption rates.

Besides these restrictions, other problems with settlement coupons include that most settlement coupons require the class member to continue doing business with the very defendant in order to receive any compensation.

Also, defendants can set settlement coupon values so that the defendant still makes a profit on each sale in which the class members redeem settlement coupons. The *Haese v. H&R Block* case that John referred to is typical here: after the settlement was announced, H&R issued a press release that assured people that the settlement really wouldn't do anything because they were going to make money on every sale that involved a settlement coupon.

Finally, there is the risk that defendants can negate the value of settlement coupons either by increasing the price of their product or by reducing the quality.

The class action system is designed with three potential safeguards to prevent these inadequate settlements.

First, the class counsel is supposed to negotiate a settlement in the best interest of the class. Second, class members are given the opportunity to object to any proposed settlement, and third, the proposed settlement must be approved by a judge who determines whether it is fair, adequate, and reasonable.

Unfortunately, evidence suggests that the safeguards may fail in the context of coupon settlements. First, because of agency cost, class counsel may pursue their own interests instead of those of the class. Because the class counsel are paid in cash, often based on a percentage of the face value of the settlement coupons, the

class counsel may maximize their attorney fees by negotiating a coupon settlement even if that settlement provides little real value to the class.

Defendants have a strong incentive to laden settlement coupons with restrictions that increase the probability of either the nonuse outcome or the induced purchase outcome. And the class counsel have insufficient incentive to prevent this so long as the aggregate face value of the coupons is high and the class counsel is being paid in cash.

Rational defendants will be willing to pay higher attorney fees in exchange for class counsel agreeing to allow restrictions on settlement coupons. Unfortunately, the interests of the defendant and the class counsel are more aligned at this point than the interest of the class counsel and the class members.

Second, class members appear ill-equipped to monitor the class counsel and to protect their own interests. The class counsel controls the relevant information. Notices of the proposed settlement are often opaque, and the terms of the coupon settlements are often too confusing to understand. In some cases, class members have thought that they were the ones being sued instead of they were the ones being offered the coupons.

Many judges appear unreceptive to class member objections as well. Furthermore, given the low stakes for each individual class member, it is perfectly rational for class members to remain silent even if they think the coupon settlement is not worth anything.

Third, with a few notable exceptions, reviewing judges may be loath to reject proposed coupon settlements. Some judges treat the face value of coupons as their true value even though this is not the case.

Judges cannot be faulted. It is exceedingly difficult to calculate the true value of settlement coupons, especially when they are laden with restrictions. Add to that both the defense counsel and the class counsel are singing the praises of the coupon settlement.

Systemic pressures also play a role here. The judge must accept or reject a proposed settlement in its entirety, and there is some level of traditional deference to class counsel who, after all, is there to protect the interests of the class. All of these make it difficult for a judge to reject a coupon settlement.

In sum, despite the safeguards in place to protect class members, the problem remains that class action litigation is often settled with settlement coupons that are largely worthless.

In my scholarship, I have discussed potential responses to this, including banning settlement coupons, restructuring them, imposing minimum redemption rates, and even having the class counsel paid with the exact same currency as the class. Thus, the class counsel would receive coupons if the class does.

In this forum I would like to consider two new potential solutions. First, collecting greater data so that we can study the problem and get a better understanding of what restrictions are imposed on settlement coupons and the effects of these restrictions. And second, encouraging greater FTC intervention

and fairness hearings to evaluate coupon-based settlements, including having the FTC receive notice of all proposed settlements, especially those that involve coupons. And I will save the discussion of those for the group discussion, which I am very much looking forward to.

MR. DELACOURT

Thank you very much, Professor Leslie. Our next panelist is Judge Brock Hornby. Judge Hornby is a United States District judge for the District of Maine. He has dealt with class action issues extensively from the bench and most recently has presided over the much-maligned MDL music CD cases, although I must note that I was very happy with the cash component, as well as the new motor vehicle Canadian export antitrust litigation. Judge Hornby.

JUDGE HORNBY

Thank you. Good morning. I'm here on the panel to give you the judge's perspective. I hope you find it helpful, but remember what George Burns said. He said, "I was married by a judge. I should have asked for a jury."

Many of the positions that you're going to hear on this panel and at this conference are what I call political with a small P. They represent substantive policy preferences about how money or goods should be distributed among plaintiff class members, defendants, lawyers, and others. And typically, they either endorse or they bemoan class actions or class action lawyers.

Well, as the judge on this panel, I'm not going to take a position on those issues. Instead, I'm going to speak from a judge's perspective and try to tell you what a judge looks for when he or she is presented with a proposed settlement involving coupons or other non-monetary relief.

I'm also going to talk about some of the baggage that a judge brings to the task, because I think many of you have an unrealistic expectation of what we judges are capable of. In fact, I'm reminded of the psychiatric evaluation that I commissioned for a defendant whose competence was in question for trial, and the Bureau of Prisons psychiatrist at the customary interview was asking him what the role was of all the various participants in the courtroom. And when it came to the judge, his response was, and this is a direct quote, the judge "takes the facts presented to him and makes everybody happy, justice or something."

I think some of you think that's what judges are capable of. We're not. Remember first that American judges are accustomed to resolving disputes in an adversary system. Originally, we were umpires. When a judge is called upon to decide a case or a conflict, we're trained to do so by applying legal rules, attempting to limit our individual value preferences.

Yet, over the last twenty-five years we have become case managers, and we've learned to manage litigation and settle cases, but even there we start from an

adversarial perspective. For us, a good settlement in the typical case is one that first and foremost makes the lawsuit go away, a settlement that will stick, not come unglued.

If we suggest an appropriate settle amount in such cases, we come up with a number, not by determining what's good for the plaintiffs or what the defendant ought to pay, but by asking what's the overall financial exposure of the defendant in a collectible judgment? In other words, what amount could the plaintiff actually put in his or her pocket after a trial and an appeal, and then we discount it by the risk of losing the case and the transaction costs of getting there, things like legal fees, expert fees, administrative downtime, things like that.

In encouraging the parties to settle a typical case, we're merely trying to bring the particular dispute to a conclusion. We're not expressing a viewpoint about litigation or justice or particular kinds of litigation or settlement categories.

And then suddenly we're told that things are different in settling a class action, that there judges are fiduciaries for the entire class. It's a catchy label, but it's dangerously misleading as a description of what trial judges are able to do.

Lawyers are fiduciaries. Trust officers are fiduciaries. Certain kinds of agents are fiduciaries. Fiduciaries have a duty of loyalty to a particular client that supercedes other obligations. In fulfilling their role they go out and investigate on their own. They acquire an expertise. They hire professionals to do work for them. They follow certain standards, and they are sued when they fail.

That's not what most judges do for a living. In fact, some of you suggested a judge should turn down a coupon settlement even though it might have a small benefit to the class, should turn it down for institutional reasons, or so that other class actions might be better in the future. A fiduciary could not do that.

So what does a so-called fiduciary judge do when he or she is presented with a proposed settlement in a class action? All the lawyers, the adversaries with whom he's accustomed to deal, are lined up on the same side defending the settlement.

The judge wonders, how am I to evaluate this proposed settlement? Should I accept what they say or should I independently gather evidence? Shall I subpoena witnesses or documents? Shall I commission experts to conduct independent studies at substantial expense?

If I want assistance or advice, I can't just pick up the phone and call a professor I know. That would probably be unethical. I can only consult a colleague or law clerks who, like me, are trained only in law.

In other words, the judge who's faced with a class action settlement is more than ordinarily anxious. Now, Judge Posner of the Seventh Circuit suggested a dozen years ago that perhaps a different model is needed. He said, and I'm quoting, "Judges in our system are geared to adversary proceedings. If we're asked to do non-adversary things we need different procedures."

In class actions—Judge Posner was speaking of attorney fee requests—lawyers are not like adversaries in litigation. They are like artists requesting a grant from the National Endowment for the Arts. Grant-making organizations

establish non-adversarial methods for screening applications. Perhaps we need something like that for cases like this, the case he was referring to.

I suggest that Judge Posner hit upon a much broader problem than attorney fee requests. His observation applies to class action settlements in general. It applies to consent decrees proposed by the parties in government-initiated litigation like environmental lawsuits. And it applies to other instances where the adversarial system no longer works.

I've not seen a good response to his observation. I can assure you that I've not seen judicial education that focuses on this unique role for a judge, and most judges do not get a steady diet of these kinds of cases so as to become self-taught.

So what does the anxious judge actually do in this context where he's asked to make a decision without legal rules and with no parties arguing the pros and cons? We don't like to subpoena witnesses. If we do, we may prejudice our ability to try the case later. We look for some kind of checklist of items against which to measure the application for settlement approval.

It may not actually tell us where to come out on a question, but it gives some comfort that we're engaging in a rational assessment that can be defended. So perhaps instinctively we are behaving somewhat like a grant-making organization that promulgates criteria and measures applications against them. But I'm sure we could learn or be taught a lot more about improving those techniques.

What does a judge do in particular when presented with a settlement involving coupons and other non-monetary relief? First, we look to the Rule 23 language and the case law, and they both tell us that neither device is absolutely prohibited.

And that's appropriate. Never say never. There are limited cases where these devices can add value to everyone's benefit, but they are certainly greeted now with emphatic skepticism by judges given all the public and appellate criticism. After all, with or without life tenure, we don't like to be publicly criticized. We live in communities just like all of you do.

So we look for additional factors or criteria against which to measure the proposed coupons or cy pres relief. We look carefully at what the appellate courts say about them too because we don't like being reversed on appeal.

I've summarized in my outline that's online what the cases and commentators say are the important factors, and other panelists refer to them as well. I'm not going to list them all here. If necessary, during the discussion we can talk about them, but most judges, most federal judges will consider each of these factors. So if you are supporting or opposing a proposed settlement, you'd be well advised to take them into account as well.

Just a comment about the valuation problem. A judge is hard pressed to put a dollar value on coupons or alternative relief, but remember that what Professor Leslie has called noise in his written remarks is already present, that a judge already has to do a lot of guessing in evaluating even a straight dollar settlement of a class action.

After all, we don't see all the discovery materials. We don't see the witnesses' performance at deposition. We don't know which witnesses are available or unavailable for trial. We don't know what the weaknesses are in the expert's opinion. We haven't seen the e-mails and the documents.

We can make a pretty good assessment of the status of the law, but on the facts we have to make an informed guess or go by instinct. Coupons and cy pres just add more uncertainty to the uncertainty that's already there in that context.

Greater FTC involvement as an amicus or perhaps as an intervener would certainly be welcomed by most judges that I know as consistent with the adversarial universe that we're accustomed to. In other words, the FTC's presence presenting evidence and argument to the Court would restore some of the balance currently lacking.

It would also be a useful antidote to a growing unease some of us have about the role of objectors, professional objectors who first appear and then they disappear, perhaps being bought off, we're told, or perhaps pressing a narrow or broader political or policy objective.

The FTC role would be somewhat like the role of state attorney generals who prosecute civil lawsuits in some of our courts, although I realize that some of you here are distinctly unenthusiastic even about their role. But there is also this other risk that if the FTC intervenes or files an amicus more than occasionally to attack coupon settlements, will there be an inference that its failure to do so is somehow tacit approval? I just raise that question.

In conclusion, let me say that unlike the Rand study authors of a few years ago, the class action one, an excellent analysis that you ought to read, if you haven't done so, but I do not volunteer judges as the solution to what some of you call the class action problem. We're not ombudsmen. We're not trained for it. We are not information gathering judges like are civil law counterparts. We're not trained for that either. We will do our best, but you won't be satisfied.

Remember, the public, Congress, the legislatures are not even satisfied with how we sentence criminals. We've been doing that for hundreds of years, and we can't get that right. So if you think that we're going to do better in this more open-ended job of settling class actions, I think we need to think again. Thank you.

MR. DELACOURT

Thank you, Judge Hornby. Our next panelist, as some of you may have noticed, is a last minute replacement. We had originally scheduled Steven Hantler from DaimlerChrysler but now we have, in his stead, Leah Lorber.

Leah is of counsel in the public policy group in the Washington, D.C. office of Shook, Hardy & Bacon. And I also have a note here that she was named a legal reform champion by the America Tort Reform Association in 2004. Leah.

MS. LORBER

Thanks. I wanted to first thank the Federal Trade Commission and the Georgetown Journal of Legal Ethics for having this symposium. I also wanted to thank Steve Hantler for getting sick so I could show up and talk at it, although I think he'll get well pretty quickly, and I'd like to refer everybody to his remarks that are online.

I'm glad that John described to you my background a little bit so you have some context for my remarks. I'm a defense attorney. I've done public policy tort reform work for the last five years so I take a pretty predictable approach.

I think that coupon settlements create a perverse incentive for over-lawyering. They waste litigant and court resources to no real consumer benefit. Attorneys bring them so they can get high fee awards and some courts, particularly in state courts—just so Judge Hornby doesn't get mad at me—know that companies will settle class actions rather than litigate them. So I think it encourages courts to certify weak cases.

Basically, what I wanted to do was tell you about some of my favorite coupon settlement stories today. Professor Leslie had already talked a little bit about the airline price-fixing case in the early 1990s. This is a case where a number of different airlines were sued for price-fixing because they used a consumer-accessible database in order to track ticket prices.

The settlement resulted in $408 million in discount airline tickets and $50 million in attorneys fees and administrative costs. The reason I like this one is this is the first time I'd ever heard of a class action lawsuit.

I was right out of college in a very low-paying job, and I had a long-distance boyfriend. We flew back and forth constantly. I had huge credit card bills because I couldn't afford to pay them off, and I thought I was going to get some money to pay off my debt.

Well, when the settlement was announced, it wasn't worth anything to me as a consumer. There were blackout dates. I couldn't combine the discounts with any kind of other ticket discounts, and at most it was good for 10 percent off a flight.

The critics, including some of the counsel for the objectors, said that this was a promotional scheme to induce travelers to fly and a deal worked out so plaintiffs' lawyers could collect fees of up to $1400 an hour.

Some of the other coupon class settlement cases that I've been interested in reading about include the case against the makers of Cheerios. In this case, General Mills was sued because pesticides approved for use on grains other than oats had come into contact with the oat grains for Cheerios. The plaintiffs' counsel admitted that nobody had been hurt. The lawyers got $1.35 million in fees and class members got a coupon for a free box of Cheerios, if they had kept their grocery store receipt proving that they had bought one in the first place.

A similar case was the Poland Springs case. Poland Springs was sued for allegedly selling bottled water that was not pure. The lawyers got $1.75 million in

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fees, and the class got more bottled water.

These can go on and on. The earmarks of coupon settlements that cause the problems for us is basically that as these stories show, the consumers don't get value and the plaintiffs' lawyers do. Often, consumers have to buy more of the product or service in order to get some benefit from the coupon settlement in the first place.

Several people today have already talked about the H&R Block case. H&R Block was sued for allegedly taking kickbacks from a bank that issued loans to H&R Block's tax preparation customers. The lawyers got $49 million, and the class got up to $45 per year in coupons for tax software and planning materials. To get the benefit of a $20 coupon to run your tax return preparations, the typical plaintiff would have to spend $102.

Other cases include a suit against Blockbuster Video for inflated overdue video fees where the class got a dollar off of future coupon (sic) rentals. In a case against a computer manufacturer for allegedly misrepresenting the size of the computer monitor, the class got $13 rebates on new computers and monitors or $6 in cash.

A lot of times these lawsuits aren't necessary in the first place. Sometimes, we believe that they are just cooked up by plaintiffs' lawyers who want to make a big fee. A Florida trial judge has called coupon settlement cases the class action equivalent to squeegee boys who at urban intersection, splash water on your windshield, wipe it off, and then expect to get paid for it. They create the problem, they provide the solution, and you really don't get any benefit.

In other cases defendants have already acted to resolve the problems and the settlement provides no additional value to the class. One example is the Intel Corporation case. Intel found a minor computer chip flaw that created about one in every 9 billion random division operations a small error. Intel created a program for its consumers to see if their computer indeed had that flaw, expanded its toll-free hotline for inquiries, and offered free lifetime replacements.

When Intel publicized this problem and the solution widely, 13 class actions were filed. Plaintiffs' lawyers took in $4.3 million, and the plaintiffs' class got nothing more than what was already going on by Intel, its continuation of existing company solutions.

Also, in coupon settlements, courts too often don't make sure that the settlements don't mean something. This has been getting a lot better since the coupon settlement problem has been publicized, but there is still too much availability for plaintiffs' attorneys to be litigation tourists and forum shop their cases around to what the American Tort Reform Association has called judicial hell holes, and what some prominent plaintiffs' attorneys have called magic jurisdictions where plaintiffs are always going to win regardless of what the facts and the law might be.

There is going to be some discussion, I'm sure, today about what can be done. A couple of solutions that have come up in the materials or in our past reading

have been creating a secondary market for the coupons, which we don't think tends to work. Some of the studies have shown that the coupons actually have to be worth $250 in order for the consumers to get a benefit on the secondary market.

Another solution has been to share the class award with charities and government, and this is kind of a feel-good resolution, but it doesn't really do anything if it's not very carefully scrutinized and also may be an incentive for courts to certify more class actions if they know that the public is going to benefit.

Good solutions include when the parties and courts make sure that the settlement actually means something. I think one of Lisa's cases that she discussed was the Mercedes-Benz suit in which it was alleged that Mercedes had failed to warn their customers about using nonsynthetic motor oils in the engine in their cars because the suit said that this could cause engine wear.

The settlement that was reached was targeted at the problem. The consumers got a $35 coupon for an oil change, and they got revised warranty protections that said if you have a problem you can take your car in, and we'll fix it.

Another way to resolve these problems is to have defendants fight, not settle, frivolous lawsuits. There was a case in Illinois involving a Jeep Cherokee where there were allegations of excessive engine noise at idle in the SUVs. The suit was filed after one of the named plaintiffs got buyer's remorse and wanted to have his car upgraded to a V-8 engine. The second named plaintiff had 135,000 miles on his vehicle when he said that it was defective, and the third named plaintiff was just afraid that her car would develop the problem. The court certified the class as a nationwide class but found that the plaintiffs were unable to prove their case and entered judgment for the defendant.

In sum, I think there are a number of different solutions that will be discussed today, but we encourage very close scrutiny of coupon settlements and fighting lawsuits where they're frivolous. Thank you.

MR. DELACOURT

Thank you very much, Leah, and thank you in particular for pinch-hitting at the last second. Our next panelist is Lisa Mezzetti. Lisa is a partner with Cohen Milstein where she works exclusively on consumer litigation and securities regulation matters. In that capacity she has had the opportunity to serve as lead counsel or principal attorney in dozens of class actions. Lisa.

MS. MEZZETTI

Thank you. I am a plaintiff's class action attorney and I feel compelled to note that when I walked in the door this morning, I was five foot, three inches tall and I'm going to keep track of how short I am when I leave this table.

One other thought that I want to open with is that I was interested to see in one

of the academic papers prepared for today's workshop that only 24 percent or so of class actions lead to settlements. The rest of them go through the judicial process, and they are dismissed or they go to trial.

An earlier academic report indicated that a very small percentage of those settlements, in the single digit percentages, actually provide only coupon benefits. So I'm not sure, truth be told, why there is such an emphasis on coupon settlements because, in fact, there is a long list of the benefits that are given to class members in today's settlements.

The list includes, and is not limited to, injunctive relief, changes in corporate day-to-day operations, changes in corporate structure, and governance, credit programs to give automatic credits to the class members, settlement research funds, coupons for free products, coupons for discounts, charitable contributions at the election of a class member if they choose not to take a coupon, ADR processes for claims if class members choose not to settle, monitoring programs, cy pres funds. The list does not end there.

So an emphasis on only one part of all of those benefits would seem to ignore at least three points. All nonmonetary benefits provide a value and we have to look at them all. All of them allow for the very important adjudication of class members' rights, rights that then lead to the return of damages. And they also allow for the recognition that there is no settlement that does not change behavior prospectively for the better.

All of that, I think, brings value from the class actions and for every class action that can be listed here as a bad class action, I could, but I don't have anywhere near the amount of time I need, I could list all the good class actions.

The laundry list also allows class members choices. They choose their value, so they're showing us that they think there is value in some parts of this buffet of choices that they are given. And in addition, this choice, this list, also acknowledges what the Supreme Court recognized in 1980, that the opportunity given to class members is of value even if they choose not to avail themselves of it, in the *Boeing Corp.* case.

So I think we have to focus on all of the values. And as I noted, the laundry list includes the very valuable injunctive relief. Now, my written paper for the workshop talks a lot about changes in corporate structure and changes in day-to-day operations.

And these include for corporate structure new management positions, education committees, the requirement that certain issues raised by line workers are reviewed by executive committees, and independent executive committees.

Day-to-day operations can also be changed, geared specifically to the class action allegations. So, for example, in a credit card case we arranged for, where the credit card company was alleged to have charged fees inappropriately and too quickly and charged products to class members when they didn't know that they were being purchased, we were able to get twelve changes, right down to the script used for the telemarketing.

The jurisdiction was maintained by the court. Reports were given to the court to confirm that the changes were made. And some people can wave their arms and say, well, but they're only temporary. How many years of changes did you get?

But I submit that first off, it's possible that it can be permanent, and if it is not permanent then either—if illegal actions occur—then another class action can be brought and should be brought in certain circumstances or more specifically, government agencies like the FTC can step in and make sure that the appropriate actions are taken long term, or longer term than the class action attorneys have brought about.

I also want to note that these changes in corporations and these laundry lists of benefits came about because settlements with nonmonetary benefits have changed over the years.

In the 1980s when these started, these coupons were the very essence of the definition of coupons. Here's a piece of paper. You get a free product or you get a discount. You won't have to pay your bill this month, Mr. Businessman, because you have a coupon. They changed. There's no question. Sometimes businesses wanted to use them for business generation. Sometimes, in large part what happened was the economies of the country changed. Because there were hundreds of thousands of class members in a case or because there were hundreds of millions of dollars of damages, each individual coupon became less valuable in and of itself.

So criticisms, whether they were valid or not, grew and the parties to class actions, the plaintiffs, the defendants, and the courts all listened and learned and we changed class actions. We changed coupon settlements.

We put secondary markets in. We have minimum distributions. We have cy pres funds. We have coupons for only certain types of products, less-expensive products that we know the individual is going to buy, like the music club CDs cases. The settlements are bolstered by the laundry list, but they are also bolstered by these changes. So the process moves and the process grows.

And looking back at old settlements does not necessarily mean that they are all bad. Indeed, I believe and I've seen and I think I have never personally been involved in a bad settlement. That just gets weeded out. Criticisms are lodged and the system works.

The courts put pressure on the parties or the objectors and the FTC, whether government or private objectors put pressures on the parties, usually on the defendant, truth be told, to make a settlement better. I have had settlements become better after they were disapproved. Bad settlements that are never approved are weeded out by the system, and I don't think we should lose sight of that.

Even with all of this, however, I do want to say that we shouldn't run from coupon settlements. We shouldn't run from redemption rates, which seems to be a very big concern for the FTC and for a lot of different critics.

And indeed, already plaintiffs and defendants and courts do not run from them.

Courts already discount the value of the face of the coupons when they are valuing settlements, and they grant fees on the lower amount.

Courts also, especially in the recent past, the last three to five years, courts demand reports on redemption rates. This has happened significantly in the Microsoft case where redemption rates will be reported not only to the court but to a newspaper in the local area. And although defendants are sometimes hesitant, they're now changing because the courts and the objectors are requiring this.

So although I believe compiling these types of statistics is already occurring and a special process for it, such as Professor Leslie talks about, is probably not necessary, if we are going to do it, then I think we have to do it on an even and fair ground.

Every class action settlement is different based on the class members, based on the coupon, the product, the terms, whether there's a secondary market, whether separate terms, separate contracts can be negotiated with class members. And that actually happened in the airline antitrust case where the businesses that received the very large bulk of those coupons used those coupons to a very high percentage of, I believe, over eighty-five percent.

The thought of using redemption rates and statistics from one class action to determine whether another class action is valid is, I think, fraught with problems unless we recognize the differences among the class actions and among the coupons because looking at a settlement value in hindsight without all the facts will always result in an unfair analysis.

Thus, I believe we cannot lose sight of the total value of these settlements, of all of the benefits. We shouldn't lose sight of the value of coupons and their redemption rates. And I think we should maintain a correct focus on recognizing all of the values of the different types of benefits and the restrictions and the protections that are already in place for these settlements. Thank you.

MR. DELACOURT

Thank you, Lisa. Our next panelist is Phillip Proger. Phil is a partner with Jones Day where he serves as coordinator of the firm's government regulation group. His practice, which focuses on antitrust matters before the U.S. and international enforcement agencies, as well as antitrust litigation, has given him frequent exposure to both the litigation and settlement of so-called follow-on class actions. Phil.

MR. PROGER

Thank you. I'm going to try and be brief because I think it would be good to get to some questions, and the panelists ahead of me have been excellent and covered a lot of the territory. I do want to thank the FTC for holding this.

I guess I come at this a little bit differently. One, I think a lot of the problems

we're talking about here are problems inherent in class action litigation and not inherent with non-cash settlements. And I want to be clear, when I think about this I'm not thinking about just coupons. I'm thinking about the broad array of non-cash settlements.

I start with one sort of basic theme which is, a lot of the criticism on cash settlements are that they bring very little value to the individual class member. And that strikes me as kind of an odd thought when class actions, in essence, in many cases, are designed to allow people who have had very small individual injuries to aggregate them so you can overall, as a society, redress the problem.

So why are we surprised now that individual class recovery is relatively small? And Lisa, I thought, makes a good point when you say that we—and I think this is the point you were trying to make—that we're undervaluing injunctive relief. I think injunctive relief in a lot of these cases is very powerful.

I will say that I think in some cases we ought to have the courage to just have injunctive relief. I think too often we throw in non-injunctive, non-cash parts to frankly dress it up so it can be settled. Class actions are very difficult to settle. There's a lot of divergent interests involved in the settlement. And while some people say that the defense counsel and the plaintiffs' counsel have similar interests, I'm not sure that's really true.

A, the plaintiffs' counsel often have very diverse interests, as has been pointed out, when it comes to fees with defense counsel. In some cases that are vertical, defense counsel have very divergent issues. There are, frankly, lawyers who specialize in objecting to these cases and can bring an adversarial position to them so these are very, very difficult cases to settle.

And one of the things I'd like us all to think about is there is a societal value in settlement. You know, Your Honor, when you made the remark that as a judge what you think about is making the case go away as a defense lawyer reminded me of Renee Zellweger's comment in *Jerry Maguire*, "You had me at hello." We're trying to now make a case go away.

And one of the other problems with this is a fundamental premise—well, look, class actions are neutral in the sense of what they do. The problem is with the case itself. If it's a meritorious case and a meritorious case where the individual harm is so small that it would have never made any sense to bring it in the first place, Rule 23 is a very good idea.

The problem is there are also cases where, frankly, there are no real meritorious individual claims, but the sheer weight of the size does produce an extortionary effect on the defendants who are not willing to bear the risk of going to litigate what they believe to be dubious claims, but because of the sheer size, the risk could virtually put them out of business.

So what does non-cash do in this situation? Well, it provides some ability to deal with the divergent risks and their assessments. The plaintiffs assess their risks of litigation and the value of the settlement. The defendants do the same and often there is a large difference between those assessments.

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What non-cash permits the parties to do, and if we view settling these cases as having a societal value, what non-cash does is often allow them to bridge those differences so that the plaintiffs feel that they are getting more value for the class. The defendants, frankly, feel that they're providing a lower cost.

I don't think you have to have this exclusively. You can combine injunctive, cash, and non-cash into settlements. You can include cy pres. But I think to try and criticize non-cash and think about excluding it would, in fact, make the class action process even more difficult than it is.

The last thing I would just say on this is, with all due respect to the courts, that I do think that there has to be some system within the process, maybe the parties at the court's direction retain as you do in mediation a master or someone like that.

But I think that we have to do a more aggressive job at really sorting out through the judicial process the adequacy of the settlement, keeping in mind the various factors that have been discussed here today.

But I would hope that as we deal with the difficulties of Rule 23 and its administration, that we not limit to the parties in the litigation creativity in settling the class while at the same time retaining a vigorous standard of review for that settlement as to the consumers. Thank you.

MR. DELACOURT

Thank you very much, Phil. Our final panelist is Paul Kamenar. Paul is Senior Executive Counsel of the Washington Legal Foundation. WLF has a very active class action amicus program and has filed objections to class action settlements, most recently in the MDL music CD case, the magazine antitrust litigation, and the Ninth Circuit's Microsoft case. Paul is also Clinical Professor of Law at the George Mason University School of Law. Paul.

MR. KAMENAR

Thank you, John. I want to also thank the FTC and the *Georgetown Journal of Legal Ethics* for sponsoring this. We are a public interest law and policy center here in Washington, D.C., and we not only file amicus but we also file actual objections on behalf of many class members.

Our focus, though, is on fighting what we think are excessive attorneys' fees where class members get very little, if anything, but the attorneys reap millions because in a typical common fund case for every dollar that doesn't go to the attorneys, that's an extra dollar that does go to the class members.

The *Washington Post*, I think, aptly characterized the class action system as "an extortion racket that needs to be fixed." And Leah described some of the examples of some of these abusive class actions.

Other chronic problems we see with the class action will be on later panels, probably today, are the adequacy of the notice, the class administrator's claim

that oh, 90 percent of the class members received notice about the lawsuit, but these are notices buried in the back pages of newspapers and magazines.

I'd like to say that they really say that 90 percent are exposed to the notice, not actually receive it. And like I say, being exposed to these notices is like being exposed to carbon monoxide. You don't know about it until it's too late. And it is too late to object or opt out of these settlements, and you only have like a week or two to do that.

I'd like to discuss briefly a couple of pros and cons of some of the relief in the form of coupons, cy pres, and tie it in a little bit to attorneys' fees. Generally thinking, money does seem preferable to coupons, but if a coupon is for a consumer product you normally regularly buy, a $20 coupon may be more valuable to the consumer than its cash equivalent of, say, $10.

In other words, if it's a hundred percent markup that the company is giving, they would settle for the $10 cash. You might say, well, I'd rather have the $20 coupon because if I only get $10 cash and have to buy a $20 product, I have to come up with another 10 bucks in cash to do that.

I'd like to discuss briefly two cases to illustrate this phenomenon. One is the CD case you've already talked about and another one is one that we're in litigation right now. Actually, Phil is representing the defendant and that's the cosmetics settlement case that involves not providing coupons but for providing actual sample size or bigger cosmetics to those who purchased what are called high-end cosmetics from the department stores, Estee Lauder, Clinique, Lancome over the years.

And there, you're not getting a coupon, but you are going to get the opportunity to get an actual cosmetic product that's valued between $18 and $25.

On the CD case, one little thing on background about that briefly that John didn't mention. Actually, the FTC got a settlement against the compact disc industry on May 10th, 2000, an injunction, a consent decree.

And amazingly, that same day, the first of 52 class action suits were filed by the plaintiffs' attorneys. Well, obviously, there's no coincidence what was going on there.

That CD case actually involved two cases, one involving those who purchased the CDs through the CD club and they got vouchers that Judge Hornby, I think, alluded to, which are 75 percent off the CD, and then those who purchased the CDs at retail stores, there you got a check in the mail, as John indicated, and I think the check was for approximately $13.80. And basically the class members were fairly happy with that.

But what is interesting there is that you had a cash fund of $67 million depending upon pro rata how many people registered to get the claim. So if 67 people registered to get the claim everyone would get $1 million out of the $67 million fund.

As it turned out, there was also a clause in the settlement agreement that said if too many people filed a claim, such that each person would get less than $5, the

whole entire $67 million would be transferred over to the cy pres fund. So there was kind of a game going on here, and as it turned out, four million people did register and pro rata into $67 million each got a check for $13.80.

We objected on behalf of several class members. The cy pres also, we objected about the evaluation. Of course, the defendant and the plaintiffs' attorney wanted to blow up the value of the CDs, the Michael Bolton CDs, the Whitney Houston CDs, to around $17.38 apiece. We said, look that's got to be discounted considerably. I think Judge Hornby did discount them to about 20 percent off of that.

Now, if you look at that case and compare it to the cosmetic case that we're in court about now, as I said, it proposes to provide up to the class size is 38 million women who bought cosmetics over the last ten years and the settlement now allows you to get an opportunity, but not a guarantee to show up at a department store one week in January in the middle of winter and pick up your product that you may not even use but—and it's only when supplies last, so you're not even guaranteed actually getting anything there.

Now, Phil argued, and I kind of agree, that this suit was a meritless lawsuit. The plaintiffs' own expert said they only had about a 7 percent chance of winning this antitrust case. So the question is from the defense point of view, well, this is the best we can do. This is what the case is worth.

But from the consumer point of view you had this problem. So we objected in that case, saying perhaps maybe the consumers might rather have a coupon where they could go in within a six-month period, redeem it as a voucher towards cosmetics they actually purchase, as opposed to waiting in line as the plaintiffs' attorney said, there's going to be a stampede at the stores during this one-week period to get your free cosmetics, and then you might not even get a guarantee that you'll get anything.

I understand that during the settlement negotiations, one of the cosmetics companies was amenable to the coupons but interestingly, the plaintiffs' attorney said no, we don't want to have coupons because the courts won't like it, and they said if we give you cash, you're only going to get a 15-cent check. I don't know where he came up with that number, either.

But it seems to me that what was really going on here was that the plaintiffs' attorneys would like to have this product, which is valued at $175 million at retail, in order to tell the court, gee, our attorney fee request of only $24 million is only like about 15 percent of this $175 million product fund, and therefore that is within the ballpark of the 15 to 25 percent range.

However, if that product was reduced to an actual cash value, let's say the $175 million worth of cosmetics is really only worth $25 million in cold cash to the company, let's discount the cosmetics some 80 percent, well, the attorneys are asking for about $25 million. Obviously, their fee would look too high if they took cash in that case, even though the consumer might want that $25 million. If you have two million filed claims, they'll get $12 checks. That may be preferable.

Solutions. How do we control this? Well, there was some talk about having special masters, waiting until the fee is redeemed—I mean, the coupons are redeemed—before the fees are paid.

One actual example that the courts are using is paying the attorneys' fees in coupons. A couple of quick cases. One where a securities settlement ended in both cash and stock, and the court said that if counsel, "have expressed faith and confidence in the value of the settlement for their clients, it is not unreasonable to require them, to some extent, to stand equally with plaintiffs in sharing in the distribution in kind," and awarded part of the fee in stock warrants. The airline travel case awarded $200,000 in nontransferable credit to the law firm for air travel. They do a lot of traveling, so I guess they could use it. A cruise line case, the court in Florida awarded a chunk of the attorneys' fees in these vouchers for cruise line trips.

And finally, with respect to statutory solutions you have in Texas for the first time, any case filed after September 1, 2003, in Texas, a class action case, says in a class action, if any portion of the benefits recovered for the class are in the form of coupons or other non-cash common benefits, the attorneys' fees awarded in the action must be in cash and non-cash amounts in the same proportion as the recovery for the class.

And currently before Congress is the Class Action Fairness Act of 2004, and a couple of provisions there require that the fees, quote, attributable to the award of coupons shall be based upon the value the class members of the coupons that are redeemed, and therefore, there's some kind of a check there in order to determine whether the fees should be reasonable. And certainly courts can do that by waiting until the coupons are redeemed.

Another is to use the lodestar fee, where you look at the lodestar rate, the hourly rate that the attorneys are making, rather than a percentage of this overinflated coupon settlement.

In conclusion, courts should carefully scrutinize all these class action cases, paying particular attention to settlements that provide for coupons and other non-monetary relief to ensure that the settlement is fair, reasonable, and adequate. And courts should also ensure that attorneys' fees in coupon cases are not excessive, perhaps unless the special master, as Phil mentioned, in fact, there is a special master in the cosmetic case right now, and to make sure that the fees are not greater than the lodestar amount. Thank you.

MR. DELACOURT

Okay. Paul, thanks very much. And I'd like to thank all the panelists for staying within their time. Thanks to that, we do have a good bit of time here for questions and answers.

I'd like to start off with a first question that ties back to Chairman Majoras' introductory remarks. She mentioned that one of the big purposes of this

workshop, we have kind of a general objective of informing ourselves about the class action mechanism, and what are the issues, and what can we do to improve the class action mechanism.

But a more specific objective is what can the FTC do? Which of these problems can be addressed by the FTC, and specifically for this panel, what can the FTC do about some of the problems with coupon compensation and non-pecuniary relief that we've identified?

So I guess I would break that down into two more specific questions. One is the way we've addressed this problem so far is by filing a series of amicus briefs. And my question would be: are there certain types of coupon compensation settlements that should raise red flags, that we should be particularly concerned about and focus on?

And second, should we be taking other steps? Should we be looking beyond the amicus filings we've been doing and look to other ways of remedying the problem? Chris, would you like to start off?

PROF. LESLIE

Sure. It seems to me what you look for red flags are the restrictions that you see on many settlement coupons. So you look for non-transferability. That's a huge red flag. You look if there are product restrictions. You look if there is an expiration date that seems relatively short, especially if it's a durable product.

But I think more importantly what we need is more data. We've got a lot of anecdotal data of coupon settlements that don't look so good. We've got some anecdotal data of coupon settlements that were fine. What we don't have is any systematic collection of data whereby we can actually look coupon by coupon and see what redemption rates are and try to get a sense of what are the restrictions in settlement coupons that are associated with low redemption rates, so we can have an empirical basis for figuring out what the real red flags are.

Currently, there's no requirement that there be reporting of redemption rates or the coupons. And it seems to me that that's the first step so that we can systematically understand settlement coupons and try to separate the good from the bad.

MR. DELACOURT

Do any of the panelists have thoughts on that? Phil?

MR. PROGER

Well, I think first and foremost, you can do what you're doing, having a workshop like this and commenting in amicus in certain cases. I think it's very important.

I think one thing you could do, and I think that this workshop starts that

process, is to take a step back and try and think through what the problem is and try and properly analyze what the problem is.

With all due respect to those who want to look at redemption rates, transferability, counsel taking it, they may be appropriate. I'm not saying they're not, but I'm not sure that we're really focusing on the cause. I think we may be focusing on a very small part of the effect, the end.

And I think we need to look at the more fundamental questions under the system whether there is adequacy, reasonableness, and fairness in this process and whether or not consumers are being protected. And to go back to a point I made earlier, whether we maybe should be looking at less what did this consumer receive in this case and more what was the overall relief to society? What was the injunctive relief? What was the cy pres? And what were the benefits from that?

MS. MEZZETTI

I don't agree with everything you're saying, but the plaintiff side is not going to run away from that any faster than the defense side. So, looking at those types of analyses are probably not a bad thing, and the FTC may be, maybe with other groups, the right entity to do those types of analyses.

I do agree with Chris that looking at coupon-only settlements and looking at the restrictions on those coupons is very important. I have already said using each coupon settlement as an example for the next, I think, is very dangerous.

If we're going to collect this data, we have to do it very carefully, and judges and the FTC and anyone else, academics who are going to use it, in addition to the parties and the courts, need to know that there has to be some true version of comparison among the cases.

Having said that however, it will show why certain coupons are used dramatically. And I want to make a correction to one misstatement I made during my remarks. I talked about the airline coupon settlement and the percentages used there. What I should have said is that is an example of businesses using coupons.

And the statistics that I've read indicate that indeed when businesses are the class members, well over 80 percent, the number I quoted, are used, not necessarily in just the airlines case, but in business class member cases in general.

In a good consumer case, one where a coupon allowed—although litigation was involved with only one product, the coupon allowed purchase of any product in any store in a nationwide department store, over ninety-nine percent of the coupons were used.

So there are coupons out there that get used and getting data on why, I agree, is a good idea. But we need to compare apples to apples all the way through, historically.

MR. KAMENAR

Well, I think that in terms of trying to get this information, I suggested in my written comments that all class actions be filed or registered on an FTC web site.

Right now, many class actions have their own web site, but I daresay everybody in this room is a class member of two or three class actions, and you don't even know about it. You don't have the time to surf the web and go through every product you purchased, gee, am I a member of a class action?

On Saturday, I got in the mail, some of you may have a notice, in a case dealing with life insurance, and typically, it's in this microprint of 40 pages and so forth right here. The point-size is about 7-point or 8-point. But the point I'm trying to make is: if the FTC had a web site where all the web sites of the class actions were there with a hotlink to those cases, everybody would at least have better notice.

Number two, since the attorneys and the parties have to file those things and are required to file on their own web site, for that case that, too, can then be available to everyone to monitor what is going.

And finally, the judges should require that the fees don't be paid until the coupons are redeemed. If there's a ninety-nine percent redemption rate like Lisa mentioned, great. You attorneys did a good job of getting good coupons. If the redemption rate is less than 1 percent because of the restrictions, why should the attorneys get the value of the whole amount?

So that kind of information, I think, should be on a centralized web site so that way, for academics, practitioners, objectors we have a way to find this, rather than have a hit-or-miss system.

JUDGE HORNBY

I think the more the FTC can be involved in the actual litigation as an amicus or otherwise, the better, because at least from the judicial point of view, we think we know whom you represent just like we do for state attorneys general. We're less certain often in terms of objectors. We're not sure of the parties when they've settled who the presenting—if they have an FTC role is a great help to the judge who's reviewing a proposed settlement.

MR. DELACOURT

All right. I'm going to turn now to a question from the audience. This one was submitted. The question is: if baseless class actions are filed, why don't defendants take a principled stand and fight them with motions to dismiss, etcetera, instead of settling to save litigation costs? In other words, don't pay the guy with the squeegee.

So, I take that one as being directed to the defense bar. So maybe, Phil, if you want to take the lead on that, and then others can chime in?

MR. PROGER

Actually, not particularly. Well, look, I mean, I understand the point but you have to deal with reality in life, and the defendants aren't the only ones in sole control of the situation. In the case that Paul mentioned, the cases were filed in state court. There is under the state court procedure the equivalent of an MDL.

The judge is a very competent, intelligent person, but from the very beginning, she told one, the panel, that she didn't want the case; two, she had never tried a class action; three, she had never had a competition case.

Before discovery was commenced the court ordered the parties into mediation, ordered the parties to retain a mediation expert, which the parties did from one of the firms that provided an individual who is a former state court judge. Mediation lasted eighteen months, and there was enormous pressure, frankly, on both plaintiffs and defendants to settle the matter. The court made it very, very clear.

A principled approach, frankly, would have cost more than a settlement. A principled approach would have cost consumers more than the settlement. And at least in my view the case had no merit and the plaintiffs have been fairly forthright in the settlement review, which by the way, there are numerous objectors including thirteen state attorney generals. And so this is fairly vigorously contested.

I think, again, when we start isolating the particularities of an individual settlement, and we do, so without the context of the value and the merit of the underlying claim you get into dangerous territory.

There is, however, injunctive relief and the injunctive relief, I believe, is very beneficial to consumers. And plaintiffs' counsel are entitled to some benefit for taking on a difficult case and bringing the case home where overall, I believe, consumers benefit from the injunctive relief.

But I don't think defendants always have the ability to decide to go forward and just contest it. By the way, there were motions to dismiss. There were summary judgment motions. They haven't been ruled upon.

PROF. LESLIE

I'd like to focus on this injunctive relief notion because it seems to me it's a little bit of a red herring, at a certain level, that when the class counsels say, look at what we're bringing, it's injunctive relief, and we'd like these high attorneys fees, they try to justify it by saying but we're also bringing all these coupons, and look at the face value of the coupons are so high.

And then when you say but the coupons aren't worth very much money, the response is yeah, but we're getting injunctive relief, too. They're bouncing back and forth between them.

The coupons often are worthless such as in the case of Schneider v. Citicorp Mortgage, which is just going down right now where the settlement coupons are the ones that are for $100, but you can't aggregate it so you can't use the $500

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coupon that's available. To use it, you have to get a new mortgage or refinance your mortgage within two years, which would require a great loss of money because you'd have to refinance at a higher rate in order to use the coupon. The coupons are nontransferable at a public sale.

So the response might be yeah, but there's injunctive relief, too. The injunctive relief that the attorneys are trying to justify their attorneys' fees on are if HUD adopts a new rule, Citicorp will follow it. And actually, at court the judge asked the defense counsel, what do you understand that the provisions of the settlement require your client to do that they otherwise don't have to do? The response: nothing.

So I just want to make sure that we're not buying this notion of there's coupons and injunctive relief because it's possible that neither one of them gives a whole lot of value to the class, and we still run the risk that the settlement coupons have a high face value that's being used to justify higher attorneys' fees than are warranted.

Ms. Lorber

I wanted to follow up on the injunctive relief argument a little bit. I think there is a basic policy controversy over whether or not you want plaintiffs' lawyers in class action lawsuits setting policy and regulating businesses, or if you want the government agencies, who are trained in doing the regulation and are familiar with the information that is needed to regulate the companies and the industries, doing the regulation.

A lot of the class action lawsuit settlements, or if there's a jury award, this all comes up in an adversarial process where there's very little opportunity to collect all the information that you need to make a good public policy decision about what's best for the country, as opposed just to what's best for the particular litigants and the attorneys on both sides and the company in the particular case.

Also, you get, and this I'm sure is going to be discussed at length tomorrow, but you can get contradictory results if you've got class action versus state attorney general regulation versus government agency regulation. So I can see that injunctive relief is appealing in some cases, but I don't think it's a blanket panacea for everything.

And just to follow up really quickly about the companies and why they don't fight the cases instead of settling them; we wish the companies would not, just because they would pay us to litigate them, but also because you're just encouraging more and more lawsuits to happen if you're going to settle stuff that isn't worth a suit in the first place.

I mean, you look at Madison County, Illinois, where there's this huge class action lawsuit industry going on, and there's just this little industry there where the defense attorneys are charging what they charge in New York and D.C. to litigate things in rural Illinois, and it's just encouraging the growth of a problem.

JUDGE HORNBY

It is important to distinguish between distaste for attorneys' fees and distaste for the small amount of a settlement or distaste for injunctive relief.

Typically, we get them all together, and so we're unhappy because there's coupons plus attorneys' fees or small settlement plus attorneys' fees, but as, I think it was Phil Proger, pointed out, the whole point of class actions is to permit the small claims to be brought. It's a separate question from the attorney fee issue. Even an individual can get injunctive relief, may or may not get attorneys' fees. That too, is a separate issue. I think it's important not to collapse these in our discussion.

MR. KAMENAR

Yeah, just briefly, I think actually, Your Honor, with all due respect, I think there is a connection there to collapse the two because the fees are such that they are able to get higher fees for very little value to the class.

Just one case in the paper on Saturday, the Halliburton securities class action case, a federal judge there in Texas rejected the settlement. You would get up to sixty-two cents for each hundred shares of stock you own. That's less than half a cent a share.

And one of the lead plaintiffs said, we don't want this proposal. And it quoted their attorney saying, "It conferred no benefit on anyone but the lawyers. We're not going to become poster children of the ridiculous settlement." So this is what Leah was kind of saying is, "hey, just say no."

One final thing was an injunctive case, the *In re Magazine Antitrust Litigation* case. Magazine prices were being too high on your subscriptions. There was just an injunction only, not even a free magazine. And the court there in the Southern District of New York this year, earlier this year said, look, you just got an injunctive relief that was minor. It didn't provide a substantial benefit on the class, and therefore, you attorneys when you're trying to use what's called a common-benefit system as opposed to a common fund where you get your fees since there was no substantial benefit, your fees are hereby denied entirely.

And we think judges should start cracking down on this and that might prevent some of these kind of worthless results for consumers.

MR. DELACOURT

I'm going to take the moderator's prerogative now and combine two questions. Both of them will be directed to Judge Hornby. To what extent in the approval process does the court have access to a neutral economic report evaluating the settlement, especially the non-monetary aspects it contains?

And a related question is: why don't judges more often appoint experts under

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Federal Rule of Evidence 706 to assist in valuing coupons and other non-monetary benefits in a class settlement?

JUDGE HORNBY

Well, those are related. Automatically, you don't have any access. In other words, it's not presented to you just off the bat by definition because instead you're being presented with expert reports that have been put together by the plaintiffs' or the defendant's lawyers.

There is appointing authority under Rule 706, and I note that the 2004 edition of the Complex Litigation Manual suggests that courts may have the authority to appoint a special master to help evaluate settlements.

I think you have to remember the context in which these things come up. The litigation has been pending usually for several years, and the court is presented with a complex settlement proposal that is defended by the lawyers in written submissions that are both legal argument and probably affidavits and analyses of various sorts.

Hearing is held. If the court is to appoint its own special expert, there has to be a procedure set up for first finding an independent expert. That having been done, then new studies have got to be undertaken, perhaps empirical studies or whatever. There will be expense involved and there will be delay and so we're probably talking about a very considerable delay period after the litigation has already been pending for a long while.

So all of a judge's instincts are to the contrary, maybe not correctly so, but they're to the contrary in the sense of here is a lawsuit that's been pending. It's time to resolve it. If I now have to consult with the parties about getting an independent expert, how long will that take? How long will the expert take? We probably ought to do it more, but bear in mind it will mean these things will take even longer to resolve before the consumer does get a payback.

There have been efforts made. Justice Breyer's been involved, I know, with setting up panels of independent experts that courts can select from. Probably that ought to be given more attention. The money will come out, of course, of the proceeds that are involved as to what takes place because courts don't have any independent authority on their own to pay such fees, but we ought to do it more, probably.

MS. MEZZETTI

The expense of these types of masters is always a concern because the court system cannot accept, probably, the expert costs, and imposing it on the parties means that, in fact, you're imposing it on the class members.

It does not mean, however, that it shouldn't be used, and in the appropriate case, I have seen it used very well. And in that circumstance, it was another

example of the system working because the court said I need more information and I need some analysis, not unlike the analysis that Professor Leslie is looking for on data and information. It's part of the system working.

And, in fact, I noted that Paul started his last comment about a settlement that you found unacceptable by noting that the court found it unacceptable and did not approve the settlement. So the system works, and it works for coupon settlements, and it works based on data, and it works based on all of the information provided to the court.

And as a plaintiffs' counsel, I doubt that Phil will disagree with me. I can tell you this: when a court asks me for information, I get it, and I give it to the court. So everything that the judge has talked about is true in terms of delay and cost, but it doesn't mean that in the right case it shouldn't be done.

MR. DELACOURT

I think we have time for one more question if everyone can give a relatively quick response to this one. It's actually one of the more challenging issues that the FTC faces when we are evaluating a settlement, a coupon settlement, and trying to determine whether we should file an amicus objection or not.

And the question is: when you face a case where the underlying harm is questionable, or maybe it's very minimal, and the coupon that is proposed by way of relief also provides minimal relief, is that a situation that we should be concerned about or is that appropriate? Do claims of low value merit coupons of low value as a solution, or is there a problem with approval of such settlements going forward? Judge Hornby?

JUDGE HORNBY

I think it's important to distinguish between small injury and small likelihood of injury. Just because an injury is small doesn't mean it doesn't deserve redress. The principle of our system is that every injury does get some kind of redress. But if it's a small likelihood of injury, then you're weighing the frivolous versus the meritorious lawsuit, and that ought to play an important role.

MR. PROGER

I think that's a very good point, and I think one of the problems we have in class actions for the courts and the parties is that often there's no easy way to separate that out, and there's no efficient way to do it.

And so when we talk about these settlements, and we talk about the benefits, it is an adversarial system between the defendants and the plaintiffs and the objectors and the opt-outs and the court.

Hopefully—I don't know if I'd go as far as you, Lisa, to say the system is working. As a matter of fact, I'd probably say it's not, but in this process there

certainly is the mechanism to try and reach what is a fair resolution.

I want to add one other thing from the parties' standpoint. We need to understand that parties in litigation should have the right to settle the cases and to now put an additional burden on them beyond what Rule 23 provides of more litigation, more proof on some of these issues, I think, is going to create more expense, more problems.

Maybe we need more vigorous use of masters. Maybe what we need to do is—in some state courts you know that only certain judges handle complex cases. Maybe in the judicial system, federally and state, we can get judges who are interested in this area and want to do only class actions. I don't know. I don't know if that's a good solution, but I hope we don't leave this area without keeping in mind that the parties do have a right to settle their cases.

MS. LORBER

Just real quickly, at first glance it sounds like a good idea: frivolous claims get coupons that aren't worth much, but to get there you have incredibly huge transaction costs, large defense costs, large imposition on the court's time. You're slowing claims of people who are legitimately injured who may have to be backed up behind these class action suits that are taking a while. Even if they settle, they're still taking several years, again in court, taking the court's attention and resources.

In turn, these large transaction costs turn into things like increased consumer prices, decisions to pull products from the market because they're being the target of class action lawsuits, the loss of money that would go into R&D, all kinds of things that have an effect on society. So overall, I would say it sounds like a good idea or a cute idea, but it's not something that I'd be in favor of.

MS. MEZZETTI

I agree with Phil that the parties, because of the professionalism of their counsel, will always seek appropriate results. When parties are not acting professionally then those settlements get weeded out.

So given the judge's distinction between a frivolous claim and a small injury, and recognizing that the parties are seeking to equitably and appropriately reach a resolution with the help of the court, I think we can reach good settlements and sometimes those are small coupons.

MR. KAMENAR

Just briefly, I mean with respect to small claims, there used to be a principle in the law, de minimis non curat lex, the law does not consider itself with trifles. The class action takes that principle and discards it and now makes these little trifles to be class actions.

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With respect to the merits of the case, meritorious cases, I think judges should look at these very carefully. As Phil said, in the cosmetics case, there were motions for summary judgment that were pending. The plaintiffs' attorneys said, their own expert said that we only have a 7 percent chance of winning.

The court should decide those motions right off the bat rather than forcing the defendants to settle these things where the attorneys, sad to say, or for the plaintiffs they like to say, they get all the money out of this and the consumers get very little.

MR. DELACOURT

Okay. Well, thank you very much to everyone.

EXHIBIT F

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CLASS ACTION REFORM, QUI TAM, AND THE ROLE OF THE PLAINTIFF

NAME: Jill E. Fisch *

BIO: Copyright © 1997 by Jill E. Fisch This article is also available at http://www.law.duke.edu/journals/lcp.

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LEXISNEXIS SUMMARY:
... The original class action suit was filed after QVC and CBS announced tentative terms for a merger; the suit was settled after QVC agreed to enter into a somewhat different merger with Comcast Corp. and Liberty Media Corp. ... In contrast, proposals to eliminate the class representative or the entire plaintiff class are based on the premise that representative suits serve a general social interest and that the incentive structure in class action litigation should seek to maximize deterrence. ... Similarly, decisions traditionally within the purview of the litigation client, such as whether to accept a settlement or file an appeal, may be made in the class action by plaintiffs' counsel with the approval of the court, even over the objections of the class representative or other members of the plaintiff class. ... Burns argues that her proposal would "result in less confusion and inconsistency in class action doctrine" and would highlight the differences between the class suit and traditional litigation. ... One tool for analyzing the implications of departure from a traditional litigation model is the qui tam provision of the federal False Claims Act ("FCA"). ... Qui tam thus offers a model of privately initiated litigation freed from the traditional constraints of control by the injured client. ... Furthermore, the government has the right to receive notice of the terms of any settlement proposed by the relator. ...

TEXT:

I

Introduction

On February 5, 1997, the Delaware Court of Chancery awarded $ 1 million in attorneys' fees to plaintiffs' counsel in In re QVC, Inc. Shareholders Litigation. n1 The original class action suit was filed after QVC and CBS announced tentative terms for a merger; the suit was settled after QVC agreed to enter into a somewhat different merger with Comcast Corp. and Liberty Media Corp. n2 Although the eventual merger price was $ 2 per share higher than the price originally offered by Liberty, the settlement did not involve any acknowledgment of wrongdoing, payment of damages, or creation of a "common fund." n3 Together with the proposed order of settlement, plaintiffs' counsel applied for a

total of $ 5.5 million in fees and expenses. n4

In making the fee award, the Chancery Court concluded that the terms and price of the eventual merger were agreed upon prior to negotiations with plaintiffs' counsel and "without any specific regard for [their] efforts." n5 Judge Steele specifically stated, "I cannot conclude that counsel's efforts resulted in the increased transaction price." n6 Moreover, the court found that counsel engaged in "substantial duplicative effort" and assumed no "substantial risk" in the litigation. n7 Despite every indication that the value rendered by counsel's participation was minimal, the court justified the fee award on the basis that counsel recorded some 1,500 billable hours and "proceeded through the appropriate motions and maneuvers with requisite professional skill." n8

It is difficult to imagine any individual client agreeing to pay $ 1 million in legal fees for the services described by the QVC court. In a class action, however, there is no analogue to the individual client. Instead, plaintiffs' counsel represents a class of plaintiffs whose claims are simultaneously too small and too numerous to warrant separate litigation. In place of the traditional client, the Federal Rules of Civil Procedure provide that one or more members of the class may bring suit as class representatives. n9

Although in theory the class representative or named plaintiff plays the role of client, the relationship between class representative and class counsel differs substantially from the traditional attorney-client relationship. Typically, class counsel is compensated by a court-ordered fee award based on statutory fee shifting, the common fund doctrine, or other similar approaches. Thus, the amount of the fee award is the result of a judicial determination rather than market forces. Moreover, the size of the fee award is substantially greater than the damages recovered by individual members of the plaintiff class. The resulting disparity between the stake of plaintiffs' counsel in the litigation and the stakes of the class members gives rise to a variety of agency problems. Additionally, the nature of counsel's stake creates an incentive for counsel to prefer a quick settlement - even one involving a significant reduction in total recovery. n10 The conflict engendered by this incentive may be aggravated by pressure from defendants who often also have an incentive to settle cases involving allegations of corporate wrongdoing quickly. n11

Particularly problematic is the possibility that class action litigation will produce handsome compensation for class counsel but little discernible benefit for class members. n12 Critics of the existing class action structure point to cases like QVC as an illustration of its shortcomings. Although many class actions do result in substantial plaintiff recoveries, in others, such as Hoffman v. BancBoston Mortgage Corp., n13 plaintiffs have even wound up owing rather than receiving money as a result of a class action settlement, although class counsel received a generous fee award. n14

The observation that the class action has, in some cases, moved away from a focus on victim compensation has led some commentators pejoratively to term it "lawyer driven litigation" and to call for reforms to produce greater client control. n15 The recent federal securities fraud legislation, for example, attempts to restructure class actions so that they more closely resemble traditional individual litigation. n16 At the same time, other commentators have applauded the growth of entrepreneurial representative litigation as a means of enabling private attorneys general to supplement government law enforcement. n17 Indeed, defenders of the modern class action advocate more substantial departures from the traditional litigation structure to deter corporate misconduct more efficiently.

These two approaches diverge with respect to the role of the class action plaintiff because of a fundamental disagreement about the proper objectives of the class action. Empowering the class representative enables the client to exercise greater control over class counsel and the conduct of the litigation. This should lead to a greater emphasis on recourse and victim compensation. In contrast, proposals to eliminate the class representative or the entire plaintiff class are based on the premise that representative suits serve a general social interest and that the incentive structure in class action litigation should seek to maximize deterrence.

As class actions struggle to combine the monetary incentives provided by plaintiff compensation with the societal interest in enforcement and deterrence, they begin to resemble a hybrid between traditional individual cases, with their focus on the client, and government enforcement actions that have no client except the public at large. Existing reform

proposals have resisted this hybrid character in favor of pushing the class action in the direction of either individual or public litigation. Before accepting either approach - and the resulting choice between strengthening the plaintiff's role and eliminating it entirely - it would be helpful to understand better the implications of the hybrid model.

These implications can be examined by an analysis of the relatively recent use of an explicitly hybrid litigation procedure: the qui tam n18 action. n19 The qui tam suit allows plaintiffs without a traditional interest to initiate litigation in order to increase corporate compliance. Examination of the qui tam suit fo cuses attention on the role of the plaintiff and the purposes behind the structural requirements of traditional litigation. Qui tam illustrates the prospect of greater flexibility in regulatory form, demonstrating that current proposals to eliminate the class representative are not as radical as they appear. An analysis of qui tam suggests advantages and implications of viewing the barrier between private litigation and public enforcement of the law as permeable.

This article will start by analyzing, in Part II, the evolution of the class action, focusing in particular on its departures from traditional individual litigation. Part III looks at various proposals for reform of class action litigation motivated by these departures and their effect on litigation incentives. Current reform proposals seek either to remodel class litigation so that it more closely resembles traditional litigation by strengthening the role of the class plaintiff, or to facilitate the deterrence objectives of representative litigation by freeing it from the structural confines of the individual suit. Ultimately the conflict between these approaches stems from disagreement about the appropriate objectives of class litigation. Part IV uses the qui tam provision as a model for exploring the structure and objectives of enforcement litigation. Qui tam litigation is a unique hybrid in which public and private resources are combined in a litigation partnership. The article explains the issues raised by qui tam and concludes in Part V by demonstrating that, although class actions are not directly analogous to qui tam suits, by lowering the conceptual barrier between public and private litigation, qui tam suggests new ways to improve the ability of representative litigation to pursue the dual objectives of victim compensation and deterrence of corporate misconduct.

II

The Evolution of the Class Action and the Departure from Traditional Litigation

The traditional model of litigation is based on the theory that private litigants file suit because they have information leading them to believe they have a claim, they have suffered an injury compensable through litigation, and the damages they expect to receive exceed their expected litigation costs. This simplified model includes several important attributes. First, the model assumes that a plaintiff's primary objective is monetary recovery or the equivalent. n20 As a consequence, plaintiffs will not file frivolous cases because they benefit only from a suit that has an expected net gain. n21 Second, although an individual's decision to bring suit will not be based on the public or social value of the litigation, society can adjust litigation incentives to align the interests of the individual litigant and the interests of society. n22 Filing fees and amount-in-controversy requirements, for example, serve as entry barriers that prevent the litigation of some claims, while treble damage awards increase the plaintiff's litigation incentive. Third, the standing requirements that enforce this model are designed to limit judicial involvement to plaintiffs who have suffered a particularized injury and to claims that can be redressed through litigation as opposed to generalized grievances more appropriately addressed through the political process. n23 Finally, the model treats the attorney-client relationship as an agency relationship in which the plaintiff, as the principal, assumes financial responsibility for the costs of the litigation, including attorneys' fees, and the attorney is subject to the plaintiff's control. n24 This control can be exercised to ensure that litigation decisions are designed to maximize the plaintiff's expected recovery.

The class action suit differs from this model in a number of respects. First, although Rule 23 of the Federal Rules of Civil Procedure ostensibly provides a procedure by which a plaintiff voluntarily can seek to act in a representative capacity, the named representative in a class action bears little resemblance to a traditional plaintiff. As a practical matter, class suits are often initiated by lawyers n25 who identify a cause of action and then search for a suitable individual to meet the requirements of Rule 23. n26 Lawyers define the parameters of the plaintiff class, with the understanding that increasing the class size, to the extent practical, is likely to increase the ultimate fee award. n27

Class members do not make an affirmative decision to participate in litigation, but instead receive some limited notice of the lawsuit providing an opportunity to opt out. n28 In the traditional context, a procedure whereby the lawyer commences a lawsuit and then contacts the plaintiffs and informs them that by doing nothing they consent both to the representation and the outcome would run afoul of legal and ethical constraints such as the prohibition against solicitation. n29

Second, the attorneys' fees in representative litigation are neither paid by the client nor determined by market forces. Instead, the court awards a portion of the settlement fund or damage award to be paid to class counsel in a successful suit. n30 The fee award is calculated either as a percentage of the total recovery n31 or on the basis of the actual time devoted to the litigation, but, importantly, the judgment about whether the attorneys' services merit the fee award is made by the court, not the plaintiff. n32 In exchange for this loss of control, plaintiff class members typically receive a corresponding benefit: freedom from responsibility for legal fees if the suit is unsuccessful. Because of the nature of class action litigation, and of small claimant class actions in particular, n33 the size of the fee award, whether calculated as a percentage of the total recovery or by reference to the hours of service provided, is far greater than the damages recovered by any individual litigant. This creates one of the most significant dif ferences between traditional and representative suits. In traditional litigation, the lawyers' recovery generally is limited to a fraction of the damages recovered by the client. Indeed, ethics provisions address the maximum percentage allowed in contingency fee arrangements. n34 However, in the typical class action, although plaintiffs' counsel receives only a fraction of the total recovery, that award greatly exceeds the amount recovered by any single litigant. This gives the lawyer, rather than the client, the greatest stake in the case.

These factors combine to create a system of lawyer-driven litigation. Plaintiffs' lawyers effectively act as entrepreneurs who manage litigation to further their own economic interests. n35 Consequently, the traditional incentive structure controlling the initiation of suit is absent. n36 The lawyers, who have the greatest financial interest in class suits, are strangers to the litigation; they have suffered no injury and lack the predicate standing to file a claim themselves. The ostensibly injured plaintiffs become mere figureheads, with little financial or other interest in the suit. n37

Moreover, although the litigation system relies on the client to monitor the lawyer's conduct in initiating and conducting litigation, the class plaintiff lacks both the interest and the ability to monitor. n38 The same absence of a significant financial stake that warranted the substitution of a class action for an individual suit also limits the economic incentive for plaintiff monitoring. The plaintiff's expenditure of time in monitoring is costly, and the expected value of this expenditure is limited substantially by the small size of plaintiff's interest. The plaintiff's interest in monitoring is reduced further by the virtual elimination of the traditional downside risks associated with unsuccessful litigation. If the class suit is unsuccessful, plaintiff class members rarely will be responsible for paying the costs of the suit, including the fees of plaintiffs' counsel; even more rarely will they be liable for sanctions under Rule 11 of the Federal Rules of Civil Procedure.

Furthermore, judicial decisions have substantially limited client control over litigation decisions in class actions. Although an individual client has the right to be represented by his or her choice of counsel, courts have held that the class representative is not entitled to make the decision to replace counsel. n39 Similarly, decisions traditionally within the purview of the litigation client, such as whether to accept a settlement n40 or file an appeal, n41 may be made in the class action by plaintiffs' counsel with the approval of the court, even over the objections of the class representative or other members of the plaintiff class. n42

Consequently, although the degree to which class plaintiffs participate in the litigation varies, the role of the class plaintiff bears little resemblance to the conduct of traditional individual litigants. Even though the class representative is charged with representing the interests of absent class members, the class representative often is absent from litigation proceedings. n43 In sum, client monitoring of class counsel may be virtually nonexistent. n44

Critics of the class action argue that these differences between traditional and representative litigation cause some

meritless suits to be filed in an effort to coerce settlement and may tempt lawyers to settle meritorious suits too cheaply. n45 These commentators argue that without sufficient client monitoring class suits do not meet the objective of compensating injured victims. Although recoveries vary, n46 evidence of suits settled for nominal payments to class mem bers or noncash recoveries suggests a reduced focus on compensation. n47 Some recently publicized settlements, for example, have provided plaintiffs with coupons offering discounts on future transactions with the defendant, in lieu of any cash recovery. n48

Recognizing that victim compensation is not the motivation for the resulting suits, some commentators have recharacterized the objective behind representative litigation as "the socially useful function of deterring undesirable conduct." n49 Class suits are applauded for the role they play in supplementing governmental efforts to enforce the law against corporate defendants whose wrongdoing results in widespread societal harm. This deterrence rationale characterizes class plaintiffs and their lawyers as "private attorneys general" who vindicate the public interest through private litigation. n50

The deterrence rationale provides powerful support for lawyer-driven litigation. To the extent that class suits provide a financial incentive for lawyers to search out and redress corporate wrongdoing, the fees awarded to class counsel are justified by the social utility of the suits. Corporate decisionmakers are encouraged by the possibility of class litigation to comply with the law instead of taking the risk that wrongdoing will be undetected or will produce harms too small to warrant litigation. Moreover, if deterrence rather than compensation is the primary objective of class litigation, it becomes less important to justify departures from the traditional litigation structure.

This trend has been reflected in the modification of ethical rules to accommodate the lawyer-driven nature of representative litigation. n51 Although ethical standards for lawyers historically have required the client to be responsible for paying the costs of litigation and have prohibited lawyers from picking up those costs, as Judge Easterbrook has recognized, these standards are inconsistent with the intent of Rule 23. n52 Similarly, the notices distributed to members of the plaintiff class are not treated as improper client solicitation even though the notices effect representation unless the recipient affirmatively opts out. Although the ethical standards were designed to assure lawyer loyalty to the client, client loyalty may be sacrificed along with client control if class suits are not really client-centered.

The deterrence rationale has not convinced all courts to modify traditional legal standards, nor has it persuaded all critics to embrace the lawyer-centered litigation model. Some reform efforts, such as recent legislative reform of securities fraud class action suits, have attempted to reverse the departure of class litigation from the traditional model and to restore client control and monitoring to the class suit. Other proposals take the existing modifications as a starting point and propose more extensive changes to the traditional litigation structure to facilitate representative litigation. To a degree, the structure of class action litigation stands at a crossroads. n53

III

Proposals for Class Action Reform

The Private Securities Litigation Reform Act ("PSLRA") n54 reflects a highly publicized attempt to reform class litigation through client empowerment. The PSLRA, which was motivated by congressional desire to transfer litigation control away from lawyers and back to clients, n55 adopted a number of provisions to reduce class counsels' control over litigation decisions and to facilitate client monitoring. n56 The reforms included banning professional plaintiffs, requiring certification by class representatives that they reviewed the complaint and authorized the litigation, and eliminating bounties and other special payments to class representatives. n57 Most importantly, the PSLRA adopted a provision establishing a special plaintiff role in securities fraud suits: the "lead plaintiff" position. n58

The PSLRA vests the lead plaintiff with control of securities fraud class actions, including the power to select class counsel. The history of the legislation suggests that it was intended to encourage institutional investors to become more active in monitoring the initiation, conduct, and settlement of litigation. n59 In particular, in establishing the

presumption that the class member with the largest financial interest is the most adequate representative of the class, Congress accepted the premise that a class representative with a large financial stake has the greatest incentive to ensure that litigation decisions reflect the interests of the plaintiff class and society as a whole.

Although experience under the PSLRA is limited, there are some indications that an empowered institutional investor can exercise control more analogous to that of a traditional individual client than the typical class representative. In Gluck v. Cellstar, n60 a case publicized as the first example of institutional investor activism under the PSLRA, the State of Wisconsin Investment Board ("SWIB") successfully obtained appointment as lead plaintiff. n61 SWIB then negotiated for the provision of legal services by a firm that traditionally does not represent class action plaintiffs, pursuant to an atypical fee structure designed to increase the incentive for counsel to maximize recovery to the plaintiff class. n62 The court approved SWIB's choice of lead counsel over the objections of Milberg, Weiss, a traditional plaintiffs' firm. n63

Preliminary results suggest, however, that cases like Gluck v. Cellstar are atypical and that the lead plaintiff provision has had little influence on the structure or conduct of securities fraud litigation. The SEC has reported that few institutional investors have sought lead plaintiff status. n64 Instead, the traditional plaintiffs' bar n65 has sought to enable its clients to obtain lead plaintiff status by combining multiple shareholders into lead plaintiff groups. n66 More-over, the statute has served to increase the dominance of the traditional plaintiffs' bar, especially the Milberg, Weiss firm. n67 The participation of institutional investors as lead plaintiffs does not appear to pose a substantial threat to this dominance. n68 Indeed, the ability of the bar to respond to the lead plaintiff requirement suggests that the PSLRA has done little to alter the degree of lawyer control over securities fraud class actions.

In contrast to the PSLRA, client elimination proposals, such as that suggested by Jean Wegman Burns, acknowledge the reality of lawyer control over class litigation and, rather than seeking to reduce that control, attempt to move the class action structure even further from traditional litigation. n69 Burns proposes eliminating the class representative in favor of a model in which class counsel represents the plaintiff class as a group. n70 Burns identifies a number of procedural obstacles created by the role of class representative and finds no identifiable benefit to retaining the role. n71 Moreover, elimination, she argues, "would have only a negligible effect on class action practice" in light of the fact that the "class attorney fashions the claim, decides on strategy, presents the evidence, and represents the interests of the class." n72 Burns argues that her proposal would "result in less confusion and inconsistency in class action doctrine" and would highlight the differences between the class suit and traditional litigation. n73

Although Burns' proposal is consistent with the direction in which class action doctrine is moving, it has several problems. A system that allows a lawyer merely to identify a class of plaintiffs and then file suit without requiring that any injured plaintiff approve the complaint or the retention of the lawyer eliminates any client check on the initiation decision. Such a system would seem to increase the opportunity for excessive and frivolous litigation that has been identified as a potential abuse of lawyer-driven litigation.

Furthermore, Burns proposes that courts consider the following question in ruling on motions for class certification: "Is there is a sharply defined issue presented in a concrete factual setting that the parties want resolved?" n74 This test highlights the problem with her approach. Under the existing incentive structure, plaintiffs' counsel may well have an issue that they want resolved. Nonetheless, dedication of judicial resources to resolve this issue may not be in the best interest of either the plaintiff class or society as a whole. In addition, Burns' effort to vest litigation decisions in class counsel threatens to weaken the already thin connection between class suits and the vindication of individual rights. Although viewing the class as the party-in-interest may satisfy the minimum constitutional requirements of standing, n75 the policies behind the standing doctrine suggest that judicial resolution may not be appropriate in every case in which the parties seek judicial involvement. n76

Eliminating the class representative also removes any possibility that the representative will monitor counsel's performance. Burns finds little harm in this result, correctly observing that plaintiff monitoring under the current system is largely ineffective. n77 Burns' proposed solution is to appoint class monitors, who need not be class members but

who have the specialized skills to monitor counsel's behavior. n78 By introducing strangers into the litigation process, Burns' proposal creates an artificial layer between the decisionmaker and those whose interest the decisionmaker is supposed to protect. In essence, Burns proposes the creation of a new agency structure within the class action suit. The problem with this proposal is its failure to acknowledge the substantial agency costs that would result from this structure. The class suit already suffers from the agency costs resulting from the divergence between the interests of class counsel and the plaintiff class. Independent monitors who lack a stake in the litigation would have less incentive than class members to monitor effectively, and monitors with a discrete interest in the subject matter of the litigation n79 would bring their own incentives and conflicts to the case. n80

Burns's proposal raises additional issues. How are costs and sanctions to be allocated if the litigation is unsuccessful or even frivolous? Will lawyers explicitly be permitted to finance a suit? Will notice be required, and if so, when? Can costs be taxed from absent class members? Is control of a class suit the reward for winning the race to the courthouse, or is the court empowered to approve the adequacy of class counsel? How should the court treat successive complaints purporting to represent the same class? The traditional model of litigation offers procedures for dealing with these questions. Although Burns correctly observes that, in many cases, these procedures are ineffective when applied to class actions, n81 severing the conceptual tie between traditional and representative litigation does not eliminate the need to address these concerns.

The identification of limited monitoring by class representatives, a common theme in both Burns' proposal and the PSLRA, suggests the need for structural reform to reduce the agency costs of the class action. An alternative way of addressing this problem would be to combine the roles of class counsel and class representative. Generally, courts have been hostile to the prospect of a lawyer serving in the dual capacity of class representative and class counsel. n82 Indeed, the federal courts have adopted a rule of per se disqualification providing that

> no member of the bar either maintaining an employment relationship, including a partnership or professional corporation, or sharing office or suite space with an attorney class representative during the preparation or pendency of a Rule 23(b)(3) class action may serve as counsel to the class if the action might result in the creation of a fund from which an attorneys' fee award would be appropriate. n83

The basis for this rule is Canon 9 of the Code of Professional Responsibility, which counsels lawyers to avoid even the appearance of impropriety. n84 The federal courts have found, virtually without exception, such impropriety in the conflict of interest created by the fact that the lawyer's fees as class counsel would greatly exceed any damage award received as a class member. n85

Although courts have used this reasoning as a basis to disqualify class representatives, their relatives, and their partners from serving as class counsel, n86 the lawyer's interest in a class action offers no possible impairment of his or her functioning as plaintiffs' counsel. While it is true that the expected legal fee is likely to dwarf the significance of damages received as a class member, combining the roles of class representative and lawyer increases the alignment of interests between the lawyer and the absent class members. This structure, in which the agent is given a financial stake in the subject of the agency, is commonly used to reduce agency costs. Instead, the risk created by the dual role is the ineffective functioning of lawyers as class representatives because they are unwilling or unable to monitor their own actions as class counsel. In theory, the appropriate judicial remedy for this risk should be removal of the dual-capacity lawyer as class representative, rather than replacement of class counsel. However, if plaintiff monitoring is ineffective anyway, as Burns suggests, or if the monitoring can be performed by someone else, the diminution in the dual-capacity lawyer's ability to monitor should not prevent him or her from holding both positions.

Judicial skepticism of counsel acting as class representative may stem from a deeper ethical concern: suspicion that lawyer-driven litigation violates traditional prohibitions against maintenance and champerty. n87 These old English rules forbade strangers to litigation, and lawyers in particular, from purchasing and pursuing other people's legal claims

because of the risk that litigious persons would foment excessive litigation for the purpose of harassment or personal gain. n88 Although the modern trend is to move away from these ethical standards in connection with the increasing tendency to view the practice of law as a business rather than a profession, some commentators question the impact of this development on the legal profession and the judicial system. Judge Kanne articulated this concern in Rand v. Monsanto Co., n89 observing, "I do not believe that the legal profession, or the American public which it serves, is better off when lawyers are first given authority to foment litigation and then are permitted to carry on that litigation at their own cost and risk." n90

Jonathan Macey and Geoffrey Miller suggest another alternative mechanism for addressing the agency problem: allowing the court to auction the right to litigate a class action suit as a private attorney general to the highest bidder. n91 The proceeds of the auction would be paid to members of the original plaintiff class who would then have no further role in the litigation. The proposal would eliminate the difference between the incentives of the plaintiff class and its counsel by reuniting the financial interest in the suit with control over litigation decisions. After the auction, the litigation would be conducted, in a sense, the same way as a traditional individual lawsuit.

The strength of the Macey and Miller proposal is its ability to combine the deterrence model of litigation with victim compensation. Indeed, the authors argue that, due to the competitive bidding process and the elimination of the skewed incentives of the current class structure, class members would recover more than under the existing class action procedure. n92 Critics have warned, however, that structural problems may interfere with an auction's ability to price the lawsuit fairly. n93 To the extent that the auction price is designed to compensate the victims of the wrongdoing, this is a serious objection. The objection is less problematic, however, if the primary goal of class litigation is to provide effective deterrence and victim compensation is only a subsidiary objective. In particular, the auction model virtually eliminates the incentive for counsel to settle strong cases cheaply and thereby sacrifice class and public interests in favor of personal gain.

The auction proposal also retains the crude aggregation effect of the existing class structure. Under the proposal, a suit seeking damages of one dollar each for a million class members and a suit seeking one hundred dollars each for ten thousand class members would be valued the same. This aggregation effect contributes to the perception that class suits are initiated in situations in which they are undesirable from a societal perspective; even a minimal recovery per class member can accumulate into a sizable award if the class size can be made sufficiently large. Moreover, freeing counsel from the responsibility for defending the adequacy of the awards made to individual class member encourages class size puffery. It is far better, from counsel's perspective, to represent an absent multitude that has no claim to a share of the proceeds.

As with the proposal to eliminate class representatives, the auction proposal also may encourage excessive litigation. A law firm can increase the riskiness of its litigation portfolio if it holds the residual interest in the claim, and it can reduce the risk associated with a specific suit through diversification. This makes it economically viable to bring suits that were too risky under traditional procedures. Determining the appropriate level of litigation depends on a variety of factors that are beyond the scope of this article and requires an empirical assessment of the effect of the auction proposal.

Finally, as Randall Thomas and Robert Hansen have noted in commenting on the proposal, the auction has the potential to undercut the incentive to commit resources investigating possible corporate wrongdoing. n94 Because the auction procedure allows an entrepreneurial lawyer to outbid the plaintiff or lawyer who files the initial suit, the financial rewards of representative litigation do not go to those who search out wrongdoing.

The proponents of these reforms describe their proposals as novel or radical. n95 From a legal realist perspective, however, proposals to eliminate the plaintiff from class actions are hardly innovative; as a practical matter, the plaintiff is already gone. In the evolving structure of representative litigation, an article exploring the role of the class action plaintiff would have little utility, except from a historical perspective. Indeed, these proposals suggest that reform of the class action structure could be even more dramatic. If the objective is deterrence rather than victim compensation, why

not eliminate the client from the class action completely and allow plaintiff's counsel to sue directly in his or her individual capacity? The court could award damages on the basis of proof of the economic damage caused by the defendant's conduct or according to a schedule of civil damage awards or fines based on the nature of the wrongdoing. The lawyer would receive a specified percentage of the amount recovered, akin to a contingency fee, and the remainder of the damage award could be used to create a fund for injured victims or allocated to benefit the victims indirectly through a cy pres distribution. n96

Uniting the lawyer and the plaintiff class into a single entity would eliminate the problem of agency costs most effectively. n97 Concededly, allowing lawyers to forgo identifying a figurehead client as the price of courthouse admission would trigger the objection that this mechanism would be champertous. In fact, however, explicitly empowering lawyers to act directly as private attorneys general would move the class action structure closer to truth than the illusion of the current system. n98 Instead of pretending that class members have assented to an attorney-client relationship when they fail to object after receiving notice of the possibility that, by doing nothing, they can receive a few dollars or a coupon, allowing class counsel to serve as plaintiff simply would unmask the nontraditional nature of representative litigation.

To recognize that class actions bear little resemblance to traditional individual litigation is not the equivalent of either endorsing or condemning their evolution. Indeed, as the variety of these reform proposals suggests, severing class actions from their ties to a more traditional litigation structure may increase the obligation to justify reform in terms of recognizable social goals. This is particularly important with respect to proposals that reduce or eliminate the traditional plaintiff's role because of the risk that such proposals would sacrifice victim compensation.

One tool for analyzing the implications of departure from a traditional litigation model is the qui tam provision of the federal False Claims Act ("FCA"). n99 Qui tam allows third-party relators who have suffered no cognizable injury to initiate and control litigation in exchange for a share of the damage award. Qui tam thus offers a model of privately initiated litigation freed from the traditional constraints of control by the injured client. Although class actions differ from suits under the FCA in important ways, examining qui tam can provide some insight into the issues and effects of modifying the plaintiff's role in an effort to facilitate enforcement-oriented litigation.

IV

Qui Tam and Class Actions

A.

Qui Tam and Private Enforcement of Law

Eliminating the plaintiff's role vests responsibility for litigation decisions in the hands of a stranger to the suit, whether that stranger is a class monitor, class counsel, or the successful purchaser at an auction, rather than in the hands of an injured plaintiff. This concept is alien to our traditional approach to private civil litigation, but common in public litigation, n100 in which society places control in the hands of a disinterested government prosecutor rather than the victim. n101 Although various efforts have been made to draw principled distinctions between private and public litigation in terms of objectives or remedies, such distinctions break down both as a historical matter and in modern litigation practice. As Harold Krent has described, the use of private litigation to supplement government law enforcement efforts dates from the eighteenth century in both the United States and England. n102 Today, civil fines and punitive damages blur the line between compensation to victims and the punishment of wrongdoers. n103

The private attorney general model of class actions similarly draws support from the perception that class suits can supplement or substitute for government enforcement efforts. Such suits may be described as privatizing the

enforcement of laws against corporate wrongdoing. Moreover, although the objectives of deterrence and compensation clearly are related in the sense that the obligation to pay compensation is the reason civil litigation deters corporate wrongdoing, n104 this compensation need not be paid to the victims to achieve deterrence. Accordingly, a private attorney general should not have to recruit an identifiable victim as a ticket to the courthouse.

This analysis forms the basis for the qui tam provision of the FCA. n105 Congress reasoned that ""one of the least expensive and most effective means of preventing frauds on the Treasury is to make the perpetrators of them liable to actions by private persons acting... under the strong stimulus of personal ill will or the hope of gain.'" n106 Accordingly, Congress created a mechanism whereby volunteer private litigants could serve as citizen prosecutors and enforce the government's fraud claims against third parties.

The qui tam provision in the FCA was originally enacted in 1863, but initially few private suits were brought under the statute. Subsequent legislative revisions and unfavorable judicial interpretations led the qui tam provision to fall into disuse. n107 In the early 1980s, however, congressional concerns about the "sophisticated and widespread fraud" being perpetrated against the government n108 resulted in adoption of several substantial legislative changes. The 1986 amendments to the FCA increased the civil penalties for a false claim, increased the relator's share of any recovery under the Act, enhanced the relator's control over the litigation, and removed some procedural impediments to the use of qui tam suits. n109 Since 1986, use of the qui tam provision has increased dramatically - relators have initiated approximately 2,000 lawsuits generating some $ 1.8 billion in total recovery. n110

Although qui tam authorizes private litigants to enforce government claims, qui tam suits are not the equivalent of traditional private litigation. Instead, the statute establishes a hybrid procedure in which the relator's litigation decisions are subject to coordination with and control by the U.S. government. Initially the relator files a complaint under seal and serves a copy of the complaint on the government. The government then has sixty days to evaluate the complaint and conduct an investigation. n111 At the conclusion of this period, the government may intervene and assume primary control over the litigation or decline to intervene and allow the relator to proceed privately. n112 If the government declines to intervene, the relator may continue to conduct the litigation in the name of the government. n113 In either case, the initial filing bars all subsequent suits based on the facts in the original complaint; no copycat suits are permitted. n114 After the government intervenes, it controls litigation decisions. n115 Although the relator remains a party to the action, the government has the authority to settle or dismiss qui tam suits over his or her objection. Nevertheless, the relator is entitled to a judicial hearing prior to disposition of the case, n116 and in addition to receiving a share of the recovery, he or she is entitled to participate in the litigation. n117

The FCA establishes a schedule for determining the bounty paid to the successful relator. The relator receives a percentage of any settlement or judgment against the defendant, as well as reasonable attorneys' fees and costs "depending upon the extent to which the person substantially contributed to the prosecution of the action." n118 The relator can receive from fifteen to thirty percent of the total recovery, depending on the nature of the information provided, the degree of the relator's participation in the case, and whether the government has intervened. n119 Because the FCA contains a mandatory civil penalty and a treble damage provision for actual government losses, the size of the bounty to which the relator is entitled may be substantial. In United States ex rel. Taxpayers Against Fraud v. General Electric Co., n120 for example, the relators received a bounty of approximately $ 11 million plus attorneys' fees. n121

B.

Constitutional Objections to Private Law Enforcement

Congress enacted a variety of qui tam statutes in the early years after ratification of the Constitution, and the use of qui tam to supplement government law enforcement dates back to eighteenth century England. n122 Nonetheless, the qui tam provision of the FCA has been subjected to repeated constitutional challenge. n123 Litigants and commentators have argued that relators are not proper plaintiffs and lack standing to bring suit under the Act, that qui tam violates

separation of powers, and that statutory authorization of third-party suits violates the Appointments Clause. n124 It is not the purpose of this article to evaluate the constitutionality of qui tam. Understanding these challenges, however, provides insight into both the analogy between qui tam and class actions and the constitutional issues raised by proposals to eliminate the plaintiff from class action litigation.

Although challenges to relator standing theoretically could be based on both prudential standing doctrine and the constitutional constraints imposed by Article III, the Court has refused to apply prudential limits on standing to cases in which Congress statutorily authorized the plaintiff to bring suit. n125 Because qui tam explicitly grants the relator a cause of action, these precedents effectively limit the argument in qui tam cases to the constitutional standing issue. Similarly, modifications to the existing class action procedure to eliminate the plaintiff and grant uninjured third parties the authority to bring suit presumably would be made by statute. Accordingly, prudential standing limits would not apply.

Nonetheless, Article III limitations on standing remain. Article III requires that the plaintiff have a personal stake in the litigation and have suffered a particularized injury resulting from defendant's conduct likely to be redressed by the relief requested. n126 In Raines v. Byrd, n127 a 1997 decision striking down the legislative grant of standing to members of Congress to challenge the Line Item Veto Act, the Supreme Court reaffirmed that Congress cannot eliminate the standing requirement of Article III simply by legislatively granting a plaintiff the right to sue. n128

Defendants have challenged relator standing under the FCA on the basis that the relator has suffered no injury as a result of the defendant's conduct. Courts have used two primary theories to uphold relator standing against this challenge. One theory treats the qui tam statute, by granting a monetary award to a successful relator, as vesting the relator with an interest in the outcome of the litigation sufficient to satisfy Article III. n129 The other theory views the government as the real party-in-interest; n130 the relator obtains standing as the government's assignee. n131

The two rationales have somewhat different implications. Congressional creation of a bounty payment grants the relator an identifiable interest in the subject of the litigation. The relator brings suit in an effort to obtain an economic benefit similar to the traditional private plaintiff. Commentators such as Cass Sunstein have argued that Congress can legislate around the standing limitations imposed by the Court in cases such as Lujan v. Defenders of Wildlife n132 by simply offering a cash bounty to litigants who are successful in bringing suit under any statute Congress wishes to have enforced by private parties. n133 Janet Cooper Alexander has argued for application of this principle to federal securities fraud, proposing a model in which damage awards would be replaced with a schedule of civil penalties, payable to the United States Treasury, and successful plaintiffs would receive a percentage of the penalty as a bounty, along with attorneys' fees. n134 Accepting that the congressional grant of the bounty is sufficient to confer standing offers the possibility of broadly replacing figurehead plaintiffs with third-party relators.

It is unclear, however, that the statutory bounty is sufficient to allow uninjured plaintiffs to satisfy Article III. One problem with this approach is that it conflates the requirement that the plaintiff have an interest in the litigation with the requirement that the plaintiff be injured. The bounty provides a relator with the type of interest mandated by the prudential standing requirements, including a sufficient concrete stake to ensure vigorous prosecution of the case. It does not, however, create a concrete injury in the plaintiff. The Court emphasized as recently as last term that a plaintiff must suffer such an injury to satisfy the requirements of Article III. n135

The Court's decision in Raines also suggests that it may be unwilling to accept Sunstein's argument that legislating a cash bounty is akin to creating a legal right that qualifies for judicial protection. Sunstein's suggestion threatens to expand congressional power substantially and to render ineffective the Court's effort to limit congressional attempts to authorize private citizens to act as regulatory authorities. There is no basis for inferring this broad congressional power from judicial acceptance of the private attorney general enforcement model; a plaintiff acting as private attorney general, unlike a qui tam plaintiff, has been personally injured by defendant's wrongdoing. n136

In the alternative, viewing the relator as an agent or assignee who is pursuing a cause of action that belongs to the

government n137 allows a court to look to the government's injury to satisfy Article III. The relator need prove only that the government has been injured, proof that generally is part of any case under the FCA. n138 Under this theory, the relator is akin to the government prosecutor; he or she does not need to show a personal stake in the litigation to act as the government's agent. The theory also is consistent with the historical underpinnings of qui tam in treating the statute as deputizing a private litigant as government prosecutor. n139

The assignment theory raises interesting questions about the degree to which the legislative power encompasses congressional authority to make this assignment of the government's rights. It nonetheless provides a substantial basis for upholding relator standing in qui tam suits under the FCA, as the government, like a private litigant, is a defrauded victim seeking to recover its damages. However, this rationale for relator standing proves problematic when extended to the type of corporate compliance claims that form the basis of traditional class actions. It would require a substantial stretch to characterize the government as the victim of a corporation's violation of antitrust, securities, or consumer protection law.

In cases in which the government is not an injured victim, third-party standing requires that the government have the power to assign its role as prosecutor. n140 The relator would act as a private attorney general in the sense of a substitute for a government enforcement official. In so doing, the relator would exercise a traditional governmental function: the executive power to enforce the law. Such congressional delegation of government enforcement authority to ordinary citizens can be attacked narrowly under the standing doc trine, as set forth in Lujan. In Lujan, the Court refused to accept a statutory provision creating a citizen suit. n141 The Court held that vindicating the public interest was a governmental function, and that Congress could not vest the general law enforcement authority in uninjured citizens. n142 The Lujan Court was particularly concerned about the capacity of citizen suits to turn federal judges into overseers of the President's power and duty to execute the laws. n143

A broader challenge to the relator as prosecutor can be made under the Appointments Clause n144 and the Take Care Clause n145 of the Constitution. Under either clause, the general argument is that allowing a volunteer citizen to enforce the law in the name of the United States violates principles of separation of powers. The statutory deputization of the relator is said to interfere with the executive power to initiate and control government litigation.

These challenges to qui tam present difficult questions. The structure of the FCA qui tam provision offers one response to this challenge. The FCA provides the government with substantial control over false claim litigation, including relator-initiated cases. The government may intervene, exercise primary control over the litigation, and settle or dismiss a case even over the objections of the relator. n146 Although relators may object to government efforts to limit their participation, n147 this control constrains the ability of the relator to interfere with government litigation strategy or enforcement policy.

Moreover, even if the government declines to intervene and thus leaves prosecution of the case in the hands of the relator, the government retains some degree of control. The relator is required to provide the government with copies of pleadings and depositions, and the government may be permitted to intervene subsequently upon a showing of good cause. Furthermore, the government has the right to receive notice of the terms of any settlement proposed by the relator. n148 Also, if the relator settles the case, the government is entitled to its share of the proceeds, whether or not it has intervened formally. n149 Additionally, the Fifth Circuit recently concluded that the statutory language gives the government an unqualified right to veto a relator's effort to settle an action, even in a case in which the government has not intervened. n150

The problem with arguing that the control given to the executive branch adequately addresses separation of powers concerns is that the government's exercise of this control is subject to judicial oversight. The government must obtain court approval to settle or dismiss a qui tam suit. n151 The government's decision to dismiss appears to be subject to a rational basis standard of review. n152 Although the court in United States ex rel. Sequoia v. Sunland Packing House Co. n153 acknowledged that principles of separation of powers limited its authority to interfere with the exercise of prosecutorial discretion by the executive branch, the opinion reveals the extensive burden placed on the government to

justify its decision to dismiss. n154

Judicial oversight of the government's decision to settle is even greater. The standard of review of a proposed settlement, which is equivalent to that used by courts in class action and derivative litigation, requires the court to find that the settlement advocated by the government is "fair, adequate, and reasonable under all the circumstances." n155 Thus, the court is required to exercise its independent judgment in evaluating the propriety of the settlement. Moreover, the statute does not authorize the court to consider many factors potentially relevant to a government decision to settle, including inconsistency of the case with government law enforcement policies or priorities, concern about parity in comparison to other cases, the efficient allocation of government resources, and the extent of the defendant's cooperation in continuing government investigations. n156

The court's task in evaluating the settlement decision is complicated by the fact that the relationship between the relator and the government may be adversarial or even hostile at this point in the case. n157 Particularly in cases in which the government has assumed the primary burden of conducting the litigation, the relator's interest in maximizing the amount recovered may be inconsistent with the legitimate government objective of efficiently deploying its prosecutorial resources. n158 The relator also may perceive the proffered settlement as an attempt to undercut its previously expended litigation efforts. Thus, the judicial oversight provided by the FCA over government litigation decisions raises serious separation of powers concerns with deputized private prosecutors. n159 At one level, the decision to initiate or terminate government litigation appears to be a core executive function; arguably it is inappropriate to grant the courts the power to decide whether such decisions are legitimate. Even if judicial supervision were appropriate in theory, the process of judicial review places a burden on the government that can require the Executive Branch to expend substantial resources defending its position and could compromise a variety of government policy interests. These effects are not accidental; congressional enactment of the 1986 amendments was premised on the belief that the Justice Department was not litigating with sufficient vigor and therefore required the help of citizen suits.

The lower courts have uniformly upheld qui tam against separation of powers challenges based on the Appointments Clause and the Take Care Clause. In large part, the analysis of these decisions has relied on the Supreme Court's decision in Morrison v. Olson. n160 Morrison, which upheld the independent counsel provisions of the Ethics in Government Act of 1978, n161 provides a tenuous foundation for upholding qui tam as a general delegation of government law enforcement power to private litigants. First, Morrison rests on a strongly functionalist view of separation of powers that marked a break from prior decisions of the Court. n162 Second, Morrison was concerned primarily with the President's power to remove executive officers. The exercise of limited executive powers by a government officer n163 whom the President cannot remove is not unique n164 and is a relatively modest encroachment on executive discretion. n165 Third, even if Morrison is read as a broad endorsement of the independent prosecutor's authority to litigate in the name of the government, the independent prosecutor is a government officer, not a private citizen. n166

More generally, principles of separation of powers raise two concerns for qui tam litigation that are not adequately addressed by Morrison: conflicts and accountability. Implicit in the objection that qui tam impermissibly delegates government control over litigation decisions is the concern that the relator and the government will disagree. As indicated above, the FCA limits the degree to which such conflicts will intrude upon the executive power by giving the government extensive control over the litigation. In addition, the potential conflict under the FCA is minimized because the government shares the relator's interest in recovering damages from the fraud. n167 This commonality provides some reason to trust the procedure of government investigation and intervention. If the relator presents a case involving strong allegations and substantial fraud, the government presumably will be eager to initiate litigation. If the relator's case is weak or insignificant, the government will not proceed.

Although academic commentary has considered whether a private attorney general has the appropriate incentives to engage in socially desirable litigation, private litigation generally is not viewed as a threat to government policy. To the extent that it is, we might expect Congress to reduce the volume of private litigation. As qui tam illustrates, however, Congress and the Executive Branch may disagree about law enforcement policy. If private litigation is justified as an

enforcement tool rather than a means of victim redress, it becomes more important to consider the degree of conflict and coordination between private and public enforcement efforts.

The potential conflict is increased in actions outside the FCA, in which the government's only interest is enforcement, rather than recovering damages. The President's enforcement priorities are based on a variety of factors, including the general public interest, political concerns, public opinion, and the appropriate delegation of executive and judicial resources. These factors also influence the choice of enforcement action, including the decision whether to pursue criminal sanctions. A core element of the executive function is the designation of these priorities. Third-party interference with this process poses a substantial threat to the executive prerogative. n168

One reason we care about this interference is accountability. Qui tam suits, like citizen environmental and taxpayer suits, pose the question of whether it is legitimate or advisable to delegate law enforcement power to those outside the political system. n169 The importance of political accountability has received extensive attention in the literature on a unitary executive. n170 Although private attorneys general seemingly pose the problem of being outside the political process, commentators have debated the definition of accountability and the extent to which the President and Executive Branch are accountable. Is it appropriate to hold those who make enforcement decisions accountable to actual voters, to those affected by the applicable laws, or to the public interest? Citizen suits and private enforcement actions allow individuals to check or counter politically determined enforcement priorities with which they disagree, a mechanism that actually may increase the responsiveness of the enforcement process. Ultimately, granting prosecutorial power to private plaintiffs may be seen as profoundly democratic.

C.

Qui Tam as an Enforcement Partnership

The foregoing analysis demonstrates that, although qui tam and the private attorney general model of class action litigation share common elements, privatizing enforcement litigation to the extent contemplated in some of the plaintiff elimination proposals would raise more difficult constitutional issues than the qui tam provision. The temptation of some commentators to analogize from qui tam to private enforcement appears to stem from some confusion about how to conceptualize qui tam. Many of the courts that have considered the constitutionality of qui tam under the FCA have concluded that the provision is most defensible if the government is viewed as the rights-holder that has assigned its claim to the relator by statute. n171 Under such a reading, however, qui tam does not vindicate privatized enforcement of the law.

It is inappropriate, however, to characterize the FCA qui tam provision as a simple assignment by the government of its right to pursue a damage claim. Instead, qui tam combines the government's role in law enforcement with the resources and incentive structure of private litigation. Qui tam neither fully privatizes enforcement of the FCA nor reduces the relator's role to that of government informant. As such, qui tam offers a unique model. Rather than attempting to choose between public and private enforcement in terms of their relative effectiveness, qui tam attempts to coordinate the contributions of both systems. n172

What contribution does private litigation make? In monetary terms, the value of the qui tam provision to the government is substantial. Qui tam suits resulted in the recovery to the government of more than $ 1 billion in the first ten years after adoption of the 1986 amendments. n173 This recovery represented approximately one-third of the government's total recovery under the FCA during this period. n174 The pace of qui tam recovery seems to be accelerating as a result of increased familiarity with the provision; the most recent Justice Department statistics report a total recovery of $ 1.8 billion. n175 Economic surveys commissioned by Taxpayers Against Fraud ("TAF"), a nonprofit litigation group, estimate that the provision has deterred more than $ 35 billion in fraud since the 1986 amendments. n176 TAF further projects recovery of $ 6.87 billion of federal fraud losses and $ 105 billion of savings from fraud deterrence. n177

What does the relator add to the government's ability to enforce the statute? Three components of the plaintiff's role add value: initiating litigation, providing information and investigative assistance, and providing litigation resources and support. The substantial bounty awarded to successful relators provides ample incentive for plaintiffs to initiate litigation under the FCA. n178 Indeed, Congress adopted the 1986 amendments to increase the incentives for plaintiffs to use qui tam. n179 Congress was concerned that the Executive Branch was insufficiently energetic in prosecuting fraud and that this laxity contributed to the extensive fraud perpetrated against the government. n180 The legislative history of the 1986 amendments indicates that Congress intended private plaintiffs, through their capacity to file claims, to operate as a check on the government. n181 Private litigants also have the incentive to proceed without unnecessary delay, which may cause relator litigation to quicken the bureaucratic pace of government action.

The informational contribution of the relator also is substantial. Indeed, the incentive structure of qui tam is tailored to place a premium on the contribution of original information, n182 with the intent that the unique access and insight of qui tam plaintiffs into the operations of government contractors may enable them to identify instances of fraud that the government would be unable to address on its own. n183 Furthermore, the relator can assist the government during the investigation process. The government has used private plaintiffs to review documents, formulate strategy, and obtain additional information during the course of an investigation. The government has even used a relator to obtain wiretap evidence of fraudulent conduct. n184 The structure of the qui tam provision facilitates this partnership because, unlike the typical victim cooperating with the government's investigation, the qui tam plaintiff has a financial interest in ensuring a successful enforcement action. This commonality of interest between the relator and the government is likely to foster increased cooperation.

Finally, the relator can supplement the government's litigation effort with private resources. The conduct of qui tam litigation varies depending on the nature of the case, the personnel involved, the practice of the particular government office, and a variety of other factors. In some cases, however, the government has given the relator's counsel a role akin to that of co-counsel. Be cause the resources available to private lawyers in terms of both money and manpower frequently exceed those of the government, this participation may result in the government reaping the benefit of more depositions and greater use of expert testimony. The government also may benefit from the litigation skills of private counsel. These benefits are provided to the government at no monetary cost n185 in qui tam cases because the relator's counsel fees are paid by the defendant and do not come out of the government recovery. n186

If private litigation is successful, why does qui tam retain such an extensive role for the government? Although the constitutional considerations discussed above may partially explain Congress's effort to vest the Justice Department with sufficient control over qui tam litigation, members of the qui tam bar attribute the success of qui tam litigation to the partnership between the private litigant and the government. The sixty-day period during which the government can review and investigate qui tam complaints provides it with the opportunity to monitor private initiation decisions. The government's subsequent power to intervene, decline intervention, or affirmatively seek dismissal allows it to play a major role in selecting meritorious suits for prosecution. Qui tam practitioners invest considerable effort persuading the government to intervene by convincing the Justice Department of the quality of the case. Ultimately, it appears that the Justice Department is an effective judge of quality. Government statistics indicate that the Justice Department has intervened in approximately twenty-two percent of qui tam suits filed since the 1986 amendments. n187 In those suits, the average recovery was more than $ 8 million. n188 By contrast, cases in which the government declined to intervene resulted in an average recovery of only $ 30,000, and the vast majority of these cases were dismissed with no recovery. n189

The government also plays a role in coordinating enforcement efforts. Although a qui tam suit may require the government to share its recovery in an enforcement action with the relator, the joint nature of the action obviates the need to consume litigation resources in duplicative public and private enforcement proceedings. Duplicative proceedings are commonplace in many areas in which class actions are deployed, such as antitrust and securities fraud. The government also can oversee the total compliance effort under the FCA and ensure consistency in litigation and settlement practices. Finally, the govern ment can coordinate private litigation with its own investigation and enforcement efforts to prevent multiple lawsuits from resulting in overdeterrence.

Government participation additionally serves to monitor the relator's contribution to the case, particularly the quality of the information provided. n190 Because the government is in a position to investigate the relator's information and also inform the court about the appropriate bounty, the incentive structure of the statute operates more effectively. In cases in which the relator has little original information to contribute, the ultimate award is likely to be too low to interest either the relator or counsel in filing suit. In cases in which the public benefits because the relator contributes new and useful information to the government, the relator is rewarded well. If the goal of qui tam is to engage private resources in searching out and redressing compliance issues, it seems essential to adopt a structure that tailors the financial incentive to the information contributed as a result of these efforts.

V

Extending the Model: The Application of Qui Tam to Class Actions

What lessons does qui tam offer for civil enforcement suits that are based on the private attorney general rationale, such as class actions? Although the qui tam model may not translate directly into other substantive areas, the value of coordination and cooperation between public and private law enforcement extends beyond the FCA. Perhaps the most important lesson from qui tam is that the conceptual barrier between private and public litigation need not be impermeable. By breaking down this barrier, qui tam offers new ways to unite both the litigation process and the goals of two systems that currently operate independently. Indeed, an analysis of qui tam suggests that we should consider the viability, both in prudential and constitutional terms, of a unified litigation process for enforcing corporate compliance with the law.

The qui tam partnership provides a mechanism for coordinating the enforcement efforts of the government and the private bar. Under the existing system, private enforcement litigation, such as class actions and citizen suits, often duplicates government enforcement efforts. n191 Multiple investigations and lawsuits based on the same conduct waste resources. n192 Private litigation also may undercut government compliance efforts by threatening the defendant's ability to negotiate a resolution with government prosecutors. n193 To the extent that the defendant faces subsequent private liability, it may be unwilling to admit wrongdoing or agree to sanctions.

Duplicative civil and government enforcement proceedings also risk overdeterrence. To the degree that compensation remedies impose the appropriate level of deterrence, any additional government penalties imposed will be excessive from a perspective of social utility. n194 In the event that compensatory damages provide insufficient deterrence, adjustments such as punitive damages are less expensive than multiple litigation.

Although duplicative litigation could be avoided by eliminating private enforcement and dedicating greater resources to public enforcement, this approach would sacrifice the valuable role of the private incentive system in supplementing government enforcement. In many areas, government enforcement levels have been criticized as inadequate. Private enforcement serves as a valuable check on government laxity and inefficiency, as well as signaling public dissatisfaction with the government's response to corporate wrongdoing. n195 Private lawsuits also can extend scarce government resources. The Securities and Exchange Commission ("SEC") repeatedly has acknowledged, for example, that private litigation enables a level of compliance that would be impossible to achieve if enforcement were limited to the government. n196

The absence of coordination between the government and the private bar also leads to confusion. Levels of enforcement may vary, carrying conflicting messages about the appropriate standard of conduct or the degree of corporate compliance. Because the incentive structure motivating the private bar need not mirror the government's priorities, no single decisionmaker can identify enforcement priorities and channel resources to meet those priorities. Litigation results can reflect inconsistencies as independent actors drive policy in multiple directions. The multiplicity of litigation also reduces the transparency of the system, especially when many cases are settled privately with stipulations that limit disclosure of the settlement terms or the nature of the defendant's behavior. As it becomes difficult to determine how the laws are being enforced, it becomes harder to evaluate and improve the enforcement process.

Transparency also reduces the potential for collusion or corruption. n197

Qui tam suggests that government and private enforcement efforts need not operate with complete independence. Indeed, the qui tam model offers a unified structure combining the incentives of private litigation with the benefits of government supervision and monitoring. Similarly, class actions and citizen suits might benefit from greater involvement by the appropriate regulatory authority. Although the plaintiffs' bar presumably would balk at the prospect of a government approval requirement, the obligation to submit a securities fraud complaint to the SEC or an antitrust suit to the Federal Trade Commission prior to filing might be less onerous than legislative restrictions on private rights of action. Moreover, plaintiffs' lawyers most likely would object to a government notification requirement due to concern that they would lose the opportunity to benefit financially from their work investigating the case or the risk that government involvement would result in undue delay or interference. These problems could be addressed, as with qui tam, by retaining a substantial financial reward for the plaintiff who successfully persuaded the government to initiate litigation, by a prompt government response to notification, and by preserving the plaintiff's right to sue if the government declined to intervene.

Government agencies might be able to function as the type of monitors envisioned by Burns, n198 but with greater technical expertise and incentives to participate than neutral third-party class monitors. Notification may enable the government, as with qui tam, to identify strong cases and to signal its evaluation to the litigants and the court. This role could facilitate the early dismissal of meritless cases. More importantly, the government's participation could reduce the risk that strong cases would be sold out through cheap settlements.

A unified enforcement proceeding could accomplish more than coordination. It also could combine the litigation resources of the private bar and the government. In some areas, the government's ability to deter corporate misconduct is limited by financial constraints, absence of personnel, or lack of technical expertise. The funding capacity and litigation experience of the private bar might cause cases to be litigated more efficiently and effectively. On the other hand, the government possesses unique law enforcement resources, including broad subpoena power, extensive records, and the ability to persuade reluctant agency officials to cooperate in investigation efforts. Rather than attempting to choose between public and private enforcement on the basis of relative effectiveness, an empirical question that may be difficult to resolve, a partnership allows society to exploit the strengths of both partners.

A single proceeding could also combine the litigation objectives of compensation and deterrence that currently are pursued separately. Qui tam differs from most government enforcement proceedings by retaining the focus on vic tim compensation. The primary goal of a qui tam suit is to maximize recovery of damages for the injured victim. Qui tam thus suggests that an effective enforcement proceeding need not sacrifice the compensation objective in favor of deterrence. The success of the qui tam provision of the FCA demonstrates the viability of using the private/government litigation partnership to pursue both goals. Through a unified proceeding, the private bar could pursue a compliance suit in partnership with the government to recover damages based on the injuries caused by the defendant's wrongdoing. The complaining plaintiff and his or her counsel could obtain a percentage of the recovery and attorneys' fees to reflect litigation services provided. The remainder of the recovery could be distributed to the victims of the wrongdoing in the manner currently employed in class actions.

This analysis is merely a preview of the type of litigation possibilities suggested by the qui tam model. Admittedly, current class action litigation differs from FCA claims in a number of ways. Most importantly, under the FCA, the relator often has unique information about the case. This enables the relator to contribute to the government's ability to enforce the law in a way that is unlikely to exist in cases involving consumer fraud, securities violations, or even civil rights. On the other hand, class actions make their most meaningful contribution to public enforcement when they are initiated by injured plaintiffs rather than by copycat claimants who base their complaints on public information or who duplicate government proceedings. Although the plaintiff in a products liability case may lack the secret information of a whistleblower, he or she may nonetheless supply important initiative and personal experience. Indeed, legislative efforts to preclude class representatives from receiving payment for their role, such as the provision in the PSLRA forbidding class representatives from receiving special compensation, n199 improperly discourage plaintiffs from

active involvement.

This model would extend hybrid litigation further to cases in which the government has no direct stake - unlike qui tam in which the government is seeking to recover on its own claim for damages. Moreover, the government would sacrifice its current monetary recovery in enforcement actions in favor of compensation for injured victims. Critics might question the incentives for active government involvement under these circumstances. Three responses are possible. First, the private attorney participating in a coordinated case would check government shirking more effectively than under the current system. Second, monetary incentives appear less essential to the behavior of government officials. Government prosecutors currently do not share in the government's recovery, and in many enforcement actions, the sanctions sought are nonmonetary. Third, enforcement actions in which the government has a financial stake, such as civil forfeitures, appear to present particular opportunities for prosecutorial over reaching. n200 Accordingly, eliminating the government's financial incentive may be desirable.

VI

Conclusion

Critics of the class action have suggested a variety of reform proposals to increase its efficiency and effectiveness. Concerns about the participation of the class representative have caused many of these proposals to focus on the role of the plaintiff, but calls for reform point in opposite directions. One approach seeks to empower the plaintiff to increase client control over the litigation process. The other approach would reduce or eliminate the role of the plaintiff in favor of enhancing the ability of the class action to deter corporate misconduct. The conflict between these approaches stems, in large part, from disagreement about the relative importance of victim compensation and deterrence of wrongdoing as litigation objectives.

Before choosing between these proposals, we should give further thought to the implications of the role of the private attorney general in enforcement of the law and, in particular, the traditional demarcation between public law enforcement and private litigation. Qui tam litigation under the federal False Claims Act provides a unique vehicle for examining the issues raised by allowing uninjured plaintiffs to bring suit as private prosecutors. More generally, the qui tam provision demonstrates the possibility of a more flexible regulatory process in which we are not forced to choose between the relative advantages of public and private enforcement, or between the pursuit of compensation and deterrence.

Remodeling class actions along the lines of qui tam is a radical suggestion. By breaking down the conceptual barrier between private litigation and public enforcement, however, qui tam provides important insights about enforcement litigation as well as possibilities for more incremental reforms. For example, qui tam raises the question of why government enforcement proceedings do not recover damages and compensate injured victims of corporate misconduct. Although legislative authorization might be required, government enforcement could pursue, as does qui tam, the dual objectives of compensation and deterrence. n201 More generally, by expanding the role of the government in private litigation and increasing the importance of the plaintiff in public enforcement, we may increase the effectiveness of litigation both in providing recompense and in deterring corporate misconduct.

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureClass ActionsClass CounselFeesCivil ProcedureClass ActionsClass MembersNamed MembersCivil ProcedureClass ActionsCompromises

FOOTNOTES:

n1. No. 13590-NC, 1997 Del. Ch. LEXIS 14 (Feb. 5, 1997).

n2. See id. at *2-3.

n3. See id. at *3-4.

n4. See id. at *1.

n5. Id. at *11.

n6. Id. at *8.

n7. Id. at *11-12.

n8. Id. at *12.

n9. See Fed. R. Civ. P. 23(a).

n10. See Epstein v. MCA, Inc., 126 F.3d 1235, 1250 (9th Cir. 1997) (describing the "jarring misalignment of interests" between class members and counsel and the incentive for counsel to settle quickly even if settlement was not in the interest of the class).

n11. See, e.g., id. at 1253 n.17 (noting defendant's "curious degree of inaction" in failing to move for dismissal, and alluding to possibility that defendant preferred cheap settlement).

n12. See generally John C. Coffee, Jr., Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working, 42 Md. L. Rev. 215, 245 (1983) (describing antitrust litigation in Maryland in which, as a result of settlement, plaintiffs received certificates redeemable for brokerage services at a 5% brokerage fee on the sale of their next home, and plaintiffs' counsel received $ 350,000 in costs and fees); Susan P. Koniak & George M. Cohen, Under Cloak of Settlement, 82 Va. L. Rev. 1051, 1054 (1996) (discussing settlements of GM Truck and Ford Bronco II cases); Note, In-Kind Class Action Settlements, 109 Harv. L. Rev. 810, 810 nn.3-8 (1996) (citing numerous settlements in which plaintiffs received no cash award, and questioning the compensatory value of such settlements).

n13. No. 91-1880 (Ala. Cir. Ct. Jan. 24, 1994).

n14. See Koniak & Cohen, supra note 12, at 1057-68 (describing terms of the settlement and award of $ 12 million in attorneys' fees to class counsel in Hoffman).

n15. One such recent attempt at reform was the Common Sense Legal Reforms Act of 1995, H.R. 10, 104th Cong., 202.

n16. See infra text accompanying notes 54-68.

n17. See infra text accompanying notes 49-53.

n18. The term "qui tam" derives from the Latin phrase "qui tam pro domino rege quam pro se imposo hac parte sequitur," meaning "who sues on behalf of the king as well as himself." In re Schimmels, 127 F.3d 875, 877 n.1 (9th Cir. 1997). The private plaintiff is referred to as the "relator." Id.

n19. Several federal statutes contain qui tam provisions. See 18 U.S.C. 962 (1994) (providing for forfeitures of vessels privately armed against friendly nations); 25 U.S.C. 201 (1994) (providing for recovery of penalties for violation of Indian protection laws); 35 U.S.C. 292 (1994) (implementing penalties for patent infringement); 46 U.S.C. 723 (1994) (providing for forfeiture of vessels taking undersea treasure from the Florida coast to foreign nations). The discussion in this article will focus on the qui tam provision of the Federal False Claims Act, which has been the basis for most qui tam litigation.

n20. Private litigation may be viewed as preserving the plaintiff's right to recourse. Recourse can be framed in monetary or nonmonetary terms, and this article uses the term "compensation" to encompass the full vindication of plaintiffs' rights.

n21. See Richard A. Posner, A Theory of Negligence, 1 J. Legal Stud. 29, 77 (1972) ("An accident victim will not spend more money on litigation than he can reasonably hope to obtain in damages."). The division of recovery between lawyer and client has no effect on the presumption that the level of litigation will be efficient as long as the client's recovery provides a sufficient incentive to file suit. See id. at 83.

n22. A broad literature explores the degree to which the private and social incentives for litigation are linked. Peter Menell's initial analysis asserted that social and private incentives to sue are linked. See Peter S. Menell, A Note on Private Versus Social Incentives to Sue in a Costly Legal System, 12 J. Legal Stud. 41, 41-42 (1983). Subsequent commentators, such as Steven Shavell and Louis Kaplow, have questioned the strength of this linkage. See Louis Kaplow, Private Versus Social Costs in Bringing Suit, 15 J. Legal Stud. 371, 372-74 (1986) (arguing that Menell and Shavell both correctly note that a plaintiff will sue only where damages exceed litigation costs, but disputing Menell's contention that an injurer takes into account all such costs in making its decisions); Steven Shavell, The Social Versus the Private Incentive To Bring Suit in a Costly Legal System, 11 J. Legal Stud. 333, 334 (1982) (arguing that private costs of suing are less than social costs because plaintiffs are not responsible for costs to defendants or society); see also Susan Rose-Ackerman & Mark Geistfeld, The Divergence Between Social and Private Incentives to Sue: A Comment on Shavell, Menell, and Kaplow, 16 J. Legal Stud. 483, 488-89 (1987) (discussing the Shavell and Menell-Kaplow models of private versus social costs of suit).

n23. See United States v. Hays, 515 U.S. 737, 743-45 (1995).

n24. Ethical rules, for example, give the client the right to determine the objectives of litigation and require the client to decide issues such as whether to accept a settlement offer. See, e.g., Model Rules of Professional Conduct Rule 1.2(a) (1995); Model Code of Professional Responsibility EC 7-7 (1982).

n25. See, e.g., Stephen E. Frank, First USA Settles Lawsuit Alleging It Switched Rates, Wall St. J., Sept. 4, 1997, at B8 (quoting Atlanta attorney Douglas Campbell as describing "a whole group of plaintiffs' lawyers... who spend their time looking for both contractual irregularities and violations of regulatory statutes and regulations").

n26. For example, lawyers have used newspaper and television advertisements to urge women with breast implants or those who used Norplant to participate in litigation.

n27. Courts exercise relatively little control over the process by which counsel determines the size of the plaintiff class, even in high profile cases. Counsel's estimation may amount to nothing more than "an educated guess." See, e.g., Ann Davis & Milo Geyelin, Issues of Eligibility Remain Hazy in Secondhand Smoke Settlement, Wall St. J., Oct. 16, 1997, at B8 (describing judicial acceptance of lead counsel's estimate that client class in recently settled suit by airline flight attendants for secondhand smoke-related illnesses included 60,000 plaintiffs; lead counsel subsequently conceded that the 60,000 figure was too high, although the large figure gave the case a higher profile).

n28. See Fed. R. Civ. P. 23(c)(2); see also Hansberry v. Lee, 311 U.S. 32, 39-44 (1940) (holding that class members could not be bound by judgment in suit in which they were given neither notice nor an opportunity to opt out); George Rutherglen, Better Late Than Never: Notice and Opt Out at the Settlement Stage of Class Actions, 71 N.Y.U. L. Rev. 258, 267-77 (describing and analyzing notice requirements).

n29. Cf. Florida Bar v. Went For It, Inc., 515 U.S. 618 (1995) (upholding, on invasion of privacy grounds, state ban on sending targeted, direct-mail solicitations to personal injury victims within 30 days of an accident). Although the Supreme Court has held that state ethical rules cannot establish absolute bans on direct-mail solicitations, the Court's holding rested, in part, on the premise that advertisements can be "put in a drawer to be considered later, discarded or ignored," a rationale that would not extend to a notice whereby such conduct constituted consent to representation. See id. at 635 (quoting Shapero v. Kentucky Bar Ass'n, 486 U.S. 466, 475-76 (1988)).

n30. Alternatively, some statutes commonly applicable to representative litigation provide for fee shifting, in which the unsuccessful defendant pays the plaintiffs' attorneys' fees. See, e.g., Clayton Act, 15 U.S.C. 15(a) (1994); Fair Labor Standards Act, 29 U.S.C. 216(b) (1994); Endangered Species Act, 16 U.S.C. 1540(g)(4) (1994). Under fee-shifting statutes, the court also determines the amount of attorneys' fees for which the defendant is responsible.

n31. The percentage of recovery method of compensation resembles the contingency fee that is employed in most personal injury litigation. See, e.g., James S. Kakalik & Nicholas M. Pace, Costs and Compensation Paid in Tort Litigation 37 (1986) (stating that approximately 95% of personal injury plaintiffs retain lawyers on a contingency fee basis).

n32. Even in individual actions, contingency fees recently have come under attack on the ground that they do not reflect reasonable compensation for the services provided. See, e.g., Richard B. Schmitt, Courts Whittle Down Lawyers' Fat Contingent Fees, Wall St. J., Jan. 28, 1998, at B1 (describing recent decisions scrutinizing standard contingency fee agreements in cases involving minimal risk and legal work).

n33. For a description of the distinction between "small claimant" and "large claimant" class actions, see John C. Coffee, Jr., Class Wars: The Dilemma of the Mass Tort Class Action, 95 Colum. L. Rev. 1343, 1351-52 (1995).

n34. See Rules Regulating the Florida Bar 4-1.5(f), reprinted in Fla. Bar J., Sept. 1992, at 526-28; Tenn. Code Ann. 29-26-120 (1980); E.D. Tex. R. CV-83(a)(1) (1997); see also Richard M. Birnholz, Comment, The Validity and Propriety of Contingent Fee Controls, 37 UCLA L. Rev. 949 (1990) (evaluating the ethical considerations of contingent fee controls in light of the need for plaintiff representation).

n35. 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 (1987) [hereinafter Coffee, Entrepreneurial Litigation]; 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 (1986) [hereinafter Coffee, Understanding the Plaintiff's Attorney]; 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 (1991).

n36. It is somewhat naive, of course, to view traditional litigation as driven exclusively by the incentives of the client, rather than those of the lawyer. See generally Frank B. Cross, The Role of Lawyers in Positive Theories of Doctrinal Evolution, 45 Emory L.J. 523 (1996).

n37. See Jean Wegman Burns, Decorative Figureheads: Eliminating Class Representatives in Class Actions, 42 Hastings L.J. 165 (1990); Howard M. Downs, Federal Class Actions: Diminished Protection for the Class and the Case for Reform, 73 Neb. L. Rev. 646, 658-60 (1994).

n38. Courts appear ambivalent about the ability of the class representative to understand the case and effectively monitor litigation decisions. For example, the Supreme Court has stated that due process requires that the named plaintiff be an adequate representative of absent class members. See Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 812 (1985). However, the Court also has concluded that a plaintiff who barely spoke English, "did not understand the complaint at all," and who could not explain the nature of the defendants' alleged misconduct was an adequate class representative. Surowitz v. Hilton Hotels Corp., 383 U.S. 363, 366 (1966). On the extent to which the Due Process Clause requires adequate representation, see Comment, The Importance of Being Adequate: Due Process Requirements in Class Actions Under Federal Rule 23, 123 U. Pa. L. Rev. 1217 (1975).

n39. See Maywalt v. Parker & Parsley Petroleum Co., 67 F.3d 1072, 1078 (2d Cir. 1995).

n40. See, e.g., Camp v. Union Mfg. Co., 549 A.2d 285 (Conn. App. Ct. 1988) (per curiam) (holding that consent of the representative plaintiff is not required for approval of the settlement in a shareholder derivative suit, and citing federal cases in accord with this holding).

n41. See, e.g., Pettway v. American Cast Iron Pipe Co., 576 F.2d 1157, 1178 (5th Cir. 1978) ("Where the named plaintiffs wish to appeal, but the class attorney concludes that an appeal is not in the best interest of the class, the district court must exercise its discretion in deciding whether to substitute class counsel to allow the named plaintiffs to maintain the appeal on behalf of the class.").

n42. See Patrick Woolley, Rethinking the Adequacy of Adequate Representation, 75 Tex. L. Rev. 571 (1997). Woolley notes that, "unlike plaintiffs in ordinary litigation, class members are denied the right to make critical decisions about their claims, including the most crucial of all decisions: whether to settle or pursue their claims." Id. at 571.

n43. In three of four federal districts analyzed in a study conducted by the Federal Judicial Center, class representatives attended the settlement approval hearing in only 11% to 28% of the cases; the attendance rate in the fourth district was 46%. See Thomas E. Willging et al., An Empirical Analysis of Rule 23 to Address the Rulemaking Challenges, 71 N.Y.U. L. Rev. 74, 100 (1996).

n44. See Jonathan R. Macey & Geoffrey P. Miller, Auctioning Class Action and Derivative Suits: A Rejoinder, 87 Nw. U. L. Rev. 458, 459 (1993).

n45. See Coffee, Understanding the Plaintiff's Attorney, supra note 35, at 685-86.

n46. See Willging et al., supra note 43, at 84 (finding that, over a two-year period, the median level of recovery per class member ranged from $ 315 to $ 528).

n47. See, e.g., Frank, supra note 25 (describing terms of proposed settlement of class action suit based on misleading credit card solicitations in which members of the plaintiff class would receive a maximum of $ 3.85 each).

n48. See Note, supra note 12, at 812-15.

n49. Coffee, Understanding the Plaintiff's Attorney, supra note 35, at 678.

n50. See generally Bryant Garth et al., The Institution of the Private Attorney General: Perspectives from an Empirical Study of Class Action Litigation, 61 S. Cal. L. Rev. 353 (1988).

n51. See, e.g., Committee on Professional Responsibility, Association of the Bar of the City of New York, Financial Arrangements in Class Actions, and the Code of Professional Responsibility, 20 Fordham Urb. L.J. 831, 832 (1993) (describing conflicts between ethical rules and practical needs of class action litigation and recent trend by courts favoring public policy considerations when faced with such conflicts); Macey & Miller, supra note 35 , at 97-105 (discussing ethical problems that would occur if ethical rules were applied strictly to representative litigation).

n52. See Rand v. Monsanto Co., 926 F.2d 596, 600-01 (7th Cir. 1991).

n53. See Joel Seligman & Lindsey Hunter, Rule 23: Class Actions at the Crossroads, 39 Ariz. L. Rev. 407 (1997).

n54. Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified in scattered sections of 15 U.S.C. (Supp. I 1995-96)).

n55. See, e.g., H.R. Conf. Rep. No. 104-369, at 2-3 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 730-31 (explaining Congress's objective of "protecting investors who join class actions against lawyer-driven lawsuits by giving control of the litigation to lead plaintiffs with substantial holdings of the securities of the issuer").

n56. See Jill E. Fisch, Class Action Reform: Lessons from Securities Litigation, 39 Ariz. L. Rev. 533, 536-37 (1997).

n57. See id.

n58. The PSLRA provides that, although any member of the plaintiff class may file a securities fraud class action, the filing plaintiff must provide notice of the complaint to other members of the class. See 15 U.S.C. 78u-4(a)(3)(A)(i) (Supp. I 1995-96). Within 90 days after publication of this notice, the court is required to appoint a lead plaintiff to oversee the conduct of the litigation. See id. 78u-4(a)(3)(B)(i). The statute instructs the court to appoint the "member or members of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members." Id. The statute establishes a presumption that the most adequate plaintiff is the person or group with the largest financial interest in the claim. See id. 78u-4(a)(3)(B)(iii)(I)(bb).

n59. The lead plaintiff provision was proposed by two law professors who suggested that institutional investors with substantial stakes could monitor securities class actions and thereby reduce agency costs. See Elliott J. Weiss & John S. Beckerman, Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions, 104 Yale L.J. 2053 (1995).

n60. 976 F. Supp. 542 (N.D. Tex. 1997).

n61. See id. at 543.

n62. See Keith Johnson, Institutional Investor Participation in Class Actions After the Private Securities Litigation Reform Act of 1995, ALI-ABA, Nov. 7, 1996, at 386-87.

n63. See Gluck, 976 F. Supp. at 543 n.3, 550 n.9.

n64. See United States Sec. & Exchange Comm'n Office of Gen. Counsel, Report to the President and the Congress on the First Year of Practice Under the Private Securities Litigation Reform Act of 1995 (visited Mar. 26, 1998), available at <http://www.sec.gov/news/studies/lreform.txt>.

n65. See James Bohn & Stephen Choi, Fraud in the New-Issues Market: Empirical Evidence on Securities Class Actions, 144 U. Pa. L. Rev. 903, 909 n.27 (1996).

n66. See Seth Goodchild & Stephenie L. Brown, Institutional Investors as Lead Plaintiffs, N.Y. L.J., June 6, 1997, at 1 (describing efforts by traditional plaintiffs bar "to continue its domination by "cobbling' together groups of unrelated small investors aggregating their holdings to meet the PSLRA criteria").

n67. See Joseph A. Grundfest & Michael A. Perino, Ten Things We Know and Ten Things We Don't Know About the Private Securities Litigation Reform Act of 1995: Joint Written Testimony Before the Subcomm. on Sec. of the Senate Comm. on Banking, Housing, and Urban Affairs on July 24, 1997 (visited Mar. 26, 1997), available at <http://securities.stanford.edu/report/testimony/970724sen1.htm> (describing nationwide pre-PSLRA appearance ratio of Milberg, Weiss as 31% and estimating the firm's 1996 appearance ratio at about 59%).

n68. See, e.g., In re Donnkenny Inc. Sec. Litig., 171 F.R.D. 156 (S.D.N.Y. 1997) (appointing institutional investor Emanon Partners as sole lead plaintiff and approving its selection of Milberg, Weiss and Wolf, Popper, another traditional plaintiffs' firm, as co-lead counsel).

n69. See Burns, supra note 37, at 165-66.

n70. See id. at 186.

n71. See id. at 173-78.

n72. Id. at 189.

n73. Id.

n74. Id. at 193.

n75. See id. at 188.

n76. See Bennett v. Spear, 117 S. Ct. 1154, 1161 (1997).

n77. See Burns, supra note 37, at 182-83.

n78. See id. at 196.

n79. Burns proposes selecting monitors with "a special interest in the subject matter of the lawsuit." Id.

n80. Indeed, the evolution of monitoring structures in corporate law bears testament to the difficulty of creating an independent monitor to mediate between the conflicting interests of centralized decisionmakers and a large group of dispersed small stakeholders. See Jill E. Fisch, Taking Boards Seriously, 19 Cardozo L. Rev. 265, 268-69 (1997).

n81. See Burns, supra note 37, at 179-86.

n82. See Neil L. Rock, Note, Class Action Counsel as Named Plaintiff: Double Trouble, 56 Fordham L.

Rev. 111 (1987).

n83. Kramer v. Scientific Control Corp., 534 F.2d 1085, 1093 (3d Cir. 1976).

n84. See Model Code of Professional Responsibility Canon 9 (1980).

n85. See generally Rock, supra note 82, at 126 (citing cases); see also Barliant v. Follett Corp., 384 N.E.2d 316, 321 (Ill. 1978) (discussing alternative rationales for prohibiting dual capacity representation and observing that the "vast majority" of federal cases prohibit such representation).

n86. See Holland v. Goodyear Tire & Rubber Co., 75 F.R.D. 743, 747-48 (N.D. Ohio 1975); Rock, supra note 82, at 112.

n87. Black's Law Dictionary defines maintenance as "maintaining, supporting or assisting either party, with money or otherwise, to prosecute or defend" litigation. Black's Law Dictionary 954 (6th ed. 1990). Champerty is "[a] bargain between a stranger and a party to a lawsuit by which the stranger pursues the party's claim in consideration of receiving part of any judgment proceeds." Id. at 231.

n88. See, e.g., Desenne v. Jamestown Boat Yard, Inc., 781 F. Supp. 866, 872 (D.R.I. 1991), aff'd, 968 F.2d 1388, 1390 (1st Cir. 1992) (identifying objective behind rules against champerty and maintenance as preventing purchasing of claims "by intermeddling volunteers for their own profit"); cf. Holland, 75 F.R.D. at 748 (observing that to allow class suits by attorneys acting as counsel for themselves would conflict with policy of judicial economy that disfavors the creation of lawsuits "where none previously existed").

n89. 926 F.2d 596 (7th Cir. 1991).

n90. Id. at 603 (Kanne, J., concurring).

n91. See Macey & Miller, supra note 35, at 6; Macey & Miller, supra note 44, at 460.

n92. See Macey & Miller, supra note 35, at 108-09.

n93. See, e.g., Randall S. Thomas & Robert G. Hansen, Auctioning Class Action and Derivative Lawsuits: A Critical Analysis, 87 Nw. U. L. Rev. 423 (1993). Thomas and Hansen argue that auction bidders have imperfect information about a suit's value, that this information problem would be compounded if defendants were permitted to bid on the suit, and that the auction process would be prohibitively expensive because of the discovery necessary to gauge the value of a suit. See id. at 425.

n94. See id. at 430 n.39.

n95. See Macey & Miller, supra note 35, at 105; Burns, supra note 37, at 165.

n96. See 2 Herbert B. Newberg, Newberg on Class Actions 10.15, 10.17, at 372-74 (3d ed. 1992) (describing use of cy pres distribution to allocate unclaimed portion of class recovery in a manner that benefits class members indirectly).

n97. See Note, Investor Empowerment Strategies in the Congressional Reform of Securities Class Actions, 109 Harv. L. Rev. 2056, 2065 (1996) ("If, instead, the class and the class attorney were a single entity, that actor would make litigation decisions in the joint interest of the two parties that maximized the gains for them both.").

n98. See Coffee, Regulation of Entrepreneurial Litigation, supra note 35, at 899.

n99. 31 U.S.C. 3729-33 (1994).

n100. This article focuses on the distinction between private and public enforcement, the latter of which can occur via criminal prosecution or a civil enforcement proceeding. The distinction between criminal and civil law is beyond the scope of this article. For further analysis of the distinction, see Mary M. Cheh, Constitutional Limits on Using Civil Remedies to Achieve Criminal Law Objectives: Understanding and Transcending the Criminal-Civil Law Distinction, 42 Hastings L.J. 1325 (1991).

n101. Cf. Young v. United States ex rel. Vuitton et Fils S.A., 481 U.S. 787 (1987) (upholding appointment of private plaintiff to prosecute criminal contempt case but invalidating the appointment of a private prosecutor with an interest in the case).

n102. See Harold J. Krent, Executive Control over Criminal Law Enforcement: Some Lessons from History, 38 Am. U. L. Rev. 275, 290-96 (1989).

n103. See Cheh, supra note 100, at 1352, 1356-57; see also Pacific Mut. Life Ins. Co. v. Haslip, 499 U.S. 1, 21 (1991) (describing the standard of review of punitive damage awards in terms of accomplishing "society's goals of punishment and deterrence")(quoting Green Oil Co. v. Hornsby, 539 So. 2d 218, 222 (Ala. 1989)).

n104. See, e.g., Posner, supra note 21, at 32-33 (explaining why plaintiff's damages are the right amount to make the defendant pay in order to achieve appropriate deterrence); cf. Janet Cooper Alexander, Rethinking Damages in Securities Class Actions, 48 Stan. L. Rev. 1487, 1515 (1996) (suggesting legislation to sever the tie between the size of the damage award and the plaintiff's injury by providing a schedule of fines awardable to successful plaintiffs in private securities fraud litigation).

n105. The FCA imposes civil liability on those who defraud the U.S. government. The statute vests the Attorney General with primary responsibility for enforcment. See 31 U.S.C. 3730(a)(1994).

n106. S. Rep. No. 99-345, at 11 (1986), reprinted in 1986 U.S.C.C.A.N. 5266, 5276 (quoting United States v. Griswold, 24 F. 361, 366 (D. Or. 1885)).

n107. See Ara Lovitt, Note, Fight for Your Right to Litigate: Qui Tam, Article II, and the President, 49 Stan. L. Rev. 853, 856-57 (1997).

n108. S. Rep. No. 99-345, at 1-2 (1986), reprinted in 1986 U.S.C.C.A.N. 5266, 5266-67. One commentator estimated that contractors were cheating the U.S. Treasury out of $ 25 to $ 70 billion per year in the early 1980s. See Erwin Chemerinsky, Controlling Fraud Against the Government: The Need for Decentralized Enforcement, 58 Notre Dame L. Rev. 995 (1983).

n109. See United States ex rel. Springfield Terminal Ry. Co. v. Quinn, 14 F.3d 645, 651 (D.C. Cir. 1994) (describing changes made by 1986 amendments to encourage citizen enforcement actions).

n110. See Telephone Interview with Joseph Krovisky, Office of Public Affairs, United States Dep't of Justice (Sept. 29, 1997) [hereinafter DOJ Statistics].

n111. See also David J. Ryan, The False Claims Act: An Old Weapon with New Firepower Is Aimed at Health Care Fraud, 4 Annals Health L. 127, 131-32 (1995) (describing qui tam filing procedure).

n112. See 31 U.S.C. 3730(b)(4) (1994).

n113. See id. 3730(b)(4)(A).

n114. See Ryan, supra note 111, at 132.

n115. See 31 U.S.C. 3730(c)(1).

n116. See id. 3730(c)(2)(A).

n117. See id. 3730(c)(1), (3).

n118. Id. 3730(d)(1).

n119. See id. 3730(d)(1), (2). In cases in which the court determines that the action results primarily from information that has been disclosed in a government proceeding or investigation or in the news media and not from information provided by the relator, the court is authorized to award a reduced bounty of up to 10% of the total recovery. See id.

n120. 41 F.3d 1032 (6th Cir. 1994)

n121. See id. at 1036.

n122. See Krent, supra note 102.

n123. The Supreme Court has not ruled on the constitutionality of the qui tam provision of the FCA. See Hughes Aircraft Co. v. United States ex rel. Schumer, 117 S. Ct. 1871, 1875 n.3 (1997) (reserving constitutional

questions about qui tam). Lower federal courts have almost uniformly upheld the provision against constitutional challenge. See, e.g., Lovitt, supra note 107 , at 854 (discussing decisions and observing that, as of the publication of the note, no federal court had accepted the constitutional challenges to the provision). But see United States ex rel. Riley v. St. Luke's Episcopal Hosp., 982 F. Supp. 1261, 1269 (S.D. Tex. 1997) (striking down qui tam provision as unconstitutionally attempting to confer standing on uninjured plaintiff in violation of separation of powers).

n124. U.S. Const. art. II, 2, cl. 2. Compare James T. Blanch, Note, The Constitutionality of the False Claims Act's Qui Tam Provision, 16 Harv. J. L. & Pub. Pol'y 701 (1993) (arguing that qui tam violates standing, separation of powers, and Appointments Clause), with Thomas R. Lee, Comment, The Standing of Qui Tam Relators Under the False Claims Act, 57 U. Chi. L. Rev. 543 (1990) (arguing in favor of relator standing based on assignment theory), and Evan Caminker, Comment, The Constitutionality of Qui Tam Actions, 99 Yale L.J. 341 (1989) (arguing that qui tam provisions are constitutional).

n125. "Congress'[s] decision to grant a particular plaintiff the right to challenge an act's constitutionality... eliminates any prudential standing limitations." Raines v. Byrd, 117 S. Ct. 2312, 2318 n.3 (1997).

n126. See id. at 2317-22.

n127. 117 S. Ct. 2312 (1997).

n128. See id. at 2317.

n129. See United States ex rel. Kelly v. Boeing Co., 9 F.3d 743, 748-49 (9th Cir. 1993).

n130. In addition to the issues identified herein, identification of the real party-in-interest in qui tam litigation is essential to resolving a variety of litigation questions such as the availability of personal defenses, the application of estoppel and waiver, and the applicability of the special procedural rules for government litigation. See Valerie R. Park, Note, The False Claims Act, Qui Tam Relators, and the Government: Which is the Real Party to the Action?, 43 Stan. L. Rev. 1061 (1991).

n131. See United States ex rel. Stillwell v. Hughes Helicopters, Inc., 714 F. Supp. 1084, 1096 (C.D. Cal. 1989); see also United States ex rel. Hall v. Tribal Dev. Corp., 49 F.3d 1208, 1212 (7th Cir. 1995) (accepting assignment theory to uphold validity of qui tam provision in Indian Gaming Regulatory Act). Courts also have considered the established history of qui tam provisions and the relator's personal interest in the litigation resulting from his or her employment situation, including the risk of retaliation, in upholding relator standing. See, e.g., Burch ex rel. United States v. Piqua Eng'g, Inc., 145 F.R.D. 452, 454 (S.D. Ohio 1992) (upholding standing based on the potential ramifications to plaintiffs' employment relationship from bringing qui tam action).

n132. 504 U.S. 555 (1992).

n133. See Cass R. Sunstein, What's Standing After Lujan? Of Citizen Suits, "Injuries," and Article III, 91 Mich. L. Rev. 163, 230 (1992). Sunstein identifies the difficulty in distinguishing legitimate congressionally

created entitlements from bounties. See id. at 232-33. Congress has granted a multitude of entitlements to variously defined groups. Once created, an entitlement is a legal right and denial of that right confers an injury that may be vindicated through litigation. Sunstein argues that, by granting an entitlement, Congress is essentially exercising the power to define an injury where no case or controversy existed before, and that this power need not be limited to injuries that were recognized at common law. See id. at 230-31. A detailed analysis of this argument is beyond the scope of this article but, if Sunstein is correct in concluding that Congress can grant standing to an uninjured third party by creating a statutory award, then Article III's limitation on congressional power is reduced to little more than a drafting constraint. See Blanch, supra note 124.

n134. See Alexander, supra note 104, at 1515-20.

n135. See Raines v. Byrd, 117 S. Ct. 2312 (1997).

n136. Cf. United States ex rel. Taxpayers Against Fraud v. General Elec. Co., 41 F.3d 1032, 1041-42 (6th Cir. 1994) (analogizing qui tam provision to traditional laws that authorize individuals to act as private attorneys general in order to uphold its constitutionality).

n137. See United States ex rel. Kelly v. Boeing Co., 9 F.3d 743, 748 (9th Cir. 1993).

n138. Cf. United States ex rel. Simmons v. Smith, 629 F. Supp. 124, 126 (S.D. Ala. 1985) (holding that an allegation of an injury to the United States Treasury is an essential element of a qui tam action under the FCA).

n139. See John P. Robertson, Comment, The False Claims Act, 26 Ariz. St. L. Rev. 899, 900-01 (1994).

n140. But see Young v. United States, 481 U.S. 787, 793 (1987) (upholding judicial appointment of private plaintiff to prosecute criminal contempt proceeding).

n141. See Lujan v. Defenders of Wildlife, 504 U.S. 555, 562 (1992).

n142. See id. at 576.

n143. See id. at 576-77.

n144. U.S. Const. art. II, 2, cl. 2; see Lovitt, supra note 107, at 860.

n145. U.S. Const. art. II, 3, cl. 4; see Robertson, supra note 139, at 907.

n146. Even if the procedural protections and litigation control afforded to the government by the FCA are sufficient to pass constitutional muster, these controls are unique to the FCA and are not generally characteristic of qui tam provisions. The other statutes currently authorizing qui tam suits do not contain analogous provisions preserving government control. See United States ex rel. Stillwell v. Hughes Helicopters, Inc., 714 F. Supp. 1084, 1086 n.3 (C.D. Cal. 1989).

n147. See United States ex rel. Burr v. Blue Cross & Blue Shield, 882 F. Supp. 166 (M.D. Fla. 1995) (describing relator's repeated objections to being excluded from discovery process).

n148. See United States ex rel. McGough v. Covington Techs. Co., 967 F.2d 1391 (9th Cir. 1992).

n149. See, e.g., United States v. Texas Instruments Corp., 104 F.3d 276, 277 (9th Cir. 1997) (upholding power of court to recharacterize settlement payment as proceeds rather than legal fees and to award government its share of those proceeds).

n150. See Searcy v. Philips Elecs. N. Am. Corp., 117 F.3d 154 (5th Cir. 1997). But see United States ex rel. Killingsworth v. Northrop Corp., 25 F.3d 715, 724-25 (9th Cir. 1994) (holding that, per 31 U.S.C. 3730(c)(3) (1994), government must show good cause to intervene at a late date and that such language applies to an intervention to challenge a proposed settlement).

n151. The government also must seek judicial assistance in limiting relator attempts to interfere with or delay the government's prosecution of the case. See also United States ex rel. Sequoia v. Sunland Packing House Co., 912 F. Supp. 1325 (E.D. Cal. 1995) (describing government efforts to exclude relators from settlement discussions due to the concern that the relators would use confidential information thereby obtained to harass defendants).

n152. See id. at 1340-41.

n153. 912 F. Supp. 1325 (E.D. Cal. 1995).

n154. See id. at 1341-46.

n155. 31 U.S.C. 3730(c)(2)(B) (1994); see also Gravitt v. General Elec. Co., 680 F. Supp. 1162 (S.D. Ohio 1988) (finding settlement sought by government inadequate and refusing to approve it).

n156. See Sequoia, 912 F. Supp. at 1342-46.

n157. See, e.g., id. at 1332-33 (describing high level of mistrust and hostility between relators and the government).

n158. This conflict is not unlike that identified between class counsel and members of the plaintiff class. See supra text accompanying notes 10-14.

n159. Moreover, the evolution of the Executive Branch into a structure with extensive and politically accountable law enforcement resources offers a partial response to those who rely on the historical acceptance of qui tam suits as a basis for defending its constitutionality. Qui tam provisions were common in this country immediately after ratification of the Constitution, an era in which the federal government was small. See Krent, supra note 102, at 290-92, 296. Qui tam suits provided a valuable supplement to the limited public enforcement resources at a time in which there was no FBI, no SEC, and no IRS. See id. at 296-300. The growth in the size of

the federal government coupled with the development of the administrative state reflect substantial changes in the capacity of the Executive Branch to enforce the law and increase the risk that private enforcement will interfere with, rather than complement, public enforcement efforts.

n160. 487 U.S. 654 (1988); see, e.g., United States ex rel. Kelly v. Boeing Co., 9 F.3d 743, 751 (9th Cir. 1993) (describing Morrison as "the authority most analogous to this case").

n161. 28 U.S.C. 49, 591-99 (1994).

n162. These prior cases include INS v. Chadha, 462 U.S. 919 (1983), and Bowsher v. Synar, 478 U.S. 714 (1986). The political context of the Morrison decision made it particularly attractive for the Court to accept some limitation on executive power. See Earl C. Dudley, Jr., Morrison v. Olson: A Modest Assessment, 38 Am. U. L. Rev. 255, 265 (1989). However, the degree and permanence with which the Court has rejected formalism remains unclear.

n163. The Morrison Court explicitly found that the independent prosecutor was a government officer appointed consistent with the Appointments Clause. See 487 U.S. at 671.

n164. Independent agencies, distinguished from executive agencies in part by the limit on presidential removal powers, currently exercise executive authority and substantially supplement the law enforcement efforts of the Department of Justice. See, e.g., Kenneth C. Davis, Administrative Law of the Seventies 14 (1976) (listing 63 independent agencies over which the President has limited removal power). Although the President exercises limited control over enforcement decisions by independent agencies, their law enforcement activities have been upheld based in part on their political accountability and in part on their limited jurisdiction. See id.

n165. The Morrison Court premised its acceptance on the independent prosecutor's limited jurisdiction and the fact that an appointment required the affirmative request of the Attorney General, in much the same way that the President exercises control over independent agencies through the appointment power. See 487 U.S. at 695. Accordingly, the Court was able to conclude that "we do not think that the Act works any judicial usurpation of properly executive functions." Id.

n166. Following a request by the Attorney General, the independent prosecutor is selected by a three-judge panel appointed by the Chief Justice; the prosecutor is not a self-selected volunteer. See 28 U.S.C. 49 (1994).

n167. Because the government has the ability to intervene, its interests are not compromised by deficiencies in the capacity of the relator to pursue the case. This obviates the need to inquire into the adequacy of the relator as government representative. See, e.g., United States ex rel. Kelly v. Boeing Co., 9 F.3d 743, 760 (9th Cir. 1993) (upholding qui tam provision against constitutional challenge on the basis that "both the government and the relator... share a single interest in successful litigation"); cf. United States ex rel. Yankton Sioux Tribe v. Gambler's Supply, Inc., 925 F. Supp. 658 (D.S.D. 1996) (evaluating Indian Tribe's motion to intervene in qui tam suit under Indian Gambling Regulatory Act on ground that relator did not adequately represent the Tribe's interests).

n168. Cf. Lawrence Lessig & Cass R. Sunstein, The President and the Administration, 94 Colum. L. Rev. 1,

15 (1994) (describing failure of Constitution to make explicit textual grant of prosecution power to the President).

n169. In the case of the independent prosecutor, such a delegation is justified by the maxim that "no person should be judge in his own cause." See id. at 109.

n170. See Steven G. Calabresi & Saikrishna B. Prakash, The President's Power to Execute the Laws, 104 Yale L.J. 541 (1994); Harold J. Krent, Fragmenting the Unitary Executive: Congressional Delegations of Administrative Authority Outside the Federal Government, 85 Nw. U. L. Rev. 62, 76 (1990); Lessig & Sunstein, supra note 168, at 4.

n171. See United States ex rel. Stillwell v. Hughes Helicopters, Inc., 714 F. Supp. 1084, 1096 (C.D. Cal. 1989); see also United States ex rel. Hall v. Tribal Dev. Corp., 49 F.3d 1208, 1212 (7th Cir. 1995) (accepting assignment theory to uphold validity of qui tam provision in Indian Gaming Regulatory Act).

n172. Cf. Stephen Calkins, An Enforcement Official's Reflections on Antitrust Class Actions, 39 Ariz. L. Rev. 413 (1997) (considering relationship and relative effectiveness of government enforcement and private class actions in antitrust).

n173. See DOJ Statistics, supra note 110.

n174. See id.

n175. See id.

n176. See Taxpayers Against Fraud, Recovery of $ 6.87 Billion of Federal Fraud Losses and $ 100 Billion of Savings from Deterrence Projected from "Whistleblower" Suits During Next Ten Years (visited Oct. 20, 1997), available at <http://www.taf.org/taf/docs/tafrel.html> [hereinafter TAF Statistics]; see also Charles Tiefer, Justices Ducked Major Issue in "Hughes," Nat'l L.J., July 14, 1997, at A21 (describing TAF statistics concerning recoveries from fraudulent contractors and estimated fraud deterred by qui tam suits).

n177. See TAF Statistics, supra note 176.

n178. The fact that the relator receives a proportion of the total recovery also preserves the relator's incentive to pursue the case vigorously and cooperate with government investigations. This incentive structure provides greater assurance that the relator will represent the government's interests adequately than does the requirement applicable to class representatives under Rule 23. See United States ex rel. Yankton Sioux Tribe v. Gambler's Supply, Inc., 925 F. Supp. 658, 664-67 (D.S.D. 1996) (finding that identity of interests between relator and Indian Tribe under Indian Gaming qui tam statute assured adequacy of representation).

n179. The amendments also protect the relator with a whistle blower provision preventing employers from discharging or discriminating against plaintiffs who file a qui tam suit. See 31 U.S.C. 3730(h) (1994).

n180. See S. Rep. No. 99-345, at 2 (1986), reprinted in 1986 U.S.C.C.A.N. 5266, 5266-67.

n181. See, e.g., id. at 25-26, reprinted in 1986 U.S.C.C.A.N. 5266, 5290-91 (describing value of amendments "in acting as a check that the government does not neglect evidence, cause unduly [sic] delay, or drop the false claims case without legitimate reason").

n182. Although qui tam lawsuits may be filed by a plaintiff who is not the original source of the information in the complaint, the statutory recovery provided to the relator in these cases is substantially reduced. See 31 U.S.C. 3730(d)(1) (1994); see also United States v. CAC-Ramsay, Inc., 744 F. Supp. 1158 (S.D. Fla. 1990) (awarding 5% bounty where action was based primarily on disclosure of information in a government audit).

n183. See S. Rep. No. 99-345, at 8 (1986), reprinted in 1986 U.S.C.C.A.N. 5266, 5273.

n184. See United States ex rel. Taxpayers Against Fraud v. General Elec. Co., 41 F.3d 1032, 1038 (6th Cir. 1994).

n185. There is a cost, however, to the relator's involvement in qui tam cases. Increasingly, the government and the relator have been involved in collateral litigation over the bounty award and counsel fees. This collateral litigation imposes transaction costs on the use of the hybrid structure, costs that can be expected to increase if the use of the qui tam provision is expanded.

n186. This structure carries with it the typical shortcomings of fee shifting, including the absence of an incentive for either the relator or the government to monitor counsel's expenditures of time and money. Indeed, this component of qui tam is most directly analogous to the problematic tendency of class action suits to generate excessive litigation costs.

n187. See DOJ Statistics, supra note 110.

n188. See id.

n189. See id.

n190. The government also may be able to monitor the risk that relators will pursue litigation for an improper purpose such as harassment.

n191. Absence of coordination also allows plaintiffs to file multiple class actions in different jurisdictions. Additionally, opt out rights permit individual litigation to duplicate class suits. See Leon E. Trakman, David Meets Goliath: Consumers Unite Against Big Business, 25 Seton Hall L. Rev. 617, 635 (1994).

n192. See, e.g., Kerotest Mfg. Co. v. C-O-Two Fire Equip. Co., 342 U.S. 180, 183 (1952) (identifying the importance of considerations of "wise judicial administration, giving regard to conservation of judicial resources and comprehensive disposition of litigation").

n193. See generally Heather L. Maples, Note, Reforming Judicial Interpretation of the Diligent Prosecution Bar: Ensuring an Effective Citizen Role in Achieving the Goals of the Clean Water Act, 16 Va. Envtl. L.J. 195 (1996) (describing cases in which courts have found that citizen environmental suits interfered with the government's prosecution efforts).

n194. See, e.g., George L. Priest, Punitive Damages Reform: The Case of Alabama, 56 La. L. Rev. 825, 831 (1996) (asserting that "the strongest theory in the modern tort academy is that full compensatory damages generate exactly the optimal level of deterrence of accidents - not too little and not too much").

n195. See Maples, supra note 193, at 224 (arguing that "citizen-litigators' incentives may be better aligned with fulfilling the goals of the statute" than those of state enforcement officials).

n196. See, e.g., Securities Litigation Abuses: Testimony of Arthur Levitt, Jr., Chairman of the Sec. and Exchange Comm'n Before the Subcomm. on Sec. of the Comm. on Banking, Housing, and Urban Affairs, 105th Cong. (1997), available at 1997 WL 416650 (stressing that the deterrence value of private litigation serves as a necessary supplement to the SEC's power to enforce the federal securities laws).

n197. See Louis Lowenstein, Financial Transparency and Corporate Governance: You Manage What You Measure, 96 Colum. L. Rev. 1335 (1996).

n198. See supra text accompanying notes 78-80.

n199. See 15 U.S.C. 772-l(a)(4) (1994); id. 78-u(a)(4) (Supp. I 1995-96).

n200. See, e.g., Mary M. Cheh, Can Something This Easy, Quick, and Profitable Also Be Fair? Runaway Civil Forfeiture Stumbles on the Constitution, 39 N.Y.L. Sch. L. Rev. 1, 3-4 (1994).

n201. Cf. Donald C. Langevoort, Capping Damages for Open-Market Securities Fraud, 38 Ariz. L. Rev. 639, 662 (1996) (suggesting that money recovered in private attorney general litigation should be paid to the government rather than distributed to investors).

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EXHIBIT G

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ARTICLE

UNDER CLOAK OF SETTLEMENT

Susan P. Koniak & George M. Cohen***

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  A. How Many Wrongs Make a Right? 1057
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* Professor of Law, Boston University School of Law. In the spring of 1995, I was contacted by a member of the office of United States Senator William Cohen (R-Me.), who told me about Hoffman v. BancBoston Mortgage Corp., No. CV-91-1880 (Ala. Cir. Ct. Jan. 24, 1994), discussed infra Section I.A.1. A number of Senator Cohen's constituents had been class members in this suit and were outraged by how they were treated by their lawyers, their bank (the defendant in the case) and the court system. After reviewing the matter, I concluded that the class members had a viable cause of action against the bank and class counsel. With the goal of helping class members obtain redress, I referred the case to the offices of the Maine and Massachusetts Attorneys General and to a private law firm. The private lawyers filed suit against the settling parties. That case was dismissed, although at the time this Article went to press the private lawyers were continuing their efforts to reverse that dismissal. Government lawyers from nine states appeared as amici in the private suit. I am serving as a consultant to the lawyers in the private action and may be compensated for my time.

I thank Scott Adams and Jennifer Wallace for their research assistance, my colleagues at Boston University for their helpful comments on this work, Hofstra Law School and the W.M. Keck Foundation for providing financial support for this research, and Ralph Wellington, Nancy Winkelman and their partners at Schnader, Harrison, Segal & Lewis as well as the partners of Wildman, Harrold, Allen & Dixon for their willingness to put themselves on the line to fight the injustice of class action abuse.

** Professor of Law, University of Virginia School of Law. I thank Jeff Harrell and Chris Gordon for research assistance and participants in the University of Virginia School of Law Faculty Workshop for helpful comments.

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INTRODUCTION

LAWYER self-dealing on a grand scale is not new. At the end of *Bleak House*, *Jarndyce and Jarndyce*—the suit that had made the fortunes of generations of lawyers[1]—"lapses and melts away,"[2] because "the whole estate is found to have been absorbed in costs."[3] Dickens' description of the last lawyer to leave the court is masterfully damning: "[H]e gave one gasp as if he had swallowed the last morsel of his client, and his black buttoned-up unwholesome figure glided away to the low door at the end of the Hall."[4] "Fog everywhere,"[5] Dickens wrote. And in that fog creep lawyers with bundles of money stepping neatly over the bodies of their destitute clients. An unwholesome picture indeed, but one that the American public has come to believe portrays the behavior of lawyers in class action suits.[6]

The public has heard enough about class lawyers to justify this image.[7] It has heard about the class lawyers in the GM Truck

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[1] Charles Dickens, Bleak House 2-3, 18 (Oxford University Press 1987) (1853).

[2] Id. at 867.

[3] Id.

[4] Id.

[5] Id. at 1.

[6] This picture of class action lawyers, in part generated by politicians and representatives of the business community and in part exploited by them, was "Exhibit A" in the recent campaign to revamp the nation's securities laws and was also used in the effort to pass so-called tort reform legislation. See, e.g., William Claiborne, Battle Over Lawsuits Raging In California; Ballot Initiatives Pit Silicon Valley Computer Titans Against Trial Lawyers' Lobby, Wash. Post, Mar. 17, 1996, at A3; Ed Mendel, All Three Tort-reform Measures Rejected; New Fight on Horizon, S.D. Union-Trib., Mar. 28, 1996, at A-5; Ed Mendel, Measure Aims to Curb Lawsuits Over Stocks, S.D. Union-Trib., Mar. 20, 1996, at A-3.

[7] Some of the public disaffection with class lawyers is undoubtedly a reaction to nothing more than the big fees awarded some class action lawyers. See, e.g., Kurt Eichenwald, Millions for Us, Pennies for You, N.Y. Times, Dec. 19, 1993, § 3, at 1; Robert Manor, Lawyers' Cases Are in a Class of Their Own; "I Am Told We Have Made a Lot of Enemies," St. Louis Post-Dispatch, Apr. 14, 1996, at 1A; Paul Taylor, A Lawyers' Fee-for-All: $610 an Hour?; Feeding Frenzy as the Legal Sharks Circle A Pool of the Consumer's Money, Wash. Post, Apr. 10, 1983, at C1; Saundra Torry, Going to the Head of the Class Action Settlement, Wash. Post, Apr. 8, 1996, (Wash. Bus.) at F7. Some significant segment of the American public seems to take affront when the compensation of others reaches above six figures, at least when the money is being taken home by corporate executives or lawyers as opposed to rock singers and movie stars. Compare Peter Carlson, Chairman of the Bucks, Wash. Post, Apr. 5,

case, who negotiated a settlement in which the lawyers would receive $9.5 million in fees, while their clients were to get coupons to buy another GM Truck.[8] It has heard about the class lawyers in the Ford Bronco II case, who requested $4 million in fees for negotiating a settlement in which their clients were to receive a warning sticker, a safe driving videotape, a road atlas, an owner's manual, a flashlight and a free vehicle inspection (but not free vehicle repairs) as compensation for having purchased a vehicle that allegedly was prone to roll over.[9]

Is this unwholesome image accurate? And if so, what should be done about the problem? At one end of the spectrum are

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1992, (Mag.) at 11; Graef S. Crystal, At the Top: An Explosion of Pay Packages, N.Y. Times, Dec. 3, 1989, (Mag.) at 25; Arthur M. Louis, Executive Pay Has Gone Hog Wild; Problem Is Many Boards Won't Say No to CEOs, S.F. Chron., May 24, 1993, at C1; Ronald E. Yates, Adding Up Arguments on CEO Pay, Chi. Trib., Mar. 3, 1996, (Bus.) at 1 (all decrying excessive corporate compensation packages) with Mal Vincent, Gimme Moore; $12.5 Million-a-Film Actress is Known for Getting Her Way in Hollywood, Virginian-Pilot (Norfolk), Oct. 18, 1995, at E1; Bernard Weinraub, Skyrocketing Star Salaries, N.Y. Times, Sept. 18, 1995, at D1 (both discussing compensation of celebrities such as movie stars and sports figures). Although the 1994 baseball strike generated some criticism for the high salaries routinely sought—and routinely earned—by sports figures, see, e.g., Bill Livingston, Growing 'Board' of Baseball's Greed, Plain Dealer (Cleveland), Sept. 4, 1994, at 1D (criticizing exorbitant salaries for players); Baseball Strike Plans, L.A. Times, Aug. 4, 1994, at B10 (Letter to the Editor) (same), little of the criticism that has been directed at corporate America and the legal profession has spilled over into criticism of athletes or entertainers.

But keying the pay of agents to the rewards they reap for their principals does not reflect only greed or malapportionment; such linkage is one way of aligning the interests of principals and their agents. See 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, 696-99 (1986) (discussing the implications of paying class lawyers on contingency basis that gives the lawyer a greater percentage for greater awards). See generally Paul Milgrom & John Roberts, Economics, Organizations and Management 423-46 (1992) (discussing agency issues related to executive compensation). Such payment systems may result in some agents making megabucks, but they also may promote more faithful performance on the part of all agents thus compensated. In any event, our target is neither high fees nor the lawyers who make them legitimately. We also think it unlikely that all of the public's hostility stems from ideological aversion to others making lots of money.

[8] Saundra Torry & Warren Brown, GM Truck Settlement Overturned on Appeal, Wash. Post, Apr. 18, 1995, at D1. For a discussion of the GM case and other class action settlements in which claimants receive non-cash benefits, see Note, In-Kind Class Action Settlements, 109 Harv. L. Rev. 810 (1996).

[9] Jesus Sanchez & Donald W. Nauss, Court Rejects GM Settlement on Value of Pickup Trucks, L.A. Times, Apr. 18, 1995, at D1, D15 (describing settlements in Ford Bronco II case and GM pickup truck case); Torry & Brown, supra note 8, at D6.

those who would deny that a serious problem with the current class action system exists,[10] or who would maintain that the existing system, perhaps with a few minor modifications here and there,[11] can handle any serious problems. After all, courts rejected both the Ford and the GM settlements, and in each case the court cited the likelihood of collusion between class lawyers and defendants as a prime reason for doing so.[12] At the other end are those who view the class action device as so inherently corrupt that its availability should be restricted, either by making such suits harder to win or by reducing the monetary rewards for lawyers and claimants who bring them.[13] In the "middle" are those who advocate incremental changes in the class action system to alleviate the most serious problems.[14] We take

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[10] David Rosenberg, Individual Justice and Collectivizing Risk-Based Claims in Mass-Exposure Cases, 71 N.Y.U. L. Rev. 210 (1996).

[11] This approach is the one currently being considered in the proposed amendments to Federal Rule of Civil Procedure 23, which were published for public notice and comment just as this Article was being prepared for publication. Committee on Rules of Practice and Procedure of the Judicial Conference of the United States, Preliminary Draft of Proposed Amendments to the Federal Rules of Appellate, Civil, and Criminal Procedure, August 1996 [hereinafter Preliminary Draft]. In our view, these proposed amendments not only do nothing to cure the abuse now present, but in fact, invite more collusion through a new provision that would sanction—with no apparent limit—the settlement of large class actions that could not be tried. We discuss this proposal infra Section II.E.

[12] In re General Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig., 55 F.3d 768, 803 (3d Cir.), cert. denied, 116 S.Ct. 88 (1995); In re Ford Motor Co. Bronco II Prods. Liab. Litig., Civ.-MDL-991, 1995 U.S. Dist. LEXIS 3507, at *27-28 (E.D. La. Mar. 15, 1995) (finding that proceedings were tainted with appearance of impropriety on part of class counsel).

[13] This approach is the one taken by the recent reform legislation in the securities and tort areas. See Note, Investor Empowerment Strategies in the Congressional Reform of Securities Class Actions, 109 Harv. L. Rev. 2056 (1996) (discussing and critiquing provisions of new statute that restricts the choice of representative plaintiffs and encourages greater participation by high-stakes investors in securities class actions); Note, "Common Sense" Legislation: The Birth of Neoclassical Tort Reform, 109 Harv. L. Rev. 1765 (1996) (discussing and critiquing tort reform bills designed to restrict the availability of punitive damages, eliminate joint and several liability, and adopt the English rule on attorney's fees). It is also the approach advocated by Wall Street Journal editorial page writer Max Boot. See Max Boot, Stop Appeasing the Class Action Monster, Wall St. J., May 8, 1996, at A15 (arguing for abolition of class actions in mass tort cases); Max Boot, Judges Rebel Against Mass Tort Excesses, Wall. St. J., Apr. 3, 1996 (same).

[14] See, e.g., Judith Resnick, Dennis E. Curtis & Deborah R. Hensler, Individuals Within the Aggregate: Relationships, Representation, and Fees, 71 N.Y.U. L. Rev. 296 (1996) (raising issues to be addressed by "intermediate solutions" to rules of

a different approach. We agree with those who argue that lawyer abuse in class actions is rampant and that the current system, far from keeping this abuse in check, is set up to shield lawyers from the consequences of their misdeeds. But our proposed solution is not to restrict the availability of class actions; this overbroad approach risks leaving too much corporate and government misconduct undeterred without addressing lawyer self-dealing. Nor is our proposed solution to work within the class action system itself to improve it, though we certainly support such efforts;[15] the participants in the system are likely to render such improvements inadequate. Instead, we propose removing the shield, or if you will, turning the system on itself.

In this Article, we discuss examples of class action settlements in which the conduct allegedly engaged in by class counsel—and in some instances by the defendants and their lawyers—could constitute a civil wrong or a criminal act under state or federal law, but a court nevertheless blessed the conduct by approving the settlement. We argue that the findings made by federal and state courts in blessing these settlements, namely, findings on the adequacy of class counsel, the lack of collusion between class counsel and the defendants, and the fairness of the settlement terms, should not immunize the conduct of the settling parties from the reach of state tort law, consumer protection law, criminal law or state and federal antitrust statutes. The process that results in these findings is simply not "full" or "fair" enough to allow those findings to trump the operation of other state or federal law designed to protect clients and the public from the misdeeds of lawyers. Moreover, we argue that

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aggregation reform proposals).

[15] For example, we support currently pending legislation that would require class action notices sent to class members to be written in plain English, so that these class members could better understand the proposed terms, and that would also require state attorneys general to receive notice of class action proceedings, so that they might monitor the course of these actions. See infra notes 106-109. discussing such legislation. Moreover, we believe that stricter standards should be applied in assessing the adequacy of class counsel—standards that could be developed through the common law process, the adoption of court rules or the amendment of Rule 23 of the Federal Rules of Civil Procedure. See, e.g., Susan P. Koniak, Feasting While the Widow Weeps: *Georgine v. Amchem Products, Inc.*, 80 Cornell L. Rev. 1045, 1115-1126 (1995) (discussing the inadequacy of courts' adequacy review as they now conduct it and arguing that more stringent standards are needed).

the doctrines that work to exempt state action, the action of federal agencies and the conduct of *parties* in litigation from the purview of the antitrust laws do not, and should not, apply to the conduct of class *counsel* in negotiating a settlement or to the terms of the contract subsequently approved as a class settlement by a court.

In short, our answer to class action abuse is "sue the bastards." In more polite terms, through this Article we hope to dispel any notion that the procedural law used to facilitate the settlement of class actions should somehow operate to cancel the substantive law designed to protect us all from the wrongful conduct of our supposed champions.

I. JUDICIALLY BLESSED WRONGDOING

A. How Many Wrongs Make a Right?

1. As Maine Goes, So Goes the Nation[16]

Imagine opening a statement from the bank that holds the mortgage to your home and discovering a "miscellaneous deduction" of $145.65 from your escrow account. You call the bank to inquire about this debit and are told that a state court in Alabama authorized the bank to deduct this money to pay the

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[16] Hoffman v. BancBoston Mortgage Corp., No. 91-1880 (Ala. Cir. Ct. Jan. 24, 1994). The discussion of *Hoffman* in this Article is based on the following documents on file with the Virginia Law Review Association: the January 24, 1994 Alabama Circuit Court opinion; the January 24, 1994 Consent Decree issued by the court; the Notice sent to class members; the brief filed by the Florida Attorney General's office objecting to the settlement and to the manner of awarding attorney's fees; a letter from Burr & Forman, Counsel to BancBoston, to Dexter J. Kamilewicz, a class member, explaining what happened in this suit and why the bank did not object to the award of attorney's fees; and a column written in the *Maine Lawyers Review* describing the effect of this settlement on Maine constituents. These materials were sent to Professor Koniak by the office of Senator William Cohen of Maine. See supra note *. We recognize that these documents may in some way misrepresent what actually occurred in this case; for example, the parties may not actually have followed the court's order. We therefore caution the reader that the discussion in this Article proceeds by assuming that the parties followed the court order, that the bank's lawyer honestly described the bank's position in the negotiation and class counsel's ultimatum to the bank, and that the Florida Attorney General's brief accurately presents the facts in evidence at the January 10-11, 1994 fairness hearing. If any of these assumptions proves incorrect, our description of what happened and the conclusions we draw from that description might need to be altered.

lawyers who were appointed by that court to represent you in a class action suit brought ostensibly on your behalf. You live in Maine.

You remember receiving a Notice in the mail about a year ago, informing you that there was such a suit pending. You read it, although you needed your reading glasses to do so because the print on the eight page document was very small,[17] and, being a lawyer, you understood it more or less. It told you that your bank allegedly had been requiring you to keep more money in your escrow account than it had a right to demand and that this suit had been brought to stop that practice.[18] "Good," you thought at the time. You read on and discovered that class counsel had negotiated a settlement with the bank: The bank was to stop requiring you to keep an excessive cushion in your account; and it was to return to you the excess money that had accumulated in your account by deducting an equivalent sum from the interest payments due on your mortgage, or, upon your request, the bank would either apply the excess toward your principal or return it to you directly.[19] You made a mental note to request at the appropriate time that the bank send your money home—a mental note you promptly forgot. There was more good news in the Notice: "interest payments" were to be paid to class members on the surplus that the bank had been keeping these past years.[20]

You could, the Notice explained, opt out of this settlement, if you chose. Page eight of the fine-print Notice said that.[21] The Notice stated, however, that anyone who opted out would "not receive any of the benefits set forth in the proposed [agreement]."[22] You read that statement to mean that if you opted out, the bank could keep requiring the excessive cushion in your escrow account and you would not receive any interest payments under the settlement. The choice to stay in the class seemed a no-brainer: You would stay in and get whatever bene-

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[17] Notice of Hearing on Proposed Settlement of Class Action, Hoffman v. BancBoston Mortgage Corp., No. 91-1880 (Ala. Cir. Ct. July 2, 1993) [hereinafter Notice].

[18] Id. at 1.

[19] Id. at 3.

[20] Id. at 4.

[21] Id. at 8.

[22] Id.

fit the settlement provided. Moreover, staying in required no effort on your part. You were in as long as you did not return the opt-out card.[23]

You understood that the benefit to you would likely be modest, as even without a lawsuit the bank would have returned the surplus in your escrow account to you when you finished paying off your mortgage. It was, after all, your money. The bank never maintained otherwise. What the lawsuit promised you was the opportunity to get your money now instead of having to wait for its return upon the expiration of your mortgage. You liked that idea: Money today is worth more than money tomorrow. The lawsuit gave you the opportunity to spend that money today or invest it as you pleased for the future, and while that benefit to you would be small, it was something. You also figured out that the interest payments you were likely to receive on the surplus that the bank had been carrying on your account in past years would be small. You found the interest formula buried in Paragraph (D)(7)(A) of the Notice:

> BancBoston will make a one-time payment to the Subclass members in an amount equal to fifty percent (50%) multiplied by seven point five (7.5) multiplied by (four (4) percent minus the interest rate paid on escrow, if any), multiplied by the average escrow surplus, which has been determined to be $58.41.[24]

Math had never been your best subject, but you were able to tell without any calculation that this formula would not produce any windfall for you.[25] The $58.41 figure in this formula, repre-

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[23] Id.

[24] Id. at 4.

[25] Neither the Notice nor the unpublished court opinion approving the settlement explains the formula used to calculate past-due interest. It is easy enough to figure out that 4% is the interest rate the bank has agreed to pay on the past surplus, particularly given the provision that any interest actually paid is to be deducted from the 4% figure, although the interest is obviously not compounded. Notice at 4. In trying to account for the 7.5 number, we imagined that it might represent the average number of years that a surplus had been maintained in the escrow accounts. We were not creative enough to imagine what the 50% figure was doing in the equation. Are you?

We gained some insight into this formula by reading an opinion in another case approving a similar formula. GMAC Mortgage Corp. v. Stapleton, 603 N.E.2d 767 (Ill. App. Ct. 1992). In that case, also involving allegations of excessive escrow cushions, the defendant company agreed to pay: ".40 x (3.3 years) x (5 1/2% interest) x (ending escrow surplus)." Id. at 772. The court explained that "the .40 figure

senting the average escrow surplus, confirmed that the benefit of having your surplus returned today instead of some years from now would also be small. After all, how much money could you make investing $58.41? Given how small your gross recovery was likely to be, it did not seem worth it to retrieve your bank statement to check how much interest you had been receiving (a number you would need to be able to use the above formula) or to search for your calculator to multiply the numbers out. You were satisfied with the general knowledge that your recovery would be small, although probably just.

You noticed that your lawyers would be requesting that the court award "a reasonable attorney's fee to be paid out of each escrow account,"[26] and wondered why the defendant bank was not being asked to pay class counsel's fee, given how small the recoveries to class members would be. However, not being an expert in such matters, you were willing to assume that this method of paying class lawyers was acceptable, perhaps even routine. You thought of asking your colleague on the faculty who teaches complex civil litigation about this, but forgot or decided it was not worth worrying about. After all, the Notice made clear that the fee to be requested would not exceed "one-third of the economic benefit conferred"[27] and lawyers

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represents a litigation risk factor, and the 3.3 years figure pertains to the applicable statute of limitations period." Id. This explanation suggests that the 50% figure is also a litigation risk factor, although this figure seems somewhat low (that is, the assumed risk of losing seems too high) given that the *Stapleton* case, which had used a .40 risk factor, preceded *Hoffman*, and that in *Hoffman*, proving liability seemed relatively straightforward. The 7.5 figure, however, remains a puzzle. It does not seem to reflect the applicable statute of limitation period, so we are left with our previous guess that it represents the average length of time the bank had held the escrow surplus. Support for this guess comes from Law v. First Ala. Bancshares, No. CV-90-003351 (Ala. Cir. Ct. Oct. 3, 1995) (unpublished opinion) (on file with the Virginia Law Review Association), another bank escrow class action in which there was testimony that the average length of time until the mortgages would be satisfied was 7.5 years. Id. at 6. This doesn't completely explain the relevance of that figure for computing *past* interest. Perhaps the generous year figure may have something to do with the stingy litigation risk figure, or perhaps the .50 is not a litigation risk figure at all but rather simply an adjustment to the 7.5 years to account for the fact that those deserving back interest had already been paying down their mortgage and so may have had less than 7.5 years remaining on average. But, as you can see, we are left with only hazy speculation on how this formula was conceived.

[26] Notice, supra note 17, at 5.

[27] Id.

getting one-third sounded unremarkable enough. More important, you already had wasted enough time making your way through this complicated Notice. Soon you forgot about the whole thing.

Now a year later you are being told that the bank has debited the lawyers' fees, but obviously there has been a mistake. You cannot bring to mind the formula for calculating your interest payments, or any of the other details of the settlement for that matter, but you have a vague recollection that the amount you expected to receive was small. How could the lawyers' fee be so high? The lawyers were to get only a third. If the lawyers' fee is $145.65, the "economic benefit" to you should be at least $436.95: much higher than you had imagined, but either that is what you are owed or the bank took too much out of your account for the lawyers. The bank employee insists there is no mistake: "The lawyers' fee *is* $145.65, and you already received your benefit. See that $2.19 credit?"[28]

Chances are that you do not live in Maine and that, wherever you live, yours was not one of the over three hundred thousand families nationwide directly affected by the settlement in *Hoffman v. BancBoston Mortgage Corporation*. But BancBoston was not the only bank to be sued for keeping excessive money in escrow accounts, and it was not the only bank to have made a settlement agreement with class lawyers that provided for class members to pay attorney's fees under a formula that left many

[28] See Will Lund, Mainers Contribute Toward $12 Million Legal Fee, Me. Laws. Rev., Feb. 15, 1995, at 17.

class members suffering a net out-of-pocket loss.[29] In *Hoffman* and the cases like it, the winners lost, and their lawyers got rich.

The class lawyers devised the payment scheme, proposed it to the courts and defended it as fair.[30] Moreover, according to BancBoston's lawyer, class counsel insisted that to settle the *Hoffman* suit the bank would have to agree not to object to class counsel's fee proposal.[31] Although the Bank was obliged as a fiduciary to manage its customers' funds responsibly, it agreed to the plan.[32] In other words, the bank decided to give away its customers' money to resolve its liability to those very customers.[33] Finally, the Alabama court, like all class action courts, was supposedly sitting as guardian of the class's interests.[34] Fine

[29] According to a letter written by BancBoston's counsel, Secor Bank entered into a similar settlement with the class lawyers who later represented the *Hoffman* class. Letter from T. Thomas Cottingham, Counsel to BancBoston Mortgage Corporation and Bank of Boston in *Hoffman*, to Dexter J. Kamilewicz 3 (Mar. 30, 1995) (on file with the Virginia Law Review Association) [hereinafter Cottingham Letter]. The First Bank of New Hampshire recently agreed to a similar scheme with another group of lawyers. Williams v. First N.H. Mortgage Corp., No. 94-5993 (Ala. Cir. Ct. Dec. 1, 1995). However, after the New Hampshire and Vermont Attorneys General objected to the attorney's fee formula, the bank and the class lawyers agreed to change the formula for calculating attorney's fees. Conversation with Walter Maroney, Senior Assistant Attorney General, State of New Hampshire, Feb. 8, 1996. Both the Secor and First Bank of New Hampshire settlements were filed in Alabama. Moreover, through confidential sources, we have learned that many other similar settlement agreements have been entered in excessive escrow cases involving banks throughout the nation. It appears that a good number of these class actions have been filed in Alabama.

[30] On the propriety of the lawyers' actions, see discussion infra text accompanying notes 48-52.

[31] Cottingham Letter, supra note 29, at 2-3.

[32] Id. at 3. Note that according to BancBoston's lawyer, the bank simultaneously agreed or decided to kick in some of its own money toward the payment of attorney's fees, presumably to soften the blow that was about to be delivered to its customers. Id. We do not know how much money, if any, the bank kicked in. Nor do we know how any such contribution affected the money charged to class members. What seems clear is that the bank did not pay the entire amount of attorney's fees and that it did not kick in enough to avoid charging some class members more than they recovered. See Lund, supra note 28, at 19 and discussion infra notes 38-46 and accompanying text.

[33] On the propriety of the bank making such a concession, see discussion infra text accompanying notes 58-62.

[34] "Under Rule 23(e) the district court acts as a fiduciary who must serve as a guardian of the rights of absent class members." Grunin v. International House of Pancakes, 513 F.2d 114, 123 (8th Cir.), cert. denied, 432 U.S. 864 (1975). See also Plummer v. Chem. Bank, 668 F.2d 654, 659 n.4 (2d Cir. 1982) ("[A] court may not

in theory, but obviously inadequate in fact. With fiduciaries like these, the class lawyers and corporate defendants who offer coupons to class members begin to look good by comparison.

The scheme in *Hoffman* was actually quite simple. Class counsel asked for attorney's fees equaling 33 1/3% of all the money the bank was wrongfully holding in escrow; that is, one-third of all the excessive cushion money. The trick was in characterizing all that money as money recovered by this lawsuit.[35] Had there been no lawsuit, 100% of the excess cushion would have been returned to class members at the time their mortgages were repaid. Therefore, what the lawsuit recovered for each class member was (in addition to the back interest) only the difference between the value of the excess cushion money in the class member's hands today and the value of the money had the bank held it until the mortgage was paid off. The lawsuit and class counsel did not "recover" the excessive cushion money being held in escrow because that money was never lost. All that the class members had lost by the bank's allegedly wrongful acts was the use of that money today and the use of that money in years past.

Class counsel backed up their fee request with testimony at the fairness hearing stating that "a fee equal to one-third of the settlement proceeds was reasonable and fair under Alabama law," and that in this case a fee of even 40% would be justified.[36] The Alabama court awarded class counsel only 28% of the surplus.[37] The problem, however, lies not in the percent

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delegate to counsel the performance of its duty to protect the interests of absent class members."); Greenfield v. Villager Indus., 483 F.2d 824, 832 (3d Cir. 1973) (discussing the district court's broad powers "as the guardian of the rights of the absentees"); Liebman v. J.W. Petersen Coal & Oil Co., 73 F.R.D. 531, 534 (N.D. Ill. 1973) (in assessing the fairness of a settlement, the court sits "as the guardian of the interests of the absent members of the class").

[35] While the fairness hearing transcript reveals some confusion on this point, it appears that class counsel used the total excess amount as some kind of rough measure of the worth of this lawsuit to the class instead of arguing that the excess money was recovered by the suit. Fairness Hearing Transcript, Hoffman v. BancBoston Mortgage Corp., No. 91-1880 (Ala. Cir. Ct. Jan. 10-11, 1994) (on file with the Virginia Law Review Association) [hereinafter Fairness Hearing]. Of course, the result is the same: The class is charged a percentage of all the excess money as if the excess money were a common fund created by the suit.

[36] *Hoffman* (No. 91-1880), Order & Opinion, Jan. 24, 1994, at 9.

[37] Id. at 13.

awarded. One-third of the "economic benefit" conferred by the suit, as the Notice put it, might indeed have been a reasonable fee. On the other hand, 389% of the economic benefit is not. Nor is 4,155%. Nor is the charging of any fee to a class member who received no economic benefit whatsoever. But, as we shall see, each of these scenarios was possible under the settlement.

For example let us consider a homeowner from Maine (or from any other state that requires, as Maine does, that banks pay 3% interest on money held in escrow) with eight years remaining on her mortgage and a surplus of $100.00 in escrow. A reasonable calculation of the economic benefit derived from this settlement is $7.19.[38] Using the court's 28% attorney's fee

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[38] We have chosen the numbers in the first example to be close to the benefit that an "average" homeowner might expect to get from the class action settlement. According to the Florida Attorney General, the average surplus was $134.50 per account, which is close to the $100 we are assuming for simplicity. See Brief of Intervenor, Florida Attorney General's Office 3, *Hoffman* (No. 91-1880) (filed Jan. 21, 1994) [hereinafter Florida Attorney General's Brief]. We also assume that a homeowner who found herself with an extra $100 might put that money in a bank account yielding 3.5% interest; a higher rate of return would be fairly unrealistic given the small amount to be invested. Finally, we assume eight years remaining on the mortgage because apparently this was the average time remaining on the mortgages in question. Id. at 12. An additional reason for using eight years is that the benefit to the class members from changing the method of escrow accounting would shortly have accrued to those class members even absent the class action. According to the court in Law v. First Ala. Bancshares, No. CV-90-03351, at 6-7 (Ala. Cir. Ct. Oct. 3, 1995) (unpublished opinion) (on file with the Virginia Law Review Association):

> On October 26, 1994 [nine months after *Hoffman*], the Department of Housing and Urban Development ("HUD") published a rule, effective on May 24, 1995, establishing escrow accounting procedures under the Real Estate Settlement Procedures Act, 12 U.S.C. § 2601 et seq., 59 Fed. Reg. 53890 (Oct. 26, 1994). HUD has acknowledged that its rule was in part initiated by private class actions such as this suit. 59 Fed. Reg. at 53890. These regulations prescribe methods of accounting for escrow accounts that include members of the Class. 24 C.F.R. §3500.17; 60 Fed. Reg. 8812 (Feb. 15, 1995). Under the new regulations [the bank] must apply the "aggregate" or "cash" method of accounting to all escrow account analyses conducted after October 26, 1997. Escrow accounts must be analyzed at least once a year, so under these new regulations, the members of the Class would have received their refunds no later than October 1998 . . . .

Although it is uncertain whether the lawyers in *Hoffman* could have anticipated this change in the rule, and whether *Hoffman* was one of the cases that induced HUD to act, the rule change at least argues for a conservative estimate of the length of time during which the class members would achieve benefits from the suit.

Given these assumptions, we compute the economic benefit to this "average" class member, which consists of back interest plus the benefit from getting the $100 back

figure and class counsel's formulation of the benefit of this suit

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sooner so the class member can invest it herself. First, we compute the back interest by referring to the formula in note 25, and by making use of the fact that Maine requires banks to pay 3% interest on escrow accounts. The formula yields $2.19 in back interest:

$$.50 * 7.5 * (4\% - 3\%) * \$58.41 = \$2.19.$$

(Note that despite the fact that the class member is assumed to have a $100 surplus, the back interest formula conclusively presumes that the surplus in past years was only $58.41.) Next, we compute the amount the class member can earn with her extra $100. In eight years, 3.5% interest compounded would yield a return of 32% or $32 on $100. Had the bank kept the surplus for those eight years and then returned it to the customer at the 3% compounded interest rate required by the state, the customer would get a return of 27%, or $27. Thus, the economic benefit from being able to invest the $100 at the higher interest rate would be $5.00. Adding $5.00 to the $2.19 back interest benefit yields $7.19, which we claim is a reasonable calculation of the economic benefit of this settlement to the "average" class member.

Economically oriented readers will recognize that the $5 benefit would have to be discounted to present value, because the $5 represents the difference in value between the homeowner's potential return in eight years and the bank's expected payment in eight years. Put another way, if the bank asked its customer today to give it $100 in return for a piece of paper worth $127 in eight years, the question is how much the bank would have to compensate the customer to take the deal. The bank would not have to pay the full $5 difference in value today but only the amount that would yield $5 if invested (which when added to the $127 yields a total of $132) in eight years. If we use 3.5% as the relevant discount rate in the present value formula the present value of the $5 is $3.79:

$$5/(1+.035)^8 = 3.79.$$

Nevertheless we do not use the discounted figure in this or subsequent examples for the following reason. The escrow surplus resulted from the fact that the bank kept an extra amount of prorated real estate taxes in the escrow account. If real estate values, and hence real estate taxes, were increasing over time, then the $100 escrow surplus would not stay constant but would increase at the same rate at which real estate taxes increased. If, for simplicity, we assume that real estate taxes (and hence the surplus) were increasing at the same 3.5% we have been using to calculate the interest the homeowner could have earned on the $100, then the present value discount would be cancelled out, and $5 would again be the relevant benefit. In essence, the $100 surplus would grow with inflation. For those so inclined, the relevant formula for the benefit to the hypothetical class member is:

$$100 * (1 + i)^n/(1 + r)^n * [(1 - r)^n - (1 - r')^n]$$

where i represents the inflation rate for real estate taxes (assumed to be .035), r is the interest rate the homeowner could earn as well as the discount rate (also assumed to be .035), r' represents the interest rate the bank is required to pay on escrow accounts (.03 in Maine) and n is the number of years (assumed to be eight). The expression within the brackets represents the difference between money invested at the market rate of interest and money invested at the bank's required rate of interest, which we have found to be $5. If $r = i$, then the first expression equals one and becomes irrelevant; the discount rate and the inflation rate offset each other. We note that even if i is 10% (and every other value stays the same), the benefit is only $8.11, which when added to the $2.19 back interest, yields a total benefit of $10.30, which still results in attorney's fees of 272%.

to the class, our hypothetical homeowner would be charged $28.00 in attorney's fees—fees that amount to 389% of the $7.19 economic benefit conferred upon her.[39]

But the situation gets even worse because the formula in fact used to calculate attorney's fees to be deducted from a class member's escrow account was not based on the actual surplus of any class member. Instead, the formula provided that BancBoston was to add up all of the money it was holding in escrow accounts and calculate what percentage of that amount was surplus money, which it should not have been holding; that percentage, calculated at one point to be about 19%, would then be used to calculate how much attorney's fees each class member owed.[40] Each class member would then pay attorney's fees

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[39] (28/7.19) * 100 = 389%. It is important to note that the more protection a state offered bank customers under its laws, the smaller the economic benefit; and thus, the worse that state's residents did under the settlement. Using the same method of calculating economic benefit we outlined supra note 38, our hypothetical mortgage holder in a state mandating 2% interest on money held in escrow would pay 144% in attorney's fees. Past interest is $4.38:

$$.50 * 7.5 * (.04 - .02) * \$58.41 = \$4.38.$$

The remaining economic benefit (assuming that the discount rate and the inflation rate are the same), see supra note 38, is:

$$100 * [(1 + .035)^8 - (1 + .02)^8] = 100 * (.32 - .17) = \$15.$$

Thus, total benefit is $15 + $4.38 = $19.38. Assuming this person was charged 28% of only the $100 actual surplus yields attorney's fees of 144%:

$$(28/19.38) * 100 = 144\%.$$

Similar calculations reveal that in a state mandating 1.5% interest our hypothetical homeowner would pay 114% in attorney's fees. Past interest is $5.48:

$$.50 * 7.5 * (4\% - 1.5\%) * \$58.41 = \$5.48.$$

The remaining economic benefit is:

$$100 * [(1 + .035)^8 - (1 + .015)^8] = 100 * (.32 - .13) = \$19.$$

Thus the total benefit is $19 + $5.48 = 24.48. This benefit yields attorney's fees of 114%.

Similar calculations reveal that in a state mandating 1% interest the homeowner would pay 93% in attorney's fees; and finally, in a state that did not require banks to pay any interest on money held in escrow this person would pay 69% in attorney's fees.

[40] See Order of Settlement Approval & Final Judgment, *Hoffman* (No. 91-1880) at 9. The 19% assumption is based on a preliminary calculation, made by BancBoston sometime prior to the fairness hearing in *Hoffman*, that 19% of all the money it was holding in escrow was surplus (excessive cushion) money. Florida Attorney General Brief, supra note 38, at 3. However, there was no finding that this 19% average was constant across the nation, and the Florida Attorney General argued that there was substantial variation in the percent that was surplus in mortgage holders accounts depending on the type of mortgage contract one had signed. Id. at 4. We remind our readers that 19% was simply the ballpark figure used at the Fairness Hearing. The

equal to 19% (or some percentage near it) of the total escrow money in her individual account times 28%, which means attorney's fees equal to about 5% of the total money in her escrow account. That charge would be assessed against the escrow account regardless of the size of the actual surplus and even if there were no surplus at all.[41] There is no question that there were some class members who had no surplus in their escrow accounts and that the lawyers and the court were aware of this fact.[42] The maximum benefit these people could get from the settlement was the $2.19 back interest payment. This is precisely the situation in which Dexter Kamilewicz claims to have found himself.[43] Yet he was allegedly assessed attorney's fees of $91 (presumably representing about 5% of the total in his escrow account).[44] These attorney's fees are 4155% of the benefit Kamilewicz allegedly received from the class settlement.

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understanding of the parties was that the figure would subsequently be adjusted based on more complete information. The figure was later adjusted and reduced, and it was this smaller percentage that was used to calculate the actual attorney's fees.

[41] Note that even if the 19% presumption were correct for every homeowner, it would be highly unlikely for anyone in Maine to have paid less than 100% in attorney's fees. To see this, compare the attorney's fees a class member would have to pay with the benefits she would presumably receive. If we let x represent the *total* amount held for this class member in escrow, then the "break-even" point at which the class member would pay in attorney's fees the full benefit received (that is 100% attorney's fees) can be computed by solving the following equation for x:

$$(.28 * .19)x = [(.32 - .27) * .19]x + 2.19$$

The lefthand side of the equation represents the attorney's fees paid by the class members, made up of a contingency rate of 28% multiplied by the percentage of the total amount held in escrow that is deemed to be surplus, namely 19%. The righthand side of the equation represents the economic benefit for Maine mortgage holders. This benefit consists of the extra interest that the class members could have received by investing the money themselves (.32-.27), see supra note 38, multiplied by the 19% of the total amount held in escrow that is deemed to be surplus (assuming that this 19% is an accurate estimate of the surplus), multiplied by x plus the $2.19 in back interest, see supra note 38. Solving the equation we get:

$$.05x = .01x + 2.19$$

$$x = \$54.75$$

Thus, every class member with more than $54.75 in her escrow account would pay more than 100% attorney's fees. For example, a class member with $60 in escrow would pay $3 in attorney's fees, but receive only $2.79 in benefit.

[42] See Order of Settlement & Approval, *Hoffman* (No. 91-1880) at 7 (discussing both surplus and shortage in escrow accounts).

[43] Kamilewicz v. Bank of Boston Corp., 92 F.3d 506 (7th Cir. 1996) (petition for reh'g denied Nov. 22, 1996).

[44] Id.

But we are still not finished. Not all class members were entitled to the back interest benefit. In particular, those whose escrow accounts were more than 30 days in arrears or who had obtained loans after September 1, 1990, did not qualify for the back interest benefit.[45] Certainly those in arrears, and probably some others, did not have an escrow surplus either. Yet, as long as they had some money in their escrow account, they too paid attorney's fees as if 19% or some comparable figure of the total money in their accounts was surplus.[46] We have now reached attorney's fee fantasyland: To infinity and beyond! The existence of these infinity cases should not, however, cause anyone to lose sight of how extreme the non-infinity cases were in their own right: 4155% attorney's fees, 389% attorney's fees. Indeed, all the people who paid more than 100% attorney's fees would have been better off if class counsel had lost the case. Some deal.

The Alabama court, ostensibly sitting as guardian for the class, approved these fees, and reaffirmed its judgment when it revisited the matter following the initiation of a lawsuit challenging class counsel's conduct in federal district court in Illinois.[47] Before we reach the central question of whether a class action court's approval of such fees should bar later litigation about the fees, let us consider what remedies would be available to an ordinary client in an analogous situation.

2. *All Blessings Aside*

If a lawyer in an ordinary lawsuit behaved the way the lawyers allegedly behaved in *Hoffman*, the client would have numerous remedies available. It is black letter law that lawyer-client contracts "must be fully and fairly explained to the client, and are

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[45] Notice, supra note 17, at 4.

[46] See supra note 40. Ted Benn, a class member who filed suit against BancBoston, claims to be one of the class members who received no benefit whatsoever yet was assessed attorney's fees. Brief in Opposition to BancBoston Mortgage Corporation's Motion to Dismiss, at 9, Benn v. BancBoston Mortgage Corp., No. 96-CV-0974-J, filed May 13, 1996 (N.D. Tex.).

[47] Although the decision was affirmed by the state court, see Order of Jan. 30, 1996, *Hoffman* (No. 91-1880) (on file with the Virginia Law Review Association), disgruntled class members undertook a collateral challenge to the settlement in federal court. See *Kamilewicz*, 92 F.3d 506.

strictly construed against the attorney."[48] If a lawyer told an ordinary client that legal fees would be one-third of the economic benefit recovered for the client in the suit, it would not take strict construction of the contract to hold that the lawyer was not entitled to one-third of money the client indisputably owned. Thus, if a lawyer for an ordinary client tried to keep one-third of the client's excessive escrow cushion based on such a contract, a client could bring suit to require the lawyer to disgorge most of the fee she had collected. And the client should win.[49] But the client's remedies would not be limited to disgorgement.

Individual clients could also sue their lawyers for malpractice and seek punitive damages for conduct like that apparently engaged in by class counsel in *Hoffman*. Punitive damages are available in legal malpractice cases in which the lawyer's breach of fiduciary duty amounts to constructive or explicit fraud.[50] In general, an award of punitive damages is deemed appropriate upon a showing that the tortfeasor's actions were intentional, fraudulent or committed in wanton disregard of another's rights.[51] Individual clients whose lawyer had advised them to

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[48] Mar Oil, S.A. v. Morrisey, 782 F. Supp. 899, 911 (S.D.N.Y. 1992) (citations omitted), aff'd in relevant part, 982 F.2d 830, 838-40 (2d Cir. 1993).

[49] See, e.g., Newman v. Silver, 553 F. Supp. 485, 496 (S.D.N.Y. 1982), aff'd in relevant part, 713 F.2d 14 (2d Cir. 1983) (holding that amount of fee, particularly in light of services rendered and the lack of specific contract, was enough to demonstrate that "a legal fraud was perpetrated on [the client]"). In *Hoffman*, testimony at the fairness hearing apparently demonstrated that class counsel had worked 10,000 hours in total. Florida Attorney General Brief, supra note 38, at 14 n.5. Class counsel's fees in total amounted to about $11,800,000 or $1,180 an hour. See Lund, supra note 28, at 19. Moreover, the circumstances in *Hoffman*, including the deceptive Notice provision on calculation of fees, do nothing to ameliorate the presumption of overreaching created by the amount of the fee itself.

[50] See, e.g., *Mar Oil*, 982 F.2d at 843-44 (finding no abuse of discretion in trial court's refusal to award punitive damages against lawyer who withdrew money from client's escrow account based on buried language providing for such fees, but noting in dicta that award of punitive damages would probably have been sustained on appeal); Hall v. Wright, 156 N.W.2d 661 (Iowa 1968) (upholding award of punitive damages against lawyer who had knowingly and falsely represented to client that seller had clear title to home that client was to purchase). See generally Annotation, Allowance of Punitive Damages in Action Against Attorney for Malpractice, 13 A.L.R. 4th 95 (1995).

[51] See, e.g., McClain v. Faraone, 369 A.2d 1090 (Del. Super. Ct. 1977) (no punitive damages without showing that lawyer's conduct demonstrated ill will, malice or an intent to cause injury); Welder v. Mercer, 448 S.W.2d 952, 954 (Ark. 1970) (requiring

settle their claims for a negative recovery would have an easy time establishing that their lawyers had demonstrated wanton disregard for their interests.[52]

Moreover, there is other evidence available on the conduct of the lawyers in *Hoffman* that would seem to support a claim for punitive damages based on intentional wrongdoing or reckless disregard for the clients' interests. According to a letter written to a disgruntled class member by BancBoston's lawyer, the bank had offered to pay class counsel's fees and to provide the class "essentially the same terms" ultimately accepted by class counsel.[53] BancBoston's lawyer explained that class counsel had refused the bank's offer to pay attorney's fees and instead had insisted that they were entitled to "a percentage of the 'economic benefit of the settlement to the class.'"[54] The lawyer stated in the letter that after many months of negotiations the bank "decided to agree to the *plaintiffs'* position on attorneys fees on condition that BancBoston be allowed to object to the attorneys

showing of intentional wrong or conscious indifference to rights of the client before punitive damages award justified).

[52] In Rodriguez v. Horton, 622 P.2d 261 (N.M. App. 1980), the court upheld an award of punitive damages amounting to two times the award of actual damages against a lawyer who had advised his client to accept an unreasonably low settlement award. The lawyer had represented to his client that the client would receive sums from other lawsuits, which did not happen, and the lawyer failed properly to advise the client of rights to certain compensation under state law. Id. at 264-65. The lawyer in that case had advised settling for $8,000, which advice the client accepted. Actual damages were assessed at $10,574.81, punitive damages at $25,000. Id. at 263. If treble damages are appropriate when one's lawyer advises settling for 30¢ on the dollar—a court should have no difficulty awarding them when the lawyer advises accepting a settlement that amounts to *negative* $3.89 on the dollar. Even those people whose banks would otherwise have paid them no interest on their surplus escrow money apparently ended up receiving only about 31¢ on each dollar of actual economic benefit. See supra note 39 and accompanying text (explaining how some such clients may have paid 69% of the economic benefit in attorney's fees).

[53] Cottingham Letter, supra note 29, at 2.

[54] Id. It is interesting that BancBoston's lawyer placed the words "economic benefit of the settlement to the class" in quotation marks. That phrase is a verbatim quote from the Notice sent to the class, but BancBoston's lawyer was referring to the settlement negotiations, not the Notice, when he used the quotation marks. By quoting this language the author of the letter avoids having to explain to the addressee (a class member and BancBoston customer) exactly what money was used to pay attorney's fees and avoids personally vouching for the accuracy of the description enclosed in the quotes.

fees at a fairness hearing to be scheduled by the court."[55] But class counsel "would not even accept that position and insisted that they would not settle unless they were allowed to apply to the court for a percentage of the settlement without any objection by BancBoston."[56] The bank thought it over and gave in, agreeing not to object to class counsel's scheme.[57]

We will return to the bank's decision not to object to the fees in a moment. First, consider what this account of the events appears to demonstrate about class counsel's intent to make off with client money being held in trust by the bank. According to BancBoston's lawyer, class counsel held up the settlement of their clients' claims until the bank promised not to speak up on behalf of those clients. According to BancBoston's lawyer, class counsel proposed that BancBoston keep the money it had offered to pay in attorney's fees and instead give up its customers' money (class counsel's clients' money) to the class lawyers. And according to BancBoston's lawyer, even that deal was not sweet enough to convince the bank to agree to raid its customers accounts, so the lawyers added a new incentive for the bank: avoiding the costs of a trial. The class lawyers added that incentive when they allegedly made the settlement contingent on BancBoston's agreeing not to object to the fee proposal. If this is what happened, to describe it as an intentional breach of a lawyer's duty to his client or wanton disregard for the client's interest seems mild.

As to the bank, it too stands in a fiduciary relationship to the class, its customers. The money that the bank agreed to help class counsel obtain by not objecting to the request for attorney's fees was money the bank held in escrow for its customers. A depository may be guilty of conversion when it disburses

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[55] Id. (emphasis added).

[56] Id.

[57] Id. at 3. However, before accepting this posture, the bank had filed objections to the settlement. Those objections demonstrate that the bank knew what effect the scheme would have on their customers. The objections stated that if the court approved class counsel's formula for calculating attorney's fees "every class member will suffer an actual net out-of-pocket loss as a result of this lawsuit." Defendants' Objections to Plaintiffs' Proposed Notice of Class Action, at 5, *Hoffman*, (No. 91-1880) [hereinafter Defendants' Objections]. "That loss," the bank continued, "will be paid to their lawyers." Id. These objections were apparently withdrawn and labeled "moot" after the bank accepted class counsel's proposal.

money held in escrow contrary to the express terms of the escrow agreement.[58] The bank apparently agreed to allow such a disbursement because the bank determined it was in its own financial interest to go along with class counsel on this matter.[59]

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[58] See Secor Bank v. Hackle, 644 So. 2d 1138, 1142 (La. Ct. App. 1994) (holding that without express contractual language in escrow agreement authorizing deduction of attorney's fees incurred by bank to collect money from mortgagor, the bank cannot unilaterally apply mortgage funds to such fees). See also Rubin Quinn Moss Heaney & Patterson, P.C. v. Kennel, 832 F. Supp. 922, 931-32 (E.D. Pa. 1993) (applying Pennsylvania law); Hunnicutt v. Higginbotham, 35 So. 469, 470 (Ala. 1903); Carter v. Hornsby, 23 S.E.2d 95, 97 (Ga. Ct. App. 1942); Lewis v. Shawnee State Bank of Shawnee, 596 P.2d 116, 120 (Kan. 1979); Pierce v. Underwood, 61 N.W. 344 (Mich. 1894); Globe Sav. Bank v. National Bank of Comm., 89 N.W. 1030, 1032 (Neb. 1902).

[59]
> Considering [certain cases cited by BancBoston's lawyer for the proposition that attorney's fees of one-third of a settlement fund were reasonable] the fact that the court had granted a motion for partial summary judgment in favor of the plaintiffs, and the fact that a trial was scheduled, with all its attendant uncertainties and expenditure of time and money by BancBoston, BancBoston finally agreed to the lawyers for the plaintiffs and the class' position on attorney's fees.

Cottingham Letter, supra note 29, at 3.

In fact, the cases cited by BancBoston's counsel do not support the position that class counsel's fee request was reasonable. Three of the four cases cited stand for the proposition that between 18% and 33 1/3% of the fund recovered by the settlement is an appropriate measure of attorney's fees. City of Ozark v. Trawick, 604 So. 2d 360 (Ala. 1992); Ex parte Brown, 562 So. 2d 485 (Ala. 1990); Reynolds v. First Ala. Bank of Montgomery, 471 So. 2d 1238 (Ala. 1985). None of those cases supports the notion that an appropriate award of attorney's fees is one-third of money no one disputed belonged to the clients. In all of the cases cited, the common fund was a pot of money that belonged to the class, after the class action, as a result of class counsel's efforts, not a pot of money whose ownership was never in dispute. "[A] litigant or lawyer who *recovers* a common fund for the benefit of persons other than himself or his client is entitled to a reasonable fee from the fund as a whole." *Brown*, 562 So. 2d at 495 (emphasis added).

In the fourth case cited, an unpublished opinion in a case against another bank involving allegations similar to those against BancBoston *and brought by the same class lawyers,* the court purportedly bought the same scheme as the one advanced here—awarding one-third of the surplus escrow money in attorney's fees. Cottingham letter, supra note 29, at 3. BancBoston's lawyer provides no citation for this case in his letter, nor does he supply a court, state or date for this decision. Thus, we have not verified that another court actually approved a similar scheme. On the other hand, we have no reason to doubt this assertion. Secor Bank, which the letter identifies as the settling defendant in this other case, is apparently headquarted in Alabama. If class counsel sued in Alabama and got a judge there to accept this novel scheme for the awarding of attorney's fees, it may explain why the suit against BancBoston was brought in Alabama—a choice that otherwise appears difficult to explain. These lawyers might have wanted to stick with a winning forum.

One unreported state trial court decision hardly seems compelling precedent. The bank's reliance on this precedent seems even less compelling given its citation of

Ordinarily, punitive damages are available in an action against a fiduciary for willful breach of the duties owed the beneficiary.[60] Therefore, absent the Alabama court's approval of the attorney's fee request, a plaintiff would stand an excellent chance of recovering punitive damages against the bank based on its agreement to cooperate with class counsel in their request for attorney's fees, particularly given that the bank stood to gain financially by going along with class counsel's request.[61] Finally, had the bank proposed this scheme and sold it to class counsel

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Reynolds, a reported opinion by the Alabama Supreme Court. In *Reynolds*, class counsel had been awarded one-third of the judgment rendered against the defendant bank and the class plaintiffs appealed, arguing that the bank had an obligation to pay the attorney's fees, not the class, given the court's order that the class be made whole for the defendant's breach of its fiduciary duty. Id. at 1241. As the *Reynolds* court explained, class counsel was not seeking any more money:

> .They agree that they have been adequately compensated for their hours . . . , but they appear before us because they believe they have a professional responsibility to see that their clients are made whole as per the law of the case as expressed by Judge Hooper and by this Court. The sole purpose of the appeal is to shift the responsibility of the fee from [the class's] shoulders to the bank.

Id. at 1241.

The Alabama Supreme Court agreed on the ground that "ample authority" supported a state court's power to shift attorney's fees from "the beneficiaries to their paid trustee." Id. at 1244. It thus reversed the trial court's refusal to shift the cost of attorney's fees to the bank and ordered the bank to pay those fees. Id. Clearly, then, BancBoston was aware of precedent suggesting that it could be required to pay fees based on some percentage of the actual recovery. Cf. *Secor Bank*, 644 So. 2d at 1142 (suggesting in dicta that an express provision in escrow agreement making the mortgagor liable for attorney's fees incurred by the bank in action it brings *against* mortgagor would raise an issue of public policy).

[60] See Rivero v. Thomas, 194 P.2d 533, 542 (Cal. Ct. App. 1948) (punitive damages permissible against trustee when there is evidence of fraud or malice, express or implied); DeToro v. Dervan Inves. Ltd., 483 So. 2d 717, 723 (Fla. Dist. Ct. App. 1985), on reh'g, op. replaced in part, 11 Fl. Law. Wk. 739 (punitive damages permissible for breach of fiduciary duty and evidence of profit made by fiduciary admissible to show willfulness of breach); In re Marriage of Pagano, 607 N.E.2d 1242, 1250 (Ill. 1992) (punitive damages permissible when trust relationship violated, there is gross fraud or wilfullness is shown).

[61] See Ramsey v. Culpepper, 738 F.2d 1092 (10th Cir. 1984) (applying New Mexico law in upholding punitive damages awarded against agent who intentionally and recklessly misled principal about principal's real estate to encourage principal to accept a deal beneficial to the financial interests of the agent). The Notice sent to class members mentioned that BancBoston had agreed not to object to the attorney's fees. Notice, supra note 17, at 5. The bank apparently acquiesced in the distribution of this Notice to class members without ever asking the court to order a clearer description of the method for calculating attorney's fees in the Notice.

instead of what appears to have happened here, the bank might be liable, whether or not it had a fiduciary duty to the class, for inducing other fiduciaries (class counsel) to breach their duties to the class.[62]

This observation brings us back to class counsel. Like the bank, class counsel also might be liable for punitive damages for inducing the bank to breach its fiduciary obligations to its customers by remaining silent about class counsel's request for attorney's fees. Thus, we have shown that several legal theories would support the award of punitive damages to a non-class-action client who proved that her lawyer and her bank had engaged in conduct similar to that which we have described. But, as to the apparent misconduct of the lawyers, there is more.

In *Phillips Petroleum Co. v. Shutts*,[63] the Supreme Court held that a state court could exercise jurisdiction over plaintiff class members from other states in an action for money damages without violating due process, provided that: (1) those representing the class (the named plaintiffs and class counsel) adequately represent the class's interests; (2) absent class members are provided notice; and (3) absent class members are given an opportunity to opt out of the litigation.[64] *Shutts* provides the basis for the *Hoffman* court's jurisdiction over class members from states other than Alabama. The class members in *Hoffman* were provided some form of notice and some opportunity to opt out, although we do not believe the notice or opt-out rights were sufficient to satisfy the due process requirement elaborated in *Shutts*.[65] But those matters aside, it is still highly questionable whether *Shutts* licenses the jurisdiction exercised in this case.[66]

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[62] Restatement (Second) of Torts § 774A (1979) (punitive damages recoverable in appropriate circumstances for the intentional tort of interfering with a contractual relationship).

[63] 472 U.S. 797 (1985).

[64] Id. at 811-12.

[65] We believe that the Notice was constitutionally deficient because it did not provide enough information for a rational actor to be able to determine whether it was in his economic interest to remain in this suit—indeed, it misled class members with its faulty description of how attorney's fees would be calculated. Further, we believe that the Notice denied a meaningful opportunity to opt out because it did not explain that negative recovery was possible or how high attorney's fees would actually be for some class members.

[66] We thank Rhonda Wasserman for bringing this point to our attention.

In *Shutts*, the defendants had argued that state court jurisdiction over absent out-of-state plaintiff class members should be no greater than state court jurisdiction over out-of-state defendants.[67] The Court rejected this argument: "The burdens placed by a State upon an absent class-action plaintiff are not of the same order or magnitude as those it places upon an absent defendant."[68] A defendant may "be forced to respond in damages," and "may also face liability for court cost and *attorney's fees*."[69] In contrast, absent class-action plaintiffs "are almost never subject to counterclaims or cross-claims, or liability for fees or costs."[70] Here, the Court inserted this footnote:

> Petitioner places emphasis on the fact that absent class members might be subject to discovery, counterclaims, cross-claims, or court costs. Petitioner cites no cases involving any such imposition upon plaintiffs, however. We are convinced that such burdens are rarely imposed upon plaintiff class members, and that the disposition of these issues is best left to a case which presents them in a more concrete way.[71]

Enter *Hoffman*, in which a foreign state court apparently ordered absent class members to pay more money than they received—a concrete case presenting the issue left open by *Shutts*. A lawyer who neglects to raise jurisdictional objections to a court order that will cost his client money, when there are serious grounds for making such an objection, will be liable for the damages caused by this neglect.[72]

But here there appears to have been more than ordinary neglect. The lawyers did more than fail to assert their clients' rights under the Due Process Clause; they urged the state court

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[67] 472 U.S. at 802.

[68] Id. at 808.

[69] Id. (emphasis added).

[70] Id. at 810 (footnote omitted).

[71] Id. at 810 n.2.

[72] See generally 3 Ronald E. Mallen and Jeffrey M. Smith, Legal Malpractice § 29.21 (4th ed. 1996) (discussing issues and citing cases concerning attorney's liability for failure to establish defense). Cf. id. § 29.26 (regarding errors in selecting venue and jurisdiction). The jurisdiction problem under *Shutts*, which we have just discussed, provides another reason to deny collateral estoppel effect to the ruling of the Alabama court. On the assumption that most state courts avoid taking money from out-of-state absent class members, we do not refer to this argument later when we address whether later suits should generally be estopped based on the prior approval of the class action.

to enter the order on attorney's fees, the constitutionality of which is in serious question. Moreover, they apparently urged this course of action to further their own financial interests. This motive for neglecting the constitutional problems with the settlement proposed, combined with the active role played by the lawyers in devising and advocating the arguably unconstitutional result, should suffice to show intentional disregard of the clients' interests or, at the very least, wanton disregard for their clients' rights. Either of these showings would justify an award of punitive damages.[73]

In addition, an individual client whose lawyer had acted like the class lawyers in *Hoffman* appear to have acted would have a viable cause of action against the lawyer for common law fraudulent misrepresentation. The basic elements of the intentional tort of fraudulent misrepresentation are: (1) a false statement of a material fact or, when there is a duty to disclose, an omission without which the statement made is materially misleading; (2) knowledge or belief by the speaker that the representation is false; (3) the intent to deceive; (4) reasonable reliance by the person to whom the statement is made; and (5) consequent harm.[74] The statement presumably drafted by class counsel for inclusion in the Notice to their clients said that the lawyers would not request a fee that exceeded one-third of the economic benefit realized from the settlement.[75] This statement is false, if, as we have argued, the lawyers requested a fee amounting to somewhere between 69% and 4155% (or more) of the economic benefit conferred on individual class members.[76]

At best, the statements on attorney's fees appear to be materially misleading in that they fail to mention that a client might

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[73] The deprivation of the class members' constitutional rights could also give rise to an action under 42 U.S.C. § 1983 (1994). "Although [lawyers] are themselves private actors, private parties who corruptly conspire with a judge in conjunction with the judge's performance of an official judicial act are acting under color of state law for the purpose of § 1983 . . . ." Kimes v. Stone, 84 F.3d 1121, 1126 (9th Cir. 1996) (holding that attorneys accused in § 1983 action of conspiring with judge to deprive plaintiff of constitutional rights cannot, consistent with Supremacy Clause, invoke state law litigation privilege, nor do they enjoy common law immunity under federal law).

[74] W. Page Keeton et. al., Prosser and Keeton on the Law of Torts, § 106, at 728-38 (5th ed. 1984).

[75] Notice, supra note 17, at 5.

[76] See supra text accompanying notes 38-46.

end up paying more money in attorney's fees than she realizes from the suit.[77] Intent to deceive may be demonstrated by evidence that the speaker knew the statement was false or materially misleading when it was made and that he made it to induce another to act in reliance on it.[78] Given that class counsel apparently devised the attorney's fee proposal, a jury could infer that class counsel knew that the fee proposal would leave individual class members paying more than one-third of their economic benefit in fees. The intent to induce reliance is shown by class counsel's apparently having offered these statements for inclusion in the Notice, upon which class counsel knew people would rely in deciding whether to stay in the class and thus incur an obligation to pay attorney's fees.

Actual reliance would have to be demonstrated by testimony that class members read the statements on attorney's fees in the Notice,[79] but presumably some number of the class read the Notice and relied on these statements. At the least, damages would equal the difference between what the clients paid in attorney's fees and what they might have paid had the statement been true.[80] Moreover, the entire fee paid to the lawyers might be considered damages, given BancBoston's statements that it was ready itself to pay class counsel a reasonable fee and provide the class with essentially equivalent relief—another instance of material information not disclosed to the class.[81] And, collateral estoppel problems aside for the moment, the fact that the Notice was authorized by a court should not present a serious obstacle to showing that the lawyers' conduct caused the damage, given that it should be easy to show that the statements contained in the Notice were either actually or constructively those of class counsel.[82]

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[77] In addition to common law fraud, such omission constitutes a breach of fiduciary duty. As a fiduciary, a lawyer has a duty to his client not to omit material information from statements upon which the client might reasonably rely. Restatement (Second) Agency § 381 (1958).

[78] Keeton et. al., supra note 74 § 107.

[79] Id. § 108.

[80] Id. § 110.

[81] Cottingham Letter, supra note 29, at 2.

[82] See infra text accompanying notes 381-82.

Punitive damages are available in cases of intentional misrepresentation.[83] And, to the extent that the bank understood the wrongfulness of what the lawyers proposed[84] and knew that those lawyers owed a fiduciary duty to the class, the bank's agreement to cooperate with class counsel in what we have just argued was intentionally tortious conduct might render the bank liable as a joint tortfeasor, irrespective of and in addition to its independent fiduciary duties to its customers.[85]

Finally, every state has enacted some form of consumer protection statute.[86] Many of these statutes provide for double, treble or punitive damages and the award of attorney's fees, even in the absence of proof of bad faith.[87] Several states have

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[83] See, e.g., Hoff v. Bower, 492 N.W.2d 912 (S.D. 1992) (punitive damages award proper for intentional misrepresentation); Keeton et. al., supra note 74 § 2, at 9-10 ("Where the defendant's wrongdoing has been intentional and deliberate, and has the character of outrage frequently associated with crime, all but a few courts have permitted the jury to award . . . 'punitive' or 'exemplary' damages . . . .") (footnote omitted). Further, class counsel might be liable under the Racketeer Influenced and Corrupt Organizations (RICO) statute, 18 U.S.C. §§ 1961-1968 (1994), which also provides for treble damages. RICO includes mail and wire fraud as "racketeering activit[ies]." Id. § 1961. This makes lawyers vulnerable to RICO charges. See United States v. Teitler, 802 F.2d 606 (2d Cir. 1986) (applying RICO statute to law firm and its members as "enterprise" in connection with lawyer's insurance fraud scheme). RICO prohibits, in any activity involving interstate commerce, the following: (1) investing income derived from a pattern of racketeering; (2) acquiring or maintaining an interest through a pattern of racketeering; (3) participating in the enterprise's affairs through a pattern of racketeering; and (4) conspiring to engage in any of these activities. Id. § 1962. Two acts of racketeering and the threat of continuing racketeering activity suffice to establish a "pattern" of racketeering. Id. § 1961(5). A criminal conviction is not necessary to support civil RICO liability. A private party who prevails on the merits in a RICO action is entitled to treble damages and litigation expenses, including attorney's fees. Id. § 1964(c).

Even if the BancBoston scheme were considered only one predicate act of fraud notwithstanding that it affected over 300,000 mortgagors, RICO liability would lie if there were evidence that class counsel perpetrated the same wrongs in an earlier suit. See supra note 59.

[84] See Defendant's Objections, supra note 57, at 5 (quoting bank's own papers to demonstrate that the bank knew the effect of the attorney's fee proposal).

[85] Restatement (Second) of Torts § 875 (1979) (each of two or more persons whose tortious conduct is a legal cause of a single and indivisible harm to the injured party is subject to liability to the injured party for the entire harm).

[86] Shelley D. Gatlin, Note, Attorney Liability Under Deceptive Trade Practices Acts, 15 Rev. of Litig. 397, 399-400 (1996).

[87] See John A. Spanogle, et. al., Consumer Law 79 (2d ed. 1991); Gatlin, supra note 86, at 397-400; Randall S. Hetrick, Comment, Unfair Trade Practices Acts Applied to Attorney Conduct: A National Review, 18 J. Legal Prof. 329, 329-30 (1993).

applied those laws to lawyer-client contracts.[88] These laws generally prohibit, as deceptive, acts that have the "likelihood of inducing a state of mind in a consumer that is not in accord with the facts,"[89] whether those acts are written or verbal and when

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[88] See Gatlin, supra note 86, at 402-08. Courts in at least four states—Connecticut, Louisiana, Massachusetts and Texas—have upheld suits against attorneys under consumer protection statutes. Heslin v. Connecticut Law Clinic of Trantolo, 461 A.2d 938 (Conn. 1983) (Connecticut Unfair Trade Practices Act applies to attorneys for purposes of an investigatory demand); Reed v. Allison & Perrone, 376 So. 2d 1067 (La. Ct. App. 1979) (applying Louisiana Unfair Trade Practices and Consumer Protection Law to attorney advertising); Guenard v. Burke, 443 N.E.2d 892, 896 (Mass. 1982) (use of unlawful contingency fee agreement by attorney may be "unfair or deceptive act or practice"); DeBakey v. Staggs 605 S.W.2d 631, 633 (Tex. Civ. App. 1980) (applying Deceptive Trade Practices Act to purchase of legal services). Courts in four other states—Montana, Oregon, South Carolina and Washington—have suggested such claims would be upheld in appropriate circumstances. Matthews v. Berryman, 637 P.2d 822, 826 (Mont. 1981) (finding attorney's acts did not constitute fraud, duress or undue influence so as to violate Montana Unfair Trade Practices and Consumer Protection Act of 1973); Roach v. Mead, 722 P.2d 1229, 1234-45 (Or. 1986) (holding on facts of case that Oregon's Unlawful Trade Practices Act did not regulate legal services rendered for investment of money rather than personal use); Camp v. Springs Mortgage Corp., 414 S.E.2d 784, 786 (S.C. App. 1991), aff'd in part, rev'd in part, 426 S.E.2d 304 (S.C. 1993) ("There is no question but what [sic] legal services come within the definition of [the Unfair Trade Practices Act]."); Short v. Demopolis, 691 P.2d 163, 168 (Wash. 1984) (holding that "entrepeneurial aspects of the practice of the law" are subject to Washington's Consumer Protection Act). Three states—Maryland, North Carolina and Ohio—have statutes that exclude lawyers from coverage. Md. Code Ann., Com. Law § 13-104 (1990 & Supp. 1994); N.C. Gen. Stat. § 75-1.1(b) (1994); Ohio Rev. Code Ann. § 1345.01(A) (Baldwin 1988). Cases in three more states—Illinois, New Hampshire and New Jersey—have rejected the application of consumer protection statutes to lawyers. Lurz v. Panek, 527 N.E.2d 663, 670 (Ill. App. Ct. 1988) (Consumer Fraud and Deceptive Business Practices Act does not regulate attorney's furnishing of legal services); Frahm v. Urkovich, 447 N.E.2d 1001 (Ill. App. Ct. 1983) ("trade or commerce" term in Consumer Fraud and Deceptive Practices Act does not include actual practice of law); Rousseau v. Eshleman, 519 A.2d 243 (N.H. 1986) (regulation of attorneys falls within exception to scope of Consumer Protection Act); Vort v. Hollander, 607 A.2d 1339 (N.J. Super. Ct. App. Div.), cert. denied, 617 A.2d 1221 (N.J. 1992) (attorney's services do not fall within intendment of Consumer Fraud Act). Cases in Arkansas, Idaho and Pennsylvania suggest that lawyers may be exempt from liability under consumer protection statutes in those states. Robertson v. White, 633 F. Supp. 954, 978 (W.D. Ark. 1986) (holding in alternative that Arkansas Consumer Protection Act not designed to regulate attorney-client relationship); Keyser v. St. Mary's Hosp., 662 F. Supp. 191, 194 (D. Idaho 1987) (holding that statute requiring proof of negligence in claim against physician barred action under Idaho Consumer Protection Act); Gatten v. Merzi, 579 A.2d 974, 976 (Pa. Sup. Ct. 1990), app. denied, 596 A.2d 157 (Pa. 1991) (finding Unfair Trade Practices and Consumer Protection Law not intended to apply to physicians rendering medical services).

[89] See, e.g., Uniform Consumer Sales Practices Act § 3(a) cmt., 7A U.L.A. 237

ever the misrepresentation is accomplished through affirmative words or by nondisclosure.[90] The statutes commonly define as per se deceptive any act misrepresenting the actual price to be paid for the services rendered.[91] Telling a client that she will be charged one-third of the economic benefit of the settlement, when the attorney's fees she is actually to be charged exceed 100% of her actual recovery (or equal 69% of that recovery) would seem to fit into this per se category and also within the general definition of a deceptive practice given above.[92]

The statutes also commonly proscribe unconscionable practices.[93] In determining what constitutes an unconscionable practice these statutes generally instruct courts to consider whether the seller knew or had reason to know that she: took advantage of the consumer's "inability to understand the language of an agreement";[94] sold the services at a price "grossly exceed[ing] the price" of similar services readily available to like consumers;[95] sold the services to consumers unable to receive any substantial benefit from the transaction;[96] or induced the consumer to enter into a transaction "excessively one-sided in favor of the supplier."[97] Arguably, all of these factors are present here.[98]

(1971) [hereinafter UCSPA]. While few states have adopted this model in its entirety, many states use it as a model in enacting their own statutes. See Spanogle et. al., supra note 87, at 70.

[90] UCSPA, supra note 89, § 3(a) cmt., at 237.

[91] Id. § 3(b)(8) cmt.

[92] One commentator has endorsed the approach taken by Texas, see Tex. Bus. & Com. Code Ann. § 17.49 (West 1987 & Supp. 1995), and Washington, see *Short*, 691 P.2d at 168, which limits the application of consumer protection laws to lawyer conduct involving "entrepreneurial" aspects of the attorney-client relationship, such as pricing, billing and collecting fees. See Gatlin, supra note 86, at 413. The conduct alleged in *Hoffman* unquestionably falls within the entrepreneurial category.

[93] UCSPA, supra note 89, at § 4(b).

[94] Id. § 4(c)(1).

[95] Id. § 4(c)(2).

[96] Id. § 4(c)(3).

[97] Id. § 4(c)(5).

[98] The consumer fraud laws generally provide some form of exemption for acts required by federal or state law, id. § 14(a)(1), or in some versions of these statutes acts "in compliance with," or "permitted under" federal or state law. See, e.g., Or. Rev. Stat. § 646.612 (1988); R.I. Gen. Laws § 6-13.1-3 (1992). The broad question of whether conduct that would otherwise be malpractice, fraud or some other violation of law should be considered immunized by the implicit or explicit licensing of that conduct by a court in the process of approving a class action settlement is addressed infra Part III. Given our position that any such approval or licensing should not be

3. *All I Know is What I Read in the Papers*

It is tempting to imagine that *Hoffman* is an aberration. We believe, however, that it is all too representative of the kind of treatment class members in suits for money damages receive. Not only do the incentives of the active participants—class lawyers, defendants and their lawyers, and the courts—lead us to this conclusion, but unfortunately, recent experience confirms it. In Part II, we explain why the incentives of the participants would lead to such abuse, but first a word about the anecdotal evidence available.

The decision in *Hoffman* was not published. Nor was the similar settlement against Secor Bank alluded to by BancBoston's lawyer in his letter explaining what went on in *Hoffman*.[99] Neither settlement is available on LEXIS.[100] Nor could one

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considered a substantive determination of those questions for purposes of collateral estoppel, see infra text accompanying notes 308-352, it follows that the findings made by a court approving a class action settlement should not be considered as "law" for purposes of the standard exemption in consumer fraud statutes. Here, we simply note that even if these exemptions were read to prevent a challenge in *Maine* to *Hoffman*-like conduct approved by a *Maine* court or a federal court in a class action settlement, a *Maine* court would not be likely to read this to exempt the conduct approved by a court in *Alabama*. If a foreign state licenses an act otherwise prohibited under the forum state's consumer protection law, the reach of forum law is determined, not by the exemption provision mentioned above, but by: (1) the Due Process Clause of the Fourteenth Amendment, which requires a forum state to have an interest sufficient to justify the exercise of sovereignty; (2) the Full Faith and Credit Clause, which requires a balancing of the possible competing interests of separate state sovereignties; and (3) the Commerce Clause, which requires a determination of whether the state's choice of law discriminates against or otherwise unduly burdens interstate commerce. Aldens, Inc. v. Packel, 524 F.2d 38 (3d Cir.), cert. denied, 425 U.S. 943 (1975). Of this list, we believe only the Full Faith and Credit Clause is relevant to an assessment of whether a court in Maine would be required to hold that the Alabama court's approval of the attorney's fee award in *Hoffman* prevents the operation of Maine's (or any other state's) consumer protection law. Given the arguments we offer infra Part III, we believe the Full Faith and Credit Clause would not apply because the original Alabama judgment would have limited estoppel effects. The Full Faith and Credit Clause requires that courts give only that effect to a foreign court judgment that such judgment would receive in the jurisdiction of origin. 28 U.S.C. § 1738 (1994).

[99] Cottingham Letter, supra note 29, at 3.

[100] Moreover, a NEXIS search on August 31, 1995, uncovered only one article on *Hoffman*, which announced that the Florida Attorney General would intervene in the case, but otherwise gave few details on the proposed settlement in that case. See Kimberly Blanton, Florida Sues Boston Bank in Escrow Case, Boston Globe, Nov. 26, 1993, at 89. The article by Will Lund, supra note 28, was published in the Maine Lawyers Review, which does not appear on NEXIS. On October 2, 1995, the

find out from published opinions that three similar settlements were offered to three separate courts, two in New York state and one in Alabama.[101] We know about those three cases only because the following people read drafts of this Article and then reported to us that they had received notices in those cases: a law professor,[102] a lawyer in private practice[103] and lawyers in the offices of attorneys general.[104] Had these people not brought these *Hoffman* clones to our attention, we would never have known about them. In short, had Senator Cohen's office not brought *Hoffman* to our attention, we would have been unaware and unable to find these other examples of apparent class action abuse.[105]

In response to the problem of inadequate information about class action settlements,[106] Senator Cohen, at our suggestion and

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Hoffman settlement was briefly discussed (and criticized) by Jane Bryant Quinn in her Newsweek question and answer column. See Jane Bryant Quinn, Leading Questions, Newsweek, Oct. 2, 1995, at 71.

[101] See infra notes 102-103.

[102] After presentation of a draft of this paper at Boston University Law School, Professor Robert Seidman of B.U. received a class action notice that he thought looked suspiciously like the *Hoffman* settlement discussed in our draft and brought the notice to our attention. Notice of Class Action Proposed Settlement and Hearing, Murray v. Shawmut Mortgage Co., No. 3037/94 (N.Y. Sup. Ct. Feb. 12, 1996) (on file with the Virginia Law Review Association). We thank him.

[103] Ralph Wellington of Schnader, Harrison, Segal & Lewis, the lawyer to whom Professor Koniak referred the class members who believed themselves wronged by the judgment in *Hoffman* and the lawyer who now represents those class members, himself received notice that he was a member of a class settlement that looked suspiciously like that in *Hoffman*. See Susan Adams, Deliberate Obfuscation, Forbes, Sept. 9, 1996, at 152-53. Mr. Wellington filed objections to the settlement, which resulted in the lawyers agreeing to refrain from seeking fees from the mortgage accounts of their clients. Id. The judge nonetheless rejected the proposed settlement on the ground that the class received no real benefit from the settlement proposed. Mr. Wellington sent us the judge's unpublished opinion, a copy of which he received from the judge in the case. See Objections to the Terms of the Settlement Agreement, Lerose v. PHH U.S. Mortgage Co., No. 08544 (N.Y. Sup. Ct. Mar. 23, 1996) (on file with the Virginia Law Review Association).

[104] Conversation with Walter Maroney, Senior Assistant Attorney General, State of New Hampshire, Feb. 8, 1996.

[105] Since the filing of the lawsuit against the *Hoffman* lawyers, the case has garnered considerably more media attention. See Susan Adams, Fighting Back: How the Outraged "Winners" of an Egregious Class Action Settlement Are Taking Their Own Lawyers to Court, Forbes, Apr. 22, 1996, at 12; Max Boot, Judges Rebel Against Mass Tort Excesses, Wall St. J., Apr. 3, 1996, at A15; Barry Meier, Math of a Class-Action Suit: 'Winning' $2.19 Costs $91.33, N.Y. Times, Nov. 21, 1995, at A1.

[106] Some information about class action settlements does exist in certain types of

with our help, introduced legislation designed to increase available information about these settlements.[107] The bill would require attorneys for class action plaintiffs to give notice of proposed settlements 120 days prior to any hearing on those settlements to the Department of Justice and state attorneys general from states where class members reside, so that these agencies might have the information and time necessary to intervene to protect the interests of class members.[108] The bill also specifies that court orders in class actions must be made available for publication in court reporters, so that lawyers, academics and the press can monitor such cases. Last, but certainly not least, the bill contains plain-language requirements for communications to class members.[109]

Given the present state of affairs, one simply cannot say how many viable claims of malpractice or breach of fiduciary duty exist. What we do know, however, is that *Hoffman* and other

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cases. For example, the Federal Securities Law Reports include information about proposed and actual settlements in class actions, as do the Class Action Reports. We believe that the available information is inadequate, however.

[107] Protecting Class Action Plaintiffs Act of 1995, S. 1501, 104th Cong., 1st Sess. (1995), was introduced by Senator William S. Cohen (R-Me.) on December 12, 1995. 141 Cong. Rec. S519,250 (daily ed. Dec. 22, 1995). For a synopsis of the bill's main provisions, see Congress: Proposed Legislation, Trade Reg. Rep. (CCH) No. 402, at 3-4 (Jan. 10, 1996).

[108] See Protecting Class Action Plaintiffs Act, supra note 107, § 1711(c)-(d).

[109] See id. § 1711 (f)-(g). The most recent available empirical study suggests that "[m]any, perhaps most, of the notices present technical information in legal jargon" and concludes that "most notices are not comprehensible to the lay reader." Thomas E. Willging, Laural L. Hooper & Robert J. Niemic, An Empirical Analysis of Rule 23 to Address the Rulemaking Challenges, 71 N.Y.U. L. Rev. 74, 134 (1996). Moreover, the study found that "notices did not appear to include sufficient information for an individual class member to appraise the net value of a settlement to the class or to calculate an expected personal share in the settlement." Id. at 133. Even notices that provide relevant information may do so in a deceptive way. For example, the notice for one of the bank escrow cases contains a paragraph that states: "[Bank] agrees to make a payment toward court-awarded attorney's fees, costs and expenses not to exceed $150,000." Adams, supra note 103, at 152. Does this provision ensure that the class lawyers will not ask for more than $150,000 and that no money will be paid by class members for the attorney's fees? Read it again carefully.

bank cases like it[110] are not the only class action suits that might give rise to later suits against the settling parties.

We do not have the space here to discuss other cases with the attention to detail that would be necessary to demonstrate with any certainty that they involve malpractice, breach of fiduciary duty or fraud. And, unfortunately, hypotheticals do not help; they would only leave us open to the charge that courts would never approve settlements like those in our hypotheticals. Would you have believed courts have approved settlements like the one in *Hoffman* had we suggested as much through a hypothetical? Nevertheless, those tempted to believe that *Hoffman* and its sister bank cases are the only cases egregious enough to warrant the remedy we propose, we provide the following brief summaries of settlements approved by federal district courts to dispel that notion.

[110] In addition to the bank cases we have just alluded to, see Brundidge v. Glendale Federal Bank, 659 N.E.2d 909, 911 (Ill. 1995) (discusing class action settlement in bank escrow case in which lawyers apparently asked for percentage of the total refund, but not revealing who was to pay those fees).

In *Georgine v. Amchem Products, Inc.*,[111] a federal district court approved a class action settlement involving hundreds of thousands of claims arising from exposure to products containing asbestos. Class counsel defined the class to include all people who were presently ill from exposure to the defendants' asbestos products, as well as all those who might become ill from exposure to those products in the future—well, almost all.[112] The definition excluded thousands of people with asbestos claims indistinguishable from those included within the class except for the fact that the excluded people were "present clients" of class counsel or other asbestos lawyers.[113] The gerrymandered

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[111] 157 F.R.D. 246 (E.D. Pa. 1994), vacated, 83 F.3d 610 (3d Cir. 1996), cert. granted sub nom. Amchem Prods. v. George Windsor, 65 USLW 338 (U.S., Nov. 1, 1996) (No. 96-270). For a description of the wrongdoing in *Georgine* that provides an example of the level of detail necessary to demonstrate that misconduct occurred, see Koniak, supra note 15. Professor Koniak served as a paid expert witness for the objectors to the *Georgine* settlement, testifying on the ethics of class counsel's conduct. Id. at 1146-47. *Georgine* is the case that first got us thinking about the importance of later suits for misconduct in class actions. We thank Roger Cramton for helping us to develop our thoughts on the misconduct in *Georgine.*

The Third Circuit recently overturned the *Georgine* settlement. 83 F.3d 610 (3d Cir. 1996). But as we argue below, this form of redress for class action abuse is rare. See infra note 186 (citing empirical evidence on the small number of class settlements overturned on appeal). In our view, the fact that the *Georgine* settlement was overturned is attributable not to the fact that the conduct in that case was so much more egregious than in other class actions, but rather to the fact that in that case, unlike most others, the objectors were well-financed and therefore able to mount an impressive (and very expensive) challenge to the settlement. Other asbestos lawyers had a significant incentive to challenge the *Georgine* settlement because, if approved, it would have significantly restricted the future income they might otherwise have expected to achieve through handling asbestos cases individually. But the lawyers who financed the challenge to the *Georgine* settlement have told us that, given what everyone understands to be the small chance of derailing such a deal, they believe class counsel and the defendants were surprised that they were met with a well-financed challenge and had calculated that no more than a challenge-on-the-cheap would be mounted. Interview with with Fred Baron, Counsel for Objectors in *Georgine*, Jan. 1994.

[112] The class included all people exposed to the asbestos products of the twenty defendant corporations (and their immediate family members) except those people who had filed suit against the companies by Jan. 15, 1993. *Georgine*, 157 F.R.D. at 257-58.

[113] Id. at 296. Because class counsel knew the cut-off date before the class settlement was filed with the court, they were able to exclude people from the class at will by getting a lawsuit on file with a court prior to Jan. 15, 1993. Moreover, there is evidence that class counsel did just that. Koniak, supra note 15, at 1057-59. The phrase "present clients" was used by class counsel to refer exclusively to those

class definition allowed class counsel to settle approximately 14,000 individual cases against the defendants for amounts that appear to be much higher than the recoveries provided class members under the class settlement.[114] But neither the absent class members nor the named class representatives were informed that their lawyers had negotiated better deals on identical claims against the same defendants for their 14,000 "present clients" than the lawyers had negotiated for the class.[115] Nor was the class informed that the defendants told class counsel that a condition of settling those 14,000 cases was a class settlement that would roll up all the future cases that might be filed against the defendants and settle them at a price the defendants could accept.[116] In our opinion, these facts give rise to a plausible malpractice suit against class counsel because they strongly suggest that class counsel sold out the class in favor of 14,000 non-class members to further class counsel's own interest in their share of the attorney's fees from those 14,000 cases, which is money paid to class counsel by the defendants in addition to the fees awarded by the district court for representing the class. An ordinary client whose lawyer traded part of the value of that client's claim to further the financial interest of some other person, such as the 14,000 "present clients," would have a viable claim of malpractice against her lawyer and a fair chance of

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excluded from the class. Id. at 1059. We put the phrase in quotation marks because class counsel had an obligation to class members to treat them as if they were present clients too. Id. at 1056-57. See also id. at 1074-78 (explaining how class counsel's efforts to distinguish the claims of their present clients from those of class members were specious, although adopted by the federal district court).

[114] Id. at 1064-74 (describing evidence that appears to show that one of the law firms serving as class counsel in *Georgine* negotiated settlements for its "present clients" that were 54% better than those negotiated for the class, and that the other firm negotiated settlements that were 72% better).

[115] Id. at 1137-42.

[116] To quote testimony from one of the representatives of the defendants offered at the fairness hearing: "Without a degree of confidence that the *Georgine* discussions would be successful, we would not have done the present inventory settlements with [class counsel] or the other numerous unaffiliated [plaintiffs'] firms [that] we did inventory deals with, that is correct." Transcript of Fairness Hearing at 193-94, Georgine v. Amchem Prods., No. 93-0215 (E.D. Pa. Feb. 23, 1994) *quoted in* Koniak, supra note 15, at 1081-82 (testimony of Lawrence Fitzpatrick) [hereinafter *Georgine* Fairness Hearing]. See also id. at 1078-86 (describing evidence that the present clients' settlements were made in exchange for defendants getting the class settlement they wanted in *Georgine*).

receiving punitive damages.[117] Although the Third Circuit rejected the *Georgine* settlement, the Fifth Circuit in *Ahearn v. Fibreboard*[118] recently approved a similar scheme in another asbestos class action developed by some of the same lawyers as the lawyers in *Georgine.* And we know of at least one other class suit, involving polybutylene pipe, in which the same scheme has been used.[119] Because lawyers are quick to recognize a profitable opportunity, we would expect that *Georgine*-style class gerrymandering will (if Rule 23 and the courts continue to permit it) become at least as ubiquitous as *Hoffman*-style "benefit enhancement" apparently is.

One final example before we move on. In 1990, lawyers for Imperial Corporation of America (ICA), the parent company of Imperial Savings Association (ISA), a failed savings and loan, negotiated a $13 million settlement of shareholder derivative claims and class action claims arising out of ICA's investments in junk bonds and consumer loans in the late 1980s.[120] ICA's insurers were to pay $12.5 million toward the settlement and ICA, $500,000.[121] The settlement provided that of the $12.5 million paid by the insurers, $2.5 million was to be "deemed" in settlement of the derivative suit; the rest was "deemed" in set-

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[117] See supra notes 73-85 and accompanying text.

[118] See Ahearn v. Fibreboard, 162 F.R.D. 505, (E.D. Tex. 1995), aff'd on appeal, In re Asbestos Litig., 90 F.3d 963 (5th Cir. 1996) (petition for reh'g pending) (approving class action settlement which, like the *Georgine* settlement, appears to define the class so as to exclude other clients of class counsel).

[119] See Spencer v. Shell Oil Co., No. 94-074 (Ala. Cir. Ct. 1995) (on file with the Virginia Law Review Association). For more on the polybutylene pipe class actions, see Richard B. Schmitt, Leaky System: Suits Over Plastic Pipe Finally Bring Relief, Especially for Lawyers, Wall St. J., Nov. 20, 1995, at A1 (discussing polybutylene ("PB") pipe case then pending in Alabama in which class definition excluded clients who individually signed a retainer with class counsel). That case was one of several class suits filed in several state courts on behalf of homeowners with PB piping. John C. Coffee, Jr. & Susan P. Koniak, Rule of Law: The Latest Class Action Scam, Wall St. J., Dec. 27, 1995, at 11. Ultimately, the plaintiffs' lawyers in these various suits, which sought to include all the same people or overlapping groups of homeowners, agreed to join one "global" settlement to be executed by a state court in Tennessee. Schmitt, supra, at A5. The Alabama suit was dropped in favor of the Tennessee settlement, id., but we have no reason to believe that the side settlements negotiated as part of the Alabama suit were affected in any way.

[120] Durkin v. Shea & Gould, 92 F.3d 1510 (9th Cir. 1996); Robert Ablon, Settlements Don't Bar Malpractice Suits, Circuit Says, The Recorder, Aug. 20, 1996, at 1 *available in* LEXIS, News Library Curnws file.

[121] *Durkin*, 92 F.3d at 1512.

tlement of the class actions.[122] The settlement released the directors and officers of ICA from any claims related to the risky investments that those directors allegedly promoted or approved.[123] After obtaining approval of the settlement from ICA's Board of Directors, ICA's lawyers and the shareholders' lawyers jointly petitioned a federal court to approve the consolidated settlement of the class and derivative claims.[124] The district court obliged.[125] On the same day that the judge approved the settlement, federal regulators ordered the seizure of ISA and placed it into conservatorship under the Resolution Trust Corporation (RTC).[126] One week later, ICA filed for bankruptcy.[127]

The bankruptcy trustee subsequently sued ICA's lawyers, ICA's directors and the plaintiff shareholders' lawyers alleging: (1) the directors assisted by ICA's lawyers and the shareholders lawyers breached their fiduciary duties to the company and engaged in a fraudulent transfer of the corporation's funds by virtue of arranging the settlement; (2) that ICA's lawyers and the plaintiffs' lawyers colluded to keep the court in the dark about ICA's insolvency, the imminent seizure of ICA by the regulators, and the strength of the case that could be made against the directors; (3) that ICA's lawyers failed to advise the directors either of the conflict of interest the directors had in approving the settlement or of the unfairness of settling the shareholder derivative claims for a mere $2.5 million; and, (4) that the plaintiffs' lawyers committed malpractice, although the basis of that claim is not spelled out in the court opinion.[128]

Although the district court dismissed the malpractice claims against the plaintiffs' lawyers,[129] and the court of appeals

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[122] Id.

[123] Id.

[124] Id.

[125] Id.

[126] Id. at 1513.

[127] Id.

[128] Id.

[129] Id. at 1514. Just as the court of appeals does not explain on what theory the bankruptcy trustee sued the plaintiffs' lawyers for malpractice, the court does not explain on what grounds the district court dismissed the claim. We were unable to get a copy of the unpublished district court opinion or any of the unpublished orders issued by the district court in time to include it in this Article, so we are unable to

dismissed the claims against the directors,[130] the Ninth Circuit in *Durkin v. Shea & Gould* held that the malpractice claims against ICA's lawyers could proceed, the prior court's approval of the settlement notwithstanding.[131] Moreover, the court of appeals did not rule on the breach of fiduciary claims and fraudulent transfer claims that are apparently still pending against both ICA's lawyers and the lawyers for the shareholders.[132]

Durkin, which was decided as this Article was in the process of being published, not only tracks our argument on the inapplicability of collateral estoppel to the kinds of suits we advocate,[133] it provides another example of the kind of abuse that may well be widespread in the settlement of class and derivative actions—company lawyers arranging a settlement that short-changes the company and its shareholders but serves the interests of directors by releasing them from liability at no cost to those directors. Once again, the fairness hearing process does not appear adequate to prevent this abuse. And once again there is no reason to think this abuse is rare. Moreover, malpractice and fraud are not the only form of wrongdoing that may lurk beneath the surface of class and derivative suit settlements. We now turn to the antitrust violations that may occur in connection with settling these cases.

B. Is There a Trust in This Class?

To most people, and certainly to most lawyers, it is unthinkable that the antitrust laws could possibly have anything to do with regulating lawyer conduct in litigation. And in simpler times, this view made perfect sense. Lawyers were "professionals," not "businessmen" competing in some market. Even if they were businessmen to some extent, at least when they put on their litigators' hats they were not engaging in economic competition in some market, but competition of a different sort.

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enlighten our readers further on the claims against the plaintiff firm.

[130] The case against the directors was dismissed in a companion opinion to *Durkin*, In re Imperial Corp., 92 F.3d 1503 (9th Cir. 1996). We come back to the reasoning on claim preclusion in that opinion later. See infra Section III.B. and notes 291, 306.

[131] *Durkin*, 92 F.3d at 1518.

[132] Id. at 1514-15.

[133] See infra text accompanying notes 329-331.

Even if their conduct in litigation affected some market, courts oversaw and regulated this conduct, and everyone knew that once government regulation intruded on the marketplace, it blunted any antitrust enforcement. Finally, even if court oversight was imperfect, lawyers were representing their clients' interests in litigation, and any attempt to beat down their conduct with the antitrust club would at the same time strike the helpless client whose access to the courts would thereby be threatened.

But these simpler times have vanished. Because of the increased use of the class action device, especially in mass tort cases, as well as the evolution of antitrust law, the once unthinkable is now thinkable. And it is time that lawyers started thinking hard. In the face of the sometimes-expressed view that the antitrust laws are effectively dead, the Supreme Court has in fact been chipping away at protections lawyers might reasonably have thought they had. It has found that the antitrust laws can reach lawyer conduct, especially when their fees are involved.[134] It has rejected the notion that either "pervasive" regulation or the approval of a government agent automatically displaces the antitrust laws. And it has recognized that private parties cannot shield themselves from the antitrust laws by incidentally connecting their activities to some government agency.[135] As people have come to recognize the limits of regu-

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[134] See Federal Trade Comm'n v. Superior Ct. Trial Lawyers Ass'n, 493 U.S. 411 (1990) (holding per se illegal boycott in support of higher wages by lawyers representing indigent criminal defendants); Goldfarb v. Virginia State Bar, 421 U.S. 773 (1975) (holding minimum fee schedule for lawyers enforced by state bar association a violation of § 1 of the Sherman Act). The *Trial Lawyers* case is especially significant, because it applied the per se rule despite some indications in earlier cases that professionals were entitled to rule of reason treatment. See FTC v. Indiana Federation of Dentists, 476 U.S. 447, 458 (1986) (applying the rule of reason to a boycott by a group of dentists in part because "we have been slow to condemn rules adopted by professional associations as unreasonable *per se*"); National Soc'y of Prof. Eng. v. United States, 435 U.S. 679 (1978). But see Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332 (1982) (maximum price-fixing scheme by doctor group held per se illegal). The Court's approach parallels the approach of some states in applying their consumer protection laws to lawyer conduct, see supra notes 88-92: where fee agreements are involved, lawyers get no special antitrust treatment.

[135] See infra Sections IV.B. and IV.C.

lation that displaces the market, antitrust has in fact enjoyed new stature as regulation that supports the market.[136]

There are at least three practices connected to the settlement of class action suits that raise serious questions under the antitrust laws. The first practice is agreements among plaintiffs' lawyers to support each other's bid to be class counsel in a particular suit. Consider, for example, what happened when Oracle Systems Corporation's stock dropped sharply on March 27, 1990. Within a week of the stock plunge, fourteen separate class actions had been filed on behalf of the various classes of Oracle shareholders, and four more were filed the following week.[137] "[M]ore than 25 of the leading plaintiffs' class action law firms in the country" had filed suit on behalf of someone in that short span of time.[138]

By April 2, 1990, two of the firms filing class actions were busy setting up a meeting of the plaintiffs' firms to achieve "consensus" on how the "litigation should be structured."[139] Two firms refused to attend, "sensing that they would be outvoted on any decisions made at the meeting."[140] But fifteen firms sent lawyers to the meeting, which was held on April 12.[141] At the meeting, these lawyers "voted on an organization of the litigation and a leadership structure of two co-lead counsel."[142] Nominations for the post of lead counsel were made, and thereafter a vote was taken, resulting in an agreement among these firms on the two firms to be presented to the court as co-lead counsel in this litigation.[143] On May 4, 1990, the two firms elected sought the court's "ratification" of the agreement. The two firms that had boycotted the April 12 meeting objected. "The

[136] See Herbert Hovenkamp, Federal Antitrust Policy: The Law of Competition and Its Practice § 19.2, at 649 (1994) (arguing that the deregulation movement of the 1970s and 1980s has greatly increased the role of antitrust in regulated industries).

[137] In re Oracle Sec. Litig., 131 F.R.D. 688, 690 (N.D. Cal. 1990).

[138] Id.

[139] Id.

[140] Id.

[141] Id.

[142] Id. (citation omitted).

[143] Id. Minutes of the meeting were prepared and signed, presumably by the attendees. Id.

two camps . . . squared off, sending volleys of disparagement at each other."[144]

Judge Vaughn Walker asked the two camps to compete for the position of lead counsel on the basis of price, requesting each camp to submit an anticipated budget for the litigation within ten days.[145] Upon request, the court granted a brief extension, but "[w]hen that deadline rolled around, the [two camps] filed a *joint* proposal to serve as co-lead counsel."[146] According to the court "[t]he prospect of competition, it seems, had whistled an end to the shouting match."[147]

Judge Walker rejected this joint bid and ordered the firms to compete by submitting, in camera, applications to the court for the post of lead counsel, detailing the applicant firm's qualifications for the post and "specifying the percentage of any recovery" the firm would charge "as fees and costs."[148] The lead firm's costs were to include any fees or costs that firm found necessary to pay any firm that it hired to assist in the litigation.[149] Most interesting, the court believed it necessary to order each firm submitting a bid to certify to the court that "its compensation proposal was prepared independently and that no part thereof was revealed to any other bidder prior to filing with the court" and, further, to order the applicants "not to confer in any manner with other firms during the preparation of bids."[150] The judge apparently believed that absent his order the lawyers would continue to engage in conduct that, in any other setting, would be considered a violation of the antitrust laws.

Our point, of course, is not that Judge Walker was wrong to question what more these lawyers might do to forestall competition. The April 12 meeting and the joint bid proposal gave him more than just cause to be concerned. And we applaud the judge's efforts to insist that these lawyers compete,[151] particular

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[144] Id.
[145] Id. at 690.
[146] Id. at 691.
[147] Id.
[148] Id. at 697.
[149] Id.
[150] Id.
[151] Other commentators have endorsed and enlarged upon Judge Walker's approach. See Jonathan R. Macey & Geoffrey P. Miller, A Market Approach to Tort Reform

ly given how few courts have made any similar efforts.[152] Rather, our point is that this judge, who represents the outer limits of concern with competition in the class action setting, was apparently willing to overlook the antitrust problems with the April 12 meeting. He asked the two camps to submit competing bids. It was not until the two remaining competitors decided to forego competition that he expressed concern with the meeting that ensured that only two camps would be competing in the first place.

In fairness to Judge Walker, in his opinion rejecting the joint bid from the two camps, he did remark in a footnote that the April 12 meeting demonstrated "a rather cavalier indifference to at least the spirit of the anti-trust laws" on the part of law-

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Via Rule 23, 80 Cornell L. Rev. 909, 912, 917 (1995) (arguing for "auction" approach to class actions); John C. Coffee, Jr., Regulating Plaintiffs' Attorneys, N.Y. L.J., Sept. 22, 1994, at 5 (assessing problems and possibilities of auctions in regulating plaintiff's attorney conduct). Our point here is not to debate the merits of any particular bidding scheme, but rather to insist (as apparently no one yet has) that the antitrust laws regulate any such scheme.

[152] Judge Walker was apparently the first federal judge to try to institute competitive bidding for class counsel. See In re Amino Acid Lysine Antitrust Litig., 918 F. Supp. 1190, 1192 n.6 (N.D. Ill. 1996); Howard Mintz, Judge Levels Collusion Charge at Class Counsel, The Recorder, Aug. 8, 1995, at 1 *available in* LEXIS, Genfed Library, Pubs File. Since *Oracle*, he has tried the same scheme in two more class actions. See In re Wells Fargo Sec. Litig., 156 F.R.D. 223, 225 (N.D. Cal. 1994); In re California Micro Devices Sec. Litig. No. C-94-2817-VRW, 1996 U.S. Dist. LEXIS 1361, at *1 (N.D. Cal. Feb. 2, 1996).

At least one other judge has attempted to follow Judge Walker's lead. See *In re Amino Acid Lysine Antitrust Litig.*, 918 F. Supp. 1190 (Shadur, J.). In that case, the court conducted an auction and awarded the class counsel position to a firm that offered a fee of 20% of the first $5 million recovered, 15% of the next $10 million, and 10% of the next $10 million, with no additional fee for any recovery over $25 million. Id. at 1198. Thus the bid capped the lawyers' fees at $3.5 million:

.2 * $5M + .15 * $10M + .1 * $10M = $1M + $1.5M + $1M = $3.5M.

The problem with this bid was that by capping the lawyers' fees, it eliminated any incentive for the lawyers to secure a recovery greater than $25 million. Although the court apparently recognized this problem and suggested that it would "give consideration to a motion for the award of some bonus fee" for any recovery in excess of $25 million, id. at 1199, the chosen lawyers settled the case three months later for an amount many have argued is inadequate. See Laurie Cohen, Thomas M. Burton & Scott Kilman, *Bargain at the Bar*: Archer-Daniels Cuts Surprisingly Good Deal in Price-Fixing Suit, Wall St. J., Apr. 12, 1996, at A1, A6. The settlement agreement, filed with the court on April 12, is reprinted in CCH Trade Regulation Reports. Lysine Price Fixing-Class Action Settlement, 416 Trade Reg. Rep. (CCH) ¶ 50,155, at 49,177 (Apr. 17, 1996).

yers, "many of whom claim expertise" in those laws.[153] But even this comment is revealing. Why "spirit?" Put aside, as we asked you to do earlier, the fact that class counsel's selection was ratified ultimately by a court. Is there much doubt that in any other setting the conduct just described would violate more than the spirit of the antitrust laws?[154]

Nor is the conduct engaged in by the plaintiff's firms in *Oracle* rare. To the contrary, it is apparently commonplace, albeit perhaps not always so well documented.[155] Every class action suit displaces competition among lawyers for individual litigants and by consolidating cases creates what might be thought of as a

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[153] *Oracle*, 131 F.R.D. at 690 n.3. Judge Walker also made reference to the antitrust laws in his more recent efforts to maintain competition. When two of the leading class action plaintiff firms that had been acting as "de facto" class counsel offered to submit a joint bid and act as co-counsel, Judge Walker warned that "joint ventures which substantially lessen competition are not tolerated under our competition laws." *Wells Fargo*, 156 F.R.D. at 226 (citing sources). Moreover, Judge Shadur responded to a request by lawyers to submit a joint bid or to discuss the case among themselves in *Amino Acid Lysine* by stating that it is:

> [M]ore than somewhat ironic in this litigation, finding its origin as it does in the antitrust laws, because any such cooperation among counsel that could cut back on the number of prospective bidders or could otherwise inhibit the independent judgment of those who bid would clearly seem to operate in restraint of trade.

918 F. Supp. at 1192 n.7.

[154] Market allocation by competitors is per se illegal under the antitrust laws. See Palmer v. BRG, 498 U.S. 46, 49 (1990) (per curiam). In fact, many view market allocation as more anticompetitive than ordinary price fixing, because it eliminates all competition, not just price competition, among competitors. See, e.g., Stephen F. Ross, Principles of Antitrust Law 148 (1993) ("[M]arket division schemes are more insidious than price-fixing agreements. A firm that enters into a price-fixing agreement can . . . still engage in non-price competition—by offering . . . products of higher quality or better or quicker service. By contrast, a market division scheme eliminates *any* competition among the carteleers.") Moreover, agreements among competitors to rotate bids constitutes "bid rigging," which is punishable criminally under the antitrust laws. See generally United States v. Heffernan, 43 F.3d 1144 (7th Cir. 1994) (Posner, C.J.) (discussing meaning of bid rigging for purposes of sentencing guidelines).

[155] This is certainly Judge Walker's view. See *Oracle*, 136 F.R.D. at 649 (explaining how competitive bidding might break up "the lawyer consortiums" often found in class action cases); *Wells Fargo*, 156 F.R.D. at 226-27 (noting that "the steering committee device . . . puts a real damper on competition" and suggesting that "this is why plaintiff class action lawyers like the device so much"); In re California Micro Devices Sec. Litig., No. C-94-2817-VRW, 1995 U.S. Dist. LEXIS 11587, at *13 (N.D. Cal., Aug. 8, 1995) (suggesting that the fact that Judge Walker received competitive bids from only two out of twelve firms that had originally been involved in the litigation was an "indicia of . . . cooperation" which "raises serious doubts about the conditions of competition in this segment of the legal services industry").

monopoly. But nothing about that fact necessitates the elimination of competition to represent the monopoly. Lawyers apparently feel free to eliminate that competition on their own by entering agreements not to compete.[156]

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[156] We do not mean to suggest that all aggregations of lawyers in litigation raise antitrust concerns. "Litigation groups" evidently developed in mass tort cases where lawyers representing individual clients found it useful to join in a group to share information and conduct joint discovery. See Paul D. Rheingold, The Development of Litigation Groups, 6 Am. J. Trial Advoc. 1 (1982). Such cost-saving activity is akin to "trade association" exchanges of information which receive rule of reason treatment under the antitrust laws. United States v. U.S. Gypsum Co., 438 U.S. 422, 440-41 & 441 n.16 (1978). Agreements among lawyers from different firms to conduct class action litigation jointly, combining their resources and sharing the risks and rewards, would be a joint venture and might also receive more lenient antitrust treatment. Such agreements have occurred in mass tort class actions. See Richard A. Nagareda, Turning from Tort to Administration, 94 Mich. L. Rev. 899, 910 & nn.38, 39 (1996).

But in many class actions (such as those involving securities, antitrust and consumer law), clients are all but an after-thought, necessary to the suit but easy to find when a suit looks promising. Thus, there is no evident need for joint activity, other than for risk-sharing purposes. In these cases, "allowing all the interested plaintiff lawyers to form a steering committee for each class action in which more than one plaintiff firm is interested essentially permits these lawyers to create an ad hoc monopoly in each such case." *Wells Fargo*, 156 F.R.D. at 226. Moreover, as Judge Walker also recognized, "to permit a joint bid by two dominant firms . . . might very well eliminate whatever possibility remains . . . of a meaningful competition to secure class counsel designation." Id. Nor would joint bidding be necessary to achieve cost saving if, as in *Wells Fargo*, the firms seeking to bid jointly were "two of the largest and most amply capitalized plaintiff law firms in the country," which "have demonstrated that they know exactly how to go about achieving leverage and risk spreading in their practices." Id. at 227.

Even if the formation of a litigation group is itself a lawful joint venture under the antitrust laws, that does not mean that all agreements made by that group would be lawful. For example, in Jones Knitting Corp. v. Morgan, 244 F. Supp. 235 (E.D.Pa. 1965), rev'd on other grounds, aff'd in relevant part, 361 F.2d 451 (3d Cir. 1966), a group of manufacturers jointly hired a lawyer to investigate possible challenges to the validity of a patent held by a competitor. The group agreed further that "[n]o member was to approach [the patent holder] individually regarding a license until after completion of the search [by the lawyer], without first consulting with the others," and if approached by the patent holder a "member would do nothing until after he had notified others in the group." 244 F. Supp. at 236. After the lawyer recommended that the group file a declaratory judgment action against the patent holder, the group agreed to fund the action. Furthermore, the "agreement . . . that no member would negotiate with [the patent holder] without notfiying the others was to continue in effect until a judicial decision was obtained." Id. at 237. The court held this agreement to be a group boycott, per se illegal under the antitrust laws. The court found that the "group was formed not only for purposes of bringing suit, but also for purposes of refusing to negotiate with [the patent holder] for licenses," and that the "freedom of each plaintiff to deal freely with [the patent holder] was restrained by the requirement of giving notice." Id. at 239. Cf. Lemelson v. Bendix Corp., 104 F.R.D.

In *Oracle*, the April 12 meeting was well documented. Minutes were kept and participants signed in.[157] We assume in most cases that anti-competitive agreements are more hidden.[158] If

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13, 18 (D. Del. 1984) (rejecting the position that the "exchange of settlement information, in the context of a joint defense with common counsel representing both of the alleged conspirators, constitutes prima facie evidence of an agreement not to settle or take a license except upon terms approved by the group," and thus holding that the plaintiff may not invoke the crime-fraud exception to the attorney-client privilege and work product doctrine); Gould v. Control Laser Corp., 462 F. Supp. 685, 691-92 (M.D. Fla. 1978) (suggesting that agreement by group challenging patent similar to agreement in *Jones Knitting* might not be a per se violation of the antitrust laws but refusing to resolve issue definitively because agreement may violate rule of reason and so defendant's motion to dismiss must be denied). Although it is possible that recent case law might support rule of reason treatment for the agreement in *Jones Knitting*, see Northwest Wholesale Stationers v. Pacific Stationery & Printing Co., 472 U.S. 284 (1985) (holding that expulsion of a member from a purchasing cooperative is not a per se illegal boycott but is subject to the rule of reason), the Supreme Court has continued to apply the per se rule to certain boycotts, see Federal Trade Comm'n v. Superior Ct. Trial Lawyers Ass'n, 493 U.S. 411 (1990) (holding per se illegal boycott in support of higher wages by lawyers representing indigent criminal defendants). We do not attempt to resolve all issues of antitrust liability here, but merely to raise issues that have so far gone largely unexplored.

[157] 131 F.R.D. at 690.

[158] In Judge Walker's most recent class action suit, he suggested that the fact that he received only two competitive bids although more than a dozen firms had been involved earlier in the litigation was evidence of collusion. *California Micro Devices*, No. C-94-2817-VRW, 1995 U.S. Dist. LEXIS 11587 at *12. Of course, the nonbidding firms vehemently denied the accusation and chastised the judge for not holding an evidentiary hearing before leveling his charge of collusion. Howard Mintz, A Class Action in Disarray, The Recorder, Feb. 20, 1996, at 1 *available in* LEXIS Genfed Library, Pubs File. Several firms suggested that the "case was simply not lucrative enough to justify that much work," even though the company had all but admitted fraudulent activity. More interesting, several firms blamed Judge Walker's innovative bidding scheme itself, claiming that it "deterred any desire to take a lead role in his court." Id. One lawyer called Judge Walker a "loose cannon on deck," while another asked, "Why fool around in his laboratory?" Id. Others have argued that "lawyers are hesitant to compete in the judicial forum." Resnik, Curtis & Hensler, supra note 14, at 388. These same commentators suggest that the fact that the defendant's lawyers had already conducted secret settlement negotiations with a leading plaintiffs' firm made other plaintiffs' lawyers "understandably reluctant to compete for appointment as lead counsel," id., even though the judge had rejected conditional approval of this settlement and specifically invited new bidders. *California Micro Devices*, No. C-94-2817-VRW, 1995 U.S. Dist. LEXIS 11587 at *3-*4.

We do not argue that Judge Walker's charge of collusion was necessarily correct; rather, we argue that because it would have been very difficult and costly for him to determine the validity of the claim at the time, the question would best be addressed in a subsequent suit under the antitrust laws. Under the antitrust laws, the question would be whether the reasons given for refusing to allow bids by other firms are really "independent" business reasons that would motivate rationally self-interested firms,

so, should the fact that a court later approves the law firm as class counsel and finds that the firm adequately represented the class immunize the earlier anti-competitive behavior? And even if the court knows about the anti-competitive agreement, and approves class counsel then, should that suffice to immunize the anti-competitive conduct? We will argue that the answer to both questions is no.

Although the agreements we have just discussed interfere with the market to represent the class, the other two practices connected to class action suits that raise serious antitrust questions interfere with a different market: the market for legal services in the private dispute resolution system set up by the class action settlement.[159] It has become common in the settlement of mass tort class actions for the settlement agreement to set up a dispute resolution system administered by private parties for the purpose of processing the individual claims of class members. What is "settled" for individual class members is that their claims will be resolved, not in the court system, but in this private system. Generally, the settlement sets out the structure of the new process: who will serve as decisionmakers, what appeal from decisions, if any, will be allowed, and what conditions, if any, will allow class members to exit the process to seek recovery in a court of law. The settlement generally sets out the criteria for establishing a class member's right to some recovery

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or whether the decisions make sense only if there were an implicit understanding among the plaintiff firms not to bid; that is, whether the decisions were really "interdependent." See Hovenkamp, supra note 136 § 4.5, at 167-69.

[159] Professor Nagareda refers to this market as an "aftermarket." Nagareda, supra note 156, at 936. This use of "aftermarket" is not the same as the use of the term in antitrust law. Antitrust law understands "aftermarkets" to involve purchases by consumers of a "system," composed of components purchased at different points in time, which "lock-in" consumers in the sense that consumers have an interest in sticking with that system to recover their "sunk costs" rather than switching to a new system. See Carl Shapiro, Aftermarkets and Consumer Welfare: Making Sense of *Kodak*, 63 Antitrust L.J. 483, 486 (1995). The Supreme Court affirmed that the antitrust laws can reach anticompetitive conduct in a derivative aftermarket even if the primary market is competitive. Eastman Kodak Co. v. Image Technical Servs. 504 U.S. 451 (1992). To the extent that private administrative compensation systems in class actions are set up for future claimants rather than current clients (ignoring for the moment that future claimants should be viewed as current clients for purposes of class counsel's ethical obligations), then the "market" the future claimants face is not really an aftermarket in the antitrust sense. They are getting a new "system."

under the system and dictates a range of recoveries for class members who can demonstrate specific injuries. In short, these settlements set up a potential new market for legal services: the market for representing individual claimants in the private administrative system set up by the settlement. And like any market it is subject to both collusive and exclusionary behavior.

The potential for collusive behavior stems from the fact that class action settlements that set up private administrative systems may include a ceiling on the fee that a lawyer working within that system may charge. These caps may be written into the settlement agreement by class counsel and the defendants and later approved by the class action court, as opposed to being imposed by the court on its own motion. Class courts have so far been enthralled with these caps, describing them as benefits to class members who might otherwise be gouged by lawyers charging unconscionable contingent fees in a system that eliminates most, if not all, of the contingency that would attend a trial of the same claim.[160] Although in antitrust cases the judiciary is quite skeptical of the proposition that capping prices by self-interested groups benefits consumers,[161] in approving class settlements courts accept this proposition without a moment's

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[160] See, e.g., In re Joint Eastern & Southern Dists. Asbestos Litig. (Johns-Manville), 878 F. Supp. 473, 556-58 (E. & S.D.N.Y. 1995) aff'd in relevant part, vacated and remanded in part, 78 F.3d 764 (2d Cir. 1996) (finding reasonable 25% cap on attorney's fees for representing future claimants in subsequent administrative procedure); id. at 561 ("The fee cap provision strikes an appropriate balance and assures reasonable compensation to future attorney and claimants alike."); *Georgine*, 157 F.R.D. 246, 285 (E.D. Pa. 1994), vacated 83 F.3d 610 (3d Cir. 1996), cert. granted sub. nom. Amchem Prods. v. George Windsor, 1996 WL 480936 (U.S. Nov. 1, 1996) (No. 96-270) (finding 20-25% cap on attorney's fees for representing future claimants in subsequent administrative procedure "reasonable and fair to the class"); Ahearn v. Fibreboard Corp., 162 F.R.D. 505, 530 (E.D.Tex. 1995) (approving of 25% cap as superior to attorney fee provisions in alternative proposed settlement), aff'd, 90 F.3d 963 (5th Cir. 1996).

[161] See Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332 (1982). In that case, the Court held per se illegal a maximum fee schedule agreed upon by doctors for purposes of obtaining reimbursement for health services provided from insurance companies. The main source of the Court's skepticism was the fact that it was not necessary for the doctors to do the price fixing. Id. at 352-54. According to the Court, the same asserted benefits of lower prices and reduced administrative costs could be achieved without the anticompetitive risks if the insurance companies or the government set the schedules. The same argument could be made in the class action context: The court could set, rather than merely approve, the fee schedule in the private administrative system.

hesitation.[162] Most strange, however, courts have so far agreed not just that caps are good, but that the caps they approve are too high.[163]

This apparent paradox can be explained only if courts are not freely choosing the cap to be applied as an exercise of some independent power to regulate the bar, but rather are accepting ceilings on fees that have been agreed to first by some group of lawyers, in most cases those on the plaintiffs' steering committee.[164] Were it not for court approval these caps would seem to

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[162] This is ironic because one of the main criticisms of *Maricopa*—that sophisticated and powerful insurance company buyers of medical services would thwart any attempt by doctors to convert a maximum price into a cartel minimum price, see Hovenkamp, supra note 136, § 5.6, at 236—is not applicable in the class action context. Class member "buyers" have no meaningful control over their lawyers and, as we argue below, neither the defendants (who could be viewed as providing "insurance" to class members, see Nagareda, supra note 156, at 926, 963) nor the judges adequately protect class members against cartel prices.

[163] For example, in In re Joint Eastern & Southern Districts Asbestos Litigation (Johns-Manville Corp.), 878 F. Supp. 473, 557, (E. & S.D.N.Y. 1995), aff'd in relevant part, vacated and remanded in part, 78 F.3d 764 (2d Cir. 1996), Judge Weinstein noted that the court "initially requested that attorney's fees for future representation of Trust claimants be limited to 20% of each claimants recovery. . . . [o]n the persistent insistence of plaintiffs' counsel, the contingency fee percentage was raised to a compromise figure of 25%, which the Courts approved as 'reasonable' . . ." Judge Weinstein went on to add:

> Undoubtedly, there are some instances where the 25% cap will lead to a large windfall for lawyers on an hourly basis. This is highly probable given the large concentration of asbestos cases in the hands of a few attorneys. In other instances, particularly in view of the relatively fixed and small amounts of recovery available under the [settlement] the fee limitation may result in too small a fee to warrant legal representation. Such unfairness is almost impossible to avoid without consideration of individual claims. The transactional costs that would accompany consideration of fees for each claim are too great in view of the small amounts involved. As to the relatively small claims, in almost all instances no attorney will be required under the settlement arrangement. If an attorney is required the claims structure insures that in almost all cases the amount of work will [be] minimal.

Id. at 557-58. Although Judge Weinstein's statement might at first seem to suggest that lawyers in the subsequent administrative system will be overcompensated in some cases and undercompensated in others, in fact what it says is that lawyers will either be overcompensated or not used. So much for a meaningful cap. But see *Georgine*, 157 F.R.D. at 285 (noting that "the availability of counsel to class members, based upon traditional considerations, is improved when counsel are adequately compensated").

[164] If the court imposed the cap unilaterally and the lawyers simply adhered to it there would be no "agreement" for antitrust purposes. See Fisher v. City of Berkeley, 475 U.S. 260, 267 (1986) ("A restraint imposed unilaterally by government does not

violate the antitrust laws. The question is what, if anything, about court approval should change that result.[165]

Class settlements may contain even more troublesome restrictions than caps on lawyer fees. Lawyers may try to include provisions that exclude competitors from the market for representing claimants post-settlement in the private administrative system. The class settlement in *Georgine*, for example, contained provisions designed to ensure that historically strong competitors in the market for asbestos clients in the tort system retained their advantage in the market that was to be created by the settlement.[166] The intention of the class lawyers and their cohorts in drafting this provision (if not in crafting the entire settlement) was to eliminate competition.[167] In the *Georgine*

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become concerted-action within the meaning of [§ 1 of the Sherman Act] simply because it has a coercive effect upon parties who must obey the law."). On the other hand "[w]here private actors are . . . granted 'a degree of private regulatory power,' . . . the regulatory scheme may be attacked under § 1." Id. at 268.

[165] It may be difficult to prove that the steering committee members "agreed" to the cap if they were not class counsel. And co-class counsel might be treated as "a single enterprise" for antitrust purposes. See Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 753 (1984). But express agreement is not necessary under the antitrust laws. See Interstate Circuit v. United States, 306 U.S. 208, 227 (1939) ("Acceptance by competitors, without previous agreement, of an invitation to participate in a plan, the necessary consequence of which, if carried out, is restraint of interstate commerce, is sufficient to establish an unlawful conspiracy under the Sherman Act."). An agreement might be inferred in *Georgine* from the fact that plaintiffs' lawyers settled their "inventory" cases with the defendants on the condition that the settlement be approved. This condition made the acquiescence of the other plaintiff firms a necessary part of the deal. Ironically, Professor Nagareda cites the agreement between the *Georgine* defendants and the non-class counsel lawyers as evidence of the fairness of the deal. Nagareda, supra note 156, at 967. He argues that class counsel's willingness to offer the fee cap was a solution to the "holdout" problem caused by recalcitrant members of the steering committee. Id. Under our scenario, such "holdouts" may have been nothing more than unwilling participants in a cartel. In antitrust law, such holdouts are desirable; some attempts to solve holdout "problems" may do nothing more than facilitate a cartel that might not otherwise succeed.

[166] 157 F.R.D. at 281.

[167] See Koniak, supra note 15, at 110 n.312 and accompanying text (referring to testimony by plaintiff's lawyer at *Georgine* fairness hearing expressing concern that "new lawyers [who] were getting into the asbestos litigation, feeding on the success of the original plaintiffs [sic] bar," which "led plaintiffs' lawyers to begin "consolidating trials" and "fil[ing] class actions" to prevent the new lawyers from "kill[ing] the goose that was laying the golden egg"). Moreover, there was testimony that suggested the provision arose out of an agreement among more plaintiffs' lawyers than just class counsel. See id. (quoting testimony from CEO of defendant organization that

settlement, one of the factors in determining a claimant's recovery under the settlement's dispute resolution system was the identity of the law firm representing the claimant.[168] Claimants who hired law firms with a historically high settlement average against the defendants in *Georgine*—that is, firms that were successful in the pre-settlement market—were to be offered more money than claimants who hired law firms without such a record.[169] We view such exclusionary restraints as more troubling than caps on attorney's fees because there is no plausible cover story that can be told about the restraint that explains how it benefits class members.[170] Yet the district court in *Georgine* approved a settlement that included such a provision. The court seemed unenthusiastic about the provision, but put

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provision was "negotiated [at the request of class counsel] after a report [from] . . . many plaintiffs' counsel").

[168] *Georgine*, 157 F.R.D. at 281.

[169] Id.

[170] One could try to tell the following efficiency story. Lawyers need to recoup their investments in "generic assets" (discovery, expert witness fees, and the like) made in developing their cases in the tort system. See Nagareda, supra note 156, at 909. If provisions allowing such recoupment are prohibited by the antitrust laws, class counsel will either (1) not make these investments (and perhaps not bring meritorious class actions); (2) charge a higher fee for their role as class counsel; (3) refuse to settle; or (4) settle for too little because their fees will be lower. There are various objections that could be made to this story—the main one being that it is far from clear that a restraint that gives certain lawyers a guaranteed market advantage is necessary to prevent such consequences. Courts have long been skeptical of similar justifications for private price-fixing arrangements. See United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 221 (1940):

> Ruinous competition, financial disaster, evils of price cutting and the like appear throughout our history as ostensible justifications for price-fixing. If the so-called competitive abuses were to be appraised here, the reasonableness of prices would necessarily become an issue in every price-fixing case. In that event the Sherman Act would soon be emasculated . . . .

Moreover, there are reasons to think that such arrangements are broader than necessary to protect any legitimate interests plaintiffs' lawyers might have. (It should be noted that Professor Nagareda does not specifically support *Georgine*'s market advantage provision in his article; he does not discuss it at all.) Even without such a provision, claimants would probably continue to make use of these firms anyway and perhaps be willing to pay a premium for their experience in handling such cases if that would mean a faster recovery. See Nagareda, supra note 156, at 935-36 (discussing fact that Dalkon Shield claimants continued to use lawyer services in filing of administrative compensation claims and noting advantage that class counsel would have in attracting clients under administrative system). Moreover, investments are not necessarily specific to one class action. They can be recouped over the course of many lawsuits. See id. at 936-37.

whatever doubts it had about the matter to the side on the ground that settlements should be judged as a whole.[171] Approval, in other words, would not be denied based on one troubling provision. What's a little anti-competitive agreement among friends?

II. THE NEED FOR SUBSEQUENT SUITS

In this Part, we argue that subsequent suits against class counsel are necessary to deter class action misconduct. Other remedies for abuse are inadequate and the incentives of the main participants in class actions will lead these participants to thwart any other solution. Thus, we believe that courts should allow subsequent suits regardless of what current doctrines say. But as we shall see in the next Part, current doctrine does not stand in the way.

A. Abuse by the Truckload

Class members harmed by a trial court's approval of an unfair or collusive settlement have remedies. Objectors, if there are any, may be permitted to appeal the trial court's approval of the settlement and claim that the court's judgment on the fairness of the settlement, the adequacy of representation or the reasonableness of the attorney's fees was an abuse of discretion.[172] Even after an appeal has been denied or the time for appeal has

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[171] *Georgine*, 158 F.R.D. at 281, 322-23.

[172] See, e.g., Plummer v. Chemical Bank, 668 F.2d 654, 655 (2d Cir. 1982) (holding that district court's rejection of settlement proposal due to concerns raised by objectors was not abuse of discretion); City of Detroit v. Grinnell Corp., 495 F.2d 448 (2d Cir. 1974) (rejecting objector's contention that settlement and fairness hearings were inadequate but holding fee award excessive). Some courts have held that absent class members have no absolute right to appeal. See, e.g., Croyden Assocs. v. Alleco, Inc., 969 F.2d 675, 680 (8th Cir. 1992), cert. denied, 507 U.S. 908 (1993); Gottlieb v. Q.T. Wiles, 11 F.3d 1004, 1013 (10th Cir. 1993); Walker v. City of Mesquite, 858 F.2d 1071, 1074 (5th Cir. 1988); Guthrie v. Evan, 815 F.2d 626, 628 (11th Cir. 1987). See generally 2 Newberg on Class Actions § 11.60, (Alba Conte ed., 3d ed. 1992) (discussing appeal of judgment after settlement approval under an abuse of discretion standard); Christopher R. Thyer, Note, Un-Appealing Class Action Settlements: Why No One Has Standing to Challenge Settlements after *Haberman v. Lisle*, 49 Ark. L. Rev. 375 (1996) (discussing Arkansas Supreme Court decision dismissing on lack of standing grounds a class member's appeal of the portion of a class settlement pertaining to attorney's fees); Timothy A. Duffy, Note, The Appealability of Class Action Settlements by Unnamed Parties, 60 U. Chi. L. Rev. 933 (1993).

lapsed, absent class members may challenge the binding effect of the settlement by bringing another action against the settling defendant for the same wrong. If they can show that they were not adequately represented in the first action, the class settlement will not preclude their maintenance of this second suit.[173] Finally, members of the class may seek to escape the effects of a class settlement by invoking procedural rules that provide for reopening or vacating final judgments.[174]

Why aren't those remedies, offered in addition to the trial court's obligation to conduct a fairness hearing to determine that the settlement is fair, the representation adequate and that there has been no collusion, enough? The simplest answer is that none of those remedies provides adequate incentives for lawyers and defendants to desist from illegal conduct in negotiating a class action settlement. All of those remedies share this in common: If a court finds misconduct, it simply denies wrongdoers the benefit of their misdeeds. That penalty, given the small risk of its being inflicted and the substantial sums to be made through misconduct, is inadequate to deter lawyers from abusing the class action settlement process.[175]

The incentive structure created by the current system of class action settlements suggests that abuse is rampant. All lawyer-client relationships create agency problems because the interests of lawyers and clients are not perfectly aligned. Lawyers are interested primarily in the size of their fees. Clients are interested primarily in the size of their recovery. Lawyers may engage in conduct that increases their fees even if this comes at

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[173] In Hansberry v. Lee, 311 U.S. 32, 45 (1940) the Supreme Court allowed plaintiffs to bring a suit that was already ostensibly resolved in a prior class action on the grounds that an absent class member not adequately represented in the class action was not bound by the first judgment. See also Richards v. Jefferson County, 116 S.Ct. 1761, 1769 (1996) ("Because petitioners received neither notice of, nor sufficient representation in, [prior] litigation, that adjudication, as a matter of federal due process, may not bind them and thus cannot bar them from challenging an allegedly unconstitutional deprivation of their property."). See generally 2 Newberg on Class Actions, supra note 172, § 11.64 (alternative to Rule 60(b) relief is collateral suit challenging judgement in original suit).

[174] See Fed. R. Civ. P. 60(b); 2 Newberg on Class Actions, supra note 172, § 11.63 (discussing vacating settlement judgments).

[175] This, of course, is one of the traditional justifications for punitive damages that many class lawyers rely on in their class action suits. See Keeton et. al., supra note 74, § 2, at 9-10.

the expense of the client's recovery. Class actions exacerbate this problem.

In ordinary lawyer-client relationships, clients can mitigate the agency problem in two ways: ex ante contracting and ex post monitoring. These solutions are unavailable or particularly ineffective in the class action setting. The reason is that absent class members, by definition the majority of the class, neither contract with the lawyer, nor are present to monitor the lawyers' actions.[176] Although client monitoring of lawyer performance is, at best, an imperfect check on lawyer self-dealing in ordinary cases, it is effectively unavailable in almost all class actions. That is, of course, the reason Rule 23(e) requires court monitoring of class action settlements, but that check too is ineffective.

We believe that court monitoring is ineffective as a check on abuse, for two reasons: The fairness hearings that courts typically hold are, by and large, non-adversarial proceedings, making it relatively easy for lawyers to hide abuse from the court;[177]

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[176] Class representatives are present, but in general courts have not insisted that class counsel consult with these representatives about the progress of the suit. Lewis v. Curtis, 671 F.2d 779, 789 (3d Cir.), cert. denied, 459 U.S. 880 (1982) (representation is found to be adequate despite the fact that class representative "displayed a complete ignorance of facts concerning the transaction that he was challenging"); J/H Real Estate v. Abramson, No. 95-4176, 1996 U.S. Dist. LEXIS 1546, at *8 n.3 (E.D. Pa., Feb. 9, 1996) ("class counsel, not the class representative, guides and orchestrates the litigation") (citing the United States Court of Appeals for the Third Circuit as authority).

Indeed, class settlements are regularly approved even though the class representative has only the vaguest idea of what the settlement provides. As the United States Court of Appeals for the Seventh Circuit stated in 1981:

> [T]he class representative's role is limited. It was found not to be enough to defeat a class certification in *Surowitz v. Hilton Hotels Corp.*, 383 U.S. 363, 366, 86 S.Ct. 845, 847, 15 L.Ed.2d 807 (1966), that the named plaintiff did not understand her complaint at all, could not explain the statements in it, had little knowledge of what the lawsuit was about, did not know the defendants by name, nor even the nature of the misconduct of the defendants.

Eggleston v. Chicago Journeymen Plumbers' Local Union No. 130, 657 F.2d 890, 896 (7th Cir. 1981), cert. denied, 455 U.S. 1017 (1982). See also Heastie v. Community Bank of Greater Peoria, 125 F.R.D. 669, 676-77 (N.D. Ill. 1989) (quoting *Eggleston* and accepting as adequate a named plaintiff who was unfamiliar with the details of the claim).

[177] The proposed amendment to Rule 23(e) would simply require all courts to do what almost all courts now do anyway—hold a fairness hearing before accepting the dismissal or settlement of a class action. The drafters of the accompanying Advisory Committee Note apparently believe that codifying the prevailing practice will somehow solve the problems associated with class action settlements:

and, judges are biased in favor of settlements, particularly in class suits, and are thus ineffective monitors of abuse. We put aside the question of judicial self-interest for the moment because we recognize that many judges and even some legal academics take umbrage at the suggestion that judges allow their own interests to interfere with their duty to protect absent class members.[178] To these defenders of judicial integrity, judicial self-interest is all but an oxymoron, which, if it exists in some obscure corner of reality, plays no role in class action litigation. Because we believe, to the contrary, that judicial self-interest is an important part of the class action abuse story and that denial of this fact leads to misguided efforts to increase the already considerable discretion of judges to accept settlements and approve them on appeal, we will later discuss in some detail these judicial incentives (with apologies in advance to all those who see this point as somewhat obvious).[179] The case that judges are ineffective monitors of class settlements is fairly strong, however, judicial self-interest aside.

Fairness hearings are more akin to ex parte proceedings than adversarial ones. A recent empirical study by the Federal Judicial Center of class actions in four federal district courts found that 42% to 64% of the fairness hearings were concluded without any presentation of objections to the proposed settlement by "class members and other objectors."[180] In many of the cases

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> The parties to the settlement cease to be adversaries in presenting the settlement for approval, and objectors may find it difficult to command the information or resources necessary for effective opposition. These problems may be exacerbated when a proposed settlement is presented at, or close to the beginning, of the action. A hearing should be held to explore a proposed settlement even if the proponents seek to waive the hearing and no objectors have appeared.

Preliminary Draft, supra note 11, at 54. Unfortunately, as we argue, the "cure" the drafters propose for the problems they recognize—a nonadversarial fairness hearing—is no cure at all.

[178] One academic colleague, who has read a draft of this Article, stated that he considered the "accusation" that judges approve class settlements that are collusive because they are blinded by self-interest, defamatory. When asked why he did not think discussing lawyer self-interest in selling out their clients was similarly defamatory, he replied: "Because the judge self-interest story isn't true." When pressed for the basis for his conviction, this colleague simply repeated that he knew judges were not self-interested in accepting class settlements and that was that.

[179] See discussion infra Section II.C.

[180] Willging, Hooper & Niemic, supra note 109, at 140. See also Thomas E. Willging,

with objectors, the objections were made, not in person, but in writing before the hearing. According to court files, class members, other than the named plaintiffs, or objectors actually attended only 7% to 14% of the settlement hearings.[181] In the absence of anyone to present the problems with a proposed settlement, the likelihood that a judge could ferret out corruption or illegality leading to or embedded in a proposal presented jointly by class and defense counsel, who come well prepared to portray the deal as fair, legal and just, is quite small.[182]

Moreover, pro se objectors will generally be no match for the lawyers presenting the settlement as fair. The Federal Judicial Center study does not say how many of the small number of objectors who appeared at fairness hearings had counsel, but it is probably safe to assume that many objections to class action settlements are raised pro se.[183] The current system provides little incentive for lawyers to seek out corruption or illegality in proposed settlements. Objecting lawyers stand little chance of

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Laural L. Hooper & Robert J. Niemic, Federal Judicial Center, Empirical Study of Class Actions in Four Federal District Courts: Final Report to the Advisory Committee on Civil Rules 57, 178 (Tbl. 38) (1996) (on file with author) [hereinafter FJC Study]. For some anecdotal evidence, see *California Micro Devices*, 1996 U.S. Dist. LEXIS 1361 at *28 (citing letter written on behalf of objectors claiming that "'once plaintiff and defense counsel agree to settle a securities class action, there is typically no one before the court with an incentive to challenge the merits of the settlement'"); see also Woodward v. Nor-Am Chem. Co., No. 94-0780-CB-C, 1996 U.S. Dist. LEXIS 7372, at *27 (S.D. Ala. May 23, 1996) (noting that at the fairness hearing on the proposed class action settlement the "Court heard arguments presented by Class Counsel and counsel for the defendant. At the hearing the Court specifically asked whether anyone in attendance wished to object to the fairness of the Settlement; no one objected.").

[181] FJC Study, supra note 180, at 57, 139 (Fig. 53).

[182] For example, in the recent *California Micro Devices* class action, a big issue in evaluating the fairness of the settlement was whether or not the defendant was on the verge of bankruptcy. The lawyers proposing the settlement claimed to have "confirmatory evidence" of this fact, but declined to share this evidence with either the court or other class members. 1996 U.S. Dist. LEXIS 1361 at *30. Judge Walker struck down the settlement without knowing the validity of the bankruptcy claim. Although he may have been correct in doing so, the downside risk was large. This may explain why according to one plaintiff's lawyer involved in the case, "'If it was before any other judge . . . it would have been a done deal.'" Howard Mintz, A Class Action in Disarray, The Recorder, Feb. 20, 1996, at 1, *available in* LEXIS, Genfed Library, Pubs File.

[183] See, e.g., *California Micro Devices*, 1996 U.S. Dist. LEXIS 1361 at *31 (noting that "input from actual class members and indirectly affected parties who have hired independent counsel . . . is very unusual in securities class actions.").

receiving fees or even the reimbursement of expenses incurred in mounting a challenge.[184] Lawyers are sometimes motivated to challenge proposed settlements in the hope of reaping some later economic benefit, such as success in one's own bid to be class counsel in a later suit or continued income from individual suits, which would be more lucrative than processing people through a claims procedure set up for class members under a proposed settlement. However, because the chances of convincing a trial judge to reject a settlement are extremely slim,[185] and

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[184] In the Federal Judicial Center study, the researchers found "no fee awards to, and few fee requests by counsel other than plaintiffs' counsel." Willging, Hooper & Niemic, supra note 109, at 155. We have found no case in which a court has awarded attorney's fees to objecting counsel for raising arguments that caused the court to disapprove a class action settlement. In *approving* a settlement, courts sometimes award fees to objectors upon a finding that the objectors conferred a monetary benefit upon the class by raising objections that resulted in the court modifying some part of the settlement (usually class counsel's request for attorney's fees). See Uselton v. Commercial Lovelace Motor Freight, 9 F.3d 849, 855 (10th Cir. 1993) (fee awarded to objecting counsel, citing Herbert Newberg, Attorney Fee Awards § 2.24, at 84 (1986)); Ace Heating & Plumbing Co. v. Crane Co., 453 F.2d 30 (3d Cir. 1971) (an objecting attorney should not be denied reasonable compensation for a benefit conferred on the class); Bowling v. Pfizer, Inc., 922 F. Supp. 1261, 1285 (S.D. Ohio 1996) (awarding attorney's fees to objectors for their role in improving the settlement for the class); 1 Alba Conte & Herbert Newberg, Attorney Fee Awards § 2.25, at 91-92 (2d ed. 1993). But see Grunin v. International House of Pancakes, 513 F.2d 114, 126-27 (8th Cir.), cert. denied, 423 U.S. 864 (1975) (objector denied fees). See also Alpine Pharmacy v. Chas. Pfizer & Co., 481 F.2d 1045, 1053-54 (2d Cir.), cert. denied, 414 U.S. 1092 (1973); Milstein v. Werner, 58 F.R.D. 544, 552 (S.D.N.Y. 1973); Newman v. Stein, 58 F.R.D. 540, 543-44 (S.D.N.Y. 1973) (securities cases denying fees to settlement objectors who conferred no class benefit).

When a court *rejects* a settlement, there is by definition no common fund from which to award attorney's fees to objecting counsel. To award counsel fees to objecting counsel who exposed a settlement as the product of collusion and thus unworthy of approval, would require the courts to find some other source of funds from which to pay those fees. Thus far, no court has taken that step, and there are no pending changes to Rule 23 that would authorize courts to pay objecting counsel when rejecting a settlement. Most troubling, the surest way for objecting counsel to receive fees is to drop their objections in exchange for a piece of the fees to be awarded to class counsel. For examples of cases in which objecting counsel switched sides to become cooperating class counsel or mysteriously disappeared, see *Bowling*, 922 F. Supp. at 1265, 1271-73; (most of the objecting lawyers became co-counsel for class and requested attorney's fees); Price v. Ciba-Geigy Corp., No. 94-0647-B-S, (S.D. Ala. 1995) (all objecting counsel dropped their objections, although changes to settlement were minor).

[185] FJC Study, supra note 180, at 58. "Approximately 90% or more of the proposed settlements were approved without changes in each of the four districts." Id. Courts made changes to 9 out of 117 settlements, id. at 178 (Tbl. 38), or 8%. With respect

the chances on appeal may not be high enough to justify the added expenses,[186] the expected benefit from derailing the settlement would have to be enormous to make it rational to launch a serious challenge.[187]

We support proposals that would encourage objectors to mount challenges to collusive settlements, such as Senator Cohen's bill that would provide state attorneys general with notice of class suits in which citizens of their respective states were absent class members.[188] We also encourage courts and rulemakers to devise methods to pay objectors who are successful in scuttling a class action settlement. But we recognize the problems with such proposals. State attorneys general have already expressed doubts about Senator Cohen's bill, which they are afraid will raise expectations that they will intervene to stop abusive settlements when they lack the resources to meet those expectations.[189] As for paying attorney's fees and costs to lawyers who persuade a judge to reject a proposed settlement, where would the money come from? If the parties were required to post a bond to settle, would that not encourage frivo-

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to attorney's fees, objections were made in 21 cases (18%), but in 19 of those cases the court awarded the full fee requested. Id. Thus, the likelihood that proposed attorney's fees would be reduced was only 2% of all settlements and 10% of all settlements in which objections were raised.

[186] In the Federal Judicial Center study, only three approved settlements were appealed, and one of those three, the only appeal filed by objectors, was reversed. In re General Motors Pick-Up Truck Litig., 55 F.3d 768 (3d Cir.), cert. denied, 116 S. Ct. 88 (1995); FJC Study, supra note 180, at 191 (Thl. 51), 193 (Tbl. 53). Ten appeals, including *GM Truck*, were filed concerning attorney's fee issues. Of the remaining appeals, two courts affirmed the fee award, two courts dismissed the appeal, one court reversed a denial of fees, one court reversed a trial court's reduction of fees, one court remanded for reconsideration and two other appeals were pending. Id. at 77, 191-94 (Thls. 51-54). The data, though sketchy, suggest that the chances of overturning a trial court's approval of a fee award or making a trial court's reduction of fees stick is no more than 40%, and probably significantly less.

[187] It happens. *Georgine*, 157 F.R.D. at 246. See also *California Micro Devices*, 1996 U.S. Dist. LEXIS 1361 at *1 (rejecting proposed securities class action settlement in light of objections by various institutional investors); Henry J. Reske, Two Wins for Class Action Objectors, 82 A.B.A. J., June 1996, at 36 (discussing successful objections to class settlements in recent antitrust and heart-valve mass tort cases). However, the economics suggest that it will happen rarely.

[188] S.1501, 104th Cong., 1st Sess. § 2 (1995). See supra notes 106-109 and accompanying text.

[189] Conversation with staff members from Senator Cohen's and Senator Kohl's offices, August 1996 (reporting on comments from state attorneys general).

lous objections? Would not the settling parties simply pay off potential objectors, keep most of the benefits of the collusive deal and save everyone a lot of work? How would such pay-offs be detected?[190]

Even if these problems could be overcome, another obstacle remains: The discovery accorded objectors in the settlement process is limited. In the small number of class actions in which objectors appear, discovery is not currently a right but a privilege.[191] When courts allow discovery, they severely limit its scope. It is not uncommon for a court to allow the objector to take the deposition of the named plaintiffs to ascertain their adequacy.[192] It is, however, all but unheard of to grant objectors the right to depose class counsel or the defense lawyers on the course of the negotiations—the type of deposition that would be most useful for uncovering the type of wrongdoing with which we are concerned.[193] Although we agree with those courts that

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[190] See supra note 184. One solution to this problem, which we support, has been suggested to us by John Leubsdorf: requiring courts to appoint advocates for the class whose job would be to raise any non-frivolous objections to the settlement. Unfortunately, this idea received a chilly reception from judges and lawyers alike at a November 22, 1996 hearing of the Advisory Committee on the Federal Rules of Civil Procedure, and we do not foresee its implementation in the near future.

[191] "While an objectant must be given leave to be heard, to examine witnesses and to submit evidence, it is within the Court's discretion to limit the proceedings to whatever is necessary to aid it in reaching an informed, just and reasoned decision." Glicken v. Bradford, 35 F.R.D. 144, 148 (S.D.N.Y. 1964) (citing Cohen v. Young, 127 F.2d 721 (6th Cir. 1942)). Cf. In re General Motors Corp. Engine Interchange Litig., 594 F.2d 1106, 1124 (7th Cir.), cert. denied, 444 U.S. 870 (1979) (court abused discretion by not allowing objectors discovery or examination of settlement negotiations). See generally 2 Newberg, supra note 172, §§ 11.45, 11.57 (noting that if negotiations violated the pretrial order, plaintiff objectors would be entitled to discovery and outlining the factors relevant to the court's decision to permit discovery).

[192] See In re NASDAQ Market-Makers Antitrust Litig., 94 Civ. 3996, 1996 U.S. Dist. LEXIS 4969, at *7 (S.D.N.Y. Apr. 18, 1996) (depositions of class representatives are allowed when the nature of the deposition bears on adequacy of representation); Beck v. Status Game Corp., 89 Civ. 2923, 1995 U.S. Dist. LEXIS 9978 (S.D.N.Y. July 14, 1995) (class representatives had been deposed in order to ascertain adequacy); Robertson v. Seidman & Seidman, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶97,524 (S.D.N.Y. May 23, 1980) (same).

[193] See *Georgine*, 157 F.R.D. at 260 n.9 (court maintains that it gave the objectors the "opportunity to probe into facts surrounding that proposed settlement through depositions of relevant persons."). The *Georgine* court did not mention that it refused to order the depositions of the two most relevant individuals, class counsel and the lawyers for the defendant, Center for Claims Resolution (CCR). This left the

have held that discovery, including depositions of class and defense counsel, should be granted in those cases in which the objectors can make out a plausible case that collusion or other wrongdoing has occurred in the course of the negotiation,[194] we also understand that there are reasons for a rule that generally disfavors the taking of such depositions. Those reasons include "the sensitive nature of the material exchanged in the settlement negotiations, the undue delay and expense of deposing the negotiating lawyers, and the potential that routine discovery into settlement negotiations may deter settlements, unduly protract negotiations, or chill candid conversation."[195]

Finally, special masters appointed by the court to review class settlements, or guardians appointed by the court to protect absent class members' interests, suffer from many of the obstacles that now face objecting counsel: insufficient funds to do a thorough job, necessary reliance on the settling parties' unsworn characterization of their association and the benefits of the deal to the class and, unfortunately, their own self-interest in cultivating a reputation for not scuttling deals. Anyone who gained that reputation might never work as a class guardian again. The next pair of settling parties would vigorously protest the ap-

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objectors the ability to question only witnesses whose knowledge of the negotiations was largely secondhand.

[194] See, e.g., Mars Steel Corp. v. Continental Ill. Nat'l Bank & Trust, 834 F.2d 677, 684 (7th Cir. 1987) (objectors may discover the details of a class counsel's negotiations with the defendants only when the objectors lay a foundation by adducing from independent sources evidence that the settlement may be collusive); Bowling v. Pfizer 143 F.R.D. 141, 146 (S.D. Ohio 1992) (same). Compare Koniak, supra note 15, at 1097-98 (suggesting that such requests should be granted when it is necessary to provide additional protections of the due process rights of the class, that is, when adequacy of counsel is put into question by the settling parties' simultaneous settlements of extraneous matters). See generally Note, The Attorney-Client Privilege in Class Actions: Fashioning an Exception to Promote Adequacy of Representation, 97 Harv.L. Rev. 947 (1984) (advocating narrowly-drawn exception to attorney-client privilege when class member seeks discovery in a challenge to adequcy of class counsel's representation).

[195] Koniak, supra note 15, at 1127 n.376. Although we recognize that the discovery available in the post-settlement suits that we propose might create some similar problems, we believe discovery that takes place after a settlement has been approved by a court (and only when a lawyer believes there is a good enough chance of demonstrating wrongdoing to bring the later case) would be less disruptive of candid conversation than extensive discovery granted as a matter of right in connection with every class and derivative suit settlement proffered to a court.

pointment of such a person and a court would be unlikely to insist in the face of that protest.[196] Moreover, we can report without attribution, for whatever it may be worth, that the guardians we have talked to understand their job is to approve the deal that the settling parties have constructed, after suggesting a few minor changes, not to recommend that the settlement be chucked. For all the above reasons, even if judges were thoroughly motivated to weed out collusive settlements (something we do not believe), they would be hard-pressed to find facts that would betray abuse in the class settlement system. This problem would not be so troubling if there were reasons to think that abuse is rare. But unfortunately, there are good reasons to think that serious abuse is rampant.

Defendants and their lawyers understand the powerful agency problem in class suits created by the inability of class members to monitor their lawyers. They understand that judges are well motivated to accept settlements, and how difficult it would be for courts, even if they were not predisposed toward settlement, to ferret out abuse in fairness hearings. Defendants understand how valuable class settlement can be: liability and transaction costs can be minimized and finality achieved.[197] Moreover, defendants care only about the total amount they must pay out in settlement, not how the payoff is distributed between class members and the class lawyer. Thus, they are well-positioned

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[196] We note that the Civil Rules Advisory Committee rejected the suggestion that Rule 23(e) be amended to require or encourage the use of special masters to ensure some form of independent review, particularly when no objectors appear. We think it likely that the Committee did this not because of the problems we identify, but simply because of the fear that the special masters would make class action settlements more costly. See Draft Minutes *in* Preliminary Draft, supra note 11, at 38 (rejecting suggestion that Rule 23(e) be amended to require or encourage the use of special masters to ensure some form of independent review, particularly when no objectors appear).

[197] Defense attorneys helped develop the notion of "settlement class actions," class actions in which the suit and settlement agreement are filed simultaneously, for just such purposes. See Note, Back to the Drawing Board: The Settlement Class Action and the Limits of Rule 23 109 Harv. L. Rev. 828, 843 (1996) ("When defense attorneys first started to experiment with the settlement class action model, they did so with one clear goal in mind: to achieve a global settlement with res judicata effect on as many present and future claimants as possible."); Roger C. Cramton, Individualized Justice, Mass Torts, and "Settlement Class Actions": An Introduction, 80 Cornell L. Rev. 811 (1995); James A. Henderson, Jr., Comment, Settlement Class Actions and the Limits of Adjudication, 80 Cornell L. Rev. 1014 (1995).

and well-motivated to propose a deal that gives class counsel a huge slice (high attorney's fees) of a small pie (a low overall settlement for the class) and pretty well-assured that class counsel will accept it, given how expensive and risky it can be to get a class action certified and ready for trial.[198]

Collusion between class counsel and defendants and their lawyers to sell out the class is facilitated by the fact that class counsel typically does not bargain in advance of the settlement with the class representative or the court over the fee arrangements. Indeed, in contrast to ordinary clients, class members do not even *know* at the start of the litigation, all questions of bargaining aside, what the lawyer will later claim that fee to be. This is another example of the consequences of inadequate monitoring by the class of class counsel, and another reason the agency problem discussed earlier is exacerbated in the class action context. Because class counsel's fee is not set in advance, collusion can occur no matter how this fee is structured. If the court uses the "lodestar" method, which involves multiplying the number of hours worked by some hourly rate and then adjusting further based on a risk factor, then class counsel can collude with defendants and their lawyers by exaggerating or unnecessarily ruuning up the class lawyer's hours.[199] When class counsel's fee is based on a percentage of the recovery, class counsel can collude with defendants and their lawyers by agreeing to support a higher contingency rate in return for a lower settlement.[200] Even if the

[198] 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 (1991). See also Roberta Romano, The Shareholder Suit: Litigation without Foundation?, 7 J.L., Econ. & Org. 55, 84 (1991) ("The principal beneficiaries of [derivative] litigation therefore appear to be attorneys, who win fee awards in 90 percent of settled suits."); Andrew Rosenfield, An Empirical Test of Class-Action Settlement, 5 J. Legal Stud. 113, 119-20 (1976) (settlements of class action suits tend to result in monetary bonuses to attorneys at the expense of class' interests).

[199] See Coffee, supra note 7, at 717-18; Macey & Miller, supra note 198, at 22-26.

[200] See John C. Coffee, Jr., Class Wars: The Dilemma of the Mass Tort Class Action, 95 Colum. L. Rev. 1343, 1349 (1995) [hereinafter Coffee, Class Wars]. Other analyses have tended to focus on the fact that fees based on a percentage of the recovery give lawyers an incentive to settle early for an amount lower than the client would want. The reason is that a self-interested lawyer would spend an extra dollar to continue the litigation only if it was less than the additional expected benefit to him from his share of the additional recovery. The client, on the other hand, wants the lawyer to

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lawyers cannot manipulate the contingency rate, they may be able to control other variables and so achieve a collusive result. In *Georgine*, the lawyers manipulated the definition of the class.[201] In *Hoffman*, they manipulated the definition of "economic benefit."[202] When monitoring is absent, fraud flourishes.

Of course, honorable plaintiffs' lawyers could try to resist offering or accepting collusive settlement with defendants. But if plaintiffs' lawyers balk at the prospect of selling out their clients, the defendant can engage in what Professor Coffee has dubbed a "reverse auction"[203] by offering the right to bargain on behalf of the class to lawyers willing to accept the lowest payment for class members. The fact that defendants often have effective control over who represents the class may seem surprising. They get that control as a result of several features of class action law. First, the defendant can credibly threaten to resist class certification. Winning certification for a class action when the defendant is committed to resisting certification is likely to be a difficult, expensive and, in many large mass tort cases, an all but impossible feat.[204] Second, if courts allow "settlement

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continue the litigation as long as his share of the expected additional recovery is positive, without regard to the lawyer's costs. Thus, the self-interested lawyer would want to settle in some cases in which the client would want to press on. An attorney might be inclined to settle a class action or derivative case early for a lower sum than he could obtain by prosecuting the case further because the attorney may conclude that his economic return from additional effort in the case would not be worth the time involved. Jonathan R. Macey & Geoffrey P. Miller, Auctioning Class Action and Derivative Suits: A Rejoinder, 87 Nw. U. L. Rev. 458, 459 (1993) (footnote omitted). Class actions exacerbate this problem because of the inadequacy of client and court monitoring of the settlement. See John C. Coffee, Jr., The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action, 54 U. Chi. L. Rev. 877, 887-94 (1987) [hereinafter Coffee, Regulation]; John C. Coffee, Jr., The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation, 48 L. & Contemp. Problems 5, 17-33 (1985) [hereinafter Coffee, Unfaithful Champion].

[201] See supra text accompanying notes 111-117.

[202] See supra text accompanying notes 35-46.

[203] Coffee, Class Wars, supra note 200, at 1354.

[204] See generally, Coffee, Class Wars, supra note 200, at 1384. In large mass tort cases, courts are quick to point to the heterogeneity of the plaintiffs' claims as a bar to class certification. See, e.g., Castano v. American Tobacco Co., 84 F.3d 734 (5th Cir. 1996) (rejecting class certification for proposed class of all nicotine-dependent persons, their estates, families, and heirs, in tort action against tobacco companies alleging injury from nicotine addiction on the grounds, inter alia, that such a diverse class fails predominance and superiority requirements of Rule 23(b)(3)); In re Rhone-Poulenc Rorer, 51 F.3d 1293 (7th Cir.) (Posner, C.J.), cert. denied, 116 S.Ct. 184

class actions," that is, class actions that are filed and settled simultaneously, then the defendant can easily shop around for the most desirable plaintiffs' lawyers.[205] Finally, if defendants do not like the proceedings in one forum, they can have (or threaten to have) a second class action suit instituted against them in a different forum. They can then stall the first suit and settle the second suit, leaving the class lawyers in the first suit unpaid.[206]

Thus, even without considering judicial self-interest, we have a situation in which agency problems make the potential for abuse enormous and in which the mechanism for checking that

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(1995) (granting defendants' mandamus petition to deny class certification in mass tort class action by hemophiliacs alleging they became contaminated with HIV after blood transfusions involving blood processed by defendants, in part because a federal sitting in diversity cannot apply a single federal legal standard under *Erie*, but must apply the law of the relevant state). Cf. Valentino v. Carter-Wallace, Inc., 97 F.3d 1227 (9th Cir. 1996) (holding that there is no absolute bar to the certification of multi-state product liability class action, but finding that the district court abused its discretion in certifying the class because there was no showing that common issues predominated over individual ones). Note that the same circuit that refused to certify the class in *Castano* on the grounds that it was too large and heterogeneous some months later certified a class "for purposes of settlement," which was as heterogeneous on the ground that heterogeneity was no bar to settlement, just to trial. Ahearn v. Fibreboard, 162 F.R.D. 505, (E.D. Tex. 1995), aff'd on appeal, In re Asbestos Litig., 90 F.3d 963 (5th Cir. 1996). We return to the problems with this approach later. See infra Section II.E.

[205] These two problems are likely to get worse, not better, because recent proposals for "reform" promise simultaneously to make it more difficult to secure class certification when the defendant is opposed and easier when it is in the interest of the defendant to dispose of all its liability in one fell swoop, in a so-called global settlement. We have in mind the recently proposed revisions to Rule 23, which make it more difficult to secure certification in a class action for money damages, but allow courts to certify such class actions for settlement purposes, despite the fact that they could not be certified for trial. We come back to this proposal later. See infra Section II.E.

[206] This is no mere theoretical problem: the GM Truck settlement was refiled in Texas state court complete with the coupon relief already rejected by the Third Circuit. See Joe Darby, Suit May Spell Cash for Parish, The Times Picayune, July 10, 1996, at B4 *available in* LEXIS, News Library, Curnws File. And the PB pipe national class action failed first in Texas, was refiled with some changes in Alabama and Tennessee, and ultimately approved by the Tennessee court. See supra note 119. Note that even if one court rejects class certification, there is generally no collateral estoppel effect on the ability of a second court in a different jurisdiction to consider certifying the class. See, e.g., J.R. Clearwater, Inc. v. Ashland Chem. Co., 93 F.3d 176 (5th Cir. 1996) (federal district court's denial of class certification does not permit federal court to enjoin state court from certifying similar class action in state court).

potential, judicial review and approval of the settlement, is poorly constructed, and to a large extent inherently ill-suited, for its assigned task. For these reasons, we maintain that class action abuse in which the class is sold out to benefit others must be quite common, not rare, and that new approaches to this problem are necessary.[207]

B. He Who Lives by the Sword

To see the inadequacy of disgorgement and the advantage of the availability of subsequent legal action against class lawyers with the possibility of punitive damages, we will consider a simple numerical example based on *Hoffman.* Had the class lawyers in a case like *Hoffman* asked for what we contend would be the upper limits of a reasonable fee—one-third of the *actual* economic benefit conferred on the class—they would have realized no more than $5 million.[208] On the other hand, by agreeing

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[207] Further evidence can be found in Professor Romano's study of all shareholder suits brought from the late 1960s through 1987, which found that the court-approved settlements in these cases exhibited "two striking features." Romano, supra note 198, at 61. "First, only half of all settlements have a monetary recovery (46 of 83). Second, awards are paid to attorneys far more frequently than to shareholders (75 of 83). In seven cases (8 percent) the *only* relief was attorney's fees." Id. (footnote omitted). After examining both the monetary recoveries and structural changes provided by these settlements, Professor Romano concluded that monetary recovery to the class was infrequent; when such recovery was provided, per share recovery was small; and structural relief was generally cosmetic. Id. at 84. In short, defendants' lawyers and plaintiffs' lawyers benefited from these suits, but neither the corporation nor the shareholders that constitute it did. Of course, one interpretation of this data is that shareholders and corporations are never ripped off for substantial sums by incompetent, disloyal or otherwise dishonest officers and directors and that the securities laws are overwritten, if not totally unnecessary. But an equally plausible, indeed we believe more plausible, explanation is that the corporation and shareholders are often abused twice: first by their officers and next by the lawyers who represent them in these shareholder suits.

[208] Although we do not know how much BancBoston finally calculated to be the total amount of escrow surplus, according to the Florida Attorney General's brief objecting to the settlement, the available evidence at the time of the fairness hearing showed that the total escrow surplus was about $42 million. Florida Attorney General's Brief, supra note 38, at 4; see also supra note 40 (noting the fact that the surplus figure used at the hearing was an approximation that was to be, and was, adjusted later). The maximum possible benefit would accrue to people in states where banks are not required to pay any interest on mortgage escrow accounts. Those homeowners could have earned on average 32% more on their money had they been able to have it today to invest. See supra note 38. Thus, the maximum possible benefit to the class

with the bank that the class would pay the attorney's fees, the lawyers arguably stood to gain as much as $14 million on the same investment.[209] The risk of ending up with no money due to the disgorgement remedies discussed above[210] would have to exceed 64% for a risk-neutral actor to refrain from the conduct alleged in *Hoffman*.[211]

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from returning the surplus money would be ($42 million surplus * .32) = $13.44 million. To this must be added the back interest benefit. In a zero interest state, back interest would be $8.76 per homeowner. There were approximately 315,000 mortgage holders, so the total maximum back interest would be $8.76 * 315,000 = $2.76 million. Total economic benefit would then be $16.2 million (= $13.44 million + $2.76 million). Assuming a reasonable attorney fee is 33 1/3%, attorney's fees would be $5.4 million. We round this down to $5 million because we know there were mortgage holders who did not receive the maximum benefit because they lived in states that required banks to pay interest on their escrow accounts. We recognize that $5 million is still higher than a reasonable attorney's fee would probably be, but we use this generous figure to emphasize that even at this high rate, the incentives to engage in wrongdoing would be substantial.

[209] The $14 million figure is based on the assumption that the lawyers reasonably could have assumed that they could get an award of one-third of the total escrow surplus of $42 million, see supra note 208, even though the court in fact awarded only 28%. See supra notes 36-37 and accompanying text. If we assume that the bank would not have assented to paying the $14 million in attorney's fees, then the bank stood to gain the $5 million in "reasonable" attorney's fees, see supra note 208, by agreeing to class counsel's attorney fee proposal to have the class pay $14 million in attorney's fees.

[210] See supra text accompanying notes 83-92.

[211] A risk-neutral actor is one who bases investment decisions only on expected values. See A. Mitchell Polinsky, An Introduction to Law and Economics 53-58 (2d ed. 1989). Risk neutrality may be a reasonable assumption if the class lawyer has a portfolio of lawsuits pending simultaneously, as many prominent class action lawyers do.

Assume that a class lawyer could obtain a settlement with 100% certainty if he requests that the bank pay $5 million in attorney's fees, and that if he requests $14 million in fees to be paid by class members there is some risk that the court will reject the settlement, leaving him with nothing. Assume further that the lawyer's costs, c, are less than $5 million, so that an honest lawyer would take the case, and that these costs are the same regardless of which settlement he proposes. The lawyer will propose the risky settlement if:

$$P(14 - c) + (1 - P)(0 - c) > 5 - c,$$

where P is the probabiliy that the court will accept the settlement. Solving for P, we get:

$$14P - cP + cP - c > 5 - c$$
$$14P > 5$$
$$P > .36.$$

Because a 36% probability of making $14 million dollars is equivalent to $5 million guatanteed, the lawyer will take the chance if the probability of court approval is equal to or greater than 36%, or equivalently, if the odds of rejection by the court are

But, as we have discussed, the risk of the class lawyers winding up with nothing is simply not that high. The Federal Judicial Center Study found only one case in which class counsel who agreed to a settlement got no recovery because the settlement was overturned and two cases in which attorney's fees were reduced, but not to zero.[212] Thus, although there is no precise data available, the risk of having a settlement undone by collateral attack for inadequate representation, or vacated for some other reason, seems quite slim.[213] Although we cannot offer a

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64% or lower.

Note that this analysis assumes that the lawyer faces no risk by proposing that the bank pay a $5 million fee. But if the bank would rather not pay this amount and can shop around for a lawyer who would accept a higher fee in return for a lower settlement, then the alternative to the risky fee might be zero (or negative if the lawyer incurred costs before making the decision to accept the settlement terms). This could significantly increase the likelihood of the lawyer's accepting the settlement. The lawyer now accepts the settlement if:

$$P(14 - c) + (1 - P)(0 - c) > 0.$$

Solving for P now yields:

$$14P - cP + cP - c > 0$$
$$14P > c$$
$$P > c/14.$$

Recall that we assumed $c < 5$. If $c = 1$, then $P = .07$. Thus the settlement rejection rate would have to be over 93% for a rational lawyer to reject this deal.

[212] See supra notes 180-187 and accompanying text. It is important to note that even when plaintiff firms are rebuffed in their attempts to be class counsel and their proposed settlements are rejected, they may still wind up with more than nothing. A recent example occurred in the *California Micro Devices* case discussed supra note 158 and accompanying text. Judge Walker, after rejecting the bid and the settlement of the Lieff Cabraser firm, and essentially accusing the firm of collusion, allowed the firm to serve as local counsel for the designated class counsel, at an hourly rate with the possibility of a multiplier. See Robert Ablon, Defrocked Lieff, Cabraser Back on Cal Micro Case as Local Counsel, The Recorder, May 14, 1996, at 4 *available in* LEXIS, Genfed Libarary, Pubs File. This is also another example of the judicial incentive problem discussed below. See infra Section II.C.

[213] See generally 2 Newberg on Class Actions, supra note 172, § 11.64, at 11-176; 11-177 (discussing collateral attack on judgment and noting that "[t]here has been limited consideration of the nature and scope of collateral review of class action judgments," also that the class action goal of conserving judicial resources might be lost if collateral review were too liberally allowed). Although Newberg states that the standard of review on collateral attacks is de novo, id., this becomes irrelevant if the case is returned to the judge who made the initial ruling, because there is little likelihood that the judge will overturn himself. The example of Judge Weinstein's ruling in Ryan v. Dow Chem. Co. (In re "Agent Orange" Prod. Liab. Litig.), 781 F. Supp. 902 (E.D.N.Y. 1991), aff'd, 996 F.2d 1425 (2d Cir. 1993), cert. denied, 510 U.S. 1140 (1994), demonstrates the strong propensity of judges to reach the same outcome they did the first time around. In *Agent Orange*, a group of veterans and their family

precise estimate of the likelihood of lawyers winding up with nothing, it would seem that any reasonable estimate would be much less than the 64% that would deter a rational class lawyer from wrongdoing in our example.[214]

On the other hand, punitive or treble damage awards resulting from subsequent suits would significantly affect the incentives of counsel by not only increasing the size of the potential loss for the lawyers but also increasing the probability that they will suffer this loss. To return to our *Hoffman*-based example, suppose that the risk of paying treble or punitive damages in a subsequent action against the class lawyers was the same as the risk of settlement rejection and fee disgorgement. If we assume

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members had brought suit in Texas state court alleging injuries resulting from their exposure to Agent Orange. Id. at 904. The case was removed to federal court and transferred from Texas to the courtroom of Judge Weinstein in New York, id. at 913, who years earlier had approved a class settlement on behalf of all veterans and their families who would claim injury in the future from Agent Orange, as well as all those who had already made such claims. Id. at 908 (describing the settlement approved by Judge Weinstein in 1985). After the Texas suit was removed and transferred, the defendants argued that the plaintiffs were bound by the prior class settlement, while the plaintiffs responded that they were not bound because they were denied due process, adequate notice and adequate representation in the first proceeding. Id. at 918-19. Judge Weinstein, who held in the first proceeding that the notice and representation were adequate, see In re "Agent Orange" Prod. Liab. Litig., 597 F. Supp. 740 (E.D.N.Y. 1984), 611 F. Supp. 1296 (1985) (reaffirming approval of settlement), again considered these issues and came to the same conclusions. *Agent Orange*, 781 F. Supp. 918-919. On appeal, the Second Circuit, which also had previously considered these matters and found the notice and representation adequate, see In re "Agent Orange" Prod. Liab. Litig., 818 F.2d 145 (2d Cir. 1987), cert. denied, 484 U.S. 1004 (1988), considered them again and also came to the same conclusions it had reached earlier.

[214] To see how important the settlement acceptance rate is, return to our previous example. See supra note 211. Let H be the collusive (high) rate (which we assumed was $14 million above) and L be the noncollusive (low) rate (which we assumed was $5 million above), and assume c=0 for simplicity. The lawyer will accept the collusive fees if:

$$PH + (1 - P)0 > L$$
$$PH > L$$
$$H/L > 1/P.$$

Equivalently, $(H - L)/L > (1/P - 1)$. The left-hand side is the minimum percentage increase over the noncollusive fee that the collusive fee would have to be for the lawyer to accept the settlement. For example, if the settlement acceptance rate P is 99%, the collusive fee H would need to be only 1% higher than the noncollusive fee L. If the settlement acceptance rate drops to 90%, the collusive fee would need to be only 11% higher. One can easily see that the temptation to sell out the class members would be very great given the likly values in our example.

an unrealistically high risk of disgorgement, say 10%, then damages of $76 million—more than treble damages of $42 million—would be necessary to deter rational class lawyers from the kind of conduct that appears to have occurred in *Hoffman*.[215] If, however, the risk of having to pay treble damages increased just slightly to 16%, that would be sufficient to deter lawyer misbehavior.[216] And actually, the risk of treble damages would not have to be that high because the award of treble damages is more likely to result in costs not typically a consequence of the disgorgement type remedies we have described.[217] The collateral consequences we have in mind include a decreased likelihood of having a court approve one's bid to be class counsel in subsequent cases and some possibility of disciplinary action.[218]

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[215] Let D be the damage measure and assume c=0 for simplicity. The lawyer would make or accept the high fee proposal if:

$$14P + (-D)(1 - P) > 5$$
$$14P - D + DP > 5$$
$$D(1 - P) < 14P - 5$$
$$D < (14P - 5)/(1 - P).$$

If P=.90 (corresponding to a 10% risk of disgorgement), then the lawyer would accept the collusive fees for any damages less than $76 million.

Actual damages to the class would be the entire $14 million fee because the defendants ordinarily would have paid the class attorney's fees. Thus, treble damages would be $42 million: not enough to deter lawyer misbehavior.

[216] Assume that the only two possibilities are that the settlement is accepted or that the lawyer is successfully sued in a subsequent action and again that costs are zero. The lawyer would make the high fee proposal if:

$$14P + (-D)(1 - P) > 5$$
$$14P - D + DP > 5$$
$$P(D + 14) > 5 + D$$
$$P > (5 + D)/(14 + D).$$

If actual damages are 14, so treble damages are 42, then the likelihood of having to pay these damages would have to be at least 1 - [(5 + 42)/(14 + 42)] or 16%.

[217] To go back to our numerical example, the lawyer would not be deterred if P > (5 + D)/(14 + D). See supra note 216 Added costs are essentially like a higher damage payment. The higher D is, the closer to 1 the fraction would get; that is, the likelihood of successful misbehavior would have to get higher. Conversely, the probability of a successful action against the class lawyers (1 - P) necessary to deter lawyers [1 - (5 + D)/(14 + D)] would get closer to zero as D increased.

[218] In malpractice actions in which the allegations amount to constructive fraud, courts may refer the matter to disciplinary authorities. See, e.g., Greycas, Inc. v. Proud, 826 F.2d 1560, 1568 (7th Cir. 1987), cert. denied, 484 U.S. 1043 (1988). On the implausibility of disciplinary action being taken against class counsel class counsel in the absence of the kinds of suits we propose, see infra notes 220-221 and accompanying text.

The lawsuits we propose would not only increase the size of the punishment assessed against misbehaving class lawyers, but would also increase the likelihood of punishment. The main reason is that treble or punitive damages, as well as attorney's fees, which are available in many of the suits we propose, provide adequate incentive for lawyers to discover and litigate instances of class action abuse. If serious challenges to collusive or otherwise illegal settlement deals are to be brought, we believe that they must be brought by attorneys, not pro se objectors. As the reader understands by now, class settlements are replete with complex terms and obscure formulas, and sophisticated proponents (class and defense counsel) are present at every fairness hearing and well-motivated to defend the deals they have cut. To encourage adequate challenges requires an examination, not of the incentives of class members injured by a corrupt deal, but of the lawyers who might act on their behalf.[219] If we assume that attorney's fees in a subsequent treble damage action against the previous class lawyers would be about one-third of the award to the class, lawyers would have as much incentive to ferret out corruption, thereby deterring future misconduct, as class lawyers now have to engage in the corruption.

In theory, one could create the same incentive structure other ways. One set of solutions would involve attempting to increase greatly the chance of having collusive settlements rejected by trial courts or appellate courts. Theory, however, is one thing; practice, another. There is no chance in the real world that class settlements will ever be rejected at a high enough rate (recall that a 64% rejection rate would have been necessary in our *Hoffman*-based example). Moreover, if courts rejected settlements that often, much of the incentive to spend time crafting good settlements would likely dissipate. One advantage of our solution is that an otherwise acceptable settlement, for example, one that enjoined a bank from keeping excessive escrow on deposit, could be left intact, while the fraudulent conduct associated with the settlement, like paying class counsel over 100%

[219] See Coffee, Regulation, supra note 200, at 896-904 (criticizing law and economics analyses based on the incentives of class members instead of the incentives of class lawyers).

attorney's fees, could be punished and deterred by an award of damages.

An alternative solution would be to impose a high penalty on misbehaving class lawyers outside the liability system, namely through discipline. Again, however, there is no chance that misbehaving class lawyers will be disciplined with a high enough probability and a severe enough sanction to deter most misbehavior. Class members would often be ignorant of the wrong or reluctant to incur the time and expense of filing and pursuing a complaint.[220] Disciplinary boards are notoriously underfunded and would be unable or reluctant to mount the effort needed to do battle with wealthy class action lawyers and powerful members of the defense bar.[221] Moreover, it is in the institutional interests of the defendants' bar and an influential subgroup of the plaintiffs' bar (class action lawyers) as well as the judiciary—a matter we will discuss next—to promote the kinds of class action settlements we are criticizing here. To expect the disciplinary authorities to resist these interests to the degree necessary to deter significant lawyer misconduct—with absolutely no monetary incentive to do so—is simply wishful thinking.

So far, we have tried to show that allowing subsequent suits against misbehaving class lawyers—suits that are allowed against lawyers in any other context—would be the most effective meth-

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[220] See David B. Wilkins, Who Should Regulate Lawyers, 105 Harv. L. Rev. 799, 829 (1992). Much of the argument we use to support our thesis—that a fairness hearing on approving a class action settlement is a poor forum in which to regulate lawyer misconduct associated with class actions and that independent legal actions are needed to do that work—parallels the analysis set forth by Professor Wilkins in his excellent article.

[221] Id. See also Charles W. Wolfram, Mass Torts—Messy Ethics, 80 Cornell L. Rev. 1228, 1234 (1995):

> Professional discipline of class-action lawyers who have been suspiciously generous with themselves at the expense of the class is out of the question. Most disciplinary staffs are overworked and underfinanced and can rather readily be out-lawyered if the stakes are sufficiently high. Moreover, disciplinary counsel would have to take on the class-action bar in a matter already decided by the judge adversely to a possible prosecution.

For an example of this problem, see the discussion of the numerous difficulties the Texas State Bar faced in prosecuting ethics charges against John O'Quinn, a prominent plaintiff's attorney, in Max Boot, The Untouchable Lawyer, Wall St. J., Feb. 1, 1996, at A18.

od for deterring the collusive behavior that the class action incentive structure encourages. Of course, allowing such suits would be costly and we must consider whether those costs might outweigh the benefits. But before we turn to the matter of costs, the matter of judicial self-interest has been long enough delayed. It is time to speak of judges.

C. Blind, Not Merely Blindfolded, Judges

Courts in class actions are supposed to fulfill the monitoring role that the client cannot. Ostensibly, the court stands in for the client as a fiduciary to ensure that the settlement is fair to the client and does not merely serve the lawyer's interest. But this arrangement simply replaces one imperfect agent (class counsel) with another (the court). Although the court has no monetary interest in the settlement, its interests are not perfectly aligned with the interests of class members.[222] Judicial self-interest may lead judges to seek power, prestige, and autonomy,[223] or may lead them to seek greater leisure.[224] Courts' strong disposition toward settlements[225] stems from both types

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[222] The self-interested behavior of judges has only recently begun to receive serious scholarly attention. See Richard A. Posner, What Do Judges Maximize? (The Same Thing Everybody Else Does), 3 Sup. Ct. Econ. Rev. 1, 3-4 & nn.3 & 4 (1993) (collecting articles analyzing judicial behavior from economic perspective). For a recent study of the role of judicial self-interest in issues such as court administration and bureaucracy, judicial salaries and habeas corpus reform, see Christopher E. Smith, Judicial Self-Interest: Federal Judges and Court Administration (1995).

[223] See Smith, supra note 222, at 7. For example, Justice Scalia in his first major address to the ABA after being appointed to the Supreme Court, gave a speech in which he argued that the federal courts have lost their elite status because they are overloaded with too many, and in particular too many routine, cases. Id at 75-76.

[224] See Posner, supra note 222, at 10 ("Because the judiciary has been placed on a nonprofit basis, we should expect that judges on average do not work as hard as lawyers of comparable age and ability.")

[225] See Coffee, supra note 7, at 714 n.121:

> Judge Henry Friendly observed that "[a]ll the dynamics conduce to judicial approval of [the] settlement[]" once the adversaries have agreed. See Alleghany Corp. v. Kirby, 333 F.2d 327, 347 (2d Cir. 1964) (Friendly, J., dissenting), aff'd en banc by equally divided court, 340 F.2d 311 (2d Cir. 1965), cert. dismissed, 384 U.S. 28 (1966). Although the case law may require full and elaborate judicial review before a settlement is approved, it is doubtful that courts have much incentive to be very demanding. Their deferential attitude is probably best expressed by one recent decision which acknowledged that: "'In deciding whether to approve this settlement proposal, the court starts from the familiar

of judicial self-interest: Settlements dispose of cases that do not involve "interesting" legal issues; and settlements clear crowded dockets with minimal court effort. Class actions magnify these effects, because the alternatives—trying the class action or, worse yet, trying the multitude of suits that make up the class action individually—are particularly burdensome alternatives. Either of those alternatives would take up significant court time and resources, and the second would have judges presiding over repetitive individual suits that they may view as boring, if not trivial.[226] On the other hand, while presiding over a major class action settlement may entail a significant amount of work, a judge seeking power, and even prestige, could hardly do better than to preside over the settlement of such a suit.[227] Moreover, while presiding over most class action settlements will not bring prestige or power, neither is it onerous duty. The Federal Judi-

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axiom that a bad settlement is almost always better than a good trial.'" In re Warner Communications Sec. Litig., 618 F. Supp. 735, 740 (S.D.N.Y. 1985).

[226] See Macey & Miller, supra note 198, at 45-46. See also Sylvia R. Lazlos, Note, Abuse in Plaintiff Class Action Settlements: The Need for a Guardian During Pretrial Settlement Negotiations, 84 Mich. L. Rev. 308 nn.1 & 2 (1985) (discussing the judicial policy of encouraging settlements in both ordinary civil and class action suits).

It is interesting to note that even Judge Posner, who is usually quite sensitive to the possibility of self-interested behavior, overlooked the extent of this problem in his recent *Rhone-Poulenc* decision. In re Rhone-Poulenc Rorer, 51 F.3d 1293 (7th Cir.), cert. denied, 116 S.Ct. 184 (1995). In overturning the district court's certification of a class action, he noted: "We do not mean to suggest that the district judge is engaged in a deliberate power-grab. We have no reason to suppose that he *wants* to preside over an unwieldy class action." Id. at 1299. But if the class action is likely to settle and the alternative is multiple individual suits, that may be exactly what the judge wants. Judge Posner did recognize the problem of judicial incentives in asbestos litigation, remarking that "[t]he number of asbestos cases was so great as to exert a well-nigh irresistable pressure to bend the normal rules." Id. at 1304. In our view, asbestos litigation is not the exception in this regard.

[227] For example, Judge Weinstein, the judge who presided over the Agent Orange class action settlement, has received an enormous amount of attention and prestige due to his handling of that case. See, e.g., Peter Schuck, Agent Orange On Trial: Mass Toxic Disasters in the Courts 111-42 (1987) (describing Judge Weinstein's handling of this major litigation); Wayne Roth-Nelson & Kathey Verdeal, Risk Evidence in Toxic Torts, 2 Envtl. Law. 405 (1996) (discussing Judge Weinstein's views of scientific evidence in Agent Orange litigation); Wade Lambert, Peter D. Sleeth & Foster Church, Critics Call Lawsuits by Groups 'Rackets,' Portland Oregonian, Apr. 23, 1996 at B16. See also Implants: A Spark of Hope, The Detroit News, June 5, 1996, at A10 (discussing U.S. District Court Judge Pointer's handling of breast implant litigation); Jay Reeves, Unbiased Expert on Breast Implants Hard to Find, The Cincinnati Enquirer, June 7, 1996, at A20 (same).

cial Center's Study shows that the average fairness hearing takes up about 40 minutes of court time, putting aside the outlier class actions that involve more time but also have a greater chance of bringing prestige.[228]

It is possible that trial courts' enthusiasm for settlement could be tempered by the possibility of reversal on appeal. One might think that appellate judges, one step removed from the mess of clogged dockets and the prospect of repetitive trials, have considerably less interest in approving every class settlement that a trial judge has accepted.[229] But being one step removed also means that appellate judges are to a large extent necessarily dependent on the findings of the trial judge as to the fairness of the terms, the adequacy of the representation and the appropriateness of the request for attorney's fees. As a consequence of this distance, appellate courts review such matters under the abuse of discretion standard,[230] which seems appropriate, but which also makes it easy for appellate judges to accept settlements. The question remains, however, what incentives, if any, would encourage appellate judges to ignore the possibility that trial judges routinely abuse their discretion in their haste to approve every class settlement—which is what we contend is going on. Empathy for the plight of lower court colleagues and

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[228] See FJC Study, supra note 180, at 169 (Table 19).

[229] In some important cases appellate judges are not so removed from the negotiation of the settlement. In the *Ahearn* case, the district judge appointed Judge Patrick Higginbotham of the Fifth Circuit as "settlement facilitator." Yet even the dissent, which objected to the district court's involvement in the settlement, stated that "there can be no criticism of Judge Higginbotham's role." In re Asbestos Litig. (Flanagan v. Ahearn), 90 F.3d 963, 1014 n.73 (5th Cir. 1996) (Smith, J., dissenting). The dissent can perhaps be forgiven for not wanting to criticize the role played by a fellow jurist. But the point is that, however honorable Judge Higginbotham's intentions and however effective his actions as mediator, it is hard to believe that his participation in the settlement (and the fact that the trial judge was now also a colleague on the court of appeals) did not influence the judgment of his colleagues on the Fifth Circuit who were asked to review the settlement agreement.

[230] The abuse of discretion standard is the most deferential standard of review. "[A]ny rulings that are within the discretion of the trial judge will be reviewed under an abuse of discretion standard. . . . [which means that] [o]nly if an appellate court is convinced that the court below was clearly wrong will it reverse a discretionary decision." Jack H. Friedenthal, Mary Kay Kane & Arthur R. Miller, Civil Procedure § 13.4, at 608 (2d ed. 1993). See, e.g., Saunderson v. Saunderson, 379 So. 2d 91, 92 (Ala. Civ. App. 1980); Keith Gas Co. v. Jackson Creek Cattle Co., 570 P.2d 918, 921 (N.M. 1977); Primm v. Primm, 299 P.2d 231, 235 (Cal. 1950).

a frustration with the apparent indifference of the public and politicians to what appellate and trial judges insist is an onerous workload seems to make appellate judges as fond, or nearly as fond, of class action settlements as trial judges.[231] Appellate judges' own preferences for leisure may also play a role in their willingness to uphold class settlements approved by lower courts.[232]

It is true that courts have an interest in promoting their reputation for fairness. That interest should encourage them to safeguard the interests of absent class members. At least so far, however, individual judges have little reason to expect negative reputational effects from approving bad class deals.[233] The press

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[231] Dean Mary Kay Kane of the Hastings College of Law, who served as Reporter for the U.S. Judicial Conference Ad Hoc Committee on Asbestos Litigation, a committee appointed by Chief Justice Rehnquist, testified at the *Georgine* fairness hearing that the judges on the Ad Hoc Committee

> were "very concerned" with cases "piling up ... [and] clogging the court system." She testified that "they were concerned that not only were the courts being cluttered with criminal litigation, but now asbestos was coming in as a major piece of litigation. . . . The judges decided . . . not to "suggest to Congress that they were indeed legislating because that was not their task, and that it would be more prudent instead simply to write a report . . . to be forwarded to Congress setting out the history, the kinds of problems that were posed by asbestos litigation," . . . The judges, however, apparently thought it unlikely that Congress would make an active effort to pass comprehensive legislation. They were concerned that . . . [such legislation] "as a practical matter . . . simply wasn't going to happen."

Koniak, supra note 15, at 1148-49 (quoting from Kane's testimony at *Georgine* fairness hearing). See also Richard L. Marcus, They Can't Do That, Can They? Tort Reform Via Rule 23, 80 Cornell L. Rev. 858, 860-66, 902-04 (1995) (describing how the "substantive preferences" of federal appellate and trial judges for reform of state tort law may be interfering with the duty of those judges to protect the legal rights of absent class members). Professor Marcus's point parallels our own, although what he labels "substantive preferences," we see as "preferences" for fewer cases and less work. In any event, we agree that trial and appellate judges have interests that may make them poor guardians for absent class members.

[232] See Posner, supra note 222, at 21 (discussing variety of devices used by appellate judges that enable them "to reduce their work as well as to avoid the hassle involved in wrestling with difficult, politically sensitive issues").

[233] A good example of judicial attitudes toward settlements in class action cases as well as toward the fairness hearings objecting to these settlements can be found in *Hoffman*. The class lawyers put on the testimony of an accountant who argued that if the class members had taken their refunds and applied it to reduce the principal of their mortgages or to reduce high-interest credit card debt, the "benefit" to the class could be in excess of the "surplus" (the class members' money, recall) wrongly held by the bank. *Hoffman*, Fairness Hearing, supra note 35, at 17-22. On

and academia have imperfect access to class settlements, a problem the legislation we have proposed and Senator Cohen has introduced is designed to help remedy.[234] Even when settlement documents are readily accessible, they are likely to be so lengthy and complex that sorting out what happened is very difficult. Class settlements are, if nothing else, heavily-lawyered affairs, and discerning fraud through reams of legalese drafted to conceal any such activity requires effort few reporters, few lawyers and few academics have thus far made. To the extent the general public, media or academics blame anyone for the abuse they perceive, albeit find difficult to document, that blame tends to land on the doorstep of lawyers, not the judiciary. We believe too that judges may, in part, have escaped their share of responsibility for whatever class action abuse exists because criticizing judges for self-interested behavior—turning a blind eye to facts that would be discomforting for them to see—is considered by many to be as profane as accusing the Pope of a lecherous eye, a charge well-nigh outside the bounds of civilized discourse.[235] And we believe judges understand all of this, which

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cross-examination, the Florida Attorney General, Hoffman (no relation to the named plaintiff), tried to make two points: first, that the accountant's calculations were based on an average length of time remaining on mortgages that did not take into account the possibility of refinancing; second, that using the refund to pay down the principal on a class member's mortgage was not the default, or even a recommended, usage, and was therefore unlikely to occur and should not be presumed. Id. at 22-34. The court responded to this line of inquiry as follows:

> Mr. Hoffman, I don't know how you all do it in Florida, but we're not going to sit around here all day and ask inane questions. I'm not interested in—if this is the best settlement for the class, what they can do with the money or can't do with the money is immaterial to the issue of whether or not they are getting the best deal. What I want you to do is get to the point and let's get on with it.

Id. at 30. Perhaps if the judge had known that the *Hoffman* settlement would wind up being publicized to the degree it has, he would have been more judicious in conducting the hearing.

[234] See supra notes 106-109 and accompanying text.

[235] See Posner, supra note 222, at 25-26 (referring to "the piety in which the public discussion of judges is usually wrapped" as one reason people have not considered self-interested interpretation of judicial behavior). While some other academics have pointed out the judiciary's self-interest in approving class actions, which have all the markings of a sell-out, most soften the point by either suggesting that the problem is limited to a few "lazy or overworked judge[s]," Wolfram, supra note 221, at 1233, or by suggesting that the "preferences" of judges are preferences worthy of respect and that only in cases of extreme system overload will judges allow these preferences to override the rights of absent class members or otherwise distort the law. Marcus,

means that they would see little risk of negative reputational effects from approving a class settlement that looks amazingly like a collusive deal, or a settlement that suggests questionable conduct under the antitrust laws.

Even more important, courts worry not only and perhaps not chiefly about their reputation among the general public, but about their reputation with their peers—other judges and lawyers.[236] Accepting a settlement that clears the dockets of one's colleagues is very likely to win one praise from those colleagues as well as gratitude from the lawyers presenting the deal;[237] rejecting such a settlement, on the other hand, may subject the judge or panel of judges to not-so-subtle rebuke from colleagues. That judge or panel may expect to suffer negative reputational effects from the lawyers involved in the deal as well as other lawyers who see the rejection as bad news for deals they might someday advance.[238]

In addition to self-interest, the judicial habit of neutrality may lead judges to accept class action settlements too readily. The traditional paradigm of judging is that of a neutral arbiter, rather than partisan or protector. In a fairness hearing, this paradigm may interfere with the court's role as guardian of, and fiduciary for, the class members. What could seem more "neutral" than accepting a settlement agreed to by both sides? And what could seem less neutral than rejecting a settlement on the ground that one side, the class members, got a raw deal? While the judiciary's obligation to protect absent class members seems too weak to break through the paradigm of "neutrality" the judiciary's fondness for settlements does not. All too often judges appear to be acting as advocates for the settlement itself, a troubling role for a guardian who is supposedly there to ensure that the settlement, arrived at without the actual consent of

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supra note 231, at 904, 907-08.

[236] See Robert D. Cooter, The Objectives of Private and Public Judges, 41 Public Choice 107, 129 (1983).

[237] It is also quite plausible that in states in which the judiciary is elected, such as Alabama (where *Hoffman* occurred), this "gratitude" will take the concrete form of campaign contributions to help finance the judge's reelection bid.

[238] See Koniak, supra note 15, at 1116-17, 1119 (describing courts' reluctance to suggest that lawyers before them colluded or otherwise broke the law in connection with a class settlement or any other matter); see also supra notes 152-158, 212 and accompanying text.

absent class members and in some cases over their objections, is good for the class and not just the judicial system or the lawyers.[239] For the reasons given in this Part and those expressed earlier on the defects inherent in the fairness hearing procedure, it is predictable that courts would be generally unreliable monitors of class counsel's performance and ineffective protectors of class members' interests.

By arguing that judicial incentives and not just the procedure in fairness hearings make judges ineffective monitors of class action abuse, however, we raise the following problem for ourselves: Perhaps judges will be as hostile to the later suits we propose as they are to stopping class action abuse *ab initio*.[240] Unfortunately, there is some evidence that this is true,[241] and

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[239] See Marcus, supra note 231, at 900 (arguing that the judicial policy in favor of settlements should not be imported wholesale into the class action arena).

Some commentators have noted that too little attention has been paid to the potential problems created when judges involve themselves in the dynamics of class action settlement negotiations and then purport to judge the fairness of settlements they have helped to create. See, e.g., Carrie Menkel-Meadow, Ethics and the Settlements of Mass Torts: When the Rules Meet the Road, 80 Cornell L. Rev. 1159, 1183 (1995) ("*The Code of Judicial Conduct* provides little guidance, and few standards in the rules or cases set limits on when a judge should refrain from examining the fairness of a settlement he has helped broker.") (footnote omitted). This problem seems ripe for more serious attention, however. Compare In re Asbestos Litig. 90 F.3d 963, 989 (5th Cir. 1996) (finding that the district judge did not need to recuse himself from deciding the fairness of the settlement because his involvement was "insubstantial") with id. at 1013-1015 (Smith, J., dissenting) (arguing that the judge should have recused himself because he "had a personal stake in finding [the settlement] to be fair," and because the settlement negotiations took place before any lawsuit had been filed).

[240] The courts' self-interest in settlement would not be entirely eliminated. Courts might surmise that allowing the kinds of suits we propose to succeed could result in a higher future caseload by deterring class action settlements. And entertaining subsequent suits would entail at least an indirect finding that the court should not have approved the class settlement, a finding courts might be loath to make.

[241] For example, in Diaz v. Sheppard, 85 F.3d 1502, 1506 n.5 (11th Cir. 1996), although the court remanded to state court, on the ground that removal was improper, the plaintiff's malpractice action against class counsel who purported to represent him in settlement of a federal class action, the appellate judges could not refrain from adding: "We have read the dissent [arguing against recognition of a malpractice claim against class counsel] and personally would not be sorry if the law compelled the result Judge Logan advocates for this case." Notice that while two appellate judges were able to resist such a broad holding, they could not refrain from expressing their desire for such a rule and one judge was ready to put in place a complete ban on such actions. The majority stressed that they were not deciding the merits of the malpractice claim. Id. at 1505.

one of our aims is to make judges more aware of the interests they might have before they too quickly block this path to deterring class action abuse. But aside from our hope that this Article will help forestall judges from dismissing these later suits without adequately considering the benefits thereby lost, there are other reasons to believe that judicial self-interest will play less of a role in the later suits we advocate than in the initial approval of class settlements. First, interfering with these suits would require, as we shall endeavor to show, some major rewriting of longstanding doctrine on res judicata, collateral estoppel and/or the constitutional protections afforded absent class members.[242] Second, the suits we propose are less of an interference with class action settlements than rejecting class settlements would be. A settlement can be left intact, while damages are awarded for malpractice or fraud, for example, committed on the class in the course of the representation.[243] Third, should injured class members and others (e.g., the Justice Department in the case of an alleged antitrust violation) be allowed to maintain the suits we propose, a jury would be available to assess whether wrongdoing had in fact occurred, which distinguishes our suits from fairness hearings or independent actions for fraud under rules like Federal Rule of Civil Procedure 60(b) in which the fact-finder is a judge. If juries, who we have no reason to believe are biased in favor of class settlements, were allowed to decide what conduct by counsel breached legal duties to the class or otherwise violated the law, we believe that alone might

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Diaz is not the only evidence that the "anything goes" attitude might interfere with the later suits we propose. In Kamilewicz v. Bank of Boston, 92 F.3d 506, 512 (7th Cir. 1996), the case spawned by the escrow class action described in Section I.A.1. of this Article, the unanimous panel justifies its holding that a federal suit against the class lawyers and the bank for conduct in a state court class action cannot be maintained in federal court, in part, on the ground that such a suit "could have ramifications far beyond this case." And in In re VMS Limited Partnership Sec. Litig., 976 F.2d 362, 369 (7th Cir. 1992), the court in denying the plaintiffs' attempt to appeal the district court's approval of the class settlement, mentions that the plaintiffs may have other remedies (presumably a suit against class counsel) but refuses to elaborate because it might "encourage one or more avenues of alternate litigation." This last quotation made us consider calling this Article or some section of it, "The Suits That Dare Not Speak Their Name," but, having no desire to encourage such judicial squeamishness, we elected not to.

[242] See infra Sections III.B.,C.

[243] See infra text and accompanying note 286.

help restore some public confidence in the class settlement process deemed so essential by judges and other interested observers. That result might serve at least the long-range interests of judges and everyone else in the country too.

D. The Costs of Allowing Later Suits

Having set forth the need for subsequent suits against lawyers involved in class actions, we need to consider the costs of these suits. One set of costs that we may readily dispose of is the potential loss of public confidence in the legal system that later suits might occasion. Indeed, we have just argued that our suits might restore public confidence. Nonetheless, it is true that the lawsuits we propose all imply that the court which approved the class action settlement failed to protect the class in some important respect. The question is whether the gain we have outlined in reduced corruption outweighs any loss in public confidence that might follow from regular admissions by the court system that, as guardians in class actions, judges often leave much to be desired. That question, however, assumes that there is some level of public confidence present to be eroded; it is not at all clear that this is so when it comes to class actions.[244] Outside the class action arena the public is quite comfortable with the availability of malpractice actions against lawyers. Moreover, as we have already suggested, allowing juries of ordinary citizens to judge the behavior of lawyers should serve in the class action context, and we believe does serve in ordinary malpractice suits, to enhance public confidence in the legal system, not to diminish it. We assume that most citizens would be appalled by a legal system that would immunize lawyers for wrongdoing that they somehow slipped past a judge, and would applaud efforts to hold those lawyers accountable for their misdeeds. In short, a judicial system willing to admit and provide some redress for the

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[244] The public's attitude toward class actions may be summed up by a recent comic strip in which an enterprising lawyer awakens an unsuspecting person and announces, "Good Morning, Sir . . . My Name is Bernard, and I'll be your attorney for today. May I suggest starting with our special class action lawsuit against a major manufacturer?" After getting rid of the lawyer with a perfunctory "Sure, what the hell," the homeowner returns to bed exclaiming, "Wake me when the nineties are over . . ." Wiley, Non Sequitur, The Daily Progress (Charlottesville, Va.) Jan. 21, 1996.

wrongs everyone seems to understand are now tolerated by the system would inspire more, not less, confidence.[245]

A second set of costs associated with subsequent suits against class action lawyers involves the transaction and institutional costs of further litigation, the costs of encouraging satellite litigation generated by an earlier suit. But restricting the availability of subsequent suits to save these costs seems particularly unpersuasive.[246] Conserving court time and decreasing the transaction costs of parties are reasons that have already been used, so to speak, to justify both the class action device and the power of a court to bind absent class members to what is essentially a contract drawn up by lawyers they never hired and the defendant who allegedly caused the class harm. Those cost-saving devices themselves often produce significant costs—costs imposed on the class itself, the original aggrieved party. The subsequent suits we propose are designed to correct for that unjustified result.

There is no reason to expect subsequent suits to cancel all the cost savings legitimately realized by the availability of class action suits or procedural devices that encourage their settlement. Given the fact that the suits we propose impose no novel obliga-

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[245] Moreover, we do not believe that procedural rules against relitigation are actually or appropriately aimed at bolstering public confidence in the courts, particularly if those rules prevent the unearthing of corruption or illegality connected to previous court process. Writing in praise of Justice Traynor for having boldly extended the ban against relitigating issues in subsequent proceedings, see Traynor's landmark decision in Bernhard v. Bank of Am. Nat. Trust & Savings Ass'n., 122 P.2d 892 (Cal. 1942), Professor Geoffrey Hazard scorned the idea that the rule could be justified as a means of inspiring public confidence in the judiciary: "Res judicata doctrine has little direct relevance to maintaining 'public confidence' in the courts. Whatever the number and significance of the elements that instill such confidence, a more or less inhibiting relitigation rule is surely minor compared to such problems as corruption, delay and inconsistency." Geoffrey C. Hazard, Jr., Res Nova in Res Judicata, 44 S. Cal. L. Rev. 1036, 1041 (1971). Nor do the antitrust immunity doctrines we discuss below have anything to do with promoting or maintaining public confidence in courts or other government agencies.

[246] It also seems unrelated to the purpose behind the policy against relitigation. These concerns could be used to justify or condemn any procedural rule, which leads us to believe that some more specific social benefit undergirds the rule against relitigation. As Professor Hazard put it: "The burdens of time and inconvenience involved in a policy which liberally allows relitigation are minuscule when compared with those burdens now imposed by elaborate discovery and pre-trial procedures, prolonged trials, and multiple appeals." Hazard, supra note 245, at 1041.

tions on lawyers, and that they would entail great difficulties of proof as well as being significantly costly to maintain, we are confident that courts would not be flooded with subsequent suits.[247] To conclude that subsequent suits of the type we propose would kill off all cost-saving benefits of class action settlements, one must assume either that all class actions are corrupt or otherwise unlawful; or that the procedural devices to prevent frivolous suits are so inadequate that we can no longer afford to recognize long-standing causes of action, such as malpractice, breach of fiduciary duty or antitrust violations. We reject both those possibilities.[248] If we are wrong, and corruption or illegality permeates every class action settlement, then ending such settlements is a good idea. And, if the rules on frivolous suits are so weak that later suits threaten good settlements as well as bad ones, then the rules designed to deter frivolous suits are the

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[247] The Connnecticut Supreme Court recently reached the same conclusion in a case in which the court allowed a claim for malpractice arising out of a divorce settlement. Grayson v. Wofsey, Rosen, Kweskin & Kuriansky, 646 A.2d 195 (Conn. 1995). In rejecting the defendants' assertion that allowing such suits would open the floodgates, the court responded:

> [W]e have no reason to believe that our resolution of the defendants' claim will prompt an increase in malpractice suits against attorneys because, in declining to narrow the existing common law remedy for attorney malpractice, we create no new claim or theory of recovery. Moreover, as the New Jersey Supreme Court has recently stated in response to the same concern expressed by the defendants here, "plaintiffs must allege particular facts in support of their claims of attorney incompetence and may not litigate complaints containing mere generalized assertions of malpractice. We are mindful that attorneys cannot be held liable simply because they are not successful in persuading an opposing party to accept certain terms. Similarly, we acknowledge that attorneys who pursue reasonable strategies in handling their cases and who render reasonable advice to their clients cannot be held liable for the failure of their strategies or for any unprofitable outcomes that result because their clients took their advice. The law demands that attorneys handle their cases with knowledge, skill, and diligence but it does not demand that they be perfect or infallible, and it does not demand that they always secure optimum outcomes for their clients.

Id. at 200-01 (quoting Ziegelheim v. Apollo, 607 A.2d 1298, 1306 (N.J. 1992)).

[248] In *Grayson* the Connecticut Supreme Court rejected an argument by the defendant lawyers that allowing malpractice suits would discourage settlements: "Because settlements will often be in their clients' best interests, we harbor no doubt that attorneys will continue to give advice concerning the resolution of cases in a manner consistent with their professional and ethical responsibilities." Id. at 200. If malpractice suits against class action lawyers were allowed, we believe the same would hold true for them. For a further discussion of *Grayson* and similar cases, see infra notes 321-323 and accompanying text.

problem, not our proposal, and those rules should be strengthened—a course of action we support.[249]

Others may object to our proposal on the ground that the lawyers who bring the subsequent suits against the class lawyers or defendants will face the same incentive problems and, therefore, could be liable themselves in yet another round of subsequent suits. Our response to this objection is threefold. First, the same potential exists for lawyers outside the class action setting who represent plaintiffs in legal malpractice actions. And we assume that no one would advocate eliminating lawyer malpractice actions for this reason.[250] Second, allowing our suits should deter both misconduct in the original class action as well as misconduct in the malpractice class action. Third, we believe that when a lawyer brings a malpractice suit, he is ordinarily acutely aware that he must himself be well-nigh beyond reproach. In fact, malpractice suits against malpractice lawyers are extremely rare birds.[251]

Finally, having addressed some of the costs of allowing the suits we advocate as a remedy for class action abuse, we want to encourage other "reformers" in this area to do the same.

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[249] Indeed, although we do not believe these rules are so weak as to be useless, we do believe that they should be stricter. See, e.g., Geoffrey C. Hazard, Susan P. Koniak & Roger C. Cramton, The Law and Ethics of Lawyering 414-17 (2d ed. 1994) (detailing the debate over sanctioning lawyers for filing frivolous cases).

[250] See Wilkins, supra note 220, at 830-35 (discussing costs and benefits of malpractice actions compared to other methods of attorney regulation).

[251] For an example of lawyer misbehavior in a malpractice suit that occurred in somewhat unique circumstances and resulted in sanctions under Fed. R. Civ. P. 11, see Jackson v. O'Hara, Ruberg, Osborn & Taylor, 875 F.2d 1224 (6th Cir. 1989). In that case, a lawyer for the plaintiff in a wrongful death action against a truck driver and his employer brought a malpractice suit against the employer's lawyers after obtaining an assignment of this supposed claim from the truck driver. The lawyer for the plaintiff was sanctioned because the employer's lawyers had refused to represent the truck driver in the wrongful death action, which the plaintiff's lawyer could have discovered by reasonable inquiry, because the truck driver had not suffered any damages that could be proved in a malpractice claim, and because the plaintiff's lawyer had filed the malpractice suit for improper purposes. Id. at 1230-31. Needless to say, this is not a typical malpractice case.

E. The Inadequacy of the Current Proposal to Amend Rule 23

As we were revising this Article in April 1996, the Committee on Rules of Practice and Procedure of the Judicial Conference of the United States approved for publication and comment revisions of Rule 23 recommended by the Advisory Committee on Civil Rules.[252] Although we doubt that any reform of Rule 23 would obviate the need for the types of suits we propose, we feel compelled to add a few words about the reforms that have been proposed for those who would like to believe that procedural reform is a more promising and less costly solution than subsequent suits. We have two general responses to the Committee's proposed revisions.[253] First, both the substance of the revisions and the process leading up to their adoption support our assertions about the incentives of all the players in the class action game to advance their own interests at the expense of class members. Second, and related, the specific changes made by the revisions would actually make matters worse for class members and therefore make our proposed subsequent suits more, rather than less, necessary.

Most notably, Proposed Rule 23(b)(4) broadly licenses courts to certify for settlement purposes class actions in which the defendants and some plaintiffs' lawyer (unappointed and unsupervised during the negotiation process by any judge) have agreed, prior to the filing of a class action in court, to settle some set of cases that might otherwise not qualify to be tried as a class action.[254] The proponents of this provision are adamant in their

[252] Preliminary Draft, supra note 11.

[253] We do not address all aspects of the proposed revisions here. Some parts of the Committee's proposal seem innocuous enough to us and may even do some good; for example, proposed Rule 23(f) makes appeal of a district court's decision to grant or deny class certification more readily subject to judicial review. Other reforms we support are suggested in the Committee Note accompanying the Rule, but not in the Rule itself. See id. at 53 ("One of the most important contributions a court can make is to ensure that the notice fairly decribes the litigation and the terms of the settlement."). On the danger of using committee notes to make substantive changes or additions to the text, see Laurens Walker, Writings on the Margins of American Law: Committee Notes, Comments, and Commentary, 29 Ga. L. Rev. 993 (1995) (courts should give little if any weight to commentary).

[254] Proposed Rule 23(b)(4) reads: "An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition . . . the parties to a settlement request certification under subdivision (b)(3) for purposes of settlement

assertion that this change is "minimalist,"[255] arguing that so-called settlement class actions are old-hat and that this provision is designed to do no more than clarify that such actions are proper in light of the Third Circuit's decisions in *Georgine* and *GM Truck*, which suggest that settlement classes are not sanctioned by Rule 23.[256] Even if the claim of modest revision were true,[257] it is no answer to the argument that such settlement class actions, old or new, are particularly prone to abuse—a point that the proponents of this Rule do not dispute or address.[258]

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even though the requirements of subdivision (b)(3) might not be met for purposes of trial." Id. at 41-43.

[255] Draft Minutes *in* Preliminary Draft, supra note 11, at 35. See also Committee Note *in* Preliminary Draft, supra note 11, at 44 (amendments are "modest").

[256] See Committee Note *in* Preliminary Draft, supra note 11, at 51:

> Subdivision (b)(4) is new. It permits certification of a class under subdivision (b)(3) for settlement purposes, even though the same class might not be certified for trial. Many courts have adopted the practice reflected in this new provision. See, e.g., *Weinberger v. Kendrick*, 698 F.2d 61, 72-3 (2d Cir. 1982); *In re Beef Industry Antitrust Litigation*, 607 F.2d 167, 170-171, 173-178 (5th Cir. 1979). Some very recent decisions, however, have stated that a class cannot be certified for settlement purposes unless the same class would be certified for trial purposes. See *Georgine v. Amchem Products, Inc.*, 83 F.3d 610 (3d Cir. 1996); *In re General Motors Corp. Pick-Up Truck Fuel Tank Litigation*, 55 F.3d 768 (3d Cir. 1995). This amendment is designed to resolve this newly apparent disagreement.

[257] It is debatable whether the provision recognizes something old-hat or not. Although courts have been considering the fact of settlement for some time in deciding whether to certify a class, See, e.g., Weinberger v. Kendrick, 698 F.2d 61, 72-73 (2d Cir. 1982); In re Beef Indus. Antitrust Litig., 607 F.2d 167, 170-71, 173-78 (5th Cir. 1979), one could argue that those decisions stand for nothing more than the quite sensible proposition that in cases in which no party has contested whether a class meets Rule 23's requirements for certification (because the parties have agreed to settle) the court can say no more than that the class appears to be certifiable, but that judgment is necessarily contingent on the settlement because no one has argued any differently. That statement is quite different than what the court in *Ahearn* said and the court in *Georgine* was invited to say, which is that a class that could not be certified for trial may be certified for settlement. This arguably "new" statement raises problems that the "old" statement does not.

[258] According to the unofficial Committee minutes, one Committee member warned that settlement classes "offer a bribe to plaintiffs' counsel to take a dive and sell res judicata" and offered that "Professor Jack Coffee's views on this subject are sound." Draft Minutes *in* Preliminary Draft, supra note 11, at 35. The only response to this point noted in the minutes was that "[c]lass members will opt out if the settlement represents a bargain to sell res judicata on terms favorable to the defendant." Id. at 36. We note that the proposed Rule 23(b)(4) does not explicitly guarantee opt out rights, though the Committee Notes insist they are preserved. See Committee Note, *in* id. at 51. Nor does it include any reforms to ensure that class members will have

Class actions that can be settled, but not tried, are particularly prone to abuse because they invite defendants to shop around for the plaintiffs' lawyer who will sell out the class at the cheapest price.[259] Although most class actions are settled anyway, licensing settlements when no class action trial is possible gives all the leverage in the settlement negotiation to one side, the defendant. The would-be class lawyer cannot threaten to bring the case to trial. If he walks away from the settlement negotiation, he gets at most the fees for handling the individual clients who have actually retained him, assuming he settles or successfully tries those cases. But rejecting a defendant's inadequate settlement on behalf of the inchoate class makes him automatically ineligible for any class attorney's fees. The next lawyer who sits down and cuts the deal gets those fees.[260]

Moreover, the proponents of this provision acknowledge that it does make one change from current practice. The new provision—at least as interpreted by the Committee Note—demands that a settlement be fully in hand and agreed to before lawyers can request (b)(4) status for the inchoate class.[261] Although the Advisory Committee Note states that this requirement gives added protection for the class, we believe that the opposite is true. Contrast the Committee's approach with an alternative: that settlement class status would be granted only to those lawyers whom a court had both appointed for the purpose of negotiating the settlement on behalf of some set of people, and had monitored during the negotiation process through some agent

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sufficient information to make a rational decision whether to opt out. The Committee defeated a motion to omit any reference to settlement clases in the revised rule by a vote of 8 to 5. Committee Note, *in* Preliminary Draft, supra note 11, at 51.

[259] See supra notes 231-239.

[260] See Letter from Steering Committee to Oppose Proposed Rule 23, to the Hon. Alicemarie Stotler, Chair, Standing Committee on Rules and Procedure 5 (May 28, 1996) (on file with the Virginia Law Review Association). Professor Koniak played a leading role in organizing the "Steering Commitee," and along with Professor Cohen and over 140 other academics signed the letter.

[261] "Certification is not authorized simply to assist parties who are interested in exploring settlement, not even when they represent that they are close to agreement and that clear definition of a class would facilitate final agreement." Committee Note *in* Preliminary Draft, supra note 11, at 52. This limitation does not explicitly appear in the text of the Rule itself, but the Committee believes it implicit in the use of the phrase "parties to a settlement," because it rejected the insertion of "proposed" before "settlement." Draft Minutes *in* Preliminary Draft, supra note 11, at 37-38.

or device. That alternative (which we are not championing because of our extreme doubts about the entire concept of settlement classes but which we set out to make a point) would demonstrate that the judges and others who were responsible for writing these rules were taking the risk of abuse seriously, instead of merely promoting class settlements at any cost. The approach of the Committee, however, ensures only that abuse will be more difficult to ferret out because all the action will take place off-stage, so to speak. The new come-with-settlement twist may protect defendants from coerced settlements, as the Minutes of the Advisory Committee suggest was the drafters' intent,[262] in contrast to what the Committee Note says about protecting the class, but it leaves class members only more vulnerable.[263]

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[262] Draft Minutes *in* Preliminary Draft, supra note 11, at 38:

> A later motion to reconsider proposed (b)(4) to add "proposed," so that it would recognize a request for certification by the parties to "a proposed settlement." [sic] It was objected that this change would encourage certification that could coerce settlement, based in part on the fear that the certification might be carried forward to trial of an unmanageable class. Certification for settlement purposes should not be available merely because the parties "have an idea about settlement." The motion failed with 2 supporting votes and 11 opposing votes.

[263] The Committee Notes offer no clue as to how proposed Rule 23(b)(4) might benefit class members. The only suggestion in the Draft Minutes is the following:

> Clients are better off, particularly when the defendants have insurance. Settlement also has the advantage of treating alike people who, although similarly situated, would be treated differently in separate actions. Choice-of-law, differences in local courts and procedure, problems of proving individual causation, and the like ensure disparate treatment if class disposition is not available.

Draft Minutes *in* Preliminary Draft, supra note 11, at 36. It is not clear to us how the presence of insurance makes settlement classes more desirable for class members. Differences in applicable law, local courts and procedure seem to be the essence of our federal system, and it is odd in this era of "devolution" that the one area in which citizens should be thought to prefer national (or, to use class action jargon "global") solutions is class actions. Finally, difficulties of proof may lead some "class members" to favor a settlement class (though even that depends on what the alternatives are), but others who do not face these difficulties would oppose it. The idea that "the class as a whole" would be better off is far from obvious. In fact, the Committee Notes themselves recognize this problem:

> Definition of the class also must be approached with care, lest the attractions of settlement lead too easily to an over-broad definition. Particular care should be taken to ensure that there are no disabling conflicts of interest among people who are urged to form a single class.

Committe Notes *in* Preliminary Draft, supra note 11, at 53. It is reasonable to ask,

The proposed amendments include only one change specifically designed to address the problems of collusive or otherwise illegal conduct associated with class action settlements: Rule 23(e) would be amended to require that courts hold fairness hearings before approving a settlement—something courts already do as a routine matter.[264] The Advisory Committee decided not to include in the Rule any specific suggestion, much less a requirement, that trial courts appoint special masters or guardians.[265] The Committee did not even include such a requirement or encouragement for those class actions in which no objectors appear to present an adversarial view of the settlement.[266] Nor did the Committee do anything to ensure that objectors who do show up have easier access to the information needed to mount a plausible challenge, although the Advisory Note recognizes this is a problem without suggesting any solutions.[267] The Committee declined to set forth factors to guide (and possibly constrain) a trial court's discretion in approving a settlement,[268] included no mention in the Notes or the text of the Rule of the signs that might indicate collusion, and—in what we can only call an excess of diplomacy—refrained from identifying a greater chance of collusion as one of the "special risks" associated with settlement classes.[269] In short, despite the Com-

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given these reservations, whether the Committee really thought that Rule 23(b)(4) would redound to the benefit of class members.

[264] Committee Note *in* Preliminary Draft, supra note 11, at 54.

[265] The Committee specifically rejected a "special master provision" recommended at a prior meeting. Draft Minutes *in* Preliminary Draft, supra note 11, at 38-39. The Draft Minutes also make reference to an "independent counsel [who] might be appointed to assist in evaluation of a proposed settlement," but only to state that the Committee has not "considered the question" of whether such an independent counsel might be desirable. Id. at 35.

[266] See Committee Note *in* Preliminary Draft, supra note 11, at 54 ("A hearing should be held to explore a proposed settlement even if the proponents seek to waive the hearing and no objectors have appeared.")

[267] Id. at 52.

[268] The Draft Minutes record that someone proposed an option "amending [Rule 23(e)] to include the list of factors for reviewing settlements recommended by Judge Schwarzer in his Cornell Law Review article." Draft Minutes *in* Preliminary Draft, supra note 11, at 35 (referring to but not citing, William W. Schwarzer, Settlement of Mass Tort Class Actions: Order Out of Chaos, 80 Cornell L. Rev. 837 (1995)). Nothing more is said about this (or any other similar) proposal.

[269] Id. at 52:

> For all the potential benefits, settlement classes also pose special risks. The

mittee's understanding that "[t]here is evidence that some state court judges are simply rubber-stamping class settlements,"[270] the Committee recommended no substantial steps to address abusive settlements; instead, it approved in Proposed Rule 23(b)(4) a broad new provision encouraging so-called settlement class actions—class actions that can be settled but could not be tried. If ever there were a provision that seems tailor-made to meet the interests of judges in encouraging class settlements and the interests of lawyers and defendants who would short-change the class for their own gain or violate other laws designed to protect the public, like the antitrust laws, Proposed Rule 23(b)(4) is it. What the proposed amendment does do is ensure that the time and resources of judges will be taxed as little as possible,[271] while preserving the possibility of a judge garnering prestige for having presided over some gigantic settlement that solves some overwhelming problem of personal injury inflicted by some defendant's product or practice. The Proposed Rule also ensures that abuse will flourish.

Along with over one hundred other law professors, we urged the Standing Committee to reject this rule and demand that the Advisory Committee come up with a more responsible draft,[272] but the pleas of academics had no discernible effect on the Standing Committee's membership.[273] We still hope that the settle-

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court's Rule 23(e) obligation to review and approve a class settlement commonly must surmount the informational difficulties that arise when the major adversaries join forces as proponents of their settlement agreement. Objectors frequently appear to reduce these difficulties, but it may be difficult for objectors to obtain the information required for a fully informed challenge. The reassurance provided by official adjudication is missing. These difficulties may seem especially troubling if the class would not have been certified for litigation, or was shaped by a settlement agreement worked out even before the action was filed.

[270] Draft Minutes *in* Preliminary Draft, supra note 11, at 38. Notice that the Committee made up largely of federal judges acknowledged this evidence as to state judges, but not as to their own colleagues.

[271] Some members of the Committee acknowledged this problem as well. See id. at 35 ("Opposition to [approval of settlement class provision] was expressed on the ground that it might encourage judges to certify classes simply in the hope that a settlement would clear the docket.") As with other objections, this one was ignored.

[272] See supra note 260.

[273] Letter from Peter G. McCabe, Secretary, Standing Committee on Rules of Practice and Procedure, to Susan P. Koniak, Steering Committee to Oppose Proposed Rule 23 (July 2, 1996) ("Although there was some disagreement [at the June 19-20

ment class provision will be rejected after the public comment period, but given our assessment of the institutional interests at play we are not confident that reason will prevail. Yet however dangerous we view the proposed rule to be, our main point is that for those who expect procedural reforms to check the abuse that we have described and somehow make unnecessary the suits we propose, we submit that the current state of procedural "reform" and the apparent priorities of the rule-makers makes that expectation a long shot and the suits we propose more necessary.

III. WHERE ESTOPPEL STOPS

The later suits we have proposed are novel. To our knowledge, no successful malpractice suit has ever been brought against class action lawyers, though as of this writing several are pending.[274] There are several possible explanations for this phenomenon. One is that the malpractice elements of causation and damages, always difficult to prove, would be especially difficult in the class action settlement context.[275] But that is not always the case. We focus in this Part on a second possible reason for the lack of such suits: Lawyers considering bringing such suits fear that they would be barred by claim or issue preclusion, or some similar procedural doctrine. We have been able to find only a handful of opinions that address the question of whether malpractice suits can be brought against lawyers involved in class action settlements. Some cases simply take it for granted that such suits are viable without discussing the question in any detail.[276] A few courts have held such suits are

meeting of the Standing Committee], the text of the proposed amendment to the rules was unchanged.") (on file with the Virginia Law Review Association).

[274] Note that we are limiting our inquiry to suits against class counsel who agree to settlements that a court approves. Other suits against class counsel are possible. For a recent example, see Mark Hansen, A Drive to Stifle Litigation, 82 A.B.A. J. 22 (June 1996) (describing recently filed malpractice suit by Chrysler against lawyer who had filed a class action suit against it on the grounds that the class lawyers had previously represented Chrysler and used confidential information about Chrysler to launch the class action).

[275] See Nicolet Instrument Corp. v. Lindquist & Vennum, 34 F.3d 453 (7th Cir. 1994) (Posner, C.J.); Geoffrey C. Hazard, Jr., The Settlement Black Box, 75 B.U. L. Rev. 1257, 1263 n.25 (1995).

[276] Diaz v. Sheppard, 85 F.3d 1502 & n.2 (11th Cir. 1996) (holding that a state law

barred by one of the relitigation doctrines.[277] A few other cases have held such suits to be maintainable, and have either explicitly or implicitly rejected defenses based on the doctrines against relitigation.[278] We argue in this Part that the doctrines barring relitigation do not and should not apply to the suits we propose. Courts that have barred these suits have done so by playing fast and loose with the elements and purposes of these doctrines.

A. The Reasons for the Rules against Relitigation

Before delving into doctrinal detail, we begin by asking what purposes undergird the rules against relitigation, and whether we risk jeopardizing those purposes with our proposal. Although the answer may seem counterintuitive or even shocking, the rules against relitigation confer substantial, efficient and legitimate social benefits by leaving most wrong verdicts in place. In general, our procedural system rejects relitigation as a method of correcting court decisions that simply get it "wrong"; that is, decisions in which the found facts supporting

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malpractice claim brought in state court against class counsel in a prisoner's rights class action cannot be removed to federal court simply because the state court might have to consider federal law in adjudicating the claim, but declining to rule on whether such suits are permissible as a matter of state law and referring to res judicata and collateral estoppel only to make the point that they are affirmative defenses that have no bearing on federal jurisdiction); Peters v. National R.R. Passenger Corp., 966 F.2d 1483, 1487 & n.3 (D.C. Cir. 1992) (rejecting collateral attack on class action settlement, stating that "redress, if any, should come from those responsible for causing his harm," and citing Zimmer Paper Prods. v. Berger & Montague P.C., 758 F.2d 86 (3d Cir. 1985) for the proposition that later suits against class counsel for malpractice are viable); In re California Micro Devices Secs. Litig., 1995 U.S. Dist. LEXIS 11587, *9 (N.D. Cal. Aug. 8, 1995) (considering the extent of a firm's malpractice insurance as an important factor in assessing a firm's fitness to serve as class counsel); In re Wells Fargo Secs. Litig., 157 F.R.D. 467, 473 (N.D. Cal. 1994) (same); In re Oracle Secs. Litig., 136 F.R.D. 639, 649 (N.D. Cal. 1991) (explaining that one advantage to be gained from making law firms compete to be class counsel is that disappointed bidders might help monitor class counsel's performance and in extreme cases bring a malpractice suit against the "winning, but bungling, bidder").

[277] Kamilewicz v. Bank of Boston Corp., 92 F.3d 506, 512 (7th Cir. 1996) (Rooker-Feldman doctrine bars claims); Golden v. Pacific Maritime Ass'n, 786 F.2d 1425 (9th Cir. 1986); Laskey v. International Union, 638 F.2d 954 (6th Cir. 1981) (collateral estoppel bars claims).

[278] Durkin v. Shea & Gould, 92 F.3d 1510, 1516 (9th Cir. 1996); Derrickson v. City of Danville, 845 F.2d 715 (7th Cir. 1988); Zimmer Paper Prods. v. Berger & Montague, P.C., 758 F.2d 86 (3d Cir.), cert. denied, 474 U.S. 902 (1985).

the judgment deviate from an accurate account of the event.[279] De novo review of factual determinations is the rare exception, not the rule.[280] Proceduralists as diverse as Geoffrey Hazard and Robert Cover have recognized these social benefits as central to the rules against relitigation.[281] Professor Hazard suc-

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[279] Appellate courts review factual findings under the "clearly erroneous" standard, which is designed to allow most judgments based on simple factual inaccuracies to stand. Fed. R. Civ. P. 52(a). "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." United States v. U.S. Gypsum Co., 333 U.S. 364, 395 (1948). The more limited view is that this standard "would prevent reversal unless the judge based his finding on a misunderstanding of the law or it was without adequate evidentiary support." Friedenthal, Kane & Miller, supra note 230, § 13.4, at 604-05 (footnote omitted). "It is not enough that we might give the facts another construction, resolve the ambiguities differently, and find a more sinister cast to actions which the District Court apparently deemed innocent." U.S. v. National Ass'n of Real Estate Bds., 339 U.S. 485, 495 (1950). A new trial is ordered based on factual errors only when those errors are so blatant that only the willfully blind, corrupt or seriously inattentive could fail to see them. This standard suggests that the purpose of ordering a new trial in such instances is not a belief that relitigation is appropriate to correct ordinary error but that relitigation is appropriate to correct error that suggests corruption, bias or some other serious institutional defect in the original forum.

[280] See supra note 213. The Supreme Court's recent pronouncements suggesting that the innocence of a prisoner condemned to death is not in itself enough to justify de novo review of otherwise final judgments reflects just how far the general principle against relitigation as a method of correcting errors has been stretched. See, e.g., Herrera v. Collins, 506 U.S. 390 (1993) (newly discovered evidence showing possible innocence does not require de novo review); Jacobs v. Scott, 31 F.3d 1319 (5th Cir. 1994), cert. denied, 115 S.Ct. 711 (1995) (same). Our reference to these cases should not be read as sympathetic. While irrelevant to the argument we present here, which is based on the premise that "errors" in class action settlements are not the product of ordinary factual error, we believe that the consequences of ordinary error should be a factor in considering whether and how stringently to apply the general rule against relitigation to correct ordinary error. See Henry J. Friendly, Is Innocence Irrelevant? Collateral Attack on Criminal Judgments, 38 U. Chi. L. Rev. 142 (1970). On the question of whether criminal convictions should be subject to liberal federal habeas review because there are significant institutional biases present in state courts and important counterbalancing biases present in federal courts, compare Robert M. Cover & T. Alexander Aleinikoff, Dialectical Federalism: Habeas Corpus and the Court, 86 Yale L.J. 1035 (1977), with Paul M. Bator, Finality in Criminal Law and Federal Habeas Corpus for State Prisoners, 76 Harv. L. Rev. 441 (1963).

[281] See Hazard, supra note 245, at 1041-42 ("If our trial procedure produced truth at every trial, the need for doctrines against relitigation would be relatively weak; all that we would be assuring against is the cost of relitigation—a value, but not a compelling one if everyone knew the results would always be the same.") (quoting with approval Professor Preble in conversation). See also note 245 and accompanying text.

As for Professor Cover, he put it thus:

cinctly described the social benefit to be derived from leaving most mistaken verdicts alone:

> The law, particularly litigation, is in Harry Kalven's phrase, a system for managing doubt and doubt requires strict management because its dissolving power is so strong. Where the system of procedure gives, as ours does, ample opportunity for developing contentions and discovering evidence, as ours does, a correspondingly extensive rule against relitigation is not merely warranted, but is essential for otherwise the procedural armory is turned on itself.[282]

The good to be realized by leaving wrong decisions alone is not, however, boundless. These proceduralists agree that it makes sense to leave uncorrected almost all erroneous decisions in which the error is attributable to the inevitable tendency of humans and their institutions to make mistakes—when the error is simple error and not error due to bias or some other defect inherent in the court that decided the case. But they also agree that the general rule against relitigation should end when the error is not simple, but is instead a function of forum bias or defect.[283] And our procedural rules generally reflect that view.[284]

> It is, of course, possible to use multiple forums to deal with the potential of mere error, and we do so occasionally in providing for a de novo review. But it is very expensive and the coordination principles necessary to deal with inconsistent outcomes may become cumbersome. Within a single forum and proceeding, the contradictions among witnesses or between different statements of a single witness may be evaluated in a single act of judgment which encompasses a view of all the contradictory material. The output of a system of redundant forums, however, is either confirmatory or contradictory *verdicts*. Presented with such verdicts, one cannot easily pass judgment on questions of error in reconstructing events without first unpacking what might be called forum effects.

Robert M. Cover, The Uses of Jurisdictional Redundancy: Interest, Ideology, and Innovation, 22 Wm. & Mary L. Rev. 639, 654-56 (1981). These observations led Professor Cover to conclude that to correct (or avoid) simple or "mere" errors redundant procedures within a single proceeding, such as direct and cross-examination, made sense, but redundant proceedings did not. Id. at 657. The latter produce only further uncertainty, given that there is no principled way to choose between two inconsistent verdicts that might be rendered. This concern about creating doubt to no apparent purpose is the precise social cost emphasized by Professor Hazard in his discussion of the rules against relitigation. See Hazard, supra note 245.

[282] Hazard, supra note 245, at 1042-43.

[283] Id. at 1041-42; Cover, supra note 281, at 658-68.

[284] For example, federal rules provide that a judgment may be vacated many years after it is entered, if it shown that it was obtained as the result of fraud on the court.

The suits we propose do not aim to redress simple error. Rather, they aim to redress the effect of self-dealing made possible by the absence of real parties in interest from the first proceeding, as well as the other inherent defects and biases in the first proceeding that make detection of such self-dealing unlikely. Thus, our proposal does not interfere with the primary social good served by our rules against relitigation: the management of doubt created by inevitable and otherwise innocent error. On the other hand, allowing a system infected with systematically biased behavior to continue unchecked is not a goal of our rules against relitigation nor is it a goal any civilized legal system should promote.

The rules against relitigation do serve another legitimate goal: ensuring that individuals are not subject to inconsistent verdicts.[285] But our suits would not compromise that goal. Nothing about the suits we propose would necessitate subjecting anyone to conflicting obligations. For example, the lawyers in *Hoffman* could simultaneously pay damages and carry out whatever obligations they might have under the class action settlement. They would face no conflicting obligations.[286] The bank, it is true, might be liable for damages for doing what it was ordered to do by the Alabama court—disburse escrow money to the lawyers—but it would appear that the bank caused this problem for

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Fed. R. Civ. P. 60(b)(6). Another example is the general principle that an issue may be relitigated when the previous proceeding did not provide a full and fair opportunity to litigate it in the first instance. See, e.g., Restatement (Second) of Judgments § 26 (1982) (claim may be relitigated when first procedure excluded opportunity to present theory or remedy advanced in second proceeding).

[285] Professor Hazard identifies this as one of the two satisfactory justifications for the general rules against relitigation, the other being the management of doubt created by simple error. "[S]o far as possible, the courts should avoid imposing conflicting legal obligations on a single individual." Hazard, supra note 245, at 1042.

[286] To give an even more extreme example, in *Derrickson v. City of Danville*, which we discuss in detail below, the Seventh Circuit held that a court-approved voting rights settlement that preserved the jobs of currrent city officials did not preclude prosecution of those officials for violating state conflict-of-interest laws. 845 F.2d at 723 (7th Cir. 1988). In the midst of describing the defendant's argument, the court made the following parenthetical aside: "Mayor Curley of Boston showed that one can run a city from jail; anyway, the resignation of a Department Head would not change or violate the decree." Id. at 720. If prosecution of participants in a settlement does not interfere with the settlement, then surely the payment of damages by participants does not interfere with the settlement.

itself by breaching its duty to protect that money when it agreed not to raise any objections to the attorney's fee plan.[287]

B. Claim Preclusion

Under the doctrine of claim preclusion, sometimes referred to as res judicata, a party who has once had the chance to litigate a matter is generally denied the opportunity to relitigate it against the same opposing party.[288] Claim preclusion, when it applies, bars later litigation of any claim a plaintiff could have raised against the defendant arising out of the transaction or occurrence that was the subject of the earlier suit, whether or not those claims were actually raised.[289] It also bars any defenses a defendant could have raised to the claim presented in the earlier suit and any compulsory counterclaims that were available at the time of the first suit.[290]

Because claim preclusion applies only when the parties in the second action are the same as those in the first action,[291] it would not apply in most of the suits we propose. Class lawyers are not parties to the settlement of class actions (the first proceeding), so claim preclusion should not bar later suits brought by class members (or anyone else) against class counsel for allegedly illegal conduct in connection with a class settlement.[292]

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[287] We address below arguments that it would be fundamentally unfair to punish people for conduct a court had in some manner blessed, see infra Section III.D.

[288] Fleming James, Jr., Geoffrey Hazard, Jr. & John Leubsdorf, Civil Procedure § 11.7, at 586 (4th ed. 1992).

[289] Id. § 11.7, at 589.

[290] Id. § 11.15, at 603-05. Noncompulsory counterclaims are not barred. See, e.g., Mercoid Corp v. Mid-Continent Inv. Co., 320 U.S. 661, 671 (1944) (failure to bring separate statutory antitrust counterclaim in patent validity suit does not render patent validity judgment res judicata with respect to the antitrust suit).

[291] Generally, the parties to the first suit are the persons and entities designated as such in the complaint and other pleadings. James et. al., supra note 288 § 11.7, at 586-87. There are, however, a few situations in which the parties for purposes of claim preclusion are not limited to those designated as such in the pleadings. Id. See, e.g., In re Imperial Corp. of America, 92 F.3d 1503, 1507-08 (9th Cir. 1996) (holding that a wholly-owned subsidiary with a board identical to its parent is entitled to be treated as a party for purposes of claim preclusion, although only the parent was technically a defendant in the first suit, a class action).

[292] "A party appearing in an action in one capacity, individual or representative, is not thereby bound by or entitled to the benefits of the rules of res judicata in a subsequent action in which he appears in another capacity." Restatement (Second) of Judgments § 36(2) (1980).

The same is true for suits against the lawyers who represented the defendant in the class settlement; defense counsel are also not considered parties to the class action settlement.[293] In only two situations would the parties to the second suit be identical to the parties in the underlying class action thus satisfying this requirement of claim preclusion. First, class members might bring a subsequent suit against the defendants for engaging in illegal conduct in connection with the class action settlement, for example, conspiring with class counsel to defraud the class and its guardian, the court, by misrepresenting the costs and benefits to the class of the settlement or of class counsel's petition for attorney's fees.[294] Second, a state or the federal government might bring a subsequent suit against the defendants for fraud or some other illegal activity connected to the settlement negotiation (such as violating the antitrust laws) when the government entity had previously intervened to object to the settlement.[295]

Identity of parties is not, however, all there is to claim preclusion; not every later suit between parties who have previously been adversaries is barred. In general, only those claims that are part of the same transaction or occurrence as the claims alleged

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None of the cases that preclude later suit against class counsel invokes claim preclusion to achieve that result. See Kamilewicz v. Bank of Boston Corp., 92 F.3d 506, 512 (7th Cir. 1996) (Rooker-Feldman doctrine bars claims); Golden v. Pacific Maritime, 786 F.2d 1425, 1428-29 (9th Cir. 1986) (issue preclusion); Laskey v. Internation Union et al., 638 F.2d 954, 957 (6th Cir. 1981) (issue preclusion); Valerio v. Boise Cascade Corp., 80 F.R.D. 626, 632-34 (N.D. Cal. 1978), aff'd, 645 F.2d 699, 700 (adopting district court's opinion), cert. denied, 454 U.S. 1126 (1981) (statute of limitations). Rather, recognizing that class counsel was not a party to the first proceeding but the plaintiffs in the later suit were, the courts rely on issue preclusion, which does not generally require identity of parties, see infra Section III.C. (discussing elements of issue preclusion), or some other procedural bar like the statute of limitations.

[293] See, e.g., Durkin v. Shea & Gould, 92 F.3d 1510, 1518 (9th Cir. 1996) (allowing suit against defense counsel for conduct connected to settling a derivative action and rejecting both claim and issue preclusion as bars to such a suit).

[294] E.g., Benn v. BancBoston Mortgage Corp., No-96-CV-0974-J, filed May 13, 1996 (N.D. Tex.) (another suit arising out of the *Hoffman* class action, but naming only the bank as a defendant). Even in this situation, the first element of claim preclusion, identity of parties, is not a simple matter. If those suing in the second suit had been *absent* class members in the first suit, they should not be presumed conclusively to have been parties in the first suit. Absent class members are bound by a judgment only if they were adequately represented. Hansberry v. Lee, 311 U.S. 32 (1940). Cf. text accompanying notes 409-414.

[295] See, e.g., Derrickson v. City of Danville, 845 F.2d 715 (7th Cir. 1988).

in the first suit are barred.[296] By definition, the wrongs that our later suits are designed to redress arise out of a different transaction or occurrence than the wrongs that were settled on behalf of the class.

Consider the facts in *Derrickson v. City of Danville*.[297] The *Derrickson* story begins with a voting rights class action against the City of Danville, Illinois, in which class counsel and four city officials assisted by the city's lawyer negotiated a settlement. The settlement included a provision allowing the four officials to retain their jobs during a three-year transition period to a new form of elected government set forth in the settlement.[298] The state conflict-of-interest law made it a crime for city officials to negotiate on behalf of the city a contract that included provisions inuring to the personal benefit of city negotiators.[299] The state attorney general believed that by negotiating the settlement with its three-year job guarantee, the city officials and city lawyer had violated that law and convened a grand jury to indict them. The federal judge, before whom the voting rights settlement was pending, enjoined the attorney general's attempt to indict the city negotiators, and, upon motion of the plaintiffs, made the state attorney general a party to the class action suit.[300] The federal district court then approved the settlement after conducting a fairness hearing on the deal. No one appealed.[301] After the court approved the class action settlement, the state attorney general reconvened the grand jury and secured the indictments he had tried to secure earlier, and for the second time, the federal district court enjoined him.[302] The Seventh Circuit, in an opinion by Judge Easterbrook, reversed the district court, lifted the injunction and allowed the state prosecution to proceed, holding that neither claim nor issue preclusion barred the later state action against those who had negotiated the class settlement.[303]

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[296] See Cound, et. al., Civil Procedure 1228-29 (6th ed. 1993).
[297] 845 F.2d at 716 (7th Cir. 1988).
[298] Id.
[299] Id.
[300] Id.
[301] Id.
[302] Id.
[303] Id. at 721.

Claim preclusion was an issue in *Derrickson* because the state attorney general had been made a party to the class action proceeding, albeit against his will, and the defendants he sought to prosecute in the later suit were also parties to the class action suit. Judge Easterbrook, however, had no trouble seeing that the self-dealing alleged to be criminal by the state attorney general was not the same "transaction or occurrence" as the voting rights violation that was resolved by the class action settlement.[304] Moreover, the Illinois Supreme Court later adopted this analysis in its decision upholding the convictions that the state attorney general eventually obtained.[305] Were these courts too narrowly defining "transaction or occurrence?"

We think not. The underlying class action was about one occurrence (a form of city government that allegedly denied people rights guaranteed by the voting rights law), while the later prosecution was about another (the use of public office for personal gain in the process of settling a lawsuit). The facts and law necessary to establish the first cause of action were not the same as those important to the second case. And the same would be true in the other situations in which claim preclusion might arguably be relevant to the later suits we propose. For example, the facts and law necessary to establish whether BancBoston committed a wrong by demanding that its customers deposit more money in escrow than their contracts required are different than the facts and law that would be relevant to determining whether the bank breached a fiduciary duty to its customers by agreeing not to object to class counsel's request for

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[304] Id. ("The criminal prosecution also did not grow out of the same 'transaction or occurrence' as the Voting Rights Act claim.") Judge Easterbrook gave a number of reasons why claim preclusion was inapplicable to the case before him. In addition to the different transaction argument, he relied on the rule that only compulsory counterclaims are considered barred by res judicata (claim preclusion) in later suits brought by a defendant against his former adversary. Id. at 721. The attorney general had been "a defendant" in the class action proceeding. "A state criminal prosecution is not a compulsory counterclaim in a federal civil suit, not least because the forum lacks the jurisdiction to try the criminal case." Id. Moreover, Judge Easterbrook explained, the authority of a government agent to enter into a settlement may generally be challenged later if overlooked in the first proceeding. Id. (citing, inter alia, United States v. Beebe, 180 U.S. 343, 351-55 (1901) and Stone v. Bank of Commerce, 174 U.S. 412 (1899)).

[305] People v. Scharlau, 565 N.E.2d 1319, 1329-30 (Ill. 1990) (adopting the Seventh Circuit's claim preclusion analysis).

attorney's fees.[306] To argue that wrongs committed in the process of litigation are properly treated as arising from the same transaction as the wrong originally litigated requires one to accept some ridiculous results. For example, that argument suggests that all later prosecutions for perjury or bribery of witnesses should be barred because such acts necessarily occur in the process of resolving a prior legal controversy.

Of course, when the parties are the same, even if the later suit is not barred by claim preclusion, it may be barred by issue preclusion, otherwise known as collateral estoppel. We turn next to that matter.

C. Issue Preclusion

In most later suits of the type we propose, the identity of parties necessary for an assertion of claim preclusion is lacking: the class suing its counsel; the class suing the defendant's lawyers; a government that had not objected suing or prosecuting class counsel or the defendants; other plaintiffs' lawyers suing class counsel for violations of the antitrust laws. In those cases, as well as the cases in which the assertion of claim preclusion would meet the "identity of parties" requirement but fail the "same transaction" requirement, the relevant relitigation question would be whether the party bringing the second suit was precluded from litigating an issue because it had been determined in the first proceeding. "Issue preclusion applies when an issue (a) was actually decided, (b) after a full and fair opportunity to litigate, and (c) was necessary to the decision."[307] We consider these requirements in turn.

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[306] But see In re Imperial Corp. of America, 92 F.3d 1503, 1507-08 (9th Cir. 1996) (holding that claim preclusion bars a later suit against the defendant when the new claims of breach of fiduciary duty and mismanagement repeat claims made in the class action litigation, e.g., that the defendant invested in bad loans and failed to establish reserves).

[307] *Derrickson*, 845 F.2d at 721 (citing Parklane Hosiery Co. v. Shore, 439 U.S. 322 (1979)); United States v. Ryan, 810 F.2d 650, 654 (7th Cir. 1987); Schellong v. INS, 805 F.2d 655, 658-59 (7th Cir. 1986); Restatement (Second) of Judgments § 27 (1980)).

1. Was the Issue Actually Decided in the First Suit?

In many of the suits we propose, the issue will not have been "actually decided." For example, the district court in *Georgine* did not consider, no less decide, whether the terms of the settlement that gave certain plaintiffs' firms a built-in advantage in the market created by the settlement violated the antitrust laws, or, for that matter, whether the caps on attorney's fees violated those laws.[308] Indeed, we know of no decision approving a class settlement that purports to have decided that the antitrust laws were complied with in selecting class counsel, that those laws were not violated by the terms of the settlement or that the attorney fee caps for the market created by the settlement are valid under the antitrust laws. Furthermore, in approving class action settlements courts do not make findings on whether the *defendant*, as opposed to the class, was adequately represented. Thus, a later malpractice or fraud action against defense lawyers who negotiated and recommended to their client a class action settlement that harms the client, for example by unduly shifting officer liability to the corporate-defendant, would not involve the redetermination of an issue previously determined in the prior proceeding.[309]

In approving a class action settlement the court is supposed to (and generally does)[310] decide that the class was adequately rep-

[308] Moreover, as we shall discuss later in detail, any explicit or implicit finding that such terms were "reasonable" is not the equivalent of a finding that no violation of the antitrust laws has occurred, see infra Section IV.C.1.

[309] In *Durkin*, which involved just such a suit by the corporation's successor-in-interest against the defense lawyers who negotiated and recommended the class settlement, the Ninth Circuit in rejecting issue preclusion made precisely this point:

> [A]s required by Rule 23.1, . . . [the class action judge] determined that the shareholder plaintiffs adequately represented similarly situated shareholders. [He] did not decide that the shareholder plaintiffs and their attorneys adequately represented the full corporate interests of [the defendant]; nor did [he] specifically find that [the defense lawyers] adequately represented the interests of a corporation on the eve of its bankruptcy.

92 F.3d at 1516 (citation omitted).

[310] In approving class action settlements, courts do not always remember to make the required findings. Of course, we take this to be further evidence of how inattentive many judges are to their responsibilities as guardians for the class. Whether it shows that or not, the fact remains that the "required" findings do not always appear on the record. For example, in Laskey v. International Union, 638 F.2d 954 (6th Cir. 1981), which held that issue preclusion prevented a later suit for malpractice against class

resented, that the settlement terms are fair and reasonable and that the attorney's fees awarded to class counsel are reasonable. Do these findings mean that the class action court has actually decided whether class counsel committed malpractice or fraud upon the class? We are convinced that the answer in both instances is no, although we hasten to add that even were our answer yes, the absence of a full and fair opportunity for absent class members to litigate these matters would, as we shall later argue, still defeat issue preclusion.[311]

The purpose of a class action court's inquiry into whether the class was adequately represented is to ensure that absent class members have received due process, and that the requirements of Rule 23(a) or its state counterpart are met.[312] Courts are notoriously vague on what constitutes "adequate representation."[313] In particular, they do not define "adequate" to be

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counsel, the district court may have neglected to find class counsel adequate, and the appellate court in its rush to find preclusion fudged the question of whether there was an "actual decision" on the issue. The appellate court said:

> Since appellants had the opportunity to object to the legal representation at the prior settlement hearing and since a finding that the class was adequately represented is necessary for finding the settlement was fair and reasonable, which in turn was essential to approving the settlement, appellants are collaterally estopped from now asserting that the legal representation was not adequate and that the UAW committed legal malpractice.

Id. at 957 (internal citation omitted). When parsed, this sentence falls short of stating that the question of adequacy was actually decided. Why? An examination of the lower court decision in *Laskey*, rendered by the same court that had previously approved the underlying class action, strongly suggests that the class action court did not make a separate finding on adequacy, a lapse perhaps attributable to the fact that no one challenged adequacy during the fairness hearings. All the district court says it "expressly found" was that the terms of the settlement were "fair and reasonable to the absent members of the plaintiff class in light of the merits of this action and other pertinent factors, and that the settlement is in the best interests of the class members." Laskey v. International Union, 27 Fed. R. Serv. 2d 473, 478 (E.D. Mich. 1978). Although courts often base their finding of adequacy of representation on the fact that the terms of the settlement were fair, see infra notes 315-320 and accompanying text, the court did not even make this connection (weak as we later argue it is) explicit. Given the apparent absence of an actual earlier decision on this matter, the Sixth Circuit's attitude toward this element of issue preclusion can only be described as lax.

[311] See infra Section III.C.3.

[312] Fed. R. Civ. P. 23(a); 2 Newberg on Class Actions, supra note 172, § 11.41, at 11-85 to 11-89.

[313] See Koniak, supra note 15, at 1116-17 (describing the emptiness of "adequacy" as a standard for judging class counsel's representation).

"nonnegligent" or "without fraud." Given the lax standards on "adequacy," as evidenced by the high approval rates for class action settlements, it is difficult to understand how a court attentive to the elements of issue preclusion could hold that a finding of adequacy amounts to a decision that class counsel caused no damages to any part of the class through carelessness or fraud in the representation, the issue to be decided in a malpractice case.[314]

The little that class action courts do say about the finding of "adequate representation" supports our view that this finding bears little relationship to the issues to be decided in a malpractice suit.[315] Most telling, courts often reduce the question of adequacy to a question of whether the settlement terms are fair and reasonable. In the oft-quoted words of the Fifth Circuit:

> It is, ultimately, in the settlement terms that the class representatives' judgment and the adequacy of their representation is ei-

[314] Compare the collateral estoppel treatment of a different issue in class actions, namely whether the finding by a federal court that a proposed class action does not satisfy the certification requirements of Rule 23 collaterally estops a subsequent state class action alleging the same facts and making the same legal claims. Even if the state has a class action rule similar to Rule 23, courts have held that because state courts might apply the relevant criteria differently, the subsequent class action is not collaterally estopped. Morgan v. Deere Credit, 889 S.W.2d 360 (Tex. Ct. App. 1994). If collateral estoppel does not bar a subsequent class action suit when the issues are this similar, how could it bar a subsequent malpractice suit when the issues are not even defined in a similar way?

[315] In addition to the quite common refrain on adequacy that we discuss next in the text, courts often treat violations of the ethics rules as irrelevant to the question of adequacy. See, e.g., *Georgine,* 157 F.R.D. at 330 ("This Court need not decide, however, whether or not a state bar disciplinary board would conclude that . . . [counsel] technically violated [ethics] Rule 5.6 [by having bound themselves in another settlement with the defendants to recommend to others the settlement being put before the court] since that issue is not before this Court in determining the adequacy of counsel."); Harris v. General Dev. Corp., 127 F.R.D. 655, 662 (N.D. Ill. 1989) ("[A]lthough the fee arrangement may give rise to a technical deviation from ethical standards, denial of class certification [based on a finding of inadequate representation] is unwarranted."). However, in malpractice actions a violation of an ethics rule is admissable and occasionally creates a rebuttable presumption that the lawyer has breached his duty to the client, an essential element of the malpractice claim. See Hazard, Koniak & Cramton, supra note 249, at 190. For a rare example of a class action court taking an ethics violation seriously, see Wagner v. Lehman Bros. Kuhn Loeb, 646 F. Supp. 643, 662 (N.D. Ill. 1986) (holding that the ethics violation rendered class counsel unfit to represent the class). It is interesting to note that the ruling in *Wagner* did not require the court to reject a class settlement because no settlement had been reached. Id. at 645.

> ther vindicated or found wanting. If the terms themselves are fair, reasonable and adequate, the district court may fairly *assume* that they were negotiated by competent and adequate counsel; in such cases, whether another team of negotiators might have accomplished a better settlement is a matter equally comprised of *conjecture* and *irrelevance*.[316]

But a finding based on an assumption is fundamentally different than one based on evidence, and a finding that the settlement terms are fair is a far cry from a decision on whether malpractice, fraud or a violation of the antitrust laws has occurred. This is especially true given the fact that, in assessing fairness, the court is to consider the settlement as a whole,[317] which allows courts to approve settlements as fair even when those settlements include provisions that damage the class or some subgroup within it, and which would not have been included absent the lawyer's breach or self-dealing.

Moreover, in an ordinary malpractice action, a finding that the settlement terms were reasonable will not relieve the lawyer of responsibility for malpractice in negotiating or recommending the settlement. In class action suits, the idea that a reasonable-looking settlement might nonetheless be the product of woefully inadequate representation is considered, in the words of the Fifth Circuit, too "conjectural" and in any event, "irrelevant." But lawyers for ordinary clients may be held liable for their negligence whenever the negligence is shown to have caused the client a loss.[318] That showing is always conjectural in some sense because it is counterfactual, but courts in lawyer malpractice suits take it for granted that such a showing may be made. Most jurisdictions that have addressed the question have held that if the plaintiff can show that the lawyer's lack of diligence or breach of loyalty caused a settlement to be lower than it

[316] In re Corrugated Container Antitrust Litig., 643 F.2d 195, 212 (5th Cir. 1981) (emphasis added). See also *Georgine*, 157 F.R.D. at 326 (quoting *Corrugated Container*); and In re Asbestos Litig. (Flanagan v. Ahearn), 90 F.3d 963, 975 (5th Cir. 1996) (same).

[317] See, e.g., Armstrong v. Board of Sch. Dirs., 616 F.2d 305, 315 (7th Cir. 1980) (individual components of an agreement are to be evaluated in light of the settlement as a whole).

[318] See generally Charles W. Wolfram, Modern Legal Ethics, §§ 5.6.2-5.6.3, at 209-23 (1986) (reviewing elements of legal malpractice and negligence generally).

would have been absent the lawyer's breach, the lawyer may be found liable for the resulting harm.[319]

As the New Jersey Supreme Court put it: "The fact that a party received a settlement that was 'fair and equitable' does not mean necessarily that the party's attorney was competent or that the party would not have received a more favorable settlement had the party's incompetent attorney been competent."[320] Thus, the legal finding that a settlement is objectively fair is

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[319] See, e.g., Edmondson v. Dressman, 469 So. 2d 571, 574 (Ala. 1985) (allowing suit for malpractice in settlement to go forward); Grayson v. Wofsey, Rosen, Kweskin, & Kuriansky, 646 A.2d 195, 199 (Conn. 1994) (holding that client's agreement to a settlement does not preclude later malpractice action); Keramati v. Schackow, 553 So. 2d 741, 746 (Fla. Dist. Ct. App. 1989) (malpractice claim not estopped, although clients had agreed to the settlement); McCarthy v. Pederson & Houpt, 621 N.E.2d 97, 101-02 (Ill. App. Ct.), app. denied, 624 N.E.2d 809 (1993) (malpractice suit not barred, although plaintiff had agreed to settle the underlying case after the settlement was reviewed by independent counsel); Sanders v. Townsend, 509 N.E.2d 860 (Ind. Ct. App. 1987), aff'd in relevant part, vacated in part, 582 N.E.2d 355 (Ind. 1991) (malpractice suit not barred, but holding on facts that summary judgment was properly granted in attorney's favor because the plaintiff failed to show that had the attorney not been negligent, the settlement or verdict award would have been greater); Braud v. New Eng. Ins. Co., 534 So. 2d 13 (La. Ct. App. 1988) (same); Fishman v. Brooks, 487 N.E.2d 1377 (Mass. 1986) (same); Lowman v. Karp, 476 N.W.2d 428, 431 (Mich. App. 1991) (per curiam) (client's agreement to settle does not bar later suit against lawyer for malpractice); Cook v. Connolly, 366 N.W.2d 287 (Minn. 1985) (same); McWhirt v. Heavey, 550 N.W.2d 327 (Neb. 1996) (client's agreement to divorce settlement does not bar subsequent malpractice action against client's lawyer for alleged negligence in settlement advice); Malfabon v. Garcia, 898 P.2d 107, 110 (Nev. 1995) (per curiam) (client may sue lawyer for malpractice even after agreeing to a settlement); Ziegelheim v. Apollo, 607 A.2d. 1298, 1304 (N.J. 1992) (malpractice suit proper when lawyer fails to exercise the same level of skill, knowledge and diligence with respect to a settlement that is required of lawyers in other contexts); Mazzei v. Pokorny, Schrenzel & Pokorny, 509 N.Y.S.2d 100 (N.Y. App. Div. 1986) (same). But cf. Douglas v. Parks, 315 S.E.2d 84 (N.C. Ct. App. 1984) (holding that because plaintiff affirmed the settlement agreement, he was precluded from bringing a malpractice suit against the attorney who represented him in the original action); Muhammad v. Strassburger, McKenna, Messer, Shilobod & Gutnick, 598 A.2d 27 (Pa.), cert. denied, 112 S.Ct. 196 (1991) (barring malpractice suit against former lawyers when client agreed to the settlement absent some showing of fraud by the attorney); Schlomer v. Perina, 473 N.W.2d 6 (Wis. Ct. App. 1991), aff'd, 485 N.W.2d 399 (Wis. 1992) (rejecting as against public policy a malpractice claim that attorney's three years of inactivity caused a lesser settlement and caused the client loss of use of money from an earlier and larger settlement). See generally James L. Regelhaupt, Jr., Annotation, Legal Malpractice in Settling or Failing to Settle Client's Case, 87 A.L.R.3d 168, §§ 3-5 (1978) (collecting cases where malpractice alleged due to attorney's settlement of case for unreasonable amounts).

[320] *Ziegelheim*, 607 A.2d at 1305.

distinguishable from a finding that the client was not damaged by the lawyer's breach. The fact, assuming it is a fact, that the result in the underlying lawsuit was objectively fair may make it more difficult for the client suing for malpractice to show that a better result would have been obtained, but there is no reason for it to be a fatal fact as a matter of law.

Indeed, outside the class action context, courts have held that clients may sue their lawyer for malpractice in negotiating and recommending a settlement that was not only explicitly accepted by the client, but also found to be fair by an earlier court charged with the responsibility of reviewing the settlement to ensure that the client was protected.[321] For example, in *Grayson v. Wofsey, Rosen, Kweskin & Kuriansky*, the Connecticut Supreme Court refused to bar malpractice actions involving the settlement of divorce proceedings, despite the fact that in such proceedings courts are obligated "to conduct a searching inquiry to make sure that the settlement agreement is substantively fair and has been knowingly negotiated."[322] The Connecticut court put the point succinctly:

> [T]he court's inquiry does not serve as a substitute for the diligent investigation and preparation for which counsel is responsible. Indeed, the dissolution court may be unable to elicit the information necessary to make a fully informed evaluation of the settlement agreement if counsel for either of the parties has failed properly to discover and analyze the facts that are relevant to a fair and equitable settlement.[323]

True, malpractice suits involving court-approved settlements, like *Grayson,* generally involve divorce settlements, not class action settlements. But what is so special about class actions that they require greater immunization of participating lawyers

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[321] See, e.g., *Grayson*, 646 A.2d at 200 (court review of the settlement does not immunize lawyer from later claim of malpractice); Ruffalo v. Patterson, 285 Cal. Rptr. 647, 648 (Cal. Ct. App. 1991) (court approval of settlement does not preclude later suit for malpractice against lawyer); Garcia v. Borelli, 180 Cal. Rptr. 768, 772 (Cal. Ct. App. 1982) (same); *McWhirt*, 550 N.W.2d at 335 (court review of divorce settlement and determination that settlement was not unconscionable does not preclude subsequent malpractice action); *Cook*, 366 N.W.2d at 291 (rejecting collateral estoppel argument because "at a hearing on approval of a proposed minor settlement, the trial court is not adjudicating issues of legal malpractice").

[322] *Grayson*, 646 A.2d at 200.

[323] Id. (citations omitted).

than divorce actions? In fact, the differences between class actions and divorce cases, if anything, cut in favor of less protection for class action lawyers, not more. The risks of negligent and fraudulent behavior surely increase as the likelihood of meaningful monitoring by the client decreases, but as surely as the client in a divorce action may have trouble monitoring the lawyer, the absent class member will have more trouble still. This makes all the more puzzling and troubling the Ninth Circuit's opinion in *Golden v. Pacific Maritime Association*,[324] which held that a class member was collaterally estopped from suing class counsel for malpractice and fraud in negotiating a settlement, in part because the class action court had made specific findings on class counsel's competence and performance.[325] *Golden* relied on an earlier case that had collaterally estopped a suit for fraud against lawyers (and other participants) involved in a bankruptcy settlement.[326] That earlier case reasoned that the Bankruptcy Act could not be administered by federal courts without the participation of attorneys, who thus deserved as much protection from relitigation as the parties to the original action.[327] Transposed to the class action arena, the *Golden* court's reasoning suggests that because lawyers are necessary for class actions, they deserve greater immunity from subsequent suits.[328] But lawyers are just as necessary for divorce actions, or

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[324] 786 F.2d 1425 (9th Cir. 1986).

[325] Id. at 1428.

[326] Samuel C. Ennis & Co. v. Woodmar Realty Co., 542 F.2d 45 (7th Cir. 1976), cert. denied, 429 U.S. 1096 (1977). In *Ennis*, the Seventh Circuit reversed a district court order refusing to enjoin a state action for fraud allegedly committed in connection with bankruptcy proceedings that had taken place five years earlier. Id. at 46. The precedential value of *Ennis* in the Seventh Circuit is, we believe, somewhat diminished in light of its later decision in *Derrickson*, 845 F.2d 715, which does not cite *Ennis*.

[327] *Ennis*, 542 F.2d at 49.

[328] It is possible to read *Golden* as standing for a narrower proposition, namely that when a lawyer brings a subsequent suit merely to "harass," collateral estoppel will bar it. 786 F.2d at 1429. The court in *Ennis* had stressed the fact the charges of fraud made by the lawyer in the subsequent suit were made "in gross bad faith," 542 F.2d at 47, suggesting that they were so frivolous as to amount to unethical conduct. *Golden* not only relied on this aspect of *Ennis*, but also suggested that the charges brought against the lawyers were frivolous and being brought for harassment purposes. 786 F.2d at 1428. The problem is that in *Ennis* there was more evidence that the subsequent suit was in fact frivolous than there was in *Golden*, where the court relied solely on the fact that the lower court "found an inference of harassment" in the state suit. 786 F.2d at 1427.

any other type of litigation, as they are for class actions. Although clients may be more dependent on lawyers in class actions, in our view this fact cuts in favor of a need for greater client protection, not greater lawyer immunity. Moreover, if the point is that lawyers would not participate in class actions unless they were guaranteed greater leeway to engage in negligent or fraudulent behavior, we believe that argument is highly implausible given the large amount of money lawyers can earn doing class actions without misconduct. If the only way to get lawyers to participate in class actions is to allow them to commit malpractice and fraud with impunity, then we should abolish class actions (a solution we do not espouse).

Even if the Ninth Circuit's reasoning in *Golden* were more defensible, the precedential weight of the case is substantially undermined by *Durkin v. Shea & Gould*,[329] the case that most strongly supports our view that a class action court's finding of adequacy does not preclude a second suit for malpractice. In *Durkin*, the first court had ruled that a derivative suit settlement was fair and reasonable, but the Ninth Circuit distinguished that finding from the issues to be decided in the malpractice case before it. In doing so, the Ninth Circuit recognized the obvious relevance of the divorce settlement cases to the class action settlement context:

> [A]lthough the California courts have not considered issue preclusion in the context of a Rule 23.1 settlement, they have consistently held that a court-approved settlement or judgment does not immunize an attorney from a subsequent malpractice action. As the California Court of Appeal has observed: "To hold otherwise would be to rule that where an attorney's negligence has caused a court to make an erroneous adjudication of an issue, the fact that the court has made that adjudication absolves the attorney of all accountability and responsibility for his negligence."[330]

One might argue that *Durkin* does not broadly support the suits we propose because it involved a malpractice suit against the defendant's lawyers rather than against class counsel, and the first court had not found that the defendant's lawyers had "ade-

[329] 92 F.3d 1510 (9th Cir. 1996).
[330] Id. at 1517-18 (citations omitted).

quately represented" the defendant. But much of the *Durkin* court's reasoning applies equally to malpractice suits brought against class counsel, as the court's reliance on the divorce cases suggests.[331]

Another case that supports our argument that a class action court's finding that class counsel was adequate is not the equivalent of a finding that class counsel has fulfilled all duties owed to class members is *Zimmer Paper Products v. Berger & Montague, P.C.*[332] In *Zimmer*, a corporate member of the plaintiff class sued class counsel for negligence and breach of fiduciary duty in failing to provide adequate notice to it of the class settlement, which allegedly caused Zimmer to lose its chance to share in the recovery.[333] Zimmer made essentially two claims: that class counsel's chosen notice procedure was itself negligent, despite the fact that the class action court approved it; and that even if the notice procedure itself was acceptable, class counsel negligently implemented that procedure.[334] Although the court rejected both claims, it did so on the particular facts before it, leaving the door open to future malpractice suits against class counsel.[335]

As to the first claim, Zimmer argued that given the large sums of money involved, class counsel was negligent to have proposed notice by first class mail; instead, class counsel should have proposed notice by certified mail, return receipt requested, and should have suggested follow-up procedures after the first notice

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[331] As we have already noted, the court below in *Durkin* did dismiss the malpractice claims against class counsel, although on what ground is not clear. As that dismissal was not before the appellate court in *Durkin*, we cannot be sure whether the appellate court would have accepted what we claim to be the implications of its reasoning. The fact that the appellate court seemed to emphasize that the first court did not rule on the adequacy of the defense lawyers may suggest that it might distinguish a suit against class counsel. On the other hand, the court also emphasized that the plaintiff's malpractice action "does not even accrue until after the settlement becomes final," id. at 1517, which could serve as an independent basis to reject issue preclusion, and one that would apply equally to a malpractice action by class members against class counsel. For further discussion of the "not accrued" point, see infra text accompanying note 372.

[332] 758 F.2d 86 (3d Cir.), cert. denied, 474 U.S. 902 (1985).

[333] Id. at 88.

[334] Id.

[335] Id. at 94.

was sent.[336] In rejecting this claim, what the Third Circuit did not say is as important as what it did. The Third Circuit did not say that court approval of the notice precluded class members from a later malpractice suit against class counsel. The Third Circuit did not say that satisfying due process or Rule 23 was the equivalent of satisfying one's fiduciary duties to the class.[337] What the Third Circuit said was:

> The bounds of fiduciary duty are undoubtedly not easy to define, but certainly we must be guided by the fact that the practice here alleged to breach such duties is a customary one, and has been approved, after careful judicial scrutiny, not only in this case but in legions of others. If class counsel in this case have breached their fiduciary duties, attorneys throughout the country who have complied with court orders and a Supreme Court-approved notice procedure may well be subject to malpractice lawsuits by anyone who alleges that he or she did not receive notice of the opportunity to file a claim.
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> We do not hold today that first-class mail and publication will always suffice, either under a due process or a fiduciary duty analysis. Indeed, given the large sums involved and the low response rate, it might have been preferable for the district court in the [underlying antitrust class action] to have required certified mail or follow-up procedures. We hold only that in this case, where the procedure employed was customary and court-approved, where there was no suggestion before the district court that a different type of notice be employed, and where the plaintiffs have offered little support for the proposition that more was required, class counsel caunot be said to have breached their duties.[338]

This language seems to say no more than that the plaintiff failed in the case before the court to establish an element of malpractice, performance that falls below that of a reasonably competent lawyer. The fact that the court referred separately

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[336] Id. at 91.

[337] The *Zimmer* court states, however, that in challenging any action by counsel that was explicitly approved by court order, such as the design of the notice plan to class members, the plaintiff "faces a standard at least as high as abuse of discretion in seeking to show malpractice by counsel who followed the court's order." Id. at 93. We think this is the wrong standard even in the limited context suggested by the Zimmer court. See supra notes 213 & 280 and accompanying text.

[338] Id. at 91-93 (footnotes omitted).

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to due process and fiduciary analysis suggests that it accepted the possibility that due process might be satisfied and a fiduciary breach, actionable as malpractice, might nonetheless exist. In addition, the court emphasized that the practice was customary, not just court-approved.[339] This suggests that the Third Circuit was applying standard tort doctrine to this suit. In every malpractice suit, whether a practice is customary is considered important in determining whether there has been a breach of duty.[340] Further, the Third Circuit suggested that even a customary practice might be negligent, also standard tort doctrine,[341] but that the plaintiff in this case had "offered little" to demonstrate that the customary practice here was, nonetheless, negligent.[342]

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[339] Id. at 93 n.8 ("[C]lass counsel did all they were ordered [by the court] and expected [by custom] to do.").

[340] Keeton et al., supra note 74 § 33, at 193-4.

[341] The T.J. Hooper, 60 F.2d 737, 740 (2d Cir.), cert. denied, 287 U.S. 662 (1932).

[342] *Zimmer*, 758 F.2d at 93. In our view, it should not be hard to make such a showing in most class actions. Custom as a defense works best when the tort victim is a customer who can contract with the defendant for the desired amount of safety. "But a firm will have no incentive to take precautions against accidents dangerous only to people with whom the firm does not, and because of high transaction costs cannot, deal." Richard A. Posner, Economic Analysis of Law 168 (4th ed. 1992). Class members typically fit this category of victim. And the available empirical evidence seems to bear out the conclusion that at least with respect to the content of the notice, class action "custom" is generally suboptimal. See Willging, Hooper, & Niemic, supra note 109, at 131-34.

As to the court's reference to the fact that no one suggested to the district court that different notice be employed, that comment runs counter to standard tort doctrine. It seems to reward class counsel for failing to devise a better notice procedure in the first place. But under standard tort doctrine that failure would work against counsel, as it would help demonstrate that counsel's breach had caused the damage. Standard tort doctine would sensibly exonerate class counsel who had fought hard for a court to accept a better notice plan, not one who stood idly by while a defective plan was adopted. That the district court heard no other plan would seem thus to be an important, if not essential, part of the plaintiff's case. What then could the Third Circuit mean by holding it against the plaintiff?

While not as clear as it could be in the opinion, what the *Zimmer* court apparently had in mind was that the class member/plaintiff, a sophisticated player who had access to lawyers other than class counsel and who had actual notice that the suit was pending, should itself have suggested some other form of notice. *Zimmer*, 758 F.2d at 92 (arguing that it would have been reasonable for Zimmer, given the amount of money at stake, its sophistication, its access to independent counsel and its actual notice of the suit, to have instructed its own lawyers to monitor the litigation and presumably class counsel's performance).

Even in this context we think that suggestion unwise. If sophisticated clients cannot

The court's response to Zimmer's second claim was even more clearly grounded in tort, rather than preclusion, doctrine. The court's response to the claim that the notice procedure was negligently implemented by class counsel even if it was not negligently crafted was that plaintiff's "extensive discovery has failed to develop any material issue of fact regarding class counsel's negligence."[343] Nowhere did the court suggest that the first court's finding of adequacy means that class counsel took every step carefully. Nor do we believe any court seriously considering what was "actually decided" by a ruling of adequacy could justify any other result. In fact, the very nature of Zimmer's second claim reinforces the absurdity of equating a finding of adequacy with a finding that class counsel has not been negligent in any stage of the class action settlement process.[344]

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rely on class counsel to protect their interests, but instead must retain individual lawyers to monitor class counsel's performance, why allow non-mandatory plaintiff class actions with sophisticated class members? Be that as it may, it is certainly ridiculous to expect ordinary class action plaintiffs to bring deficiencies with the notice procedure or other matters to a court's attention or risk losing their right to complain later of the performance of their lawyers.

The only other way to read the Third Circuit's reference to the arguments presented to the class action court on notice is as some veiled reference to an estoppel argument: No one raised the defects in the earlier proceeding, so the class (and individual members) are precluded somehow from raising them now. This argument is not supported by standard preclusion doctrine. Claim preclusion doctrine would prohibit raising arguments later that could have been raised earlier, but that doctrine only applies when the parties to both actions are identical. Class counsel, the defendants in *Zimmer*, were not parties to the first suit.

343 Id. at 93.

344 Judge Weis, dissenting from the majority opinion in *Zimmer*, assumed arguendo that class counsel's proposed notice plan was non-negligent because it was customary, but rejected the majority's conclusion that the plaintiff had not made out a prima facie case of class counsel's negligence in implementing the notice plan. Id. at 94 (Weis, J., dissenting). He renounced the idea that "no further action" was required of class counsel after so few class members responded to the notice in the case. Id. Further, he commented on the class counsel's attempt to justify their inaction by suggesting it too was customary. The lawyers had cited evidence showing that a return rate of 12% was customary in similar class action suits. Id. at 95. Presumably they offered this evidence to show that most class counsel took no further action to notify class members of their right to a share in the recovery when there was such a low return. Commenting on this argument, Judge Weis stated that the accepted low return rate raised "a very serious question about the legitimacy of class action damage suits," in which recovery and attorney's fees were calculated on the assumption that 100% of the class would seek recovery from the fund. Id. at 95 n.2. He may have missed the point here. The serious question about class action suits raised by the 12% return rate may have more to do with the adequacy of the representation provided by class

In addition to making findings on adequacy of representation, courts in approving a class action settlement are supposed to ensure that the settlement was not the product of collusion between the class lawyers and the defendant. Unfortunately, courts are no better at explaining what a finding of "no collusion" means than they are at explaining what they mean when they find class counsel adequate. However, the few courts that have addressed the question of what constitutes collusion seem to equate collusion with intentional fraud.[345] It is thus plausible to argue that whenever the class action court bothers to find no collusion, it "actually decides" that class counsel and the defendant have not committed fraud, at least jointly. We disagree, but we defer full discussion of this question for the moment to consider the other necessary elements of issue preclusion.

2. Was Resolution of the Issue Necessary to the Earlier Decision?

In some instances the court that approved the settlement may have opined on the precise issue raised in the later suit, but for issue preclusion to apply the issue must have been necessary to the first court's decision. For example, the district court in *Georgine* might have said, although it did not, that the antitrust laws were not violated by the provision giving certain plaintiffs' firms an advantage in the market created by the settlement. But could such a statement reasonably be construed to have been necessary to any of the issues before the court: whether

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counsel than with the legitimacy of making defendants pay for all the damage they cause, instead of just 12%.

Judge Weis pointed out that class counsel were invested with important responsibilities to protect absent class members and were "not only fiduciaries, but well compensated ones as well." Id. at 97. To hold such "well compensated fiduciaries" to any lesser standard of performance than ordinary lawyers makes no sense to us and apparently made little to Judge Weis.

[345] See *Georgine*, 157 F.R.D. at 331 (citing Point Pleasant Canoe Rental v. Tinicum Township, 110 F.R.D. 166, 169-70 (E.D. Pa. 1986)). The court quoted Black's Law Dictionary to define collusion:

> An agreement between two or more persons to defraud a person of his rights by the forms of law, or to obtain an object forbidden by law. *It implies the existence of fraud of some kind, the employment of fraudulent means, or of lawful means for the accomplishment of an unlawful purpose.* A secret combination, conspiracy, or concert of action between two or more persons for fraudulent or deceitful purpose.

Id. (quoting Black's Law Dictionary 240 (5th ed. 1979)) (emphasis added).

the settlement as a whole was fair and reasonable or whether class counsel adequately represented the class? In *Derrickson,* the first court in ruling that the consent decree was "fair, adequate and reasonable," had praised the city officials and city lawyer, who would later become the *Derrickson* defendants, for having negotiated such a fair decree:

> The defendants did not violate their fiduciary relationship to the city or secure a personal advantage in conflict with their duty to serve the city. . . . If the Illinois statutes are in conflict with the settlement, and I conclude they are not, then the state statutes should give way to the policy of the federal law. I conclude that the proposed decree is fair, adequate and reasonable and that it does not violate state or federal law.[346]

But, in analyzing the elements of issue preclusion, the Seventh Circuit held that this comment was not necessary to the district court's decision.[347] According to Judge Easterbrook, although the district court had to find that the decree itself comported with state law before approving it because parties cannot liberate themselves from law through court-approved settlements,[348] it did not have to decide that the manner of negotiation was lawful. Implicitly, then, Judge Easterbrook separated the findings a judge must make before approving a settlement—findings on adequacy of representation and a lack of collusion—from a finding that the conduct of the parties in reaching agreement comported with other law.[349]

Concurring separately in *Derrickson,* Judge Cudahy acknowledged that the majority's distinction between the validity of the decree and the alleged illegality of the negotiations was plausible, but argued that the distinction was unworkable in practice: "[E]ither consent decrees must address and resolve all state law problems, including the lawfulness of the *means* of settlement, or there should be no consent decrees."[350] He argued that let-

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[346] *Derrickson,* 845 F.2d at 723 (quoting district court order approving the consent decree).

[347] Id.

[348] Id.

[349] The Seventh Circuit also found, despite the language from the district court quoted in the text supra at note 346, that the district court had not actually decided the question of whether the terms of the settlement violated state law. Id. at 723.

[350] Id. at 724 (Cudahy, J., concurring).

ting a decree stand, while sending the negotiators to prison is "the height of hypocrisy."[351] Although Judge Cudahy did not elaborate on the hypocrisy charge, what he must have meant was that the judgment in a subsequent suit implicitly criticizes the protection afforded the class or the public in the first suit, while leaving the first judgment intact. The law, however, leaves settlements in ordinary suits in place in the interest of finality, while allowing the plaintiff to sue his lawyer for negligently having advised the client to settle or negligently handling the client's suit so that settlement was the best option. The settlement is left intact but the lawyer is liable. What makes a similar result unbearably "hypocritical" in the class action context?[352]

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[351] Id. at 725 (Cudahy, J., concurring).

[352] Some insight into this question may be gleaned from court cases that bar a criminal defendant who remains incarcerated from recovering damages against his lawyer for malpractice on the ground, inter alia, that the justice system cannot tolerate awarding damages for an imprisonment it otherwise affirms. See, e.g., Zeidwig v. Ward, 548 So. 2d 209, 214-15 (Fla. 1989) which concludes that

> approving a policy that would approve the imprisonment of a defendant for a criminal offense after a judicial determination that the defendant has failed in attacking his conviction on grounds of ineffective assistance of counsel but which would allow the same defendant to collect from his counsel damages in a civil suit for ineffective representation because he was improperly imprisoned. . . . is neither logical nor reasonable.

The legal standard for obtaining a reversal of one's conviction on the ground of ineffective assistance of counsel is more difficult to meet than the ordinary malpractice standard. See Susan P. Koniak, Through the Looking Glass of Ethics and the Wrong with Rights We Find There, 9 Geo. J. Legal Ethics 1, 5-12 (1995). The reality is that we imprison some people, though their lawyers committed malpractice in defending them. See, e.g., Smith v. Ylst, 826 F.2d 872, 874 (9th Cir. 1987), cert. denied, 488 U.S. 829 (1988) (psychiatric reports showed that the defendant's lawyer suffered "paranoid psychotic reaction[s]" during the trial, but the court upheld the conviction because the defendant failed to show prejudice); Berry v. King, 765 F.2d 451, 454 (5th Cir. 1985), cert. denied, 476 U.S. 1164 (1986) (no presumption of prejudice on showing that defense counsel was addicted to drugs, and prejudice not shown by counsel's stipulation to virtually all elements of the crime when state could easily have proved the elements). See generally Martin C. Calhoun, Note, How to Thread the Needle: Toward A Checklist-Based Standard for Evaluating Ineffective Assistance of Counsel Claims, 77 Geo. L.J. 413 (1988) (advocating list of minimal criteria to evaluate ineffective assistance of counsel claims). Denying that reality is a lot more hypocritical than admitting the truth and trying to explain the societal interests that supposedly justify using a tougher standard in cases aimed at reversing convictions. Having drawn an analogy between the misconduct of criminal defense lawyers and that of class counsel, we would like to point out that it is reasonable to assume that lawyers who represent indigent defendants cannot bear the costs of their own misconduct because

If some class actions approved by courts as fair and reasonable involve collusion or malpractice, denying that fact seems to us much more hypocritical than admitting it, providing some redress, and yet leaving the settlements in place. If there are legitimate reasons for the lax standards used by courts in approving class action settlements—standards that allow a fair amount of collusion and malpractice to go unnoticed by the class action court and the courts reviewing such settlements, then those reasons should be articulated. They should not, however, be used as an excuse to deny the reality of abuse. That is hypocrisy.

3. *Full and Fair Opportunity to Litigate*

Although a finding that the first court did not *actually decide* the issue to be litigated in the second suit or a finding that the resolution of the issue was *not necessary* to the first action would suffice to defeat issue preclusion, no court need rely on such findings to allow the later suits we propose. The final requirement of issue preclusion is that a party against whom preclusion is sought had a *full and fair opportunity to litigate* the issue in the first proceeding.[353] We maintain that in none of the later suits that we propose could a court find that the class action provided a full and fair opportunity to litigate the kind of misconduct we have described.

First, as class action courts now conduct fairness hearings, these hearings are not adversary proceedings.[354] To hold that hearings, which are in many cases essentially ex parte presentations to a judge, are the equivalent of a fair opportunity to litigate is absurd.[355] Second, even class members who appear

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in general they are poorly compensated by the state for their efforts. Class lawyers and defendants in class action are not similarly undercompensated for having participated in a class action settlement. Thus, an important argument for restricting later suits against criminal defendants is not available to support similar restrictions on suits against class counsel and defendants in class actions.

[353] Restatement (Second) of Judgments § 27 (1980). We note that a similar requirement applies to claim preclusion as well. In addition to showing that the parties are the same and the transaction is the same, to establish claim preclusion, one must show that "the procedure in the first action (including the possibility of appeal) did not exclude an opportunity to present the matter advanced in the second action." James, Hazard & Leubsdorf, supra note 288, § 11.15.

[354] See supra notes 177-196 and accompanying text.

[355] Once again, courts outside the class action context have recognized this point in

through independent counsel to object to the settlement or to object to class counsel's representation of the class do not receive a full and fair opportunity to litigate malpractice, fraud or antitrust claims. This is so as a factual matter because courts conducting fairness hearings severely restrict objectors' access to the evidence that would be necessary to sustain a finding on any of these matters. As we have already pointed out, discovery during a fairness hearing is tightly controlled and considered a privilege, not a right.[356] In any of the later suits we propose, the access to evidence afforded to the plaintiffs would be far greater than that typically available during the fairness hearing.[357]

In *Derrickson*, Judge Easterbrook's rejection of issue preclusion begins by making just this point about the availability of evidence.[358] The Illinois Attorney General had not been afforded discovery rights in the class action proceeding, which meant for the Seventh Circuit that he had not had a full and fair opportunity to litigate whether the defendants and their counsel

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rejecting the collateral estoppel defense in a malpractice action arising out of a settlement. See Cook v. Connolly, 366 N.W.2d 287, 291 (Minn. 1985):

> Neither is the hearing on a proposed minor settlement designed to afford a full and fair opportunity to consider the issue of lawyer competence. The minor's guardian, a layperson, is ill-equipped to raise the issue, much less present it; counsel for both the minor and the defendant are interested in obtaining approval, not disapproval, of the proposed settlement, and the minor's attorney, surely, is unlikely to use the occasion to confess any professional inadequacy.

[356] See supra notes 191-195 and accompanying text.

[357] The Ninth Circuit ignored these problems in *Golden*, 786 F.2d at 1426. In *Golden*, the plaintiffs who brought the later malpractice suit had objected to the adequacy of counsel on the same ground during the fairness hearing, but their objections had been rejected. Id. at 1426, 1428. The Ninth Circuit, without considering the limited evidence available to objectors in the first proceeding, simply asserted that their first opportunity to litigate had been full and fair. Id. at 1429. The failure to consider the nature of the first proceeding and the impediments that might have prevented the objectors from making their case limits the persuasive power of the *Golden* decision. In any event, the holding in *Golden* seems limited to later suits for malpractice brought by class members who had actually objected to class counsel's adequacy during the fairness hearing on the same ground now being pressed in the malpractice suit—the facts in *Golden* emphasized by the court. Whether after the Ninth Circuit's recent decision in *Durkin*, 92 F.3d 1510, which did not bother to cite *Golden*, even that limited holding would be adhered to by the Ninth Circuit is unclear. Consider, for example, that *Durkin* emphasizes that issue preclusion is inapplicable to malpractice claims because they do not accrue until the first proceeding has concluded. Id. at 1517.

[358] 845 F.2d at 721-22.

had violated state conflict-of-interest laws in negotiating the settlement.[359] Of course, one could imagine a procedural change that would allow broad rights of discovery in fairness hearings.[360] However, not only is no such change likely to occur any time in the near future,[361] but even were such a change to be implemented it would not be enough to transform fairness hearings

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[359] Id. The Seventh Circuit suggested that the lack of discovery in the class action settlement process was particularly decisive on the question of opportunity to litigate because the Attorney General was denied an alternative forum for discovering the information by the injunction that stopped his first attempt to convene a grand jury. Of course, any class member or state attorney general who, while the class action settlement was pending before a federal judge, tried to invoke an alternative forum to investigate whether misconduct had occurred during the class action negotiations would in all likelihood be similarly enjoined. If the class action was pending before a state court that lacked the ability to enjoin the parallel proceeding because it was brought in federal court or in a court of another state, the result would nonetheless in all likelihood be the same. The parallel court probably would not exercise jurisdiction during the pendency of the first filed suit. In either case, no alternative forum would be available to get the information necessary to litigate fully and fairly whether the conduct in the ongoing class suit was wrongful.

Moreover, we do not believe that the availability of another route to the information necessary to litigate a matter fully should redound to the benefit of the forum that denied the necessary information. The class action forum is not rendered any fairer by the fact that some other forum assisted the litigant, at considerable added expense to that litigant. We therefore assume that the Seventh Circuit's reference to the injunction was meant to emphasize how inhospitable the first forum had been to the litigant and was not meant to suggest that the availability of another forum makes the primary forum fairer.

The Seventh Circuit did, however, make another point on the opportunity to litigate that is important. Noting that the "district court was not the right forum for litigating a criminal case," the court remarked that the state's attorney "was understandably reluctant to try to prove" his case there and thus did "no more than express concern about possible violations." Id. Would not a federal prosecutor or a federal attorney from the antitrust division who suspected civil violations of the antitrust laws feel similarly restrained, even assuming the class action settlement was pending before a federal court? In the case of a potential criminal violation, the situation would be almost directly analogous: Without a grand jury indictment a federal prosecutor would have no more freedom to press his case that a crime had been committed than the state attorney general in *Derrickson*. As for a civil claim, the federal attorney would undoubtedly feel obligated not to make such allegations without having conducted an appropriate investigation first. But how likely is it that that could be accomplished before the fairness hearing proceeding commenced? Presumably, private lawyers would be similarly reluctant to press forcefully any serious charges without an opportunity to make their case or the evidence to back up those charges.

[360] But see supra note 195 (discussing plausible objections to allowing broad discovery rights in every fairness hearing).

[361] See supra notes 264-271 and accompanying text.

into full and fair opportunities to litigate issues of misconduct connected with the settlement.

Putting factual assertions about the nature of fairness hearings aside, we see a deeper problem with equating fairness hearings with a full and fair opportunity to litigate misconduct in connection with the settlement. To explain that problem we start with a longstanding exception to the rules against relitigation (both issue and claim preclusion). Preclusion will not be recognized when claims were not presented or were unsuccessfully presented by a party because of fraud or concealment on the part of one's adversary or one's own attorney.[362] Implicitly, just such a claim of concealment of (class or defense) counsel's negligence, of counsel's (and the defendant's) fraud, or of other misconduct by counsel lies at the heart of the later suits we propose. The Restatement (Second) of Judgments provides that preclusion will not apply when "the party sought to be precluded, as a result of the conduct of his adversary or other special circumstances, did not have an adequate opportunity or incentive to obtain a full and fair adjudication in the initial action."[363] The Comment to this section makes clear that "other special circumstances" specifically includes concealment by a fiduciary.[364] The Comment also makes clear that the exception is designed to protect persons not in a position to litigate the matter fully in the earlier proceeding because, for example, they were then suffering from some "mental or physical disability that impeded effective litigation."[365] Absent class members are in an analogous position to those suffering from some mental or physical disability or those who otherwise lacked, through no fault of their own, the "incentive" to obtain a full adjudication

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[362] See Restatement (Second) of Judgments § 26 cmt. j (1980):

> A defendant [in a later action] cannot justly object to being sued on a part or phase of a claim that the plaintiff failed to include in an earlier action [or a fortiori failed to fully adjudicate] because of the defendant's own fraud.
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> . . . .
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> The result is the same when the defendant [in the later action] was not fraudulent, but by an innocent misrepresentation [or a fortiori a negligent misrepresentation] prevented the plaintiff from including the entire claim in the original action [or a fortiori failed to fully adjudicate the issue].

[363] Id. § 28(5)(c).

[364] Id. § 28 cmt. j.

[365] Id.

in the earlier proceeding. Absent class members are told in the class notice that they need not appear, that they will be represented and that their interests will be protected. The class notice thus in a sense disables them; it is designed to decrease whatever incentive they might have to appear.[366]

At its core, our argument against preclusion is a variant of this longstanding concealment exception. In the earlier suit, the class was represented by the very party, class counsel, whose conduct the class now wishes to place in issue.[367] Moreover, the defendants were aligned with class counsel in the first suit in seeking court approval of the settlement. Together, class counsel and the defendants, central players in the first suit, have every reason and opportunity to conceal from the class and the class action court the true nature of their association.[368]

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[366] Contrast *Laskey*, in which the Sixth Circuit disposes of all the elements of issue preclusion in one sentence:

> Since appellants had the opportunity to object to the legal representation at the prior settlement hearing and since a finding that the class was adequately represented is necessary for finding the settlement was fair and reasonable, which in turn was essential to approving the settlement, appellants are collaterally estopped from now asserting that the legal representation was not adequate and that the UAW committed legal malpractice.

Laskey v. International Union, 638 F.2d 954, 957 (6th Cir. 1981) (internal citations omitted).

The idea that class members who were not represented by independent counsel in the class action proceeding had a full and fair opportunity to litigate an issue (adequacy of representation), which no one in the former proceedings, including the court, ever mentioned was a legal issue is untenable. See supra note 310 (explaining how the class action court in *Laskey* appeared to ignore the issue of adequacy). The Sixth Circuit suggested that class members should have retained independent counsel during the class action proceeding, who then would have known that adequacy was an issue to be raised. *Laskey*, 638 F.2d at 956-57. But those same class members had been apprised that class counsel was their lawyer. They had been told in the Notice they could seek independent representation, but they were also told they had a lawyer. Id. at 956. The idea that class members, present or absent, have a full and fair opportunity to litigate the adequacy of their own lawyer's conduct in the very proceeding in which that lawyer is representing them, even when they are unrepresented by independent counsel and when the court generally provides no funds for such a lawyer, is ludicrous. We do not think the *Laskey* sentence constitutes a precedent worth following.

[367] If the plaintiff in the later suit is the prior defendant suing defense counsel, as in *Durkin*, the point is the same. If it is a state agency who unsuccessfully objected as an intervenor to the class settlement, the point is inapposite, but our other arguments on claim and issue preclusion would apply.

[368] See also supra text accompanying notes 316-317 (noting that class action courts rely on class counsel representations in assessing whether a settlement is fair and

All the critical findings made by a class action court—that the settlement was fair, class counsel adequate, and collusion absent—may be a product of class counsel's negligence or fraud, either or both accepted without objection by the all-too-congenial defendant. Consider that in assessing the fairness of the settlement the court is to consider, inter alia, the extent of discovery completed, the stage of the proceedings, and the experience and views of counsel.[369] All those factors are subject to manipulation by class counsel. The findings of the class action court are thus not severable from class counsel's performance.[370] And that is true even when there are objectors who mount an adversary challenge to the settlement terms because of the limited ability objectors have to discover what the settling parties actually did and did not do. This intractable agency problem accounts for the general rule that absent class members are entitled to have a second court rule on whether they were adequately represented in the class suit,[371] and underlies our argu-

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arguing that it is inappropriate to treat the fairness finding as preclusive on the issue of whether the class suffered damages as a result of class counsel's alleged malpractice).

[369] See, e.g., Officers for Justice v. Civil Service Comm'n, 688 F.2d 615, 625 (9th Cir. 1982), cert. denied, 459 U.S. 1217 (1983).

[370] As the court pointed out in *Grayson*, 646 A.2d at 200 ("Indeed, the . . . court may be unable to elicit the information necessary to make a fully informed evaluation of the settlement agreement if counsel for either of the parties has failed properly to discover and analyze the facts that are relevant to a fair and equitable settlement.").

[371] Hansberry v. Lee, 311 U.S. 32, 45 (1940) acknowledges implicitly the seriousness of this agency problem and seeks to solve it by guaranteeing that absent class members have a chance to litigate for themselves subsequently the question of whether they were adequately represented in the first suit. In a recent unanimous decision by the Supreme Court, *Hansberry* was reaffirmed. Richards v. Jefferson County, 116 S.Ct. 1761 (1996). See also Gonzalez v. Cassidy, 474 F.2d 67, 72 (5th Cir. 1973) (allowing class members to avoid claim preclusion by challenging the class action judgment on the ground that they were inadequately represented in the class action).

We believe that the rule of *Hansberry*—that due process requires that absent class members be allowed to challenge the adequacy of the representation they received before they can be considered bound by the first judgment—provides sufficient justification by itself for rejecting the defenses of claim and issue preclusion in most, if not all, of the later suits we propose. See infra text accompanying notes 409-414. But we do not rest our arguments entirely on *Hansberry* for two reasons. First, some of the later suits might be held not to imply that class counsel was inadequate; for example, suits brought by the defendant against defense counsel or an antitrust suit brought by the class. Second, one might argue that *Hansberry* should be read narrowly to prescribe only one remedy for the agency problem we describe, namely relitigation of the original wrong against precisely the same defendants.

ment that the first proceeding should not count as a full and fair opportunity to litigate misconduct connected to the settlement. In *Durkin*, the court stated that the earlier fairness hearing could not have afforded the plaintiff a full and fair opportunity to litigate because "a malpractice action does not even accrue until after the settlement becomes final."[372] This statement can be seen as another way of pointing out the absurdity of expecting parties to discover and adjudicate a wrong in a proceeding tainted by the wrong itself. Any such requirement would make a farce of the concept of "full and fair opportunity to litigate." In sum, we argue that fairness hearings are intrinsically incapable of providing a full and fair opportunity to litigate whether class counsel (and/or the defendant and/or its counsel) intentionally, recklessly or negligently breached a duty to the class (or to the defendant), or whether class counsel or the defendant and its agents violated any other duty in the course of negotiating the settlement. For that reason alone there is no basis to hold that the later suits we propose are precluded.

D. "But the Court Said I Could"—Or Why Equitable Estoppel Will Not Do

After *Derrickson*, the state attorney general indicted and obtained a conviction of the city officials and the city lawyer who had negotiated the Voting Rights Act consent decree, and on appeal the Illinois Supreme Court affirmed the conviction.[373] The Illinois Supreme Court accepted Judge Easterbrook's understanding of claim and issue preclusion in its opinion.[374] The court also addressed another argument made by the defendants: Even if the criminal prosecution was not estopped under ordinary preclusion rules, it should be estopped as a matter of equity.[375] The defendants argued that they justifiably relied on the

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[372] *Durkin*, 92 F.3d at 1517.

[373] People v. Scharlau, 565 N.E.2d 1319, 1328-29 (Ill. 1990), cert. denied, 501 U.S. 1252 (1991).

[374] Id. at 1329.

[375] Id. at 1329-30. The equitable estoppel argument was also made in Chief Judge Bauer's dissenting opinion in Wright v. DeArmond, 977 F.2d 339, 350 (7th Cir. 1992), cert. denied, 507 U.S. 1051 (1993) (Bauer, C.J., dissenting), another post-*Derrickson* proceeding. In *Wright*, the Seventh Circuit denied a habeas petition filed by the city officials and the city lawyer whose prosecutions *Derrickson* allowed. Id. at 340-41.

blessing of their conduct by the federal judge.[376] The Illinois Supreme Court answered that any reliance on the federal judge's statements was not justified, given that the federal judge's comments did not deal with the "substantive issues underlying [their] eventual conviction."[377] Thus, findings on adequacy, the fairness of settlement terms and the lack of collusion in a class action should be understood as limited-purpose statements and not as grants of immunity for all conduct in the course of negotiating a settlement. Any broader statements by the class action judge, approving of the parties' conduct, should be seen as a form of extrajudicial comment. We will return presently to this point.[378]

But the problems with the justifiable reliance argument run deeper. Although it possesses some superficial appeal, the justifiable reliance argument will not wash. In most cases it is counterfactual and, in all, it is inconsistent with well-accepted principles of law.

As to the factual difficulty, to paraphrase the Illinois Supreme Court's rejection of the equitable estoppel argument in the post-*Derrickson* proceeding: "What reliance are you talking about anyway?"[379] The actions that violated state law—negotiating a contract that secured the defendants a personal advantage—took place prior to any court statements blessing the conduct.[380] Given that class action settlements are negotiated off-stage, so to speak, and court approval comes only later, the same lack of reliance will be present in almost every instance of abuse for which we propose a later suit be allowed.

Judge Bauer asked "how these defendants were to know that what they were up to was wrong—not just morally but criminally," given that a federal judge approved their conduct. Id. at 350 (Bauer, C.J., dissenting).

Other cases that we have discussed make only suggestive references with respect to equitable estoppel. *Zimmer* expresses concern about the fairness of imposing "new notice requirements retroactively." 758 F.2d at 93. The equitable estoppel concern also finds expression in the allusions in *Golden* to "harassment," 786 F.2d at 1427, and the broad language in *Ennis*, 542 F.2d 45, on which *Golden* relies regarding protection of lawyers in the same degree as parties.

[376] *Scharlau*, 565 N.E.2d at 1329.

[377] Id.

[378] See discussion infra notes 391-399 and accompanying text.

[379] *Scharlau*, 565 N.E.2d at 1329-30.

[380] Id. at 1329.

It is true that courts approve some actions of class counsel before the action is taken; for example, courts evaluate a notice plan for consistency with due process and Rule 23 requirements, and approve the plan before it is implemented. But in the case of settlement class actions, the plan is normally devised by class counsel with the cooperation of the defendants, and is presented to the court generally without adversarial challenge.[381] The key point is that class counsel, with or without the defendants, drafts a plan and urges it upon the court, not the reverse. If the court accepts it, the court does so in large part because the *court* is relying on counsel's arguments that the plan is adequate. It bewilders us how those facts can give rise to a plausible claim that class counsel justifiably relied on the court's ruling.[382]

As a matter of law, the reliance argument is particularly weak when made by lawyers. Although courts are generally loath to recognize policy exceptions to the rules of estoppel,[383] they have long accepted one policy as capable of trumping the rules against relitigation: the special obligation of courts to protect clients from their lawyers.[384] This exception was first articulated in *Spilker v. Hankin*,[385] which denied a lawyer the benefit of claim preclusion in an action by the lawyer to collect a fee from a client. The client sought to contest the validity of the underlying fee contract, and the lawyer claimed that the matter was res judicata, having previously won a judgment against the client, after trial on the merits, for payment on the fee contract. In *Spilker*, the court held that the judiciary's special obligation to protect clients from their lawyers was "more important to the

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[381] Even when the defendants oppose the notice plan, their interests are not coextensive with those of the class who might be damaged by inadequate notice.

[382] Our bewilderment is not idiosyncratic. Generally, people are not entitled to rely on judgments they have induced by even innocent misrepresentations. Restatement (Second) of Judgments § 26, cmt. j (1980).

[383] See, e.g., Westwood Chem. Co. v. Kulick, 656 F.2d 1224, 1229-31 (6th Cir. 1981) (discussing the very few public policy exceptions that have been recognized to the rules against relitigation).

[384] Id. at 1229 (discussing this exception, which was first articulated in Spilker v. Hankin, 188 F.2d 35 (D.C. Cir. 1951)). *Spilker* is also cited as authority for there being rare policy exceptions to the rules against relitigation in the Restatement (Second) of Judgments § 26 reporter's notes on cmt. i (1980).

[385] 188 F.2d 35, 37-39 (D.C. Cir. 1951).

public than universal application of res judicata."[386] The identical balancing of interests supports our position in this Article and makes particularly unpersuasive any reliance argument put forth by lawyers.[387] If the lawyer in *Spilker*, even absent actual fraud, was not permitted to rely on a previous judgment in his favor after a trial, why should class lawyers be allowed to claim justifiable reliance on the findings of a court that relied on the lawyers' representations to the court in making those findings?[388]

A similar form of equitable estoppel argument is often heard from persons or entities that claim to have relied on statements by government agents to the effect that certain conduct is lawful under some statute or other. There is, however, a long line of Supreme Court cases rejecting equitable estoppel in those situations.[389] Moreover, those cases, which many in the corporate community bemoan as unfair,[390] reflect sound jurisprudential theory. To estop the government, or anyone else for that matter, from arguing to a court that conduct was unlawful, on the ground that a government agent had blessed the conduct would be to transfer the power to say, with binding authority, what the

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[386] *Westwood*, 656 F.2d at 1229 (describing the holding in *Spilker*).

[387] An additional reason for the lawyer exception to equitable estoppel is that lawyers understand better than others that seemingly inconsistent holdings are possible in our legal system.

[388] As we have argued, we do not think standard estoppel doctrine provides for estoppel in the cases we propose. For that reason we have not relied on the *Spilker* exception to justify the suits we propose. It should, however, be noted that for those who dispute our analysis of whether estoppel applies, *Spilker* provides an additional doctrinal argument in favor of our position.

[389] The modern line of cases runs from Office of Personnel Mgmt. v. Richmond, 496 U.S. 414 (1990) (holding that the government may never be estopped based on an agent's erroneous disposition of government money and emphasizing that, if there is any situation in which it would be appropriate to equitably estop the government based on its agents words, the circumstances would have to be "extreme"), back to Federal Crop Ins. Corp. v. Merrill, 332 U.S. 380, 384 (1947) (government not bound by interpretation of law given by administrative agents). In *Richmond* the Court expressed dismay that lower federal courts had read its longstanding refusal to rule out any possibility of equitable estoppel as a license to find circumstances that justify estopping the government based on its agents representations. Id. at 422. The Court pointed out that it had "reversed every finding of estoppel that we have reviewed," in an effort to make it as clear as possible to the lower courts that in almost no instance was such estoppel appropriate. Id. The only two Justices to dissent in *Richmond*, Justice Brennan and Justice Marshall, are no longer on the Court.

[390] See, e.g., Jay A. Sigler & Joseph E. Murphy, Interactive Corporate Compliance 160-65 (1988).

law means from the judiciary[391] to thousands of executive branch agents. The result would be a Tower of Babel of law—thousands upon thousands of binding interpretations of law privately dispensed in conversations between government agents and individuals or corporate entities.

Of course, the interpretations the *Derrickson* defendants sought to invoke to estop later charges of illegality were offered by a judge, not by an executive branch official, and were offered in a court opinion, not a private conversation. The jurisprudential point is, nonetheless, important. A judge's power to interpret law extends only so far as the court's rightful jurisdiction. A judicial determination made without a full and fair opportunity to litigate the matter before the judge differs from a statement by an executive branch agent only because it is made by a person dressed in a black robe. But it is not the judge's costume, the court chamber or the mere fact that a judge writes his thoughts down in an opinion that make what judges say about the law authoritative. It is that they speak after process, not before it and not in the absence of it.

Judge Easterbrook seemed to acknowledge this point at the end of his opinion in *Derrickson*. There he returned to the question of what the class action court actually decided, concluding that the district court "did not *in fact* resolve the lawfulness of the negotiating process [and therefore] . . . could not enjoin the state proceedings."[392] He cited *Chick Kam Choo v. Exxon Corporation*,[393] interpreting the scope of the so-called relitigation exception to the Anti-Injunction Act, which authorizes a federal court to issue injunctions "to protect or effectuate its judgments."[394] In *Chick Kam Choo*, the Supreme Court stated that the relitigation exception applied only to issues that were "previously . . . *presented to* and decided by the federal court,"[395] emphasizing that these requirements were to be strictly applied[396] and that the record, not merely the opinion of the court, was to be examined in deciding what was actually de-

[391] See Marbury v. Madison, 5 U.S. (1 Cranch) 137, 177 (1803).
[392] 845 F.2d at 723 (emphasis added).
[393] 486 U.S. 140 (1988).
[394] 28 U.S.C. § 2283 (1994).
[395] 486 U.S. at 147 (emphasis added).
[396] Id. at 148.

cided.[397] As we read the Seventh Circuit opinion, it uses *Chick Kam Choo* to deny that all the holdings and findings that judges make are entitled to equal respect. In effect, the Seventh Circuit refused to read a court opinion as having "actually decided" matters the court should not have decided, given the evidence and arguments presented to it.[398]

We agree. Words that judges speak without the benefit of process are no more worthy to be called authoritative interpretations of law than the words any one of us speaks. That is the

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[397] Id. (quoting Atlantic Coast Line R.R. Co. v. Locomotive Eng'rs, 398 U.S. 281, 290 (1970)).

[398] Having held that in deciding whether to approve a class action settlement, a judge is not required to decide whether the negotiations leading to the settlement were conducted in accordance with state law, the Seventh Circuit added, however, that the better practice would be to consider such matters:

> It is not wise to approve a consent decree if a crime has been committed. As the concurring opinion soundly observes, "a consent decree purchased at such a price should not be accepted, regardless of other benefits it may provide." A court ought to avoid approving a decree negotiated by illegal means—it ought to resolve on the merits all issues necessary to ensure that the decree is a lawful, binding obligation of the persons who agree to it.

Derrickson, 845 F.2d at 723. In context, we believe it is wrong to read the "ought" in the last phrase to mean "must." And to the extent that it is obvious that a settlement was negotiated by illegal means, we agree. Any other position seems absurd. Moreover, we take it this is all Judge Easterbrook meant. Or more precisely, we take it he did not mean that a judge approving a class action should try to determine conclusively, although he does not have to, whether any state or federal law was violated in the course of negotiating the settlement. Proceedings devoted to that goal would not only be unwieldy, but with no trained advocate present in most settlement proceedings to make the case that other law had been violated in the course of reaching the settlement, any such broad findings would also be inherently unreliable and ultimately disrespectful of the interests underlying the state or federal laws under consideration.

In a separate and strongly-worded concurrence, Judge Cudahy agreed with the preclusion law articulated by the majority but only in light of the "case's strangely contorted history." Id. at 724 (Cudahy, J., concurring). For Judge Cudahy, the critical facts in *Derrickson* were that the state attorney general sought to raise his concerns to the district court, was denied a full hearing and was nonetheless subjected to an adverse determination of the question by the district court. Id. (Cudahy, J., concurring). Although Judge Cudahy seems most concerned about the possibility that state action might undo federal policy reflected in the Voting Rights Act contrary to the Act's intention and general principles of federalism, his argument sweeps more broadly. Id. at 724-25 (Cudahy, J., concurring). See supra text accompanying notes 349-352.

difference between a system based on due process and one founded on idolatry or the arbitrary use of power.[399]

We thus find no factual, legal or jurisprudential reason to accept the general argument of equitable estoppel. In the later suit, the actor's intent should be judged as of the time the alleged breach or otherwise unlawful action was contemplated. Moreover, the actor's role in convincing the court to accept a particular course of conduct should be considered of critical importance in assessing whether the actor can be held liable for damages resulting from the license issued by the court. Inaction by one charged with a duty to protect the class, like class counsel or a defendant with a pre-existing fiduciary relationship to the class, should suffice to show not only a breach of duty but also a causal relationship between the breach and the damage to the class resulting from court approval against which no fiduciary argued.

One last matter before we move on: Should it matter in equity that the plaintiff in the later suit chose not to appeal the fairness determination, chose not to file a motion for relief from the judgment under Rule 60(b) and chose not to relitigate the original matter as, at least, absent class members might under *Hansberry v. Lee*?[400] Should these alternative avenues operate somehow to foreclose the later suits we propose? We have already explained why those avenues are inadequate to deter the abuse that we hope will be deterred by our later suits.[401] Thus, if precedent suggested that actions for damages should be estopped even when the elements of estoppel were not satisfied so long as some relief might be available in some other proceeding, like an action to vacate the judgment, we would argue that prece-

[399] It is true that Walker v. Birmingham, 388 U.S. 307 (1967) (holding that in general the unconstitutional orders of a judge must be obeyed until they are overturned by a higher court), runs contrary to this point. We believe the holding in *Walker* to be misguided, but even that decision acknowledges that the order must be one issued by a court of competent jurisdiction over the subject matter in dispute and that orders with only a "frivolous pretense to validity" do not fall under the general rule. Id. at 315. Be that as it may, the judicial statements at issue in the present context are generally not orders to the parties insisting that they take certain action, and the issue is not the right to disobey them without resorting to court process. The statements are more akin to blessings, a form of after-the-fact licensing, not orders at all.

[400] See discussion supra note 371 and accompanying text.

[401] See text accompanying notes 175-187.

dent should not be applied here. But there is no such line of precedent.[402] Indeed, what precedent there is suggests the opposite result.[403]

In *Derrickson*, Judge Easterbrook explained that claim preclusion was particularly inappropriate in the context before the court because Supreme Court precedent held that a governmental agent's "lack of power to bind the sovereign, overlooked in negotiating a settlement, may be raised later on."[404] The Supreme Court cases he cited, however, *United States v. Beebe*,[405] and *Stone v. Bank of Commerce*,[406] both involved actions *to set*

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[402] The Seventh Circuit opinion in Kamilewicz v. BancBoston, 92 F.3d 506 (7th Cir.), suggests, although it falls short of actually holding, that class members' remedies for fraud or malpractice committed by their counsel are limited to reversing the judgment on appeal or vacating the judgment under Rule 60(b) or some state equivalent. See Id. at 511-12. The Seventh Circuit held that federal courts lack subject matter jurisdiction over later actions for fraud and malpractice based on conduct connected to a settlement approved by a state court. Id. at 512. The absence of subject matter jurisdiction was grounded in the *Rooker-Feldman* doctrine, which holds that Congress has not vested subject matter jurisdiction in lower federal courts to hear appeals from state court judgments. Id. at 509-10. Rooker v. Fidelity Trust Co., 263 U.S. 413 (1923); District of Columbia Court of Appeals v. Feldman, 460 U.S. 462 (1983). The Seventh Circuit, in a unanimous opinion by Judge Evans, held in effect that the later suit for fraud and malpractice was in the nature of an appeal. Id. at 512. We say that this case suggests that appellate review or a 60(b) action are the exclusive remedies open to class members, because if a malpractice/fraud action is in the nature of an appeal no federal or state court has jurisdiction to hear the claims except the appellate court above the original class action court. That is true because one trial level state court has no more jurisdiction over an appeal from another trial level state court (from the same state or from another state) than a lower federal court would have. The logical extension of the Seventh Circuit's holding then would be that class members are restricted to appeals or actions to vacate the class judgment that they claim was tainted by fraud or other illegality. We believe the Seventh Circuit's opinion is wrong for many reasons, one of which is that a malpractice action is not and never has been an action in the nature of an appeal.

[403] See Edmondson v. Dressman, 469 So. 2d 571, 574 (Ala. 1985) (rejecting defendant lawyer's "contention that a party must have the underlying judgment set aside before proceeding against an attorney who negligently caused the compromise or settlement of his client's case for an unreasonable sum of money"); Cook v. Connolly 366 N.W.2d 287, 291 (Minn. 1985) (holding that "plaintiff's malpractice action is an independent cause of action not subsumed in the plaintiff's personal injury action, and, consequently that setting aside the court-approved settlement is not a prerequisite to maintenance of plaintiff's malpractice action").

[404] *Derrickson*, 845 F.2d at 721. This rule may be seen as a variation on the general exception based on misrepresentation, innocent or fraudulent, in the first suit. See supra text accompanying notes 362-365.

[405] 180 U.S. 343 (1901).

[406] 174 U.S. 412 (1899).

aside judgments agreed to by government attorneys, who lacked the authority to enter into the agreements, not later actions to punish the wayward government agents. Implicitly, then, Judge Easterbrook, by relying on these cases to hold that a later suit is permissible, is saying that there is no reason to confine the government to one remedy, *vacatur*, as opposed to another, damages or imprisonment, when a government agent has acted unfaithfully. Indeed, for him the existence of one remedy implies the existence of the other.

If that is so, why should class members be limited in their choice of remedy? Like the government, absent class members may seek to avoid the effects of a settlement by claiming their lawyer has exceeded her authority to enter into the settlement. Specifically, absent members can allege that they were inadequately represented by counsel, notwithstanding that the class action court appointed plaintiffs' counsel and apparently found otherwise in its approval of the settlement.[407] Neither of the Supreme Court opinions cited by Judge Easterbrook relies on sovereignty as a ground for decision; both rely instead on the general principle that agreements made by lawyers without authority are not binding on their clients.[408] Thus, neither citation easily supports granting a choice of remedy to the government, while denying that choice to others bound by settlements negotiated by unfaithful agents.

The State of Illinois did not appeal the Voting Rights Act settlement or otherwise seek to nullify it, but the Seventh Circuit refused to restrict the government to that remedy. The reason it makes sense not to restrict the government to an action to set aside the settlement is that the settlement overall might be acceptable to the state, while the faithless conduct might not be. The state might nonetheless have been harmed by the faithless activity, and the conduct might nonetheless be conduct worthy of deterring by a suit for damages or imprisonment. The same analysis would seem to apply whether the

[407] *Hansberry*, 311 U.S. at 41-46.

[408] See *Beebe*, 180 U.S. at 352 (relying on Robb v. Vos, 155 U.S. 13 (1894), for this proposition); and *Stone*, 174 U.S. at 423 ("We are also of the opinion that as city attorney he had no greater power to bind the city by that agreement than would an attorney have in the case of an individual.").

faithless agent was negotiating on behalf of the state or on behalf of a class.

Moreover, only parties to an action have a right to appeal or to seek relief under Rule 60(b) or its state counterparts.[409] At least since *Hansberry* was decided in 1940, it has been clear that absent class members are considered parties and not strangers to the class action litigation *only* if those absent class members were adequately represented in the class proceeding,[410] a principle unanimously reaffirmed last term by the Supreme Court in *Richards v. Jefferson County*.[411] To hold that absent class members, seeking to sue their own lawyers for fraud or malpractice or the class action defendant and its lawyers for fraud or some other wrong, are limited to appealing the initial decision or moving to vacate it is to presume conclusively that they are parties to the first proceeding. That presumption is unjustifiable[412] so long as the claims they seek to raise in their later suit necessarily include an allegation that they were denied adequate representation or adequate notice[413] as the later suits we advocate by class members generally will. Any holding to the contrary conflicts not only with the due process protection guaranteed by *Hansberry* and *Richards*, but also with the due process analysis in *Martin v. Wilks*.[414]

We rest our case on estoppel.

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[409] Fed. R. Civ. P. 60(b).

[410] *Hansberry*, 311 U.S. at 41-46.

[411] 116 S. Ct. 1761, 1764 (1996).

[412] It passes unjustifiable and moves to ridiculous in those jurisdictions in which absent class members have no right to appeal a final judgment in a class action unless they were granted a right to intervene. For cases holding that absent class members have no absolute right to appeal, see supra note 172.

[413] The presumption is also unjustified in any later suit alleging denial of a meaningful opportunity to opt out of the class action, at least when the original class action involved a money suit for damages brought under Rule 23(b)(3) or in a state court that otherwise would lack personal jurisdiction over the absent class members having no minimum contacts with the state court presiding over the class action. Fed. R. Civ. P. Rule 23(b)(3) (guaranteeing the right to opt out); Phillips Petroleum v. Shutts, 472 U.S. 797, 811-12 (1985) (allowing a state court to take jurisdiction over out-of-state absent class members who otherwise lack minimum contacts with a state only if those people are guaranteed adequate representation, adequate notice and an opportunity to opt out of the suit).

[414] 490 U.S. 755, 758 (1989) (holding that nonparties are not bound by a class action court's entry of a settlement or consent decree).

IV. Everything the Antitrust Bar Should Know about Antitrust Law but Is Afraid to Ask

A. All I Want is a Room Somewhere

So far we have discussed the variety of lawyer wrongdoing that can occur within class actions, the need for subsequent suits to deter and punish such wrongdoing, and the fact that court approval of class action settlements does not shield this wrongdoing as a matter of procedural law, such as collateral estoppel. In this Part, we focus on a subset of lawyer wrongdoing, namely antitrust violations.[415] The idea of antitrust suits against class action lawyers is even more novel than the idea of malpractice suits; no antitrust actions have ever been brought, let alone brought successfully. Although making out a prima facie case might sometimes be difficult, and finding a party other than the government with standing to bring an antitrust claim arising from conduct in a class action will not always be easy, we do not believe that those problems explain the complete absence of the antitrust claims we advocate. Rather, we think that the false but nonetheless widely held belief that court involvement in the class action settlement process somehow suspends the operation of other laws threatens to lull lawyers into lapses in the antitrust context, where longstanding immunity doctrines beckon lawyers engaged in anticompetitive behavior to feel safe when a government actor—particularly a judge—blesses that behavior. The three immunity doctrines that offer this siren song are the state action doctrine, federal regulatory immunity, and the *Noerr-Pennington* doctrine.[416] But as we shall argue, the imagined comfort of these doctrines is ephemeral. The antitrust laws lie in waiting, a trap for the unwary.

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[415] We do not focus in this Article on state antitrust laws and the parallel immunity doctrines that would apply, but these laws are largely similar in the relevant respects to the federal antitrust counterparts, and where they are not, the arguments we would make in favor of rejecting the immunity defenses would be essentially the same.

[416] This doctrine, derived from the Supreme Court's decision in Eastern R.R. Presidents Conf. v. Noerr Motor Freight Co., 365 U.S. 127 (1961), and elaborated upon in United Mine Workers v. Pennington, 381 U.S. 657 (1965), generally immunizes from antitrust liability private petitioning of the government for favorable legislative, judicial, or administrative action. The doctrine is commonly referred to as the "*Noerr-Pennington* doctrine," "*Noerr* immunity" or petitioning immunity.

The essence of the three antitrust immunity doctrines can be captured in terms of simple dichotomies. The antitrust laws condemn private restraints, not governmental restraints; they address competition, not regulation; they reach commercial activity, not petitioning activity. To illustrate, if lawyers who make fee agreements in class actions are engaged in private, commercial activity that restrains competition, the antitrust laws should apply; if they are engaged in activity that seeks governmental restraints or activity that is subject to governmental regulation, the antitrust laws should not apply. Despite the attraction of such simple dichotomies, stating the issue in this way does not get us very far.

The problem is that the anticompetitive restraints we allege exist in some class actions raise unique issues in antitrust immunity. First, class actions are at the same time a form of litigation and a form of regulation.[417] To the extent that the litigation aspect of class actions predominates, the applicable immunity doctrine would not be state action or federal regulatory immunity, but *Noerr* immunity. The typical issue in *Noerr* immunity cases, however, is usually whether the litigation itself is an anticompetitive weapon, not whether the litigation provides a backdrop for anticompetitive (lawyer) activity. This suggests that class actions, for antitrust immunity purposes, are more like a kind of regulatory regime in which the court's role is like that of an administrative agency.[418] Like administrative agencies, courts in class actions are called upon to approve private contractual arrangements—settlements. But most antitrust immu-

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[417] Regulation is usually viewed as characteristically different from litigation: it takes place ex ante; it covers a broad range of persons; it is continuous; and it is done by legislatures and administrative agencies thought to have expertise in a particular area. Litigation, by contrast, takes place ex post; is narrow in scope, in that it covers only the parties to the litigation; is a one-shot proposition; and is handled by nonspecialized courts. See Posner, supra note 342, at 367-69 (discussing the differences between regulation and litigaton). Whatever the merits of distinguishing between regulation and litigation in general, class actions certainly make the distinction less tenable.

[418] See generally Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 809 (1985) (noting that, from the plaintiffs' perspective, the class action "resembles a 'quasi-administrative proceeding, conducted by the judge'") (citations omitted); Nagareda, supra note 156, at 899 (1996) (drawing an analogy between recent class action settlements in mass tort cases and administrative regimes, but not addressing the application of antitrust laws to such regimes).

nity cases involving administrative agencies involve anticompetitive conduct by the parties who are the primary subject of the regulation, not the lawyers whose conduct is only incidentally regulated, if at all. Thus, class actions present unique issues which the Supreme Court has never explicitly addressed: How do the immunity doctrines apply to litigation as a regulatory system? How should the immunity doctrines view settlements that must be approved by a court? How should the immunity doctrines deal with regulatory schemes that predominantly regulate one area and only incidentally regulate another? We address these questions next.

B. When a Rose Is Not a Rose or Why State Action Will Not Work

The state action doctrine, derived from the Supreme Court's decision in *Parker v. Brown*,[419] aims to promote the values of federalism and state sovereignty by immunizing from antitrust liability conduct mandated or permitted by state regulatory schemes.[420] The Court in *Parker* reasoned that in enacting the Sherman Act,[421] Congress did not intend "to restrain a state or its officers or agents from activities directed by its legislature" or "to nullify a state's control over its officers and agents."[422]

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[419] 317 U.S. 341 (1943).

[420] In light of this purpose, class lawyers would probably be able to raise the state action immunity defense only when they had brought the class action in state court. The mere fact that a class action was filed in federal court under its diversity jurisdiction, and so involved state substantive law (for example, tort law), would not make the state action doctrine applicable, because the relevant regulation for state action doctrine purposes would be the rules governing a class action, which are federal. See Fed. R. Civ. P. 23. There would be no relevant state action. The only possible exception would be if some state statute or ethics rule regulated the relevant lawyer conduct. As we argue below, there are no such state statutes or ethics rules, with the possible exception of state maximum contingent fee statutes. See infra note 457.

Although filing patterns could change (an unlikely event if the proposed changes to Rule 23 are enacted), most class actions involving the types of provisions we are concerned with have been filed in federal courts, not state courts. Thus, the state action doctrine—probably the strongest defense that could be raised to an antitrust challenge—is currently of limited applicability.

[421] Act of July 2, 1890, ch. 647, 26 Stat. 209 (1890) (codified as amended at 15 U.S.C. §§ 1-7 (1994)).

[422] 317 U.S. at 350-51.

However, the Court cautioned that "a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful, . . . and we have no question of the state . . . becoming a participant in a private agreement or combination by others for restraint of trade."[423] Thus, federal competition policy does not automatically trump state regulatory policy, but neither can state regulatory policy freely displace federal competition policy. The two must co-exist. Figuring out what that means in practice is the trick.

The Supreme Court offered general guidance as to how federal competition and state regulatory policies might coexist in *California Retail Liquor Dealers Association v. Midcal Aluminum*,[424] by formulating a two-part test for determining whether the state action exemption applies. First, the challenged activity must be authorized by a "clearly articulated and affirmatively expressed" state regulatory policy.[425] Second, any private activity authorized by such a policy must be "actively supervised" by an appropriate government agency.[426] Both prongs of the *Midcal* test attempt to determine how committed a state is to a regulatory regime that supplants the federal antitrust law policy of competition.[427]

Therefore, to qualify for state action immunity, the state must supply evidence of its commitment to a regulatory regime ex ante, by adopting a regulatory program that displaces existing competition (a clear articulation), and must supply evidence of its commitment ex post by enforcing that program (active super-

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[423] Id. at 351-52 (citations omitted).

[424] 445 U.S. 97 (1980).

[425] Id. at 105 (citations omitted). To satisfy this prong, the state must establish a "system of regulation, clearly articulated and affirmatively expressed, designed to displace unfettered business freedom." New Motor Vehicle Bd. v. Orrin W. Fox Co., 439 U.S. 96, 109 (1978).

[426] *Midcal*, 445 U.S. at 105 (citations omitted).

[427] See Federal Trade Comm'n v. Ticor Title Ins. Co., 504 U.S. 621, 636 (1992) (noting that both prongs "are directed at ensuring that particular anticompetitive mechanisms operate because of a deliberate and intended state policy") (citations omitted). The *Midcal* test is an elaboration of the Court's reasoning in *Parker* that the state action exemption applies if "it is the state . . . which adopts the program and which enforces it with . . . sanctions, in the execution of a governmental policy." *Parker*, 317 U.S. at 352.

vision).[428] If the state demonstrates the requisite commitment, the federal antitrust laws will not question the correctness of the state's decision, as the concern of state action immunity is more with the process and structure of state regulation—the demonstration of commitment—than with the substance of the state regulation.[429] Still, the presumption is against finding immunity: "[S]tate-action immunity is disfavored, much as are repeals by implication."[430]

In determining the applicability of the state action doctrine to an antitrust suit against lawyer conduct, we first look to who may articulate state regulatory policy in the class action context. We next look carefully at the *Midcal* prongs and consider whether lawyers could demonstrate that the state action doctrine ought to apply to their anticompetitive conduct in class actions.

We conclude that lawyers defending an antitrust suit against their conduct in class actions would have a hard time showing that their anticompetitive fee agreements made prior to or contemporaneously with class action settlements would satisfy either of the *Midcal* prongs. States have not demonstrated any commitment to regulate such agreements, either ex ante or ex post, in a way that displaces federal antitrust policy. The lawyers creating and controlling the terms of these restraints are private parties pursuing their own financial interests. They are not

[428] The active supervision requirement does not apply where the actor is a municipality rather than a private party. Town of Hallie v. City of Eau Claire, 471 U.S. 34, 46 (1985).

[429] See, e.g., Hovenkamp, supra note 136, § 20.3, at 677 (1994) ("This [state-action] test is 'non-substantive' in the sense that the state is free to regulate in as anticompetitive a manner as it pleases, provided that it takes its own regulatory policy seriously and ensures that private firms act consistently with the stated policy.") See also Einer R. Elhauge, The Scope of Antitrust Process, 104 Harv. L. Rev. 667 (1991) (discussing various "process views" of the state-action doctrine).

[430] *Ticor Title*, 504 U.S. at 636 (citation omitted). The more a state cedes decisionmaking authority to private parties with financial, as opposed to political, interests in the result of those decisions, the less likely the courts are to exempt the resulting decisions under the state action doctrine. Id. at 633 ("Actual state involvement, not deference to private price-fixing arrangements under the general auspices of state law, is the precondition for immunity from federal law.") See also Cantor v. Detroit Edison Co., 428 U.S. 579, 593 (1976) (When a case involves "a mixture of private and public decisionmaking," the issue is whether "the private party exercised sufficient freedom of choice to enable the Court to conclude that he should be held responsible for the consequences of his decision.").

pursuing a public anticompetitive interest articulated by the state.

1. *Who May Articulate State Policy*

As a preliminary matter, we need to identify the source of state regulatory policy. The Supreme Court applies state action immunity without requiring that the *Midcal* prongs be satisfied when the challenged action is that of the "state itself" rather than that of private actors.[431]

The "state itself" notion captures the idea that only certain agents of the state may articulate a state policy to displace the antitrust laws by some form of regulation. Nonsovereign state representatives and private parties merely implement the policy articulated by a sovereign state representative; they may not articulate state policy themselves. When the "state itself" acts, "the danger of unauthorized restraint of trade does not arise."[432] However, because the anticompetitive conduct of nonsovereign state representatives and private parties in implementing the policy could diverge from the state policy articulated by the sovereign, this conduct is subject to greater scrutiny (in the form of the *Midcal* test).[433]

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[431] Hoover v. Ronwin, 466 U.S. 558, 567-69, 579 n.33 (1984); Community Communications Co. v. City of Boulder, 455 U.S. 40, 52, 57 (1982) (citations omitted). In determining whether challenged anticompetitive conduct is that of the "state itself," the answer cannot be determined by simply looking to what party is the named defendant in the suit, because the state itself may be the real party in interest. See Southern Motor Carriers Rate Conf. v. United States, 471 U.S. 48, 58-59 (1985) ("The success of an antitrust action should depend upon the nature of the activity challenged, rather than on the identity of the defendant."); *Hoover*, 466 U.S. at 575 (noting that in *Bates* the Court had determined that the claims were "against the State" and that the state "was the real party in interest" rather than party actually named in the litigation) (quoting Bates v. State Bar of Arizona, 433 U.S. 350, 361 (1977)).

Characteristic of its perhaps overly elaborate doctrinal machinations in this area, the Court, in deciding whether the state itself has acted, has sometimes considered whether the state policy is clearly articulated and actively supervised, despite the Court's disavowal of the *Midcal* test in such cases. See, e.g., *Bates*, 433 U.S. at 361-62 (noting that appellants' claim was against an "agent of the court [the state bar] under [the court's] continuous supervision", and that "disciplinary rules reflect a clear articulation of the State's policy with regard to professional behavior"). Thus, the analysis tends to be largely the same as it would be under the *Midcal* test.

[432] *Hoover*, 466 U.S. at 569.

[433] Id. at 568 ("Closer analysis is required when the activity at issue is not directly that of the [state], but is carried out by others pursuant to state authorization."). It

The question of who may articulate state policy is important for the antitrust actions we propose because these actions would not directly challenge any action of the two entities that most clearly articulate the state's regulatory policy as the "state itself," namely the state legislature and the state supreme court acting in its rulemaking capacity.[434] State statutes and supreme court rules govern the conduct of lawyers in class actions, and supreme court ethics rules govern the conduct of lawyers generally.[435] But although state action protection is strongest when the regulatory policy articulated by the state legislature or the state supreme court is challenged directly,[436] an antitrust suit challenging anticompetitive lawyer conduct in class actions would not directly challenge either statutes or procedural rules governing class actions or any ethics rule.[437] At most, such a suit would

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is important to note that the Court uses "authorization" in two distinct ways. The usage we are concerned with in this section (and the one in the passage just quoted) refers to the power to articulate an anticompetitive policy. But in the quotation in the text accompanying note 432, the Court uses "authorization" to denote whether a nonsovercign state representative or private party is implementing a state policy in accordance with state law or rather is engaging in "unauthorized" anticompetitive conduct. The usages are distinct because a state agent may be unauthorized to *articulate* an anticompetitive policy but may be authorized to *implement* an anticompetitive policy articulated by others. On the "authorization in implementation" requirement, see discussion of City of Columbia v. Omni Outdoor Advertising, 499 U.S. 365, 370-72 (1991), infra notes 449-452 and accompanying text.

[434] There is no question that state legislatures articulate state regulatory policy as the "state itself." State supreme courts are likewise authorized to articulate state regulatory policy when acting legislatively, rather than in a judicial capacity. *Hoover*, 466 U.S. at 568.

The Court has not decided whether other state actors are sovereign for purposes of articulating state policy. In *Hoover*, the Court explicitly reserved the question of whether "the Governor of a state stands in the same position as the state legislature and supreme court for purposes of the state-action doctrine." Id. at 568 n.17. But we know of no executive orders or similar directives from state governors that apply to class actions.

[435] See, e.g., id. at 569 n.18 ("[R]egulation of the bar is a sovereign function of the Arizona Supreme Court.").

[436] See, e.g., id. at 558 (state supreme court committee's decision to reject bar applicant held immune); Bates v. State Bar, 433 U.S. 350 (1977) (state supreme court ethics rule restricting lawyer advertising held immune); Parker v. Brown, 317 U.S. 341 (1943) (state statute restricting competition among food producers held immune).

[437] The fact that no state statute is being challenged on its face makes inapplicable the doctrine of "preemption" espoused by the Court in Rice v. Norman Williams Co., 458 U.S. 654, 661 (1982) (holding that "a state statute, when considered in the abstract, may be condemned under the antitrust laws only if it mandates or authorizes conduct that necessarily constitutes a violation of the antitrust laws in all cases, or if

challenge an inferior state court's application of the state's class action rules which govern the approval of settlement agreements by private parties. Thus, unless the trial court acts as the "state itself," the protection afforded by the state action doctrine to anticompetitive lawyer conduct in class actions is governed by the *Midcal* test.[438]

The trial court does not act as the "state itself" in making or approving either class action settlements or class counsel fee arrangements. Political subdivisions of the state cannot articulate state regulatory policy for state action doctrine purposes.[439] Nor can state regulatory agencies acting alone authorize anti-

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it places irresistable pressure on a private party to vioalte the antitrust laws in order to comply with the statute"). The precise relationship between the preemption doctrine and state action immunity is unclear. Professor Hovenkamp argues that the two should be merged into a single standard. Hovenkamp, supra note 136, § 20.1, at 672.

[438] Laywers who make agreements concerning their fees for acting as advocates are certainly not authorized to articulate state policy. Federal Trade Comm'n v. Superior Ct. Trial Lawyers Ass'n, 493 U.S. 411, 424 (1990) (lawyers cannot immunize private agreements concerning their fees by invoking the need to protect the public interest generally or their clients' interests in particular). In Goldfarb v. Virginia State Bar, 421 U.S. 773 (1975), the Supreme Court held that a local bar association's rule providing that a member's deviation from its minimum fee schedule could lead to disciplinary action did not enjoy state action immunity precisely because lawyers adopted the rule acting in their private capacity. The state action doctrine was found to be inapplicable despite the Court's explicit recognition that "[t]he interest of the States in regulating lawyers is especially great since lawyers are essential to the primary governmental function of administering justice, and have historically been 'officers of the courts.'" Id. at 792. Cf. Allied Tube & Conduit Corp. v. Indian Head, 486 U.S. 492, 501-02 (1988) (private standard-setting association engaged in private conduct in promulgating safety standards, even though state legislatures regularly adopt them as law, because no offical authority was conferred on it by any government and because its members were not accountable to the public). By contrast, lawyers who serve on a disciplinary board, which enforces the state supreme court's ethics rules, are immune from antitrust liability for their enforcement activities because they act as agents of the state. See Lawline v. American Bar Ass'n, 956 F.2d 1378, 1384 (7th Cir. 1992), cert. denied, 510 U.S. 992 (1993).

[439] For example, because "municipalities 'are not themselves sovereign,'" they cannot authorize anticompetitive ordinances without the legislature granting them the specific and affirmatively expressed authority to regulate. Community Communications Co. v. City of Boulder, 455 U.S. 40, 54 (1982) (citations omitted). On the other hand, the mere passage of an anticompetitive ordinance by a municipality and the adherence to that ordinance by private individual is insufficient to establish a conspiracy under § 1 of the Sherman Act. Fisher v. City of Berkeley, 475 U.S. 260 (1986) (upholding municipal rent control ordinance as not preempted by the Sherman Act because no private anticompetitive agreement was proved).

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competitive behavior merely because the state creates them and gives them broad powers.[440] Therefore, it seems that in the judicial sphere, a trial court, as a subordinate court, could not by itself authorize a state regulatory policy even if the state grants that court broad powers which could be construed as "legislative" or "rulemaking" powers in the class action context.

If, however, the trial court acts as an arm of the state supreme court in its supervisory capacity, the trial court may speak for the "state itself." In *Hoover v. Ronwin*,[441] a disgruntled applicant to the bar challenged the denial of his admission, alleging that the lawyer members of the court-appointed bar committee had conspired to "artificially reduc[e] the numbers of competing attorneys in the State of Arizona."[442] The Court found that because the state supreme court "retained strict supervisory powers and ultimate full authority over [the committee's] actions,"[443] the applicant was challenging conduct of the state supreme court itself despite the fact that the committee administered and graded the bar examination. In addition, to support its conclusion that the applicant was challenging conduct of the state supreme court itself, the Court pointed to the following facts: that the committee's authority was limited to making recommendations directly to the state supreme court, which "itself made the final decision to grant or deny admission to practice";[444] that the state supreme court required the committee to submit its grading formula to the court before each exam;[445] and that "a disappointed applicant was accorded the right to seek

[440] Southern Motor Carriers Rate Conf. v. United States, 471 U.S. 48, 62-63 (1985). We therefore disagree with Professor Elhauge's assertion that *Southern Motor Carriers* stands for the proposition that, "all that must be clearly shown . . . [to establish clear articulation] is a general intent to create a regulatory agency." Elhauge, supra note 429, at 692 n.123.

[441] 466 U.S. 558 (1984).

[442] Id. at 565.

[443] Id. at 572.

[444] Id. at 573. See also id. at 575-76 ("Only the Arizona Supreme Court had the authority to grant or deny admission to practice in the State."); id. at 575 n.27 ("Under Arizona law, the responsibility is on the court—and only on it—to admit or deny admission to the practice of law."); and id. at 581 (noting "the incontrovertible fact that under the law of Arizona *only* the State Supreme Court had authority to admit or deny admission to practice law").

[445] Id. at 572.

individualized review by filing a petition directly with the court."[446]

In the class action context, by contrast, there is no similarly direct state supreme court supervision and control over trial courts. The trial court makes a final judgment, not a mere recommendation, in approving settlements. Even if objectors to an approved settlement can appeal the trial court's decision to the state supreme court,[447] the state supreme court does not use its supervisory powers to oversee specific class action rules on appeal; it merely acts in its judicial role as a court of last resort.[448]

Although the trial court is not "authorized" to speak as the state itself of its own authority, a trial court's approval of a class action settlement that includes an anticompetitive agreement by lawyers may still be an "authorized" implementation of state law. In *City of Columbia v. Omni Outdoor Advertising*,[449] the Supreme Court held that "in order to prevent *Parker*['s state authorization requirement] from undermining the very interests of federalism it is designed to protect, it is necessary to adopt a concept of authority broader than what is applied to determine the legality of the [nonsovereign state actor's] action under state law."[450] *Omni* stands for the principle that, for purposes of the state action doctrine, the authority of a nonsovereign state actor can be established even if "the nature of [the nonsovereign actor's] regulation is substantively or procedurally defective."[451]

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[446] Id. at 576.

[447] See supra note 172.

[448] The Court in *Hoover* suggests that the state supreme court's denial of the applicant's petition after initially denying him admission was itself state action. *Hoover*, 466 U.S. at 577 ("[T]here was *state action* by the court itself explicitly rejecting Ronwin's Claim.") This statement raises the possibility that the supreme court acting in its adjudicative capacity alone might constitute state action. But the Court seems to back off from this notion in an accompanying footnote, which states: "Our holding is based on the court's direct participation in every stage of the admissions process, including retention of the sole authority to admit or deny." Id. at 577 n.30.

[449] 499 U.S. 365 (1991).

[450] *Omni*, 499 U.S. at 372. When the Court refers to authority in this context, it refers to "authority to implement" rather than "authority to articulate" an anticompetitive state policy. On the two meanings of "authorization," see supra note 433.

[451] *Omni*, 499 U.S. at 371. The Court held that "an expansive interpretation of the *Parker*-defense authorization requirement would have [the] unacceptable consequence[ ]" of transforming "state administrative review into a federal antitrust

In the class action context, many states' laws authorize trial courts to approve class action settlements so long as they are fair, adequate, and reasonable.[452] Under this standard, a trial court might be able to approve, consistent with state law, a class action settlement containing an anticompetitive agreement among lawyers. But even if class action settlements that contain anticompetitive lawyer agreements violate state law, under the Court's reasoning in *Omni*, the trial court's approval of those anticompetitive agreements may still be "authorized" for purposes of the state action doctrine.

But although under *Omni* a settlement agreement containing anticompetitive provisions could be considered "authorized" for state action purposes, even if unlawful under state law, that type of authorization is not sufficient to establish a state action immunity defense. The "clear articulation" and "active supervision" requirements set forth in *Midcal* would still have to be met to establish antitrust immunity. Thus, we must look to the pronouncements of the state legislature and state supreme court (in its rulemaking capacity) and evaluate these pronouncements under the two *Midcal* prongs. We turn to these prongs next.

2. *Clear Articulation*

We must first look to see whether a state's rules governing class actions contain a "clear articulation" of a policy to displace competition in some market. If these rules evidence a state policy to promote competition in a particular market[453] or to

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job." Id. at 371-72 (citations omitted).

[452] See, e.g., Adams v. Robertson, 676 So. 2d 1265 (Ala. 1995), cert. granted, 1996 U.S. LEXIS 4538; 65 U.S.L.W. 3254 (October 1, 1996). This standard usually derives from case law rather than the class action rules themselves. Many states have class action rules based in whole or in part on the Federal Rules of Civil Procedure; thus, the rules on settlement typically track the language of Fed. R. Civ. P. 23(e), which simply states that "[a] class action shall not be dismissed or compromised without the approval of the court." See, e.g., N.Y. Civ. Practice Law, Rule 908; Ill. Civil Practice Law, 735 I.L.C.S. 5/2-806; Mass. R. Civ. P. 23(c); Pa. R. Civ. P. 1714(a); Tex. R. Civ. P. 42(e).

[453] An explicit statement that a particular regulatory regime is not intended to displace competition also precludes a finding of clear articulation. See Goldfarb v. Virginia State Bar, 421 U.S. 773, 789 & n.19, 791 (1975). However, the party seeking federal antitrust enforcement is not required to show an explicit intent not to displace competition to avoid the state action defense.

remain neutral with respect to competition in a particular market,[454] state action immunity does not apply. On the other hand, if the state mandates conduct that would be considered anticompetitive under the federal antitrust laws, that is a sufficiently clear articulation.[455] For example, if a state statute or supreme court rule established a required fee schedule for lawyers in class actions, that would be a clearly articulated policy to displace competition.[456] No state has done so, however.[457] But

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[454] See Community Communications Co. v. City of Boulder, 455 U.S. 40, 55 (1982) ("Plainly, the requirement of 'clear articulation and affirmative expression' is not satisfied when the State's position is one of mere *neutrality* respecting the . . . actions challenged as anticompetitive.").

[455] See, e.g., Bates v. State Bar of Arizona, 433 U.S. 350, 360, 362 (1977) (holding that restrictions on lawyer advertising contained in the state supreme court's disciplinary rules are "'compelled by direction of the State acting as sovereign'" and so "reflect a clear articulation of the State's policy") (quoting *Goldfarb*, 421 U.S. at 791).

[456] Cf. *Hoover*, 466 U.S. at 579 n.32 (distinguishing the Court's holding of no state action immunity in *Goldfarb* on the ground that in that case, "state law did not refer to lawyers' fees, the Virginia Supreme Court Rules did not direct the State Bar to supply fee schedules, and the Supreme Court did not approve the fee schedules established by the State Bar").

[457] Some state legislatures and supreme courts have regulated lawyer fees by adopting schedules of *maximum* percentages to apply to contingency fee arrangements. See, e.g., N.Y. Ct. Rules 603.7(e), 691.20(e) (McKinney 1996) (rules of the New York Appellate Division, First and Second Departments, delineating schedule of reasonable fees in personal injury and wrongful death, but excluding medical, dental or podiatric malpractice); N.Y. Jud. Law § 474-a (McKinney 1996 Supp.) (schedule governing contingency fee contracts in medical, dental, or podiatric malpractice); Cal. Bus. & Prof. Code § 6146(a) (West 1993) (schedule governing contingency fee contracts in "an action for injury or damage against a health care provider"); Cal. Bus. & Prof. Code § 6147.5(a) (West 1996) (schedule governing contingency fee contracts in claims for recovery between merchants); Fla. Stat. Ann. Bar Rule 4-1.5(f)(3)-(4) (West 1994 & 1996 Supp.) (schedule governing personal injury claims); N.J. Gen. Application Rule 1:21-7 (1994) (schedule governing contingency fees in tort actions).

Although these statutes could be interpreted as clearly articulating a policy to displace competition among lawyers, we think that they would not pose a significant threat to most of the suits we envision. First, only a minority of states have these statutes, and in some states, the statutes apply only to a small subset of cases, normally medical malpractice actions, which to date have not been the subject of class actions. Hazard, Koniak, & Cramton, supra note 249, at 537. In class actions that extend to claimants in multiple jurisdictions, it is unlikely that all of these jurisdictions will have fee cap statutes. Second, it is not clear that the statutes apply to the conduct we are concerned with, namely bid rotation and price fixing in the private administrative system.

In addition, all state ethics rules proscribe "unreasonable" fees, but none attempts to establish a fee schedule. See ABA Model Rules of Professional Conduct Rule 1.5

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mandated anticompetitive conduct is not necessary. Express statements in state statutes or procedural rules that permit or contemplate anticompetitive conduct would also be sufficient to satisfy the clear articulation requirement.[458] None of the applicable state statutes or procedural rules specifically contemplates lawyer agreements concerning fees or class counsel selection, however.[459]

But express statements permitting or contemplating anticompetitive conduct are also not necessary to satisfy the clear articulation requirement.[460] The state need not authorize the specific restraint challenged, nor need it articulate an intention to permit

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(1994); ABA Model Code of Professional Responsibility DR 2-106 (1981). These rules certainly express no state policy to displace competition.

[458] *Southern Motor Carriers*, 471 U.S. at 61 (stating that "a state policy that expressly *permits*, but does not compel, anticompetitive conduct may be 'clearly articulated' within the meaning of *Midcal*") (citation omitted). This conclusion was implicit in New Motor Vehicle Bd. v. Orrin W. Fox Co., 439 U.S. 96 (1978), in which the Court held that a regulatory scheme that expressly allowed, but did not require, an automobile franchisee to protest the establishment of a competing dealership in its market area was "clearly articulated and affirmatively expressed, designed to displace unfettered business freedom." Id. at 109.

[459] Some state class action rules based on the Federal Rules of Civil Procedure have no explicit provision on attorney's fees at all, leaving it up to case law. See, e.g., Mass. R. Civ. P. 23; Tex. R. Civ. P. 42. States that do have rules on fees neither set these fees nor say anything about lawyer agreements concerning them. See, e.g., N.Y. Civ. Prac. L., Rule 909 (McKinney 1976) ("If a judgment in an action maintained as a class action is rendered in favor of the class, the court in its discretion may award attorney's fees to the representatives of the class based on the reasonable value of legal services rendered and if justice requires, allow recovery of the amount awarded from the opponent of the class."); Pa. R. Civ. P. 1716 ("In all cases where the court is authorized under applicable law to fix the amount of counsel fees it shall consider, among other things, the following factors . . . ."). The Uniform Class Action Act does contain a provision concerning attorney's fee agreements that could be interpreted as covering the type of agreements we are concerned with, but simply requires the class lawyers to file such agreements with the court. Uniform Class Action Act, § 17; see also id. §12(c)(3) (requiring notice of proposed settlement sent to class members to include "any agreements made in connection with the dismissal or compromise"). In our view, this provision expresses no state policy against competition among lawyers. In any event, only two states, Iowa and North Dakota, have adopted the Uniform Class Action Act. See 12 Uniform Laws Annotated, 1995 Supplementary Pamphlet, at 28-29 (prefatory note to Uniform Law Commissioners' Model Class Actions Act Rule).

[460] The Supreme Court has made this clear in *Southern Motor Carriers* and *Omni*, both of which we discuss more fully infra notes 463-480 and accompanying text. See also Hovenkamp, supra note 136, § 20.4, at 679 (noting that "most of the details of the regulatory scheme itself may be left to the state agency or governmental subdivision that carries it out").

anticompetitive effects.[461] It is sufficient if the state demonstrates a commitment to displace competition by adopting a regulatory scheme that is clearly inconsistent with competition.[462]

For example, in *Southern Motor Carriers Rate Conference, Inc. v. United States*,[463] the Court held that a statute requiring a state agency to prescribe "just and reasonable" rates for intrastate transportation satisfied the clear articulation requirement, and authorized the agency to allow private common carriers to combine into "rate bureaus" for the purpose of collectively proposing rates which the agency could accept or reject.[464] The Court read the statute to create an "inherently anticompetitive rate-setting process," which demonstrated that the state "clearly intend[ed] to displace competition in a particular field with a regu-

[461] See *Hoover*, 466 U.S. at 574 ("The reason that state action is immune from Sherman Act liability is not that the State has chosen to act in an anticompetitive fashion, but that the State itself has chosen to act."). The Court in *Hoover* rejected the plaintiff's argument that even though the state supreme court regulated bar admissions, the state did not intend to restrict the number of lawyers anticompetitively, but was in effect duped by the private bar into doing so. The Court's point seems to be that as long as the state supreme court "knew and approved the *number* of applicants," id. at 576 n.28, the state supreme court had endorsed a regulatory structure inconsistent with competition—the lack of expressed anticompetitive intent being irrelevant. For further discussion of this point, see infra note 471.

[462] *Southern Motor Carriers*, 471 U.S. at 64. According to Professor Hovenkamp, there must be "something suggesting that the state contemplated the activity being challenged and decided to permit it." Hovenkamp, supra note 136, § 20.4, at 679. Professor Elhauge interprets these pronouncements as effectively eliminating the clear articulation requirement. See Elhauge, supra note 429, at 691-92 (asserting that is has "become increasingly evident that nothing has to be very clear or affirmative about state authorization to immunize regulation" and that the "test that . . . really drives the Court's conclusions" is that "antitrust review should not apply whenever a financially disinterested state agency regulates"). But that interpretation is correct only if "clear" means "specific language." In the Court's view, actions can speak as clearly as words.

[463] 471 U.S. 48 (1985).

[464] Id. at 50, 63. The main holding of the case, ostensibly, was that state statutes that expressly permitted, but did not require, collective ratemaking by truckers constituted a clearly articulated state policy. Id. at 63.

latory structure."[465] But just what makes the state's intent so clear is not so clear from the Court's opinion.

The Court's only explanation of what made the state's intent clear comes in a footnote, in which the Court stressed the fact that under the statute, the agency "is not authorized to choose free-market competition. Instead, it is required to prescribe rates for motor common carriers on the basis of statutorily enumerated factors. . . . [which] bear no discernible relationship to the prices that would be set by a perfectly efficient and unregulated market."[466] The Court's implicit assumption in *Southern Motor Carriers* seems to be that the state statute reduced the incentive of any individual trucker to propose lower rates than other truckers, because the state agency would determine just and reasonable rates and apply them in any event. The Court thus seems to be saying that once the state chooses to preclude individuals from setting their own prices, there is no competition in the sense that matters for antitrust purposes, so it is fair to assume that the state has clearly authorized other forms of anti-competitive behavior, such as the creation of cartels to propose rates to the state.[467]

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[465] Id. at 64. The Court acknowledged that it had reached a different result in Georgia v. Pennsylvania R.R. Co., 324 U.S. 439 (1945), in which the question was "whether Congress intended to immunize a *federal* regulatory program from the antitrust laws." *Southern Motor Carriers*, 471 U.S. at 56 n.18. We discuss this inconsistency infra at note 554.

[466] *Southern Motor Carriers*, 471 U.S. at 65 n.25.

[467] Although this interpretation is consistent with the Court's view that antitrust policy is a price competition policy above all else, it is inconsistent with another part of the reasoning in *Southern Motor Carriers*. In an earlier part of the opinion rejecting the notion that a state must compel anticompetitive conduct to get the protection of state action immunity, the Court stated:

> Most common carriers probably will engage in collective ratemaking, as that will allow them to share the cost of preparing rate proposals. If the joint rates are viewed as too high, however, carriers individually may submit lower proposed rates to the Commission in order to obtain a larger share of the market. Thus, through the self-interested actions of private common carriers, the States may achieve the desired balance between the efficiency of collective ratemaking and the *competition fostered by individual submissions.*

Id. at 59 (emphasis added). The Court was referring to the states that had statutes expressly allowing collective rate-setting, which evidence a stronger intent to allow anticompetitive behavior. But if a state statute does not mention collective rate-setting and if the possibility of individual submissions to the state "fosters competition," then how has the statute "not authorized [the state or its commission] to choose free-market competition." Id. at 65 n.25. In other words, in what sense has

In *City of Columbia v. Omni Outdoor Advertising*,[468] the state statute restricted competition, not by directly interfering with price competition by authorizing rate setting or cartels that might propose rates to the state but by restricting free entry into a market. Free entry facilitates undercutting of a competitor's prices, and because new firms are attracted to industries with excessive profits (that is, high prices relative to costs), excessive costs, or both. Free entry also drives a firm's prices down to its costs and forces it to minimize its costs.[469] In *Omni*, the Court held that a city ordinance regulating billboards was entitled to state action immunity. The Court reasoned that a state statute authorizing a city to regulate zoning was sufficient articulation of a policy to displace competition in the market for land use.[470] The basis of this reasoning is that a zoning statute inherently allows local governments to grant restrictive licenses that deny free entry.[471] Thus, zoning (like collective rate-setting) is a form

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the state "clearly articulated" a policy that allows cartels to propose rates? The state *commission* did choose to allow collective rate-setting, but the agency itself, as the Court recognized, could not authorize anticompetitive conduct for state action purposes. Id. at 62-63. Perhaps the Court was assuming, however tacitly, that the statute in question prohibited the state agency from approving an individual rate simply because it was lower than those of competitors. To that extent, although some competition could exist, the state agency could not choose completely free competition. Although we do not believe that our attempt to rescue the Court from the inconsistency inherent in *Southern Motor Carriers* is very powerful, we believe our argument's weakness reveals not our failure of imagination but the fundamental flaws in the Court's decision in this case. We return later to a criticism of *Southern Motor Carriers*. See infra note 554. For the time being, however, we treat it as binding precedent, however flawed, that we have no reason to believe will soon be reversed and proceed to analyze whether this flawed case presents major problems for the suits we propose.

[468] 499 U.S. 365 (1991).

[469] Economists refer to these beneficial effects of competition as allocative and productive efficiency, respectively.

[470] According to the Court:

> The very purpose of zoning regulation is to displace unfettered business freedom in a manner that regularly has the effect of preventing normal acts of competition, particularly on the part of new entrants. A municipal ordinance restricting the size, location, and spacing of billboards (surely a common form of zoning) necessarily protects existing billboards against some competition from newcomers.

Id. at 373.

[471] We can now see why *Hoover*, despite all its discussion of whether the "state itself" acted, can be viewed as merely an application of the clear articulation requirement. In *Hoover*, the Court placed great reliance on the fact that, "the

of state regulation inconsistent with one of the basic premises of competition (as defined for antitrust purposes)—in this case, free entry.[472]

The class action context presents a different situation. Consider first lawyer agreements to make proposals to a trial court concerning the selection of class counsel and the proper fee to be paid to class counsel. At first glance, these agreements seem similar to the collective rate bureaus permitted (but not required) by the state statutes in *Southern Motor Carriers*. The key difference, however, is that the rules governing class actions do not in any way inhibit meaningful competition from occurring. They do not direct the court to determine just and reason-

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Committee could not reduce the *number* of lawyers in Arizona." *Hoover*, 466 U.S. at 575. Instead, the state supreme court by its rules "reserv[ed] the ultimate authority to control the number of lawyers admitted to the Arizona Bar." Id. at 578 n.31. Like the zoning statute in *Omni*, the state supreme court rules controlling the number of lawyers inherently restrict free entry. In fact, controlling entry is the essence of creating a profession. To allow an antitrust claimant to base a claim on the restriction of entry, therefore, would inevitably interfere with the state's regulatory interest.

The restriction of free entry was also the very point of the regulatory scheme in *New Motor*, which required a car manufacturer to seek agency approval before opening a retail dealership in the territory of an existing franchisee if the existing franchisee protested to the agency. New Motor Vehicle v. Orrin W. Fox Co., 439 U.S. 98, 98-100 (1978). Like the state supreme court in *Hoover*, the agency had the authority to restrict the number of dealers in an area. Such authority is inconsistent with a regime of competition in which free entry is a prerequisite.

[472] In addition to price-setting and free entry, a third aspect of competition is that other than offering a superior product, acts that exclude a competitor are impermissible. Antitrust law has long included the notion that a monopolist may not refuse to deal if its purpose is solely to perpetuate its monopoly. In Town of Hallie v. City of Eau Claire, 471 U.S. 34, 42 (1985), the Court held that a statute authorizing a city to provide sewage services within a self-defined district and to refuse to provide sewage services outside this district clearly articulated an intent to allow the city to engage in anticompetitive conduct, namely a refusal to deal. It is not hard to see why the statute at issue in *Hallie* is inconsistent with this third premise of competition.

To the extent that *Hallie*—with its focus on the "foreseeability" of the anticompetitive results, id. at 42-43—and *Omni*—with its broad notion of authorization, see supra notes 449-450 and accompanying text—imply a greater scope for state action protection than does *Southern Motor Carriers*, it may derive from the fact that the Court has given special treatment to municipalities under the state action doctrine. The Court in *Hallie* stressed that it can presume that "[a] municipality acts in the public interest," 471 U.S. at 45, because "municipal conduct is invariably more likely to be exposed to public scrutiny than is private conduct." Id. at 45 n.9. By comparison, trial courts in class actions often do not operate under the same degree of public scrutiny in approving class counsel fees and settlements as do municipalities in enacting ordinances. See supra notes 233-235 and accompanying text.

able rates according to specified criteria, and then apply these rates to all counsel within some group over a range of cases, which would be the equivalent of the regulatory scheme in *Southern Motor Carriers*. Rather, the most the rules do is to require the court to approve class counsel in the case before it as adequate and class counsel's fee in that case as reasonable; that is, the rules contemplate that the court is, in effect, buying services on behalf of the class.

But as the court recognized in *In re Oracle Securities Litigation*,[473] lawyers could compete for the right to be class counsel by offering bids undercutting the bids of the other lawyers. More to the point, not only do the state statutes that require courts to approve class counsel fees as reasonable not preclude such competition, nothing in those statutes precludes a judge from *requiring* such competition.[474] If he did, then the fee chosen by the court would, unlike the fees in *Southern Motor Carriers*, bear a "discernible relationship to the prices that would be set by a perfectly efficient and unregulated market."[475] In short, nothing in the need for a class to have counsel or the requirement that a court approve of that counsel and counsel fees is inherently inconsistent with competition to be that counsel or more to the point here, with the idea that lawyers would compete on the basis of price to be chosen as class counsel.[476]

Southern Motor Carriers and *Omni* provide even less support for finding a clearly articulated state policy to displace competition among lawyers for claimants who seek to recover under the

[473] 131 F.R.D. 688 (N.D. Cal. 1990).

[474] See supra notes 148-52 and accompanying text.

[475] *Southern Motor Carriers*, 471 U.S. at 65 n.25. In fact, this type of competition is similar to what the Court was trying to preserve in Federal Trade Comm'n v. Superior Ct. Trial Lawyers Ass'n, 493 U.S. 411 (1990), in which the Court held that a boycott by a group of trial lawyers against a local government in hopes of forcing the government to increase the lawyers' hourly compensation was a per se violation of the antitrust laws. If anything, the potential for competition in situations like *Oracle* is greater than the potential in *Trial Lawyers* because in *Trial Lawyers* the lawyers could not negotiate prices individually; they could only decide individually whether or not to accept employment at the rate offered by the city.

[476] According to Professor Hovenkamp, "[i]f the statute is neutral on the question and there appear to be both competitive and non-competitive ways of operating under the statute, the court may insist on the former." Hovenkamp, supra note 136, § 20.4, at 681. This is nothing more than the common antitrust technique of condemning a questionable restraint when a less restrictive alternative is available.

private administrative system established by class action settlements like *Georgine v. Amchem Products* and other mass tort cases. When such a system is set up as part of a class action settlement, counsel representing individual claimants in the private system are not class counsel within the meaning of the state's class action rules. State class action statutes say absolutely nothing about lawyer fees other than fees for class counsel.[477] In fact, these statutes do not even contemplate private administrative systems that might require counsel, let alone foresee the anticompetitive effects of such systems Nor is there anything inherent in the structure of class action regulation, or even in statutes setting maximum contingency fees in certain classes of cases, that precludes price competition by lawyers representing individual claimants *outside of the court system*, or that precludes new lawyers from freely entering the market for representing these individual claimants, and thereby displacing class counsel or other lawyers who may have previously represented those claimants. The most that can be said is that these private administrative systems are consistent with the class action rules and maximum fee statutes, and that lawyer anticompetitive agreements concerning these administrative systems may be consistent with state policy,[478] which is insufficient to establish the state's clear intent to displace competition under *Southern Motor Carriers* and *Omni.*

It is true that in some sense a class action is like a regulated monopoly.[479] Class actions can be said to displace competition among lawyers for individual litigants by consolidating individual cases into the class monopoly. Under *Southern Motor Carriers*,

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[477] See supra note 459.

[478] Whether or not the administrative systems violate state law is irrelevant for purposes of determining whether the state action doctrine applies. See supra notes 449-453 and accompanying text. If the state has a clearly articulated policy to displace competition, the fact that a particular agent of the state violated the policy in acting anticompetitively does not remove the immunity. See Hovenkamp, supra note 136, § 20.4, at 680-81. On the other hand, if the state has no clearly articulated policy, the fact that a particular agent of the state complied with state law does not create immunity.

[479] See *Oracle*, 131 F.R.D at 693 n.12. (asserting that "the need to prosecute the claims of the class collectively rather than individually may create a so-called 'natural monopoly,'" but that this should not preclude use of market mechanisms in choosing class counsel).

it could be argued that once the state displaces this competition by creating class actions and by authorizing judicial review of settlements and class counsel fees, it demonstrates a clear intent to regulate all aspects of lawyer behavior concerning class actions. Trial courts must be given great leeway, under this view, "because they are able to deal with problems unforeseeable to, or outside the competence of, the legislature."[480]

The Court, however, rejected exactly this argument in *Cantor v. Detroit Edison Co.*[481] In *Cantor*, the Court held that a regulated utility that provided "free" light bulbs to its paying electricity consumers was not immune from the antitrust laws under the state action doctrine, even though the utility submitted tariffs including the light bulbs to a state agency. The Court found that the mere fact that the state pervasively regulates a monopoly does not mean that federal antitrust policy cannot reach anything concerning that monopoly.[482] In support of its position, the Court advanced several arguments relevant here.

First, the Court found that although the state had demonstrated an intent to displace competition in the market for electricity, it did not demonstrate a similar intent with respect to the market for light bulbs.[483] Because the Court found that the state

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[480] *Southern Motor Carriers*, 471 U.S. at 64.

[481] 428 U.S. 579 (1976).

[482] This finding is consistent with the Court's approach with respect to patents. The mere fact that a patent confers a licensed monopoly on the patent holder does not immunize that party from the antitrust laws. See Hovenkamp, supra note 136, § 7.11 at 290 (noting that the "power to exclude [conferred by a patent] is not unlimited, and courts have often found patentees guilty of exclusionary practices"). The Court has also reached essentially the same conclusion with respect to professionals. Although they are regulated with respect to some of their activities, when they act to restrain markets in which the state has no regulatory interest, the antitrust laws sometimes reach their conduct. See, e.g., National Soc'y of Prof. Eng'rs v. United States, 435 U.S. 679 (1978) (canon of ethics prohibiting competitive bidding for the purpose of minimizing risk of inferior work held unlawful under the Sherman Act); Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332 (1982) (maximum fee arrangement among competing physicians violated Sherman Act); Federal Trade Comm'n v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411 (1990) (collective boycott by lawyers targeted at forcing local government to increase pay to lawyers violated Sherman Act).

[483] Specifically, the Court found that:

> The distribution of electricity in Michigan is pervasively regulated .... [But t]he distribution of electric light bulbs in Michigan is unregulated. The statute creating the [regulatory] Commission contains no direct reference to light bulbs. Nor, as far as we have been advised, does any other Michigan statute authorize

did not intend to displace competition in the light bulb market, the Court saw no reason to prevent antitrust law from regulating that market.[484] *Cantor* thus mandates that in deciding whether to apply the state action doctrine to a regulated firm, a court must identify the market in which the state has displaced competition and determine whether that market is the same as or separable from the markets in which the alleged restraint of trade is occurring.

In our context, the fact that a class action is a single "case" does not mean that there is a single market any more than a single tariff filing in *Cantor* meant that there was a single market that included both electricity and lightbulbs. The only possible market in which the states, by permitting class actions, displace competition is the market for lawyer services in bringing claims against the class action defendants in the state court system. After the court's approval of the class action, lawyers can no longer compete to represent clients in the state court system by offering better terms to these clients because the class action precludes private suits arising out of the same transaction as the class action by class members who have not opted out.

Contrast this market with the markets in which we suggest plaintiffs' lawyers may have restrained competition in *Oracle* and *Georgine*. The market in which the lawyers might have restrained competition in *Oracle* is the market for the right to represent the class action monopoly.[485] The market in which the

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> the regulation of that business. Neither the Michigan Legislature, nor the Commission, has ever made any specific investigation of the desirability of a lamp-exchange program or of its possible effect on competition in the light-bulb market. Other utilities regulated by the Michigan Public Service Commission do not follow the practice of providing bulbs to their customers at no additional charge. The Commission's approval of respondent's decision to maintain such a program does not, therefore, implement any statewide policy relating to light bulbs. We infer that the State's policy is neutral on the question whether the utility should, or should not, have such a program.

Cantor, 428 U.S. at 584-85; see also id. at 594 (finding that "the option to have, or not to have, such a program is primarily [the utility's], not the Commission's").

[484] See id. at 596 ("There is no logical inconsistency between requiring [the utility] to meet regulatory criteria insofar as it is exercising its natural monopoly powers and also to comply with antitrust standards to the extent that it engages in business activity in competitive areas of the economy.").

[485] Cf. Fishman v. Estate of Wirtz, 807 F.2d 520, 533-35 (7th Cir. 1986) (holding that restriction on "competition to acquire a natural monopoly" is an antitrust injury).

lawyers might have restrained competition in *Georgine* is the market for lawyer services in representing individual claimants in the private administrative system. Although the buyers (claimants) and sellers (plaintiffs' lawyers) in these markets are the same as in the "regulated" market, and the "product" bought and sold in each market is lawyer services, the markets involved are very different in the sense that matters for antitrust purposes under *Cantor*—namely that elimination of competition in the first market does not necessarily affect competition in the other two markets.[486] Nothing in the class action rules suggests the states are interested in regulating these markets simply because they want to eliminate individual claims in the court system.[487]

Of course, the mere fact that a separate market can be identified does not answer the question of whether a court should consider the two (or more) markets separately for antitrust purposes. The Court's second argument in *Cantor* was that whatever the state's regulatory goals were in the electricity market, they were not inconsistent with antitrust enforcement in the light-bulb market.[488] The Court reasoned that if the light-bulb exchange program were held to violate the antitrust laws, "there [would be] no reason to believe that Michigan's regulation of its electric utilities [would] no longer be able to function effect-

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[486] The tying doctrine in antitrust law requires a similar determination that there are two separate products being tied together. Whether or not there are two products does not depend on the physical characteristics of the products but on whether the products could be offered separately at reasonable cost and in a way that consumers might demand. See generally Jefferson Parish Hosp. No. 2 v. Hyde, 466 U.S. 2 (1984) (discussing the requirement of two products in tying analysis). The *Georgine* restraints could be viewed as tying arrangements in that class counsel could be trying to tie the sale of their services as class counsel to the sale of their services as lawyers for individual claimants in the private administrative system.

[487] See sources cited supra notes 452 and 459. Lawyer competition in fees is generally unregulated. See Goldfarb v. Virginia State Bar, 421 U.S. 773 (1975). Furthermore, class action rules make no direct reference to lawyer competition. With the possible exception of state maximum fee statutes, neither state legislatures nor state courts have ever investigated the desirability of regulating lawyer competition. And not all class actions involve settlements that establish private administrative systems that require claimants to secure a lawyer's services. The choices made seem to be the lawyers' choices, not the court's.

[488] *Cantor*, 428 U.S. at 596 ("[The state's] regulation of respondent's distribution of electricity poses no necessary conflict with a federal requirement that respondent's activities in competitive markets satisfy antitrust standards.").

ively."[489] In fact, if anything, the light-bulb program might have hindered the state's regulatory efforts by artificially increasing the rate base on which the state calculated the utility's rates, and by distorting consumer choices for electricity as compared to substitute energy sources.[490] Thus, just as an overly narrow state action immunity might unduly interfere with state regulatory efforts, there is a danger that "[f]or States [seeking] to benefit their citizens through regulation, a broad doctrine of state-action immunity may serve as nothing more than an attractive nuisance in the economic sphere."[491]

In the class action context, too broad a view of the state action immunity could interfere with the state's regulatory goal—namely, fair resolution of claims at the lowest cost. Competition in the market for the right to be class counsel and in the market

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[489] *Cantor*, 428 U.S. at 598. The Court reached the same conclusion 30 years earlier, in United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944), which held that the antitrust laws could apply to the business of insurance. The Court in *South-Eastern Underwriters* stated:

> The argument that the Sherman Act necessarily invalidates many state laws regulating insurance we regard as exaggerated. Few states go so far as to permit private insurance companies, without state supervision, to agree upon and fix uniform insurance rates. Cf. *Parker v. Brown*, 317 U.S. 341, 350-52. No states authorize combinations of insurance companies to coerce, intimidate, and boycott competitors and consumers in the manner here alleged . . . .

South-Eastern Underwriters, 322 U.S. at 562.

The decision in *South-Eastern Underwriters* prompted Congress to enact the McCarran-Ferguson Act, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§ 1011-1015 (1994)), which specifically exempts the insurance industry from the federal antitrust laws. It should be noted, however, that the McCarran-Ferguson Act does not exempt boycotts from antitrust immunity. 15 U.S.C. § 1013(b) (1994).

[490] The *Cantor* Court noted:

> In 1972 [the utility] provided its residential customers with 18,564,381 bulbs at a cost of $2,835,000. In its accounting to the Michigan Public Service Commission, [the utility] included this amount as a portion of its cost of providing service to its customers. [The utility's] accounting records reflect no direct profit as a result of the distribution of bulbs.

428 U.S. at 583-84. In an accompanying footnote, the Court added that of the total cost reported, "$2,363,328 was paid to the three principal manufacturers of bulbs from whom [the utility] made its purchases; the other $471,672 represented costs incurred in the use of [the utility's] personnel and facilities in carrying out the program." Id. at 583 n.8. A 20% markup might lead one to suspect that the utility had engaged in some creative accounting. If so, the light-bulb program might have allowed the utility to evade the state's regulatory goals and unduly increase prices to consumers.

[491] Federal Trade Comm'n v. Ticor Title Ins. Co., 504 U.S. 621, 637 (1992).

for representing claimants in the private administrative system would arguably further that goal.[492]

The Court's third argument in *Cantor* was that the state's regulation of the market for electricity did not conflict with antitrust policy because the state's policy itself was not anticompetitive.[493] Unlike regulation whose "very purpose . . . is to avoid the consequences of unrestrained competition," state regulation of natural monopolies "does not necessarily suppress competition" because there might not have been competition to begin with.[494] Thus, by regulating natural monopolies, states demonstrate no intent to displace competition.[495]

In the class action context, the Court's argument makes sense. Class actions that aggregate small claims, by grouping cases together, create economic incentives to bring cases that would be uneconomical if filed individually. These class actions do not necessarily displace competition that would otherwise exist; rather, they make possible claims that would otherwise not be brought. There is no competition for bringing uneconomical cases.[496]

Even when class actions consolidate cases that could otherwise be brought individually, as is often the case in the mass tort context, class actions are not necessarily inconsistent with the competition policy of the federal antitrust laws. A class action

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[492] One might argue that improving imperfect state regulation is no business of the federal antitrust laws. But that argument misses the point. The antitrust laws do not apply because they further the state's regulatory goal (though that is an incidental benefit). They apply because in the class action context, the states have not committed to a regime of regulation that displaces competition, and thus, there is no state action immunity.

[493] *Cantor*, 428 U.S. at 595-96 (noting that "public utility regulation typically assumes that the private firm is a natural monopoly and that public controls are necessary to protect the consumer from exploitation.").

[494] *Cantor*, 428 U.S. at 595. See also id. at 596 n.33 (stating that "the 'very reason for the regulation of private utility rates . . . is the inevitability of a monopoly that requires price control to take the place of price competition.'") (quoting Otter Tail Power Co. v. United States, 410 U.S. 366, 389 (1973) (Stewart, J., dissenting)).

[495] The Court's assertion that regulation of natural monopolies does not necessarily suppress competition may be wrong as a factual matter in the case of utilities. The fact that a utility is a natural monopoly simply means that one utility can serve the entire market at lower cost than if several utilities compete in the market. That may make competition undesirable, but it does not make it impossible or even unlikely. Generally, the antitrust laws preclude the argument that competition is undesirable.

[496] In this sense, class actions that aggregate small claims are somewhat like natural monopolies.

may be more like a joint venture than a natural monopoly. The antitrust laws have long recognized that not all cost-saving joint ventures are antitrust violations, even if some competitors cannot effectively compete against the joint venture.[497] The joint venture view of class actions is supported by the fact that class action statutes and rules often protect lawyer competition for clients through opt out procedures.[498] In these cases, lawyers have every incentive to compete by trying to entice class members to opt out by offering them a better deal than they would get if they stayed in the class.[499] Even if opting out is almost meaningless as a practical matter, the mere fact that an option for individual competition is available makes class actions generally consistent with federal antitrust policy.[500]

In short, if class actions are not necessarily anticompetitive monopolies, it is hard to see why the regulation of class actions necessarily displaces competition. And if there is no necessary displacement of lawyer competition—if, in the *Omni* Court's language, displacement of competition is not the "very purpose"

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[497] See, e.g., Broadcast Music v. Columbia Broadcasting Sys., 441 U.S. 1 (1979) (holding that blanket licensing arrangements were not per se unlawful). As for the inability of competitors to compete against a joint venture, it is useful to recall that one of the most repeated phrases in antitrust jurisprudence is that the antitrust laws protect competition, not competitors. See, e.g., Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962) ("Taken as a whole, the legislative history illuminates congressional concern with the protection of *competition*, not *competitors*.").

[498] See, e.g., Tex. R. Civ. P. 42(c)(2).

[499] Though the purpose of these opt-out provisions may be to protect due process for litigants rather than to promote competition among lawyers, the effect these provisions have on competition seems to preclude the state (or lawyers) from arguing that the state intends to displace competition by regulating class actions. The same could be said of provisions allowing objectors to appear at a fairness hearing. As we have already discussed, objectors are rarely represented by counsel. See supra notes 180-187 and accompanying text. When counsel appear on behalf of objectors, it is fair to assume that those counsel have a financial stake in overturning the settlement. This financial stake could come from the potential to act as class counsel in a new class action or to represent substantial numbers of individual clients if no class action settlement occurs, both of which would be to the economic detriment of the lawyer proposing the settlement. Thus, we would expect to see represented objectors only when their counsel have a competitive interest in the rejection of the settlement. See supra note 184.

[500] In *Broadcast Music*, the Court relied in part on the fact that individual bargaining was available to purchasers of music (although individual bargaining rarely occurred) to find that blanket licenses offered by joint ventures of composers were not per se illegal. 441 U.S. at 11, 12, 23.

of class action regulation—it is hard to see what could possibly make the state's intent to displace competition "clear" within the meaning of *Southern Motor Carriers* and *Omni.*

3. *Active Supervision*

Even if class action lawyers could successfully show that procedural rules governing class actions represent a clearly articulated policy to displace competition among lawyers, they would still have to satisfy the second *Midcal* prong—that of "active supervi-

sion."[501] Class action lawyers would have a tough time showing that the courts actively supervise the restraints.

The active supervision doctrine requires the state to do more than leave private parties to their discretion in carrying out state regulatory policy; the state must have some oversight or supervisory role in monitoring and ensuring compliance with its clearly articulated regulatory policy. In *Midcal*, the Court held that although a state statute clearly authorized resale price maintenance in the wine industry, it violated the Sherman Act because

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[501] See, e.g., Patrick v. Burget, 486 U.S. 94, 100 (1988) ("Only if an anticompetitive act of a private party meets both [the clear articulation and active supervision] requirements is [the conduct deemed state action]."); *Southern Motor Carriers*, 471 U.S. at 62 ("A private party may claim state action immunity only if both prongs of the *Midcal* test are satisfied."). Thus, a state cannot declare that its regulatory policy favors competition and at the same time argue that it actively supervises those carrying out its regulatory policy to make sure that they adequately protect competition. Were this allowed, it would stand the Supremacy Clause on its head by allowing states to preempt the enforcement of the federal antitrust laws by enacting antitrust laws and other procompetition statutes at the state level.

On the other hand, if a state does not have a clear regulatory policy specifically promoting or displacing competition, but actively enforces the regulatory policy that it has adopted, the question arises whether the active supervision alone can effectively satisfy the clear articulation requirement. The Supreme Court position on this issue is unclear because in its cases involving disputes over the scope of the active supervision requirement since *Midcal*, the existence of a clearly articulated policy to displace competition was either found or not discussed. Federal Trade Comm'n v. Ticor Title Ins. Co., 504 U.S. at 631 (noting that because the FTC had conceded that the clear articulation prong was satisfied, the immunity question turned only upon the proper interpretation and application of the active supervision requirement); *Patrick*, 486 U.S. at 100 ("In this case, we need not consider the 'clear articulation' prong of the *Midcal* test, because the 'active supervision' requirement is not satisfied."); 324 Liquor Corp. v. Duffy, 479 U.S. 335, 344 (1987) (holding that state statute imposing mandatory resale price maintenance in liquor industry meets the clear articulation requirement). The case that comes closest to active supervision of a regulatory policy without a clearly articulated policy on the facts is the pre-*Midcal* case of *Cantor*. Recall that in *Cantor*, the state regulatory agency repeatedly approved the utility's light bulb sales as part of its tariff approval, but the Court found that approval did not suggest that the state's policy was to displace competition in the market for light bulbs. See *Cantor*, 428 U.S. at 584 ("Neither the . . . Legislature, nor the Commission, has ever made any specific investigation of the desirability of a lamp-exchange program or of its possible effect on competition in the light-bulb market."). Perhaps *Cantor* suggests that active supervision could sometimes establish a clearly articulated policy. But to the extent the clear articulation requirement is about fair notice to both regulated parties and citizens, allowing aggressive agency regulation in the face of state inaction to constitute a clearly articulated regulatory policy for state action doctrine purposes is troubling.

there was no active supervision by the state.[502] The Court reasoned:

> The State simply authorizes price setting and enforces the prices established by private parties. The State neither establishes prices nor reviews the reasonableness of the price schedules; nor does it regulate the terms of fair trade contracts. The State does not monitor market conditions or engage in any 'pointed reexamination' of the program. The national policy in favor of competition cannot be thwarted by casting such a gauzy cloak of state involvement over what is essentially a private price-fixing agreement.[503]

In *Patrick v. Burget*,[504] the Court interpreted this active supervision test as laid out in *Midcal* to mean that "state officials have and exercise power to review particular anticompetitive acts of private parties and disapprove those that fail to accord with state policy."[505] In both of these cases, the Court found that there was no state procedure to review the reasonableness of prices or the anticompetitive nature of the restraint.

In the class action context, trial courts must approve class action settlements. In doing so, they must consider whether the settlements are in the interest of the class. As part of this determination, they may take into account the reasonableness of fees

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[502] *Midcal*, 445 U.S. at 105-06.

[503] Id. at 105-06 (footnote omitted). The Court reached essentially the same conclusion in Schwegmann Bros. v. Calvert Distillers Corp., 341 U.S. 384 (1951). The basic difference was that *Schwegmann* arose during the reign of the Miller-Tydings Act, ch. 690, Title VIII, 50 Stat. 693 (1937) (repealed in 1975), which allowed states to permit resale price-maintenance contracts. The Court held in *Schwegmann* that the Miller-Tydings Act did not exempt from antitrust scrutiny a state-supported resale price maintenance program in which retailers who did not want to contract with distributors to maintain minimum resale prices were compelled to do so. *Schwegmann*, 341 U.S. at 388-89.

On the other hand, in Fisher v. City of Berkeley, 475 U.S. 260 (1986), the Court upheld a municipal rent control ordinance against antitrust challenge because:

> [It] places complete control over maximum rent levels exclusively in the hands of the Rent Stabilization Board. Not just the controls themselves but also the rent ceilings they mandate have been unilaterally imposed on the landlords by the city. . . . Adopted by popular initiative, the Ordinance can hardly be viewed as a cloak for any conspiracy among landlords . . . ."

Id. at 269. Our argument, of course, is that judicial approval of class action settlem.nts can and should be viewed as a potential cloak for conspiracies among lawyers.

[504] 486 U.S. 94 (1988).

[505] Id. at 101.

charged by class counsel as well as the reasonableness of attorney's fees permitted to be charged in any private administrative system set up by the settlement. It is the fixing of these fees that constitutes an anticompetitive restraint. Because the court has the authority to review the reasonableness of prices, and to disapprove of any settlement that contains fees failing to accord with state policy, the court's supervision over class action settlements does not suffer from the same defects that led the Court to deny state action immunity to the restraints in *Midcal* and *Patrick*.

But the trial court's authority to engage in a substantive review of lawyer fees may not be sufficient to satisfy the active supervision requirement. The Court in *Patrick* left open the question "whether judicial review of private conduct ever can constitute active supervision."[506] If the court were to hold that only administrative agencies can provide adequate (for state action purposes) review, that would not, however, mean that court review of class settlements was inadequate under the state action doctrine.[507] The "judicial review of private conduct" that the Court had in mind in *Patrick* was ordinary litigation to review the merits of a peer-review decision by a group of doctors to terminate a competing doctor's hospital privileges.[508] But, as we argued above, trial courts in class actions could be viewed as more akin to administrative agencies than courts, which normally "review" private conduct through ordinary litigation. Moreover, the fact that the restraint in the class action context

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[506] Id. at 104. On the facts of the case, the Court found that even if judicial review could constitute active supervision, it did not here because:

> [I]f [judicial] review exists at all, [it] falls far short of satisfying the active supervision requirement. . . . [I]t is not clear that Oregon law affords any direct judicial review of private peer-review decisions. . . . Moreover, the Oregon courts have indicated that even if they were to provide judicial review . . . the review would be of a very limited nature.

Id.

[507] At least one commentator argues that the Court will say judicial review is sufficient under certain circumstances. Michal Dlouhy, Note, Judicial Review as *Midcal* Active Supervision: Immunizing Private Parties from Antitrust Liability, 57 Fordham L. Rev. 403, 416-23 (1988). See also Bolt v. Halifax Hosp. Medical Center, 851 F.2d 1273, 1282 (11th Cir. 1988), vacated en banc and per curiam, 874 F.2d 755 (11th Cir. 1989), cert. denied, 110 S. Ct. 1960 (1990) (holding that judicial review may constitute "active supervision").

[508] *Patrick*, 486 U.S. at 96-97.

does not occur until the trial court approves a settlement could further support interpreting court approval of class action settlements as "active supervision."[509] Thus, whatever the Court eventually decides about judicial review in the *Patrick* context, court supervision in the class action context presents a different case.

Even if judicial review can at least in some cases satisfy *Midcal*'s active supervision prong, the question of whether a trial judge is authorized to engage in the necessary review remains. In reviewing a class action settlement, a trial judge faces a situation unlike that faced by the typical administrative agency in one crucial respect: The judge is not predominantly regulating lawyer conduct, but is supposedly approving a settlement in a way that protects the rights of the litigants. The judge cannot consider agreements concerning lawyer fees, such as those in *Georgine*, separately from the rest of the settlement; the judge must evaluate the settlement as a whole.[510] Thus, one could argue that the judge lacks the authority to actively supervise in the way that *Midcal* contemplates.

Moreover, if active supervision means continuous supervision, the argument that class action judges actively supervise a regulatory system is significantly weakened. *Midcal* is unclear on the question of whether active supervision requires continuous supervision so long as there is at least one review of the reasonableness of price schedules. A later and similar case, *324 Liquor Corp. v. Duffy*,[511] sent mixed signals on this question in the

[509] Professor Elhauge considers the timing of judicial review as a crucial factor in deciding whether judicial review can satisfy the active supervision requirement: "The key question . . . is not whether a court or agency provides the disinterested state process for controlling the terms of restraints, but whether that process occurs before or after the market injury." Elhauge, supra note 429, at 716. Thus, he argues that judicial review should satisfy the active supervision requirement only when the review is "disinterested, substantive, and provided *before* the restraint becomes effective." Id. at 716-17 (emphasis added). He continues: "Because pre-injury review is typically more common for agencies than courts, agency review will provide active supervision more often than will judicial review. But that does not mean that judicial review never provides active supervision or that agency review always does." Id.

[510] Courts can and do review class counsel fees separately from the rest of the agreement, but the actions we are discussing here do not directly challenge the class counsel fee award. It is less clear whether courts can review the fee caps for the private administrative systems separately from the rest of the agreement.

[511] 479 U.S. 335 (1987).

footnotes. The Court held invalid a state regulatory system that required retailers to charge at least 112% of the "posted" wholesale price for liquor, but allowed wholesalers to sell at less than the "posted" price.[512] The Court stated that a "simple 'minimum markup' statute requiring retailers to charge 112 percent of their actual wholesale cost *may* satisfy the 'active supervision' requirement."[513] But, in the very next footnote, the Court rejected the argument that "periodic reexaminations by the state legislature" and the potential for the regulating agency to allow individual wholesalers and retailers to depart from the regulated prices constituted active supervision.[514] The Court found that neither of the above "exerts any significant control over retail liquor prices."[515]

At the very least, the Court's opinion suggests that if continual monitoring is required, it must be comprehensive monitoring of prices by the agency that regulated in the first place. But requiring continual monitoring would not always make sense. In particular, recall the situation in *Oracle*, where the antitrust allegation would be that the lawyers colluded in choosing class counsel and proposing class counsel fees. It is not apparent what monitoring the court could do other than examining the bid submitted and deciding if the proposed fee was reasonable. If the lawyers are engaging in bid rotation,[516] only monitoring from one class action to the next would catch it. There is no assurance that any one judge will have every (for example) securities class action in a particular state. Of course, this is not so much a question of the authority to monitor as the likely effectiveness of monitoring.

When, however, antitrust allegations concern the fees to be charged in the private administrative system established under a class action settlement, it makes a big difference if active supervision requires continuous supervision. Although courts retain continuing jurisdiction to adjudicate disputes that arise from the implementation of the settlement,[517] it is not clear that

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[512] Id. at 352.
[513] Id. at 344 n.6 (emphasis added).
[514] Id. at 345 n.7.
[515] Id.
[516] See supra note 154.
[517] See, e.g., Ivy v. Diamond Shamrock Chem. Co. (In re "Agent Orange" Prod.

that jurisdiction would qualify as continuing supervision over the fees paid to lawyers within the administrative system. First, continuing jurisdiction does not normally empower courts sua sponte to "engage in any 'pointed reexamination' of the [system's operation]." Parties or aggrieved others must bring disputes to the court for adjudication and there is obviously no guarantee that any party would do so. Thus, there is no assurance that continuing jurisdiction would amount to continuing supervision or even sporadic supervision. Second, although in theory it is conceivable that the settlement itself could include terms that try to confer on a court the responsibility to conduct periodic pointed reexamination on its own initiative, it is questionable whether by contract (which is what a class settlement is) private parties could effectively confer such new responsibilities on state judges, or any state actor for that matter,[518] or how

Liab. Litig.), 996 F.2d 1425, 1432 (2d Cir. 1993), cert. denied, 510 U.S. 1140 (1994) ("[The judge] has continuing jurisdiction over the Agent Orange I class action, not only to administer the settlement fund, . . . but also to ensure that the Settlement Agreement as a whole is enforced according to its terms.") (citations omitted); Price v. Ciba-Geigy Corp., No. 94-0647-B-S, at 58 (S.D. Ala. 1995) ("The Court shall retain jurisdiction . . . with respect to future performance of, and any claims relating to performance of, the Settlement agreement and judgment.")

[518] If A and B wrote a contract that provided that a state judge would come check every six months to see that building construction was proceeding in accordance with the contract terms, it is inconceivable that a state would accept that the judge had thus effectively been given some new power of office. The responsibilities of state judges are defined by the state's laws and its constitution, not the private agreement of parties. It is generally accepted that court approval of a settlement does not change that agreement into "public law." See, e.g., Derrickson v. City of Danville, 845 F.2d at 718 (stating that "a consent decree is fundamentally a contract and therefore does not bind a governmental body to any greater degree than a contract"); Air Line Stewards & Stewardesses Ass'n, Local 550 v. Trans World Airlines, 713 F.2d 319, 321 (7th Cir. 1983) ("A settlement agreement is a contract and as such, 'the construction and enforcement of settlement agreements are governed by principles of local law applicable to contracts generally.'") (quoting Florida Educ. Ass'n v. Atkinson, 481 F.2d 662, 663 (5th Cir. 1973)). In any case, it is not clear that class action settlements attempt to expand the court's role beyond the traditional one. Compare Price v. Ciba-Geigy Corp., No. 94-0647-B-S, Exhibit A ¶ III.B (Stipulation of Settlement) (S.D. Ala. 1995) ("The COURT shall retain jurisdiction over this case and the DCA and MMT FUNDS and shall use its equitable powers to enforce this STIPULATION and to protect its jurisdiction over this case and all parties and SETTLEMENT CLASS MEMBERS. The COURT shall have jurisdiction over all phases of this STIPULATION.") with id. ¶ XXIII.E ("No modification of this STIPULATION may be made except by written agreement of CLASS COUNSEL and CIBA-GEIGY CORPORATION approved by the COURT.")

a court could as a practical matter carry out such responsibilities assuming they could legally be conferred on state judges.

In addition to the question of whether the court has the authority to supervise, *Ticor Title* directs that the State must have also "played a substantial role in determining the specifics of the economic policy."[519] In particular,

> [w]here prices or rates are set as an initial matter by private parties, subject only to a veto if the State chooses to exercise it, the party claiming the immunity must show that state officials have undertaken the necessary steps to determine the specifics of the price-fixing or ratesetting scheme. The mere potential for state supervision is not an adequate substitute for a decision by the State.[520]

The Court stressed that especially where price fixing is involved, active supervision should not be casually inferred.[521] Although the involvement of courts in approving class action settlements is greater than the involvement of the agencies in *Ticor Title*, the features the Court found crucial point toward an absence of active supervision. The lawyers set fee terms as an initial matter subject only to a potential veto by the court. The court may not be at all aware of potential price fixing. And even if it is, though the court may examine the specifics of the scheme, it does not "determine" these specifics in any meaningful way, given its obligation to consider the settlement as a whole.

It appears, therefore, that class action lawyers cannot demonstrate that the courts actively supervise their anticompetitive restraints. Thus, they cannot satisfy the second *Midcal* prong, and state action immunity does not exempt anticompetitive lawyer conduct from the federal antitrust laws.

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[519] 504 U.S. at 635.
[520] Id. at 638.
[521] Id.

4. Summary of State Action

We can summarize the preceding discussion in a straightforward way. The anticompetitive conduct that lawyers involved in class actions may engage in would not, under current doctrine, and should not, in light of the serious potential for abuse, enjoy the cloak of state action immunity. Neither of *Midcal*'s two prongs would be satisfied. No authorized state actor has clearly articulated any state policy to displace competition in the markets where we claim the potential for anticompetitive behavior exists. These markets are the market to be class counsel in any pending and future class action, and the market to represent claimants in a private administrative system established by a class action settlement. *Cantor* teaches that even if class actions themselves represent state regulation that the antitrust laws cannot reach, state action immunity does not attach to collateral markets that the state does not intend to regulate. The market to be class counsel and the market to represent claimants in a subsequent non-court system are such collateral markets.

Even if there were a clearly articulated state policy to displace competition in these markets, there is no active supervision of such a policy. Courts approving class action settlements must evaluate the settlement as a whole; therefore, they cannot effectively monitor anticompetitive behavior occurring in and around class actions. Certainly monitoring is impractical when anticompetitive behavior can occur over the course of several class actions, such as in the bid rotation scenario. And in the private administrative system cases, monitoring is either not in fact done or is beyond the court's competence or authority to do. The court in such a system cannot serve as a roving regulator that continuously reevaluates the specific terms of the settlement, but merely as an arbiter of disputes that may arise. If the court tries to do more, on its own initiative or at the behest of the parties, the court risks straying beyond its constitutional function. For these reasons, a state action immunity defense to an antitrust suit brought agains class action lawyers charged with the types of anticompetitive conduct we have discussed would likely fail.

C. Class Actions as Federal Regulation

1. Reasonable Does Not Mean Right

The Supreme Court has developed a strong presumption in favor of the antitrust laws when they conflict with other federal regulatory statutes. Congress must demonstrate a "clear intent" to displace the antitrust laws, just as state legislatures must clearly articulate a policy inconsistent with competition.[522] Unlike state legislatures, Congress may demonstrate its clear intent by providing express antitrust immunity.[523] Yet even when Congress provides for express immunity, the Court strictly construes these exemptions.[524]

When no applicable federal statute contains an express antitrust immunity, the Court has been quite reluctant to imply immunity. Immunity from the antitrust laws by implication has been found only "in cases of plain repugnancy between the antitrust and regulatory provisions."[525] Further, the Court has found

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[522] National Gerimedical Hosp. & Gerontology Ctr. v. Blue Cross, 452 U.S. 378, 389 (1981) (citing United States v. National Ass'n of Secs. Dealers, 422 U.S. 694 (1975); Gordon v. New York Stock Exch., 422 U.S. 659 (1975)).

[523] Congress has often provided just such express antitrust immunity, and several Supreme Court cases address the scope of such immunity. See United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 350 n.27 (1963) (citing various statutes in which Congress provided express antitrust exemption); see also Hughes Tool Co. v. Trans World Airlines, 409 U.S. 363 (1973) (construing express grant of antitrust immunity under the Federal Aviation Act of 1958); Carnation Co. v. Pacific Westbound Conf., 383 U.S. 213, 220-22 (1966) (discussing previous application of express grant of immunity under the Shipping Act of 1916); Maryland & Virginia Milk Producers Ass'n v. United States, 362 U.S. 458 (1960) (applying antitrust exemption under the Capper-Volstead Act of 1922); see generally E.H. Schopler, Annotation, Applicability of Federal Antitrust Laws as Affected by other Federal Statutes or by Federal Constitution—Supreme Court Cases, 45 L. Ed. 2d 841 (1976) (collects and discusses Supreme Court cases applying individual statutes).

[524] Federal Maritime Comm'n v. Seatrain Lines, 411 U.S. 726, 733 (1973) (citing the Court's "frequently expressed view that exemptions from antitrust laws are strictly construed"). In following its policy of strict construction, the Court has not hesitated to find that some restraint exceeded the scope of the express antitrust immunity. See, e.g., *Pacific Westbound Conference*, 383 U.S. at 217-20; *Maryland & Virginia Milk Producers*, 362 U.S. at 469-70; United States v. Borden Co., 308 U.S. 188, 204-05 (1939).

[525] *Philadelphia Nat'l Bank*, 374 U.S. at 350-51 ("Repeals of the antitrust laws by implication from a regulatory statute are strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions.") (footnote ommitted). For other cases similarly indicating reluctance to imply immunity, see *National Gerimedical Hospital*, 452 U.S. at 388; *Gordon*, 422 U.S. at

such repeals by implication "only if necessary to make the [regulatory law] work, and even then only to the minimum extent necessary."[526]

In *National Gerimedical Hospital & Gerontology Center v. Blue Cross of Kansas City*,[527] the most recent Supreme Court case discussing implied federal regulatory immunity, the Court reaffirmed its reluctance to imply antitrust immunity. The Court also offered additional guidelines to its federal regulation immunity jurisprudence. First, although Congress may displace the antitrust laws if it demonstrates a clear intent to do so, pervasive regulation alone is not sufficient to establish the requisite clear intent.[528] Second, "antitrust repeals are especially disfavored where the antitrust implications of a business decision have not been considered by a governmental entity."[529] On the other hand, if Congress empowers a regulatory agency "to authorize or require the type of conduct under antitrust challenge," it expresses a "much clearer" intent to repeal the antitrust laws.[530]

682; Otter Tail Power Co. v. United States, 410 U.S. 366, 372 (1973).

[526] Silver v. New York Stock Exchange, 373 U.S. 341, 357 (1963).

[527] 452 U.S. 378 (1981).

[528] *National Gerimedical Hospital*, 452 U.S. at 389 ("Even when an industry is regulated substantially, this does not necessarily evidence an intent to repeal the antitrust laws with respect to every action taken within the industry.") (citing *Otter Tail Power*, 410 U.S. at 372-75; United States v. Radio Corp. of America, 358 U.S. 334, 346 (1959)). In *National Gerimedical Hospital*, the Court held that the National Health Planning and Resources Development Act of 1974 did not "create a 'pervasive' repeal of the antitrust laws as applied to every action taken in response to the health-care planning process." *National Gerimedical Hospital*, 452 U.S. at 393. The idea that pervasive regulation does not create immunity with respect to all aspects of the industry parallels the Supreme Court's decision in Cantor v. Detroit Edison Co., 428 U.S. 579 (1976), in the state action context. See supra notes 481-484 and accompanying text.

[529] *National Gerimedical Hospital*, 452 U.S. at 390. The Court compared this statement with *Otter Tail Power*, 410 U.S. at 374 ("When . . . relationships are governed in the first instance by business judgment and not regulatory coercion, courts must be hesitant to conclude that Congress intended to override the fundamental national policies embodied in the antitrust laws."). This notion parallels the Court's active supervision requirement in the state action context. See supra Section IV.B.3.

[530] *National Gerimedical Hospital*, 452 U.S. at 389. Professor Hovenkamp offers the following summary:

> [T]he less the regulatory regime interferes with the workings of the market, the more room for antitrust. Intervention under the antitrust laws is generally appropriate with respect to market decisions that (a) are actually or potentially anticompetitive; and (b) are made according to the discretion of private firms without effective agency supervision.

National Gerimedical Hospital suggests that lawyers involved in class actions have little hope of prevailing in antitrust suits on federal regulatory immunity grounds. Congress has not expressed a clear intent to exempt lawyers from the antitrust laws. Neither the Federal Rules of Civil Procedure, nor the Rules Enabling Act, nor any other federal statute expressly immunizes lawyer conduct in and around class action suits from the antitrust laws. Whatever "pervasive regulation" means, it would not seem to include the regulation of class actions. Federal Rule of Civil Procedure 23, which governs class actions, gives very little direction and very broad discretion to federal judges overseeing class actions. In particular, neither the text of Rule 23, nor of the other Federal Rules, nor of the Rules Enabling Act purports to regulate competition among lawyers—whether for the position of class counsel or in the private administrative systems set up as part of class action settlements (themselves not contemplated by the regulatory regime). Not surprisingly, then, federal district judges who approve class counsel and class action settlements almost never consider the antitrust implications of business decisions made by the lawyers. That means, under *National Gerimedical Hospital*, that antitrust immunity would be denied. While at least two federal judges have tried to mandate competitive bidding for the position of class counsel and have reminded the lawyers that they are subject to the antitrust laws, as we have noted, even those judges did not consider all the possible antitrust implications of the conduct before them.[531] Thus, the only possible argument for lawyers in class actions that might entitle them to federal regulatory immunity is that Congress and the Supreme Court, by giving district courts broad discretion to oversee class actions, have "empowered" them to "authorize" anticompetitve conduct by lawyers.

As we shall see, however, a close examination of these Supreme Court cases reveals that the authority of and discretion

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Hovenkamp, supra note 136, § 19.2, at 649. Professor Hovenkamp's summary is somewhat misleading in that the cases finding no immunity view the degree of agency supervision as not dispositive. See infra text following note 581. Also, his test would seem to require a result contrary to the Court's finding of immunity in United States v. National Ass'n of Secs. Dealers, 422 U.S. 694 (1975) [hereinafter *NASD*]. For a discussion of *NASD*, see infra Section IV.C.1.c.

[531] See supra note 152-153 and accompanying text.

given to district courts to choose class counsel and approve class action settlements would not suffice to confer federal regulatory immunity. Moreover, this would probably remain true even if the courts, when approving class settlements, began to consider explicitly—as they should—the possible antitrust implications of lawyer conduct. We consider three groups of cases: (1) railroad rate cases, in which railroad cartels submitted joint rate proposals to a federal agency, and the Court declined to find implied immunity; (2) contract approval cases, in which regulated firms negotiated a potentially anticompetitive deal which required and received agency approval, and the Court declined to find implied immunity; and (3) authorized restraint cases, in which the Court found implied immunity. If the cases in the first two groups make one central point, it is this: A federal agency's approval of private anticompetitive conduct does not by itself immunize that conduct from a later antitrust suit. This conclusion holds even if the agency can and does take antitrust considerations into account in making its decision, and even if the antitrust suit would completely undermine the agency's decision.[532] Federal agency approval of private anticompetitive conduct may immunize conduct only if Congress either grants the agency specific antitrust enforcement powers or specifically approves of anticompetitive conduct; instances in which Congress has done so are found in the cases in the third group. Class actions do not fall into that category.

[532] Justice White, in his dissent in *NASD* (a case granting immunity) summarized the cases rejecting immunity as follows: "Absent express immunization or its equivalent, private business arrangements are not exempt from the antitrust laws merely because Congress has empowered an agency to authorize the very conduct which is later challenged in court under the antitrust laws." *NASD*, 422 U.S. at 737-38 (White, J., dissenting).

a. I've Been Colluding on the Railroad

The idea that agency approval does not by itself create immunity is implicit[533] in the very first antitrust cases that the Court decided on the merits, *United States v. Trans-Missouri Freight Association*[534] and *United States v. Joint Traffic Association*.[535] In both cases, railroad cartels had filed rate schedules with the Interstate Commerce Commission ("ICC").[536] The Interstate Commerce Act required railroads to make such filings (though it did not require joint filings)[537] and also required that the ICC approve the rates as "reasonable,"[538] which the ICC apparently did. The railroads argued that because their rates were "reasonable" within the meaning of the Interstate Commerce Act, their price fixing agreements to establish and maintain these rates did not and could not violate the Sherman Act, as, they argued, Section 1 of the Sherman Act prohibited only unreasonable restraints of trade.

The Court flatly rejected this argument. In *Joint Traffic*, the Court stated that railroads could not "combine as one consolidated and powerful association for the purpose of stifling competition . . . even though the rates provided for in the agreement may for the time be not more than are reasonable."[539] This holding was grounded in the Court's reasoning in *Trans-Missouri Freight* that the Interstate Commerce Act neither expressly prohibited nor permitted price-fixing agreements,[540] nor did it

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[533] The Court made the implicit explicit in Keogh v. Chicago & Nw. Ry. Co., 260 U.S. 156, 162 (1922) ("The fact that these rates had been approved by the Commission would not, it seems, bar proceedings by the Government."); id. at 161-62 (interpreting *Trans-Missouri Freight* and *Joint Traffic* to hold that even though the ICC had established that the rates "were reasonable and non-discriminatory," nevertheless, "under the Anti-Trust Act, a combination of carriers to fix reasonable and non-discriminatory rates may be illegal; and if so, the Government may have redress by criminal proceedings . . . by injunction . . . and by forfeiture").

[534] 166 U.S. 290 (1897).

[535] 171 U.S. 505 (1898).

[536] *Trans-Missouri Freight*, 166 U.S. at 303; *Joint Traffic*, 171 U.S. at 562.

[537] Interstate Commerce Act, ch. 104, § 6, 24 Stat. 379, 380 (1887).

[538] Id. at 379 (1887) ("All charges made for any service rendered or to be rendered . . . shall be reasonable and just; and every unjust and unreasonable charge for such service is prohibited and declared to be unlawful.").

[539] *Joint Traffic*, 171 U.S. at 571.

[540] *Trans-Missouri Freight*, 166 U.S. at 314-15, 335. In particular, the Court noted that the Interstate Commerce Act "was not directed to the securing of uniformity of

"furnish[ ] a complete and perfect set of rules and regulations which . . . cover all cases concerning transportation by railroad and all contracts relating thereto."[541] These cases thus led to the establishment of a bedrock principle of antitrust: A price fixing claim may not be defended on the grounds that a cartel's prices are reasonable.[542]

Both *Trans-Missouri Freight* and *Joint Traffic* were suits brought by the federal Government, so the Court could have limited their holdings—that antitrust suits can be brought despite agency approval—to suits brought by the Government and not to suits by private parties.[543] But in *Georgia v. Pennsylvania Railroad Co.*,[544] the Court allowed a suit by the state of Georgia, as parens patriae, seeking injunctive relief[545] against a railroad cartel for fixing rates that the ICC had approved.[546] The Court found that "[t]he fact that the rates which have been fixed may or may not be held unlawful by the Commission is immaterial

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rates to be charged by competing companies, nor was there any provision therein as to a maximum or minimum of rates." Id. at 315.

[541] Id. at 316. This concept—that an incomplete and imperfect set of rules and regulations establish implied antitrust immunity—is the source of the suggestion made in some of the later cases that "pervasive regulation" might sometimes be enough to establish implied antitrust immunity.

[542] See, e.g., Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 353-54 (1990) ("If any proposition is firmly settled in the law of antitrust, it is the rule that the reasonableness of the particular price agreed upon by defendants does not constitute a defense to a price-fixing charge."). Perhaps the most often quoted rationale for this rule is found in United States v. Trenton Potteries Co., 273 U.S. 392 (1927), in which the Court stated that "[t]he reasonable price fixed today may through economic and business changes become the unreasonable price of tomorrow." Id. at 397.

[543] The Court's statement in Keogh v. Chicago & Nw. Ry. Co., 260 U.S. 156 (1922) that "[t]he fact that the[ ] rates had been approved by the Commission would not . . . bar proceedings by the Government" could have supported such an interpretation. Id. at 162.

[544] 324 U.S. 439 (1945).

[545] Id. at 446-47. Georgia also sought damages, but the Court rejected the state's claim on the authority of *Keogh*. *Pennsylvania R.R.*, 324 U.S. at 453. We discuss the *Keogh* doctrine and its applicability to damage suits against class action lawyers infra Section IV.C.2.

[546] In so deciding, the Court found it necessary to distinguish a line of previous cases holding that § 16 of the Clayton Act barred injunction suits against private carriers subject to the Interstate Commerce Act and regulated by the ICC. *Pennsylvania R.R.*, 324 U.S. at 454. The Court found § 16 inapplicable because "the relief which Georgia [sought was] not a matter subject to the jurisdiction of the Commission[.]" Id. at 455.

to the issue before us,"[547] and stressed that the ICC's finding that the potentially fixed rates fell within a "zone of reasonableness" did not mean that the conduct leading to those rates could escape antitrust scrutiny.[548] Moreover, because the ICC neither had the authority to grant the injunctive relief sought by the state[549]—namely dissolving the combination or confining it within legitimate boundaries to remove the cartel's influence in the field of rate-making[550]—nor supervisory authority over the cartel as such, the Court deemed ICC approval of rates irrelevant to the antitrust question. The Court concluded that Congress did not intend the regulatory scheme to "eliminate the emphasis on competition and individual freedom of action in rate-making,"[551] and that to hold otherwise would permit "monopoly power [to be] created under the aegis of private parties without Congressional sanction and without governmental supervision or control."[552]

Taken together, the railroad rate-fixing cases support our claim that lawyers in class actions would not be successful in asserting federal regulatory immunity from the antitrust laws.

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[547] Id. at 460.

[548] Id. at 460-61. The Court added that "[d]amage must be presumed to flow from a conspiracy to manipulate rates within that zone." Id. at 461.

[549] Id. at 456, 459-62. On the question of the ICC's authority to grant injunctive relief, the Court stated that

> Congress has not given the Commission . . . authority to remove rate-fixing combinations from the prohibitions contained in the anti-trust laws. It has not placed these combinations under the control and supervision of the Commission. Nor has it empowered the Commission to proceed against such combinations and through cease and desist orders or otherwise to put an end to their activities.

Id. at 456.

[550] In discussing the injunctive relief sought by the state of Georgia, the Court also found that:

> The aim [of the injunction] is to make it possible for individual carriers to perform their duty under the Act, so that whatever tariffs may be continued in effect or superseded by new ones may be tariffs which are free from the restrictive, discriminatory, and coercive influences of the combination. That is not to undercut or impair the primary jurisdiction of the Commission over rates. It is to free the rate-making function of the influences of a conspiracy over which the Commission has no authority but which if proven to exist can only hinder the Commission in the tasks with which it is confronted.

Id. at 460.

[551] Id. at 458-59.

[552] Id. at 459.

These cases emphasize that an agency determination that rates fall within the "zone of reasonableness" under some statutory framework does not preclude competition from producing rates that are even more "reasonable."[553] There is no conflict between the regulatory policy in the railroad cases and the antitrust policy of competition.[554] Similarly, the fact that district court judges may oversee and cap lawyer fees—both for class counsel and for lawyers in private administrative systems set up by class action settlements—does not obviate or conflict with the antitrust policy that competition ought to influence these fees.[555]

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[553] This is essentially the same point courts have made in allowing malpractice actions against lawyers who mishandle a settlement negotiation even though a court approves the settlement as reasonable. See, e.g., Ziegelheim v. Apollo, 607 A.2d 1298, 1305 (N.J. 1992) ("The fact that a party received a settlement that was 'fair and equitable' does not mean necessarily that the party's attorney was competent or that the party would not have received a more favorable settlement had the party's incompetent attorney been competent.") (quoted in Durkin v. Shea & Gould, Nos. 95-55432 & 95-55434, 1996 U.S. App. LEXIS 20695 at *18-*19 (9th Cir. Aug. 19, 1996).

[554] But cf. Southern Motor Carriers Rate Conf. v. United States, 471 U.S. 48 (1985), which reaches a result—in the state action, as opposed to federal exemption, context—that seems inconsistent with the railroad rate cases cited above, which found no conflict between the regulatory policy and the antitrust policy of competition. The only rationale the Court offers for its differing view in the state action context is that Congress can easily correct a federal court that erroneously rejects an exception to the antitrust laws, while state legislatures cannot "overrule" a holding by a federal court that the state action doctrine does not apply. *Southern Motor Carriers*, 471 U.S. at 57-58, n.21. This rationale is weak: A state can almost always "overrule" a court rejection of state action immunity by regulating more clearly. See Hovenkamp, supra note 136, § 19.1, at 648-49. For example, had *Southern Motor Carriers* rejected the state action immunity argument on the ground that a statute simply requiring an agency to approve "reasonable" rates does not clearly articulate a policy to displace competition, the state could have passed a statute explicitly permitting collective rate-making (as several of the states in *Southern Motor Carriers* did). It is true that states lack Congress's ability to simply draft statutes evidencing an intent to have the federal antitrust laws not apply and have it be so merely by virtue of that legislative statement. But nothing seems to be stopping the states from writing into their statutes that it is their intent to have their regulations qualify for state action immunity, although they do not seem to do so. Thus, although we have offered a rationale for the approach taken in *Southern Motor Carriers*, see supra notes 466-467 and accompanying text, on the assumption that the Court was correct in concluding that a "reasonable rate" statute clearly articulates a state policy favoring collective ratemaking, and although we have argued that even the standard adopted by that case does not help lawyers involved in class actions, see supra notes 473-478 and accompanying text, we think the case was wrongly decided on this issue and that the Court's approach in the federal regulatory immunity cases is superior.

[555] Indeed, the recent federal statute revising securities class actions uses language similar to the Interstate Commerce Act when discussing attorney's fees. 15 U.S.C.

Moreover, the Court's concern that the ICC did not have sufficient authority to remedy antitrust violations in *Pennsylvania Railroad* is, if anything, magnified in the class action context. The ICC was a single agency charged with continuous supervision over rates. By contrast, federal district court judges are independent and do not form a coordinated agency. Lawyers may file class actions in many different districts before many different judges, subject to jurisdictional and other constraints.[556] It would seem impossible for a single judge even to begin to control bid rotation behavior by lawyers of the type that may have been going on in *Oracle.* And as for class action settlements, the court's role is even more limited than the ICC's role was: The district court has the authority only to approve or disapprove the settlement. It cannot, while serving as class action overseer, issue injunctions extending beyond the class action before it, impose criminal sanctions[557] or award damages in response to anticompetitive conduct.

b. Let's Make a Deal—And Get the Agency to Approve

Just as the Court had concluded that federal agency approval of "reasonable rates" did not establish antitrust immunity in the trilogy of railroad cases, in another trilogy of cases, the Court held that agency approval of private contracts under a "public interest" standard—essentially the standard applicable to class action settlements—was also not enough to displace the antitrust laws. The Court reached this conclusion even though in each of the three cases the agency involved had considered the potential anticompetitive effects of the conduct in question in making its determination.

§ 77z-1(a)(6) provides: "Total attorneys' fees and expenses awarded by the court to counsel for the plaintiff class shall not exceed a *reasonable* percentage of the amount of any damages and prejudgment interest actually paid to the class." (emphasis added).

[556] The Judicial Panel on Multidistrict Litigation can transfer to a single jurisdiction cases involving "one or more *common questions of fact.*" 28 U.S.C. § 1407(a) (1994) (emphasis added). Thus, the statute does not confer the authority to transfer *all* securities (or other) cases involving common questions of law to a single jurisdiction.

[557] Cf. *Derrickson*, discussed supra notes 291-306, 346-352, 373-414 and accompanying text (judicial approval of class action settlement in voting rights case does not preclude subsequent criminal prosecution of agents for city who negotiated the settlement for violating state conflict of interest laws).

In the first case of this trilogy, *United States v. Radio Corporation of America*,[558] the Government attacked a contract between NBC and Westinghouse under which NBC was to acquire a Westinghouse-owned television station in Philadelphia in exchange for an NBC-owned station in Cleveland and three million dollars in cash.[559] The Government alleged that NBC had conspired with RCA, then NBC's parent company, to force Westinghouse to agree to the contract by threatening to end the NBC network affiliation of Westinghouse's Boston and Philadelphia stations and to withhold NBC affiliation from Westinghouse's Pittsburgh station.[560] The Communications Act[561] required the Federal Communications Commission (FCC) to review such transactions under a "public interest, convenience, and necessity" standard.[562] The FCC did not hold a hearing, but "decided all issues relative to the antitrust laws that were before it,"[563] and approved the contract of sale. Although the Justice Department had a right to request a hearing by the FCC and to seek judicial review of the FCC's decision, it instead opted to file an antitrust suit.[564]

The Court unanimously held that FCC approval did not bar the Government's antitrust suit.[565] It relied primarily on the fact that the language of the Communications Act as well as the legislative history specifically recognized the continuing validity of the antitrust laws and court enforcement of those laws.[566] But the Court went on to explain why agency approval of a private

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[558] 358 U.S. 334 (1959).

[559] Id. 358 U.S. at 335-36.

[560] Id. at 336. Because NBC was a wholly-owned subsidiary of RCA, the § 1 suit would today be barred under Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984), which rejected the "intraenterprise conspiracy" doctrine in such cases. Id. at 759-66.

[561] Communications Act of 1934, ch. 652, 48 Stat. 1064 (1934) (current version codified as amended at 47 U.S.C. § 151 et seq. (1994)).

[562] *RCA*, 358 U.S. at 337 (quoting 47 U.S.C. § 310(b) as it was codified in 1959).

[563] Id. at 338.

[564] Id. at 338.

[565] Id. at 352-53.

[566] The Court held that the "[legislative] history compels the conclusion that the FCC was not intended to have any authority to pass on antitrust violations" and that "it is equally clear that courts retained jurisdiction to pass on alleged antitrust violations irrespective of Commission action." Id. at 343-44.

contract does not necessarily create a "pervasive regulatory scheme" to which antitrust immunity may attach:

> [Defendants RCA and NBC], like unregulated business concerns, made a business judgment as to the desirability of the exchange. Like unregulated concerns, they had to make this judgment with knowledge that the exchange might run afoul of the antitrust laws. Their decision varied from that of an unregulated concern only in that they also had to obtain the approval of a federal agency. But scope of that approval in the case of the FCC was limited to the statutory standard, "public interest, convenience, and necessity." The monetary terms of the exchange were set by the parties, and were of concern to the Commission only as they might have affected the ability of the parties to serve the public. Even after approval, the parties were free to complete or not to complete the exchange as their sound business judgment dictated. In every sense, the question faced by the parties was solely one of business judgment (as opposed to regulatory coercion), save only that the Commission must have found that the "public interest" would be served by their decision to make the exchange. No pervasive regulatory scheme was involved.[567]

In two subsequent merger cases, the Supreme Court reaffirmed and expanded the *RCA* approach towards agency ap-

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[567] Id. at 350-51 (citations omitted). The Court's discussion from the quoted paragraph is clouded by the fact that it comes in a section of the opinion in which the Court purported to decide whether "the over-all regulatory scheme of the Act requires invocation of a primary jurisdiction doctrine." Id. at 346. But as the "primary jurisdiction doctrine" is a doctrine of temporary abstention by a court until an agency decides issues within its expertise, and not a doctrine of immunity, the placement seems somewhat odd. See Hovenkamp, supra note 136, § 19.4, at 655 ("The 'primary jurisdiction' doctrine, as its name implies, is not an antitrust exemption but a jurisdictional mechanism for proceeding with a case that may involve an antitrust claim."). As Justice Harlan seemed to think, the fact that the FCC had already approved the transaction would seem to make any discussion of "primary jurisdiction" pure dictum. See *RCA*, 358 U.S. at 353 (Harlan, J., concurring in the judgment) (The Court's holding that a "Commission determination of 'public interest, convenience, and necessity' cannot either constitute a binding adjudication upon any antitrust issues that may be involved in the Commission's proceeding or serve to exempt a licensee *pro tanto* from the antitrust laws" alone is "dispositive of this appeal."). Perhaps the Court simply meant to suggest that a comprehensive regulatory scheme could create some limited form of immunity. In any event, whatever the Court meant by the primary jurisdiction doctrine, if agency approval of a private anticompetitive agreement does not even call this limited immunity into play, then a fortiori it cannot give rise to full regulatory immunity.

proval of private transactions. In *California v. Federal Power Commission*,[568] the Federal Power Commission ("FPC") approved a merger between a natural gas company and a pipeline company under the Natural Gas Act's[569] "public convenience and necessity" standard.[570] The case arose after the state of California intervened in the FPC hearing and sought review by the federal court of appeals, which affirmed the FPC's approval of the merger.[571] It was from this judgment that the petition for certiorari was filed and granted. Although the FPC had invited the Justice Department to participate in its hearings, the Justice Department declined, and instead proceeded with an antitrust suit to block the merger.[572] Thus, in *Federal Power Commission*, unlike *RCA*, not only was there a hearing held by the agency but there was also judicial review of the agency's approval. Still, the Court found no antitrust immunity. The Court found that the Natural Gas Act provided no express exemption;[573] that the FPC had not been given the power to enforce the antitrust laws;[574] and, as in *RCA*, that "there [was] no 'pervasive regulatory scheme' including the antitrust laws that has been entrusted to the Commission."[575]

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[568] 369 U.S. 482 (1962).

[569] Natural Gas Act, ch. 556, 52 Stat. 821 (1938) (current version codified at 15 U.S.C. § 717 et seq.).

[570] *Federal Power Comm'n*, 369 U.S. at 484-85.

[571] *California v. Federal Power Comm'n*, 296 F.2d 348 (D.C. Cir. 1961), rev'd, 369 U.S. 482 (1962).

[572] *Federal Power Comm'n*, 369 U.S. at 484.

[573] See id. at 485-86.

[574] See id. at 486. The Court noted that § 7 of the Clayton Act did contain an antitrust immunity for "transactions duly consummated pursuant to authority given by the . . . Federal Power Commission . . . under any statutory provision vesting such power in such Commission," id. at 486, but the Court found that § 7 itself does not vest such power. See Id. at 486. Moreover, the Court noted that § 11 of the Clayton Act omits the FPC from a list of agencies authorized to enforce § 7. Id. at 486.

[575] Id. at 485 (quoting *RCA*, 358 U.S. at 351). The Court did not even see the immunity question as the main issue in the case; rather, the Court considered the main issue to be whether the FPC should have awaited the outcome of the antitrust suit before considering the merger application. In a reversal of the primary jurisdiction doctrine, the Court held that the agency "should have held its hand until the courts had acted." Id. at 488. United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963), addressed the case in which the agency acts prior to filing of the antitrust suit. See infra notes 576-581 and accompanying text.

In the second merger case, *United States v. Philadelphia National Bank*,[576] the Comptroller of the Currency approved a merger between two banks pursuant to the requirements of the Bank Merger Act.[577] The Court followed essentially the same analysis as in *Federal Power Commission*, but went further because the suit in *Philadelphia National Bank* arguably undermined not only the agency's decision, but the Bank Merger Act itself.[578] The Court found that the Bank Merger Act did not give banking agencies the authority to enforce the antitrust laws or to grant immunity from those laws.[579] The Court also noted that "[a]lthough the Comptroller was required to consider [the] effect upon competition in passing upon [the banks'] merger application, he was not required to give this factor any particular weight."[580] Finally, the Court again found that the regulatory

[576] 374 U.S. 321 (1963).

[577] Id. at 332. The Court noted that the statute required the Comptroller to "take into consideration the effect of the transaction on competition (including any tendency toward monopoly), and . . . not approve the transaction unless, after considering all of such factors, it finds the transaction to be in the public interest." Id. at 333 n.8 (quoting Bank Merger Act, 74 Stat. 129 (1960) (current version at 12 U.S.C. § 1828) (1994)).

[578] See id. at 384-85 (Harlan, J., dissenting) (arguing that as a result of the majority opinion, "the Bank Merger Act is almost completely nullified," the "only vestige" remaining being "that the banking agencies will have an initial veto"). Of course, the Bank Merger Act would not be completely nullified in the sense that the Government might simply decline to challenge a merger which the Comptroller had approved on antitrust grounds. Moreover, the only issue in *Philadelphia Nat'l Bank* was whether a suit could be brought under the Clayton Act; there was no dispute that the Bank Merger Act did not immunize an antitrust challenge under the Sherman Act. Id. at 354.

[579] Id. at 351. The Court reached its conclusion despite the fact that at the time the Bank Merger Act was passed, at least some members of Congress as well as the Justice Department assumed that § 7 of the Clayton Act did not apply to bank mergers. Id. at 348. The Court found that because "the appplicability of § 7 to bank mergers" was a "subject of speculation" this assumption was largely irrelevant in determining Congressional intent in passing Section 7, see id. at 348-49, and therefore, irrelevant to the immunity question.

Justice Harlan's dissent, on the other hand, emphasized the importance of the fact that this assumption was held by members of Congress and the Justice Department. See id. at 373-74, 377-79, 381, 384 (Harlan, J., dissenting). Justice Harlan also relied on statements in the legislative history to the effect that competition was not supposed to be the controlling factor in merger approvals by the Comptroller. Id. at 382-83 (Harlan, J., dissenting).

[580] Id. at 351. The Court went on to state that the Comptroller "was not even required to (and did not) hold a hearing before approving the application; and there is no specific provision for judicial review of his decision." Id. at 351. But given the

regime established under the statute did not amount to "pervasive regulation" of the banking industry, as banking regulation, though extensive, did not for the most part cover the type of conduct most likely to conflict with the antitrust laws: There was no rate regulation, no prohibition on discrimination, and no restriction on where banks could make loans and solicit deposits.[581]

The trilogy of cases reviewed in this section stand for the proposition that agency review of private transactions under a public interest standard does not confer antitrust immunity. Such review does not amount to "pervasive regulation," even if the agency considers the antitrust implications of the challenged conduct, even if the antitrust plaintiff can make its case before the agency at hearings, and even if appellate courts review the agency decision. Although the Court has never fully articulated why the antitrust laws take priority over agency approval of private conduct, we think this approach makes sense from both a political and pragmatic perspective. Politically, the Court's decisions recognize that absent some clear indication from Congress, agencies lack the authority to determine the scope of possibly conflicting statutes. Pragmatically, the decisions implicitly recognize that the dangers of capture, corruption, and collusion—however great they are at the legislative level—may be even greater at the agency level.

What implications do these three cases have in the context of anticompetitve lawyer conduct in class actions? Each of the three cases involved statutory schemes with far stronger claims to creating antitrust immunity than has Federal Rule of Civil Procedure 23. Rule 23 does not even contemplate the possibility of anticompetitive lawyer conduct, let alone direct the court to consider the effects of class action settlements on competition

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fact that in *Federal Power Comm'n*, there had been both a hearing and judicial review, it is hard to see why these facts mattered. *Federal Power Comm'n*, 369 U.S. at 484. In any case, the Court elsewhere in the opinion suggests that the existence of judicial review is not critical to the immunity question. See *Philadelphia Nat'l Bank*, 374 U.S. at 351 n.30 (suggesting that judicial review of the Comptroller's decision might be possible, but intimating no view on the question); see also id. at 354 ("But here there may be no power of judicial review of the administrative decision approving the merger, and *such approval does not in any event confer immunity from the antitrust laws*.") (emphasis added).

[581] Id. at 352.

policy. Further, with regard to the pragmatic perspective that these cases implicitly endorse, courts in class actions seem to be exposed to the same capture, corruption, and collusion influences as federal agencies. Those who think courts immune have not paid sufficient attention to court behavior in class actions. Judges have a strong self-interest in settling these lawsuits—docket clearance being perhaps the strongest—even if those settlements have various troubling features.[582]

c. *Has the Court Retreated?*

Since it decided *RCA*, the Court has found implied federal regulatory immunity from the antitrust laws in three cases.[583] One of the three cases involved airline regulation under the Federal Aviation Act; the two other cases involved securities regulation under several different statutes. These cases do not signal a retreat from the position that agency approval of private conduct alone is insufficient to create antitrust immunity; instead, they represent fairly narrow exceptions to the general presumption against finding implied immunity. In each of these cases there was explicit language in the statute that either endorsed specific, potentially anticompetitive conduct that the agency had the authority to approve, or empowered the agency with antitrust enforcement authority. No similar features exist in any statute governing class actions.

The first case, *Pan American World Airways, Inc. v. United States*,[584] involved allegations of anticompetitive activity by Pan Am in connection with Panagra, a joint venture between Pan Am and W.R. Grace. The lawsuit, which the Civil Aeronautics

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[582] See supra Section II.C.

[583] In another case, Hughes Tool Co. v. Trans World Airlines, 409 U.S. 363 (1973), the Court found antitrust immunity based on an express provision in the statute immunizing agency approval of certain private transactions from antitrust liability. Id. at 384-85. *Hughes Tool* held that because the agency involved had engaged in continuous supervision and approval, the statute's express immunity applied although in approving the transactions the agency did not specifically consider and approve the anticompetitive aspects of the conduct. Id. at 389. Lawyers involved in class actions have no plausible claim of express immunity; therefore, we find *Hughes Tool* inapplicable to our discussion of antitrust suits controlling lawyer conduct in class actions and do not discuss this case further (although it can be distinguished on other grounds as well).

[584] 371 U.S. 296 (1963).

Board ("CAB") had asked the Government to file, alleged that Pan Am had formed Panagra pursuant to a market division agreement in which Pan Am had agreed not to compete in certain locations and Panagra had agreed not to compete in others, and further alleged that Pan Am had used its control over Panagra to prevent Panagra from seeking the CAB's approval to extend its routes into the United States.[585]

The Court found that Section 411 of the Federal Aviation Act,[586] which gave the CAB authority to determine whether any air carrier had been or was engaged in unfair methods of competition, and which further empowered the CAB to issue a cease and desist order to respond to unfair methods, created an implied antitrust immunity.[587] The Court reasoned that the antitrust challenge involved division of territories, the limitation of routes and the relations of common carriers to "air carriers," each "precise ingredients of the Board's authority."[588] Also, the Government sought only injunctive relief and divestiture, and the Court found that the CAB had the power under the statute to grant both of those remedies against the specific conduct alleged.[589] Most important to its holding, the Court found that the "unfair methods of competition" language of Section 411 of

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[585] Id. at 298.

[586] Federal Aviation Act of 1958, Pub. L. 85-726, § 411, 72 Stat. 731, 769 (1958) (similar contemporary provision at 49 U.S.C. § 41712 (1994)).

[587] See *Pan Am*, 371 U.S. at 309-310. Section 414 of the Federal Aviation Act of 1958 contain[ed] an express immunity provision for certain transactions approved by the Civil Aeronautics Board. 49 U.S.C. § 1384 (1958) (similar contemporary provision at 49 U.S.C. § 41308 (1994)). In *Pan Am*, express immunity did not apply both because the CAB had not issued an "order" approving the conduct, id. at 298 (noting that CAB had asked the government to file the antitrust suit), and because even if it had, the alleged conduct was not specifically covered by the statutory exemption because it originated before the enactment of the statute, id. at 309 (noting that § 414 would apply to prospective application of the statute, but § 411 applies even to conduct predating the statute); id. at 320 (Brennan, J., dissenting) (noting that the Court conceded that the Board could not have issued an order that would qualify for express immunity). In *Hughes Tool*, the Court relied on § 414's express immunity provision. *Hughes Tool*, 409 U.S. at 386-87.

[588] *Pan Am*, 371 U.S. at 305.

[589] The Court contrasted *Pan Am* with Georgia v. Pennsylvania R.R. Co., 324 U.S. 439, 455-56 (1945), describing the two cases as "quite unlike" one another due to the fact that in *Pennsylvania R.R.* the agency involved (the Interstate Commerce Commission) lacked the authority to issue an injunction against the conduct in question. See *Pan Am*, 371 U.S. at 305-06 & 306 n.11.

the Federal Aviation Act derived from Section 5 of the Federal Trade Commission Act,[590] and that Section 411 was therefore "designed to bolster and strengthen antitrust enforcement."[591] The Court concluded that "the Act leaves to the Board under Section 411 all questions of injunctive relief" against the anti-competitive conduct alleged by the Government.[592]

Pan Am creates a fairly narrow exception to the presumption against implying immunity. It merely holds that if a statute specifically grants an agency the equivalent of antitrust enforcement powers, conduct within the agency's normal regulatory authority is immune from antitrust suits when those antitrust suits seek a remedy that the agency could grant.[593]

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[590] Id. at 303 ("[S]ection [411] was patterned after § 5 of the Federal Trade Commission Act."). See also id. at 306-307 (discussing the relevance of the Federal Trade Commission Act in determining the scope of the language "unfair methods of competition" in the Federal Aviation Act).

[591] Id. at 307. As the dissent points out, however, § 5 of the Federal Trade Commission Act was not intended to displace antitrust enforcement, either by the Justice Department or by private parties. See id. at 324 (Brennan, J., dissenting) (asserting that "§ 5 has uniformly been construed to provide for dual enforcement by courts and agency of the antitrust laws, not exclusive enforcement by the agency").

It is not clear from the Court's opinion whether private antitrust suits seeking injunctive relief would be barred, though the Court does note that the unfair methods of competition language as used in § 411 of the Federal Aviation Act "do[es] not embrace a remedy for private wrongs but only a means of vindicating the public interest." Id. at 306.

[592] Id. at 310. The Court further noted that "[i]f it were clear that there was a remedy in this civil antitrust suit that was not available in a § 411 proceeding before the C.A.B.," there would be no immunity, but the antitrust court would have to give primary jurisdiction to the CAB to make factual findings. Id. at 313 n.19. As Justice Brennan points out in his dissent, the Court's approach suggests that a suit for damages might still have been available. Id. at 321, 326 (Brennan, J., dissenting).

[593] The fact that *Pan Am* predates Unitcd States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963), in which the Court rejected a claim of immunity in the absence of such a statutory provision, supports this narrow interpretation of *Pan Am.* Ricci v. Chicago Mercantile Exch., 409 U.S. 289 (1973), further supports this interpretation of *Pan Am.* In *Ricci*, the Court declined to find that the Commodity Exchange Act conferred general antitrust immunity on exclusionary conduct by commodity exchanges. The Court's rationale, in part, was that the area of administrative authority created by the statute did not appear to be particularly focused on competitive considerations, as the statute contained no express provision directing administrative officials to consider the antitrust law policies in carrying out their duties nor any other indication "that Congress intended the adjudicative authority given the Commission and the Secretary to be a complete substitute for judicial enforcement." *Ricci*, 409 U.S. at 302-03 n.13. However, in *Ricci*, the Court applied the primary jurisdiction doctrine to require that the antitrust court stay its hand until the agency had ruled on whether the challenged

The two securities cases create equally narrow exceptions to the presumption against immunity. In *Gordon v. New York Stock Exchange*,[594] the Court unanimously found that the NYSE's rule fixing broker commissions was immune from antitrust challenge. The Court relied primarily on language in Section 19(b) of the Securities Exchange Act, which it found

> gave the SEC direct regulatory power over exchange rules and practices with respect to "the fixing of reasonable rates of commission." Not only was the SEC authorized to disapprove rules and practices concerning commission rates, but the agency also was permitted to require alteration or supplementation of the rules and practices . . . .[595]

Because the SEC could not merely approve or disapprove of the price fixing but could also require alteration or supplementation of private rules and practices, the Court found a direct conflict between the regulatory regime and the antitrust laws not present in the *RCA* group of cases denying immunity.[596] The conflict was that "the exchanges might find themselves unable to proceed without violation of the *mandate* of the courts or of the SEC."[597] But the Court did not seem to rely solely on the stat-

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conduct violated the Commodity Exchange Act. Id. at 302.

[594] 422 U.S. 659 (1975).

[595] Id. at 685.

[596] See supra Section IV.C.1.b.

[597] *Gordon*, 422 U.S. at 689 (emphasis added). In a nearby footnote, the Court distinguished *Philadelphia Nat'l Bank*, in part, on the "lack of conflict between the Bank Merger Act and Clayton Act standards." Id. at 689-90 n.14. But because the standards of the Bank Merger Act and Clayton Act did in fact conflict in *Philadelphia Nat'l Bank*, what the Court must have meant was that because the Comptroller could not mandate mergers (the anticompetitive conduct), but could merely approve them, banks would never face conflicting mandates from the Comptroller and an antitrust court. The same was true in California v. Federal Power Commission, 369 U.S. 482 (1962).

A harder case is presented if a party asks the agency not to approve but to stop anticompetitive conduct. This was the situation in Otter Tail Power Co. v. United States, 410 U.S. 366 (1973). In that case, Otter Tail Power refused to sell wholesale power to municipalities. Some of the municipalities asked the Federal Power Commission (FPC) to compel the utility to provide the power. The Court held that the FPC's authority to compel "procompetitive" conduct did not provide antitrust immunity. *Otter Tail Power*, 410 U.S. at 375-76 ("[T]here is no basis for concluding that the limited authority of the Federal Power Commission to order interconnections was intended to be a substitute for, or to immunize Otter Tail from, antitrust regulation for refusing to deal with municipal corporations."). The Court explicitly reserved the question of what would happen if the FPC had issued an order refusing

ute's explicit grant to the SEC of the power to alter exchange rules and practices;[598] in addition, it emphasized active regulatory oversight by the SEC[599] as well as repeated congressional approval of exchange commission rate practices[600] in reaching its holding.

The other securities law case finding implied antitrust immunity, *United States v. National Association of Securities Dealers*,[601] goes beyond *Gordon* and seems to present a more expansive approach to federal regulatory immunity than the Court has taken in its other cases.[602] In *NASD*, the Government alleged that mutual fund underwriters and broker-dealers entered into agreements "to restrict the sale and fix the resale prices of mutual-fund shares in secondary market transactions between dealers, from an investor to a dealer, and between investors through brokered transactions."[603] The Court held the NASD's activities

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to compel interconnection. *Otter Tail Power*, 410 U.S. at 375-77.

[598] See *Gordon*, 422 U.S. at 685 (noting that "this case involves explicit statutory authorization for SEC review of all exchange rules and practices dealing with rates of commission and resultant SEC continuing activity."); see also id. at 691 (resting immunity on "the statutory provision authorizing regulation, § 19(b)(9), the long regulatory practice, and the continued congressional approval" together).

[599] See id. at 685 (noting the SEC's "active role in review of proposed rate changes during the last 15 years"); see also *Gordon*, 422 U.S. at 689 ("[T]he commission rate practices of the exchanges have been subjected to the scrutiny and approval of the SEC."); id. at 690 ("[T]he SEC has been engaged in deep and serious study of the commission rate practices of the exchanges and of their members, and has required major changes in those practices.").

It is also interesting to note that the Court distinguished *Philadelphia Nat'l Bank*, in part, on the basis of "an absence of continuing regulatory oversight." Id. at 690 n.14. Because *Philadelphia Nat'l Bank* involved a merger, it is not clear what "continuing oversight" would accomplish. Perhaps the Court is suggesting that when an agency approves a transaction that has continuous anticompetitive effects, the Court will almost never find immunity because "continuous oversight" by the agency is infeasible. In the class action context, courts do not exercise "continuous oversight." See supra notes 516-518 and accompanying text.

[600] See *Gordon*, 422 U.S. at 690 (stating that "Congress has indicated its continued approval of SEC review of the commission rate structure").

[601] 422 U.S. 694 (1975) [hereinafter *NASD*].

[602] See Gail Yvonne Norton, Comment, The Antitrust Immunity Doctrine and United States v. National Association of Securities Dealers: Stepping on Otter Tail, 28 Hastings L.J. 387 (1976) [hereinafter Hastings Comment].

[603] *NASD*, 422 U.S. at 700. The Government also alleged that the NASD had conspired with its member dealers to prevent the growth of a secondary market in mutual fund shares. Id. at 701-02.

immune from antitrust liability in light of the regulatory scheme created by the Investment Company Act of 1940.[604]

The Investment Company Act had been "designed to restrict most of secondary market trading" in mutual fund shares, and thereby curb the perceived abuses in that market.[605] One section of the Act eliminated price competition in certain secondary market sales, and arguably created an implicit antitrust immunity, but that section was inapplicable in *NASD*.[606] The section that did apply, Section 22(f),[607] did not explicitly eliminate price competition, but merely authorized funds "to impose restrictions on the negotiability and transferability of their shares," provided they "do not contravene any rules and regulations the [SEC] may prescribe."[608] The SEC had not prescribed any such rules and regulations, but had left it up to the underwriters and broker-dealers to develop the restrictions themselves.

Without bothering to distinguish its prior cases refusing to find immunity in the face of agency approval of private conduct, the Court stated simply: "Congress has made a judgment that these

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[604] Id. at 729-30 (construing § 22 of the Investment Company Act of 1940, codified at 15 U.S.C. § 22 (1970)).

[605] See id. at 700. The problem addresed by the Act was the "two-price system" problem. The price of mutual fund shares was typically set daily, based on the prior day's prices of the securities in the fund's portfolio. After the close of the stock exchange, there was a divergence between the existing mutual fund price, based on the prior day's stock prices, and the next day's mutual fund price, based on the closing stock prices. Insider dealers and others were able to take advantage of this spread in prices by engaging in arbitrage trading in the secondary market. See id. at 706-07. See also Hastings Comment, supra note 602, at 417-18.

[606] Section 22(d) of the Act eliminated price competition in dealer sales of mutual fund shares by prohibiting dealers from selling these shares "to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus." *NASD*, 422 U.S. at 711 (quoting 15 U.S.C. § 80a-22(d) (1970)). By its terms, § 22(d) excepts sales between dealers, and the Court held that § 22(d) also does not cover sales made by a broker-dealer acting as a broker, that is, selling as an agent for an investor rather than for the broker's own account. Id. at at 711-20.

[607] This section provides:

> No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

15 U.S.C. § 80a-22(f) (1970).

[608] *NASD*, 422 U.S. at 720-21.

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restrictions on competition might be necessitated by the unique problems of the mutual-fund industry, and has vested in the SEC final authority to determine whether and to what extent they should be tolerated . . . ."[609] Having divined congressional intent to immunize private conduct from antitrust liability, the Court noted that the fact that the SEC had merely acquiesced in fund-initiated restrictions for over thirty years did not mean the SEC was asleep at the wheel, but rather that it had made "an informed administrative judgment that the contractual restrictions employed by the funds to protect their shareholders were appropriate means for combating the problems of the industry."[610] Ultimately, the Court held that the Act's encouragement of restrictions in the secondary market by NASD and its members immunized their conduct from antitrust attack, because the "close relationship"[611] between the challenged activity and "the restriction that the SEC consistently has approved pursuant to § 22(f)"[612] made "the SEC's exercise of regulatory authority . . . sufficiently pervasive to confer an implied immunity."[613]

NASD lends the strongest support to a claim of federal regulatory immunity for lawyers in federal class actions. It is the only case in which the Court has found antitrust immunity arising out of no more than an agency's approval of private conduct and the pervasiveness of the regulatory regime.[614] It involved a stat-

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[609] Id. at 729.

[610] Id. at 728. See also id. at 734 (noting that "the history of [SEC] regulations suggests no laxity in the exercise of [its] authority.").

[611] Id. at 733.

[612] Id. at 733.

[613] Id. at 730. The Court summarized its holding as follows:

> In this instance, maintenance of an antitrust action for activities so directly related to the SEC's responsibilities poses a substantial danger that appellees would be subjected to duplicative and inconsistent standards. This is hardly a result that Congress would have mandated. We therefore hold that with respect to the activities [of NASD and its members] challenged in Count I of the complaint, the Sherman Act has been displaced by the pervasive regulatory scheme established by the Maloney and Investment Company Acts.

Id. at 735.

[614] The Court had suggested in a prior securities case, Silver v. New York Stock Exchange, 373 U.S. 341 (1963), that because the Securities Exchange Act expressly contemplated a degree of self-regulation and mandated a duty of self-policing by stock exchanges, there might be antitrust immunity for anticompetitive acts by exchanges. *Silver*, 373 U.S. at 360-61. In reaching this conclusion, the Court considered § 6(b) of

ute that does not grant antitrust enforcement powers to the SEC, as the Federal Aviation Act granted the CAB in *Pan Am.*[615] Nor was there active agency and congressional oversight, as there was in *Gordon.*[616] Moreover, the Court did not focus on the possibility that the SEC might require anticompetitive

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the Securities Exchange Act, codified at 15 U.S.C. § 78f(b)(6), which requires exchanges that register with the SEC to maintain rules providing for the expulsion of a member for conduct "inconsistent with just and equitable principles of trade." *Silver*, 373 U.S. at 353.

In *Silver*, however, the Court held that NYSE's termination of a nonmember's wire connections with NYSE members was not immune from the antitrust laws because NYSE had not provided any procedural safeguards against abuse. *Silver*, 373 U.S. at 364 ("Our decision today . . . holds that [the Securities Exchange Act] affords no justification for anticompetitive collective action taken without according fair procedures."). Invoking *Pennsylvania R.R.*, *Silver*, 373 U.S. at 357, the Court held that the statute was "not sufficiently pervasive to create a total exemption [for exchange self-regulatory acts] from the antitrust laws," *Silver*, 373 U.S. at 360-61, because the SEC lacked "jurisdiction over particular applications of exchange rules." Id. at 358. And although the Court suggested that if the exchange provided procedural safeguards there might be partial immunity for "particular instances of exchange self-regulation," id. at 358-60, 361, the Court found "no need . . . to define further whether the interposing of a substantive justification in an antitrust suit brought to challenge a particular enforcement of the rules on its merits is to be governed by a standard of arbitrariness, good faith, reasonableness, or some other measure." Id. at 365-66.

In Ricci v. Chicago Mercantile Exchange, 409 U.S. 289 (1973), the Court took a slight step beyond *Silver*, rejecting a total exemption from the antitrust laws but suggesting that a limited immunity might apply where a member of the Chicago Mercantile Exchange claimed the Exchange had wrongfully transferred his membership. Id. at 303. The Court suggested limited immunity might apply because the Commodity Exchange Act required that all dealers in commodity futures be "a member of a board of trade," id. at 303, and therefore, it "clearly contemplate[d] a membership organization and hence the existence of criteria for the acquisition, transfer, and loss of membership." Id. at 303. But because the Commodity Exchange Commission had jurisdiction over the Exchange's conduct (unlike the SEC in *Silver*), the Court held that under the primary jurisdiction doctrine, the antitrust court should wait until the agency decided whether the conduct was lawful under the Commodity Exchange Act before deciding the antitrust immunity question. Id. at 304-06. The Court did not, therefore, hold that agency approval of the conduct would result in antitrust immunity.

[615] See supra notes 590-591 and accompanying text; see also Hastings Comment, supra note 602, at 424-25.

[616] See supra notes 598-600 and accompanying text; see also Hastings Comment, supra note 602, at 423-24. In this sense, *NASD* suggests that federal regulatory immunity can sometimes be stronger (more likely to be applied) than state action immunity, in that federal statutes can give more leeway to private conduct with less active supervision. However, comparing *Pennsylvania R.R.* with *Southern Motor Carriers* suggests that federal regulatory immunity is generally weaker than state action immunity.

conduct and therefore subject regulated firms to inconsistent mandates, a point the Court had emphasized in *Gordon*. Rather, the Court in *NASD* suggested that the mere fact that the statute permits private parties to enter anticompetitive agreements is alone sufficient to establish "clear repugnancy" with the antitrust laws.[617]

Was the Court in *NASD* trying to undermine its prior jurisprudence on federal regulatory immunity?[618] We think the answer is no.[619] *NASD* is unique because the regulatory regime involved in the case is unique. Congress had essentially decided in the Investment Company Act that competition in the secondary market for mutual funds should be restricted to promote competition in the primary market. Congress sought to restrict competition in the secondary market directly through Section 22.[620] Congress thereby reversed the ordinary presumption in

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[617] See *NASD*, 422 U.S. at 729 ("There can be no reconciliation of [the SEC's] authority under § 22(f) to permit these and similar restrictive agreements with the Sherman Act's declaration that they are illegal *per se*.").

[618] The dissenting Justices thought so. See id. at 735-48 (White, J., dissenting, joined by Justices Douglas, Brennan, and Marshall). A case can be made that *NASD* represents an example of the new Burger Court majority trying to undo Warren Court precedents with which it disagreed. (The same could be said of *Southern Motor Carriers* in the state action context). We prefer the explanation that follows in the text, however.

[619] Several courts trying to interpret the *NASD* decision agree. See North Carolina ex rel. Edmisten v. P.I.A. Asheville, Inc., 740 F.2d 274, 284 n.10 (4th Cir. 1984) (en banc), cert. denied, 471 U.S. 1003 (1985) (recognizing that *NASD* "represents something of an aberration" from the line of prior implied regulatory immunity cases, but finding that "[m]ore recent cases," such as *Cantor* reaffirmed the prior "plain repugnancy test"); Oahu Gas Serv. v. Pacific Resources, 460 F. Supp. 1359, 1373 (D. Haw. 1978) ("*NASD*'s rationale is quite puzzling and the import of the decision is unclear," but "*NASD* cannot be given so expansive a reading as to discard three decades of well-established and consistent antitrust immunity precedent, for the pre-*NASD* axioms were reaffirmed in *Cantor* . . . ."); cf. Hastings Comment, supra note 602, at 429 ("Having failed either expressly to discard traditional immunity criteria on the one hand, or to unambiguously promulgate new ones on the other, the *NASD* holding is little more than a legal conundrum, and simply cannot be said to be the stuff of which judicial revolutions are made. It would not appear unreasonable to predict that the lower courts and the antitrust bar will agree. . . .). But see Finnegan v. Campeau Corp., 915 F.2d 824, 828-29 (2d Cir. 1990), cert. denied, 499 U.S. 976 (1991) (relying on *NASD*, *Gordon*, and *Silver* to find implied antitrust immunity and ignoring all prior cases).

[620] See *NASD*, 422 U.S. at 724-25 (explaining how § 22(d) and § 22(f) work together to restrict secondary market sales). Not all agree that the purpose of § 22 was anticompetitive. Recall that the specific purpose of § 22 was to end the arbitrage

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favor of competition policy,[621] which makes this statutory scheme unlike those in *RCA*, *Federal Power Commission* and *Philadelphia National Bank*. This difference may explain why the *NASD* Court never attempted to distinguish those cases and why it relied on reasoning that those cases had seemed to reject.[622] None of the regulatory schemes involved in those cases had as their primary purpose the restriction of competition

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trading opportunities arising out of the mutual fund two-price system. See supra note 605. According to one critic of *NASD*, although § 22 "could arguably be interpreted as having an anticompetitive regulatory objective"—to curb those abuses in the secondary market— "it does not follow that the underlying regulatory objective was to eliminate competition categorically in the market for mutual funds." Hastings Comment, supra note 602, at 418. This criticism misses the Court's point. It is evident that § 22 cuts more broadly than simply restricting arbitrage trading to eliminate the two-price system problem in the secondary market. It is also evident that Congress could have, see id. at 421 (noting prior version of bill that would have granted the SEC power to eliminate "backward pricing"), and later did, see id. at 419, n.196 (discussing "forward pricing system" established in 1968), regulate more narrowly to eliminate that problem.

The Court's point is that Congress, in enacting § 22(f), deliberately chose an overbroad regulatory scheme, a scheme that expressly allowed the SEC to approve private agreements restricting competition in the secondary market. Once Congress enacted a statute that permitted private anticompetitive restraints, it did not matter that some competition in the secondary market would be consistent with both the purpose of § 22 and the antitrust laws. Cf. id. at 419 (arguing that if § 22's "main function was simply to insure a generally orderly distributive system, it is still not apparent from the rather superficial economic analysis in *NASD* that such an orderly system could not in fact accommodate secondary market transactions").

[621] For the sake of clarity in doctrine, it would have been helpful if the Court had made this point more explicitly.

[622] The reasoning rejected includes: (1) the idea that an agency's authority to disapprove of private conduct, which authority has not been exercised, is sufficient to create immunity, see *RCA*, 358 U.S. at 352-53 (no immunity even though agency approved contract); *Federal Power Comm'n*, 369 U.S. at 485-86 (no immunity even though agency approved merger); *Philadelphia Nat'l Bank*, 374 U.S. at 351 (no immunity even though agency approved merger); (2) the idea that whether an agency weighs competitive concerns in the absence of a statutory mandate is relevant to whether the Court should find implied immunity, see *RCA*, 358 U.S. at 338 (no immunity even though agency "decided all issues relative to the antitrust laws that were before it"); *Federal Power Comm'n*, 369 U.S. at 484-86 (no immunity even though agency invited Justice Department to participate in hearings because agency did not have the power to enforce the antitrust laws); *Philadelphia Nat'l Bank*, 374 U.S. at 351 ("Although the Comptroller was required to consider [the] effect upon competition in passing upon [the banks'] merger application, he was not required to give this factor any particular weight; . . ."); and (3) the idea that there is a danger that regulated firms will face inconsistent standards simply because an antitrust court might disapprove of conduct that an agency had previously approved, see supra note 597.

in some market.[623] Even in the railroad rate regulation cases, although the Interstate Commerce Act arguably did seek to restrict competition in rates, the reasonableness standard of that statute did not declare all price competition in the market suspect.[624] By contrast, the statute attempting to eliminate unwanted arbitrage at issue in *NASD* cannot tolerate a zone of reasonableness; any undercutting of the set market price is undesirable. Viewed this way, *NASD* squares with the rest of the Court's federal regulatory immunity jurisprudence. If Congress adopts a policy against competition in some market and expressly permits private anticompetitive conduct subject to agency oversight, it creates an immunity from the antitrust laws.[625]

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[623] For further evidence that this factor was important to the Court's decision, see Otter Tail Power v. United States, 410 U.S. 366, 374 (1973) (refusing to find a "pervasive regulatory scheme" creating antitrust immunity where the regulatory statute evidences "an overriding policy of maintaining competition to the maximum extent possible consistent with the public interest").

[624] Recall that in the state action context, however, the Court in *Southern Motor Carriers* concluded that rate regulation—at least where accompanied by a requirement that the regulatory agency set rates based on noncompetitive factors—was inconsistent with competition policy.

[625] This reading of *NASD* would arguably lead to a different result in Finnegan v. Campeau Corp., 915 F.2d 824 (2d Cir. 1990), cert. denied, 499 U.S. 976 (1991). In that case, the Second Circuit held that bidding agreements in corporate takeovers—including agreements to refrain from such bidding—enjoy antitrust immunity because the Williams Act implicitly repealed the Sherman Act with respect to the regulation of such agreements. *Finnegan*, 915 F.2d at 828. The court reasoned that the Williams Act and accompanying regulations explicitly contemplate joint bidding arrangements, which Congress and the SEC have chosen to regulate only by requiring their disclosure. *Finnegan*, 915 F.2d at 830. The court then concluded: "We cannot presume that Congress has allowed competing bidders to make a joint bid under the Williams Act and the SEC's regulations and taken that right away by authorizing suit against such joint bidders under the antitrust laws." Id. In our view, the mere fact that the Williams Act contemplates joint bidding does not express a policy against competition any more than a partnership statute does. Not all joint bids to achieve a corporate takeover would restrain competition or violate the antitrust laws. See Edward B. Rock, Antitrust and the Market for Corporate Control, 77 Calif. L. Rev. 1365, 1393 (1989) ("Allowing individuals to band together to make tender offers may be procompetitive: It may permit some bidders to enter the bidding, or create new bidders for larger targets, thereby increasing the competition in the market for corporate control."). Most important for present purposes, there is no indication in the text or legislative history of the Williams Act that Congress intended to allow restraints of trade in the market for corporate control; if anything, Congress' intention seems to be to promote competition in this market. See id. at 1393-94. Thus, Congress in the Williams Act did not reverse the general presumption in favor of

Most important for our purposes, in the class action context, *NASD* can have no application. Congress has adopted no policy against competition in class actions in Rule 23 or any federal statute. Even if class actions themselves could be viewed as anticompetitive, as we argued in the state action section,[626] the fact that Congress permits class actions does not mean that Congress intends to displace competition in either the market for class counsel or the market for lawyer services in a private administrative system created by a class action settlement. *NASD* is perfectly consistent with the theme of *Cantor*—that in deciding questions of antitrust immunity, courts must focus on the relevant market.[627] It does not adopt a "pervasive regulation" approach to immunity. Rather, *NASD* adopts a particularistic regulation approach: The market at issue must be examined to see whether Congress has adopted a policy against competition in that market. There is no such policy as to the markets on which we have focused. *NASD*, therefore, does not support a claim of antitrust immunity for lawyers in cases involving conduct like that in *Oracle* and *Georgine*.

Furthermore, if *NASD* does not apply, the ordinary presumptions of the federal regulatory immunity cases kick in. That is, the fact that an agency approves a rate as reasonable or a private transaction as consistent with the public interest is not sufficient to displace the antitrust laws. Courts appointing class counsel, approving class action settlements and retaining jurisdiction over subsequent private administrative systems do no more than the federal agencies whose actions the Court has held

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competition. It did not intend in the Williams Act to restrict competition in the market for corporate control by allowing joint bidding; it intended to improve competition in this market by facilitating bids that might not otherwise be made. For a further critique of the case, see Comment, Implied Repeal of the Sherman Act Via the Williams Act: *Finnegan v. Campeau Corp.*, 65 St. John's L. Rev. 965 (1991).

In any event, those class action lawyers who would seek solace in *Finnegan*, because the challenged activity in that case (agreements not to bid) may be similar to some of the activity we have discussed here, should think again. There is no statute comparable to the Williams Act that permits or contemplates bidding agreements of any sort by lawyers.

[626] See supra notes 479-487 and accompanying text.

[627] The relevant market for immunity purposes is the market in which the legislature intends to displace competition. See supra notes 484-487 and accompanying text.

insufficient to create immunity. Once again, we conclude that class action lawyers do not have the cloak they imagine.

2. *The* Keogh *Doctrine and Damage Suits*

Even if private conduct is not fully immune from the antitrust laws as a result of federal regulation, it might enjoy a limited immunity: immunity from private treble damage actions. In *Keogh v. Chicago & Northwestern Railway Company*,[628] the Court held that a shipper could not sue a cartel of railroad carriers for damages resulting from fixing a rate "higher than that which would otherwise have prevailed,"[629] when this rate had been properly filed with, and after a formal hearing approved by, the Interstate Commerce Commission.[630] The Court reaffirmed *Keogh* in *Square D Company v. Niagara Frontier Travel Bureau, Inc.*,[631] and extended it to situations in which the ICC had not held formal hearings before allowing the tariffs filed with the agency to take effect.[632] If lawyer fees in class actions are like tariffs in ICC regulation, then *Keogh* would prevent private treble damage actions by class members.[633]

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[628] 260 U.S. 156 (1922).
[629] Id. at 163.
[630] Id. at 162.
[631] 476 U.S. 409 (1986).
[632] Id. at 417.
[633] We note at the outset that even if courts decided to apply the *Keogh* doctrine to bar antitrust damage suits by class action members, *Keogh* would not bar injunctive suits or criminal actions by the government. *Keogh*, 260 U.S. at 161-62. Nor would it likely bar damage suits by competitor law firms harmed by the anticompetitive activity. See Barnes v. Arden Mayfair, 759 F.2d 676, 679 (9th Cir. 1985) ("Keogh did not . . . hold that carriers are immune from all antitrust actions, only those for which relief may be sought readily from the regulatory agency. . . . Because [the alleged] activities would be beyond the scope of the ICC's jurisdiction, the antitrust action was not subject to [summary judgment] dismissal."); City of Kirkwood v. Union Elec. Co., 671 F.2d 1173, 1179 (8th Cir. 1982), cert denied, 459 U.S. 1170 (1983) (allowing plaintiff's claim of antitrust injury caused by an alleged "price squeze" applied by competitors and holding that neither "an award of antitrust damages nor the granting of properly conditioned injunctive relief" would be barred); Essential Communications Systems v. American Telephone & Telegraph Co., 610 F.2d 1114, 1122 (3d Cir. 1979) (holding that damages and injunctive relief were not barred despite FCC oversight and state tariff regulatory schemes). But see Pinney Dock & Transp. Co. v. Penn Central Corp., 838 F.2d 1445, 1457 (6th Cir.), cert. denied, 488 U.S. 880 (1988) (holding *Keogh* doctrine applicable to competitor suits); Lifschultz Fast Freight v. Consolidated Freightways Corp., 805 F. Supp. 1277, 1295-96 (D.S.C. 1992) (holding filed rate

But the *Square D* Court's reaffirmation of *Keogh* was lukewarm at best. Acknowledging criticisms of the doctrine, the Court decided to preserve *Keogh* merely for stare decisis reasons. It noted that "the *Keogh* rule has been an established guidepost at the intersection of the antitrust and interstate commerce statutory regimes for some 6 1/2 decades."[634] Moreover, the Court was reluctant to overrule established doctrine "in an area that has seen careful, intense, and sustained congressional attention."[635] Given the Court's dim view of *Keogh*, lower courts would probably be reluctant to expand the doctrine into a new area not traditionally viewed as one of the "interstate commerce statutory regimes," such as the class action area.[636]

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doctrine applicable to actions by competitors).

[634] *Square D*, 476 U.S. at 423.

[635] Id. at 424. In particular, Congress had passed the Reed-Bulwinkle Act, Pub. L. No. 80-662, ch. 491, 62 Stat. 472 (1948) (codified as amended at 49 U.S.C. § 10706 (1994)), which immunized from the antitrust laws approved collective ratemaking activities, 49 U.S.C. § 10706(b)(2), and the Motor Carrier Act of 1980, Pub. L. No. 96-296, 94 Stat. 793 (1980) (codified in scattered sections of 49 U.S.C.), but had left *Keogh* undisturbed. The Reed-Bulwinkle Act was at least in part a response to Georgia v. Pennsylvania R.R. Co., 324 U.S. 439 (1945), which had allowed private antitrust suits to enjoin collective ratemaking procedures used by railroads. See *Southern Motor Carriers*, 471 U.S. at 70 (Stevens, J., dissenting). The exemption created by the Reed-Bulwinkle Act did not bar the antitrust suit in *Square D* because the plaintiff's allegation was that the defendants had engaged in conduct that was not authorized by the terms of the agreement approved by the ICC. *Square D*, 476 U.S. at 413-14.

[636] It is true that outside of the antitrust arena, the Court has applied the *Keogh* limitation to public utilities as the "filed rate doctrine." See Maislin Inds. v. Primary Steel, 497 U.S. 116 (1990); Arkansas La. Gas Co. v. Hall, 453 U.S. 571 (1981); Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co., 341 U.S. 246 (1951). Moreover, lower courts after *Square D* have strengthened and expanded the filed rate doctrine to cover RICO claims, to cover state regulation as well as federal regulation, and to reject a "fraud on the agency" exception. See, e.g., Sun City Taxpayers' Ass'n v. Citizens Utils. Co., 45 F.3d 58, 62 (2d Cir.), cert denied, 115 S. Ct. 1693 (1995) (RICO suit for submitting false information to state agency; no fraud exception); Wegoland, Ltd. v. Nynex Corp., 27 F.3d 17, 22 (2d Cir. 1994) (RICO class action; no fraud exception); Taffet v. Southern Co., 967 F.2d 1483, 1494-95 (11th Cir.) (en banc), cert denied, 506 U.S. 1021 (1992) (RICO suit against state-regulated utility; no fraud exception); H.J., Inc v. Northwestern Bell Tel. Co., 954 F.2d 485, 488-92, 494 (8th Cir.), cert. denied, 504 U.S. 957 (1992) (RICO class action against state-regulated utility alleging that regulated utility bribed state agency; court holds no fraud exception to filed rate doctrine and that filed rate doctrine applies to state agencies). We do not focus on the recent lower court "filed rate doctrine" cases for several reasons. One reason is that these cases do not involve antitrust claims. Thus, to the extent they establish broader standards of immunity than *Keogh* and *Square D.*, these

A close examination of the reasoning in *Keogh* supports the conclusion that courts would be unlikely to extend it to the class action settlement context.[637] First, the *Keogh* Court noted that the Commerce Act already provided a damage remedy for the charging of "illegal" rates, so if the ICC had found the rates to be "unreasonably high" the shipper would have been able to recover any damages in an action either before the ICC or in federal court.[638] The Court then asked rhetorically whether Congress should be presumed to have intended an "additional remedy" under the antitrust laws.[639] In the class action context, the Court would not reach its rhetorical question: There is no comparable damage remedy under Rule 23 available to a class member charged an "unreasonably high or discriminatory" fee by class counsel or individual counsel in the administrative proceeding. The only possible remedy would be a motion under Rule 60(b), which, if available in this context, is a far cry from an equivalent damage remedy.[640] Moreover, since *Keogh* the

standards may not apply to the antitrust laws, which enjoy a privileged position among federal statutes. Moreover, there is no reason to think that courts would extend these cases beyond public utilities to class actions, because the rationale used in the utility cases just does not fit. For example, in *Taffet* the court pointed out that allowing consumer suits against public utilities would inevitably raise the prices that those same consumers would have to pay, as the utilities would add legal expenses to their rate base. *Taffet*, 967 F.2d at 1492. In contrast, allowing suits against class lawyers would have no such necessary effect because offending firms would still have to compete with other firms in future class actions. See also supra notes 556-557 and accompanying text (discussing other differences between ICC rate regulation and class actions).

[637] Judge Friendly's opinion for the court of appeals in *Square D* argues that the rationales in *Keogh* no longer support the Court's holding in that case due to subsequent developments. *Square D*, 760 F.2d at 1352-56. Professor Hovenkamp suggests that at the very least, the problems with the Court's reasoning in *Keogh* supports narrowly construing the case. Hovenkamp, supra note 136, § 19.6, at 660 (asserting that "a doctrine as indefensible as *Keogh* should be narrowly construed"). Our argument is that even if the rationales are accepted on the terms laid out by *Keogh*, they do not apply to the class action context.

[638] *Keogh*, 260 U.S. at 162.

[639] Id. at 162 ("Can it be that Congress intended to provide the shipper, from whom illegal rates have been exacted, with an *additional remedy* under the Anti-Trust Act?") (emphasis added).

[640] See supra Section II.B (discussing the difference between disgorgement remedies and remedies that provide damages, particularly punitive or treble damages). Rule 60(b) operates to vacate an earlier judgment, reversing whatever relief the first court ordered. It does not provide damages to the party who succeeds in getting a judgment reversed. Moreover, it is not clear that an antitrust violation by class lawyers constitutes "fraud . . . or other misconduct of an *adverse* party" or a "fraud upon the

Court has disavowed the notion that an alternative remedy is alone enough to justify antitrust immunity, which suggests that the duplicative remedy rationale of *Keogh* is not that important.[641]

The remaining rationales in *Keogh* derived from the Court's view that once the Commission approved the rate, it was "for all practical purposes, the legal rate,"[642] and "[t]o be legal a rate must be non-discriminatory."[643] The Court reasoned that allowing an individual shipper to recover damages would violate the non-discrimination (or uniform rate) principle, because it would "operate to give him a preference over his trade competitors."[644] The Court further reasoned that any allegation that the Commission would have accepted a lower rate would be extremely difficult to prove, because "it is possible that no lower rate . . . could have been legally maintained without reconstituting the whole rate structure for many articles moving in an important section of the country."[645] Finally, the Court stressed that if the

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court," grounds upon which relief might be granted. Fed. R. Civ. P. 60(b) (emphasis added).

[641] Otter Tail Power Co. v. United States, 410 U.S. 366, 373-75 (1973) (holding that the availability of a remedy for the alleged anticompetitive conduct before an administrative agency is not sufficient to create antitrust immunity). This holding suggests that the Court would not rely too heavily on the duplicative remedy rationale in deciding whether to extend *Keogh*.

[642] *Keogh*, 260 U.S. at 163.

[643] Id. at 164. What the Court meant by "non-discriminatory" is not clear from the opinion, but at the very least it seems to mean that it is important to the regulatory scheme that all railroad customers pay the "same" rate in some sense; that is, there must be some form of price uniformity in the system.

[644] Id. at 163 ("If a shipper could recover under § 7 of the Anti-Trust Act for damages resulting from the exaction of a rate higher than that which would otherwise have prevailed, the amount recovered might, like a rebate, operate to give him a preference over his trade competitors."). As Judge Friendly pointed out in his opinion in *Square D*, 760 F.2d 1347, 1352 (2d Cir. 1985), the Supreme Court has since rejected the nondiscrimination rationale in Carnation Co. v. Pacific Westbound Conf., 383 U.S. 213, 219 n.3 ("There is no reason to believe that Congress would want to deprive all shippers of their right to treble damages merely to assure that some shippers do not obtain more generous awards than others."). Judge Friendly also pointed out—interestingly in light of our topic—that class actions, unavailable at the time *Keogh* was decided, would alleviate the *Keogh* Court's concerns. 760 F.2d at 1352 ("Furthermore, the argument is scarcely applicable to class actions . . . , a means of avoiding Justice Brandeis' concerns that was unavailable in actions at law in 1922."). But cf. Wegoland Ltd. v. Nynex Corp., 27 F.3d 17, 22 (2d Cir. 1994) (finding class action challenge by utility ratepayers insufficient to overcome filed rate doctrine).

[645] *Keogh*, 260 U.S. at 164. Judge Friendly's response to this concern was that the

Commission had in fact approved a lower, noncollusive rate for all shippers, the shipper would have gained no advantage over its competitors because it would have been forced to pass on any cost savings to its customers.[646]

By contrast, when courts in class actions approve lawyer fees, they do not establish "for all purposes, the legal rate"[647] between lawyers and clients in the sense intended by the Court in *Keogh.* Class actions do not *regulate* lawyer fees in the *Keogh* sense because they do not impose any requirement of nondiscrimination (uniform rate setting) on courts when they approve class counsels' fees for representing the class. As for a court that approves a settlement that sets caps on the fees lawyers may charge in the administrative system created by the settlement, unlike the ICC, that court is not obliged to approve any rates at all for this market. And because it has no mandate to regulate this market, the court has no more reason to approve uniform fees than it does to regulate lawyer fees generally. In fact, the courts do not typically approve uniform fees; they approve *maximum* fees. There would be no disruption to the regulatory system—no need for "reconstitution of the whole rate structure"[648]—if injured class members proved that the maximum rate approved by the court resulted from collusion and resulted in excessive fees. Moreover, because the lawyers' services are sold to the ultimate consumer (the claimants), none of the Court's concerns about unfair competitive advantage or pass-on is relevant.

ICC would have to make precisely the same calculations in a damages case under the Interstate Commerce Act, and the antitrust court could always refer the issue to the ICC before resolving the case. *Square D*, 760 F.2d at 1352-53. The same, of course, would be true of a Rule 60(b) motion in the class action context (assuming it is held to be a substitute for an antitrust damage action).

[646] *Keogh*, 260 U.S. at 165. Judge Friendly's response to this rationale was that the Court had subsequently held that a plaintiff can recover damages even if it is able to pass on these damages to its customers. *Square D*, 760 F.2d at 1353 (citing, inter alia, Hanover Shoe v. United Shoe Mach. Corp., 392 U.S. 481, 487-94 (1968)).

[647] *Keogh*, 260 U.S. at 163.

[648] Id. at 164. Note the same would be true for the rate regulation by the states in *Southern Motor Carriers*. Thus, under our interpretation of *Keogh*, if *Southern Motor Carriers* had come out the other way then private damage suits against the cartels would have been allowed.

This interpretation of *Keogh* is consistent with the Court's reading of the case in *Square D*. The plaintiffs in *Square D* had argued that *Carnation Company v. Pacific Westbound Conference*[649] supported overruling *Keogh*. *Carnation* allowed a shipper to bring a treble-damage action against a group of shipping companies that had engaged in collective ratemaking. The governing regulatory statute was the Shipping Act,[650] which created an exemption from antitrust liability for collective ratemaking pursuant to agreements that the Federal Maritime Commission ("FMC") had approved.[651] The defendants had not obtained this approval, but argued nevertheless that the antitrust laws could not reach their conduct.[652] The Court rejected this argument.[653] The *Square D* Court distinguished *Carnation* from *Keogh* in part on the ground that in *Carnation* the FMC had not approved the challenged ratemaking agreements.[654] But the Court went on to note that "the Shipping Act gives the Federal Maritime Commission far more limited authority over rates than the Interstate Commerce Act gives the ICC."[655] The import of this statement seems to be that the scope of the *Keogh* doctrine is narrower when the agency merely approves agreements rather than regulates rates.[656] The role of the FMC under the Shipping

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[649] 383 U.S. 213 (1966).

[650] Id. at 215 (stating the issue as whether "the Shipping Act, 1916, 39 Stat. 728, as amended, 75 Stat. 762, 46 U.S.C. §§ 801-842 (1964 ed.), precludes the application of the antitrust laws to the shipping industry").

[651] Id. at 216 (citing § 15 of the Shipping Act, codified at 46 U.S.C. § 814).

[652] Id. at 217.

[653] Id. at 217.

[654] *Square D*, 476 U.S. at 420-21.

[655] Id. at 422 n.29. The Court also quotes approvingly from Judge Friendly's opinion in the court of appeals below: "Although the [Federal Maritime Commission] can and does take effects on competition into account in approving conference agreements under 46 U.S.C. § 814, . . . the Shipping Act does not give the Commission any mandate to regulate *rate* competition and, indeed, the statutory scheme was designed to minimize the role of the FMC in this regard." Id. at 422-23 n.29 (quoting *Square D*, 760 F.2d at 1363).

[656] Thus, the *Carnation* Court explicitly rejected the application of the *Keogh* "nondiscrimination" rationale in the context of the Shipping Act. *Carnation*, 383 U.S. at 219 n.3 ("There is no reason to believe that Congress would want to deprive all shippers of their rights to treble damages merely to assure that some shippers do not obtain more generous awards than others.") See also United States v. Radio Corp. of America, 358 U.S. 334 (1959). In *RCA*, the Court distinguished contract approval cases from common carrier rate regulation cases. Whereas common carrier regulatory

Act is closer to the role of a district court under Rule 23. The court can approve private agreements, but it has no mandate to regulate lawyer fee competition. This suggests that *Keogh* would not apply to Rule 23.[657]

This interpretation of *Keogh* is also consistent with the Court's later decision in the state action immunity case of *Cantor v. Detroit Edison Company*.[658] *Cantor*, by rejecting the utility's state action immunity defense, implicitly held that private damage actions would be available against a regulated utility for anticompetitive conduct in an unregulated market (the dissent made much of this point).[659] As we argued in the state action

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schemes were based on some notion of uniformity of rates, with which antitrust enforcement might interfere, in contract approval cases like *RCA*, there were "no rate structures to throw out of balance," and therefore "sporadic action by federal courts can work no mischief." *RCA*, 358 U.S. at 350.

[657] *Carnation* did restrict the damages that could be recovered: The plaintiff could recover only damages resulting from agreements that were not approved by the FMC. *Carnation*, 383 U.S. at 216 (holding that "the implementation of rate-making agreements which have not been approved by the Federal Maritime Commission is subject to the antitrust laws"). But the Shipping Act explicitly exempted from antitrust liability agreements that the FMC had approved. The Court ordered the antitrust action stayed until proceedings were held to determine whether the conduct was covered by prior agreements that the FMC had approved. Id. at 223-24. It is a plausible reading of *Square D*, however, that absent a statute explicitly immunizing conduct approved by an agency from antitrust liability, *Keogh* would not bar damage suits when an agency had approved of certain conduct, if that agency had limited regulatory authority. This argument is important because *RCA* and the other contract approval cases in which the Court denied immunity all involved suits by the Government, rather than private treble damages suits. Thus, the Court has not definitively resolved the question of whether *Keogh* would bar damage suits when an agency approves a contract, though we think *Carnation* points in the direction of allowing such suits.

[658] 428 U.S. 579 (1976).

[659] Id. at 598-99 (plurality opinion) (responding to criticism of availability of treble damages as a result of Court's opinion), id. at 603 (plurality opinion) (rejecting dissent's proposed rule that "no matter how peripheral or casual the State's interests may be in permitting [a private proposal] to go into effect, the state act would confer immunity from treble-damage liability"). One could argue that *Cantor* is irrelevant because it involves the state action doctrine rather than federal regulatory immunity. It is true that none of the *Cantor* opinions cited *Keogh*. But significantly, the Court in *Cantor* viewed the scope of state action immunity as identical to the scope of federal regulatory immunity. Id. at 596-97 ("Congress could hardly have intended state regulatory agencies to have broader power than federal agencies to exempt private conduct from the antitrust laws. Therefore, . . . the standards for ascertaining the existence and scope of such an exemption surely must be at least as severe as those applied to federal regulatory legislation."); id. at 596-97 nn. 33-37 (relying on

section, neither the market to represent the class nor the market to represent individual claimants in a subsequent administrative procedure should be viewed as the relevant regulated market.[660]

Even if consumers would be barred from seeking damages, competitor law firms might not be, assuming they show injury. Competitors might have a hard time proving "antitrust injury" in cases alleging maximum price fixing, because as the Court recognized in *Atlantic Richfield Company v. USA Petroleum Company*,[661] maximum price fixing should induce firms either to undercut the cartel if the maximum in fact is a minimum, or to provide superior service at higher prices if the maximum forces the cartel members to cut back on service.[662] A firm that refuses to take these actions has not suffered an antitrust injury. The exception is if predatory pricing is alleged. Some lower courts have held that *Keogh* does not apply when competitors allege predatory pricing.[663] The settlement agreement in *Georgine* does not involve classic predatory pricing, but it raises many of the same concerns.[664] Recall that the settlement provided that certain law firms would automatically be offered higher recoveries for their clients. In this regime, a disfavored law firm would have to lower its rate because a plaintiff coming

federal regulatory immunity cases). Although the Court later rejected this view in *Southern Motor Carriers*, which implicitly held that state action immunity was *broader* than federal regulatory immunity, *Southern Motor Carriers* reaffirmed the basic holding of *Cantor*. See supra notes 554 and 616.

[660] See supra notes 483-487 and accompanying text. *Cantor* also provides another reason why we find the recent filed rate cases inapplicable here. Those cases all involve attempts to challenge rates set by an administrative agency in the market the government sought to regulate.

[661] 495 U.S. 328 (1990) (holding that independent gasoline dealers could not sue other dealers subject to an alleged maximum retail price maintenance scheme because, absent predatory pricing, the independent dealers had been harmed by competition, and so had not suffered an antitrust injury) [hereinafter *ARCO*].

[662] Id. at 337. The Court's holding was that a competitor distributor does not suffer an antitrust injury, and therefore may not recover damages, when it complains that a rival manufacturer has imposed a maximum resale price maintenance scheme on its distributors, unless the maximum price is a predatory price.

[663] See supra note 633.

[664] Of the three possible antitrust problems we have raised, the *Georgine* scheme of allowing designated law firms to get higher recovery for their clients would seem to be the best candidate for a competitor law firm antitrust suit. This scheme involves a type of predation in that the disfavored law firms, because a plaintiff coming to them will get a lower recovery, must lower their rates to perhaps below-cost levels. We leave a full discussion of this problem for another day.

to it would get a lower recovery, but it might be unprofitable to charge the lower rate.

3. The Relevance of the Rules Enabling Act

Putting aside all the arguments we have already made, there is another reason why federal regulatory immunity from the antitrust laws should not apply to lawyer conduct in class actions. The federal "regulatory" scheme is Rule 23 and the case law interpreting that Rule. The scope of Rule 23, like all the Federal Rules of Civil Procedure, is governed by the Rules Enabling Act.[665] The Rules Enabling Act provides that the Federal Rules "shall not abridge, enlarge or modify any substantive right."[666] Rights under the antitrust laws are certainly substantive rights. To bar a plaintiff from bringing an antitrust suit on the ground that a court's approval of a class action settlement under Rule 23 created an immunity from the antitrust laws would be to interpret a Federal Rule so as to "abridge" a substantive right.

A recent case supports that reading of the Rules Enabling Act: *McCoy v. Massachusetts Institute of Technology*.[667] In *McCoy*, the First Circuit held that a union's trust fund administrator conld not rely on Rule 64[668] to justify asserting a lien under a state mechanic's lien law,[669] which would otherwise be preempted by the Employee Retirement Income Security Act of

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[665] 28 U.S.C. § 2072 (1994).

[666] 28 U.S.C. § 2072(b) (1994).

[667] 950 F.2d 13 (1st Cir. 1991), cert. denied, 504 U.S. 910 (1992).

[668] Rule 64 provides that during the course of an action in federal court, subject to certain exceptions:

> all remedies providing for seizure of person or property for the purpose of securing satisfaction of the judgment ultimately to be entered in the action are available under the circumstances and in the manner provided by the law of the state in which the district court is held, existing at the time the remedy is sought . . . .
>
> The remedies thus available include arrest, attachment, garnishment, replevin, sequestration, and other corresponding or equivalent remedies, however designated and regardless of whether by state procedure the remedy is ancillary to an action or must be obtained by an independent action.

Fed. R. Civ. P. 64.

[669] The Massachusetts statute "allow[ed] the trustee of an employee benefit plan to assert a lien against property improved through the labor of plan participants in order to collect overdue benefit contributions." *McCoy*, 950 F.2d at 15.

1974 ("ERISA").[670] The fund administrator argued that Rule 64 triggered ERISA's own anti-abridgment rule.[671] Citing the Rules Enabling Act's anti-abridgment provision, the court held that "[i]f [the administrator's] argument were correct, the upshot would be to give birth to a new, independent cause of action,"[672] which "would obviously affect substantive rights and thus alter substantive law" in contravention of the Rules Enabling Act.[673] If the Federal Rules cannot trigger a federal statute's "anti-abridgment" provision, it would certainly seem that they cannot trigger the antitrust laws' immunity doctrines.[674]

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[670] 29 U.S.C. § 1001 et seq. (1994).

[671] ERISA's anti-abridgment rule is found at section 514(d), 29 U.S.C. § 1144(d) (1994), which provides that ERISA shall not "be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States . . . or any rule or regulation issued under any such law."

[672] *McCoy*, 950 F.2d at 21.

[673] Id. at 21. Other cases have similarly held that no federal cause of action arises from the violation of the Federal Rules of Civil Procedure, because to do so would enlarge substantive rights in violation of the Rules Enabling Act. See Port Drum Co. v. Umphrey, 852 F.2d 148 (5th Cir. 1988) (Rule 11); Rogers v. Furlow, 729 F. Supp. 657 (D. Minn. 1989) (Rule 35).

[674] *McCoy* is consistent with the views of commentators who see a primary purpose of the Rules Enabling Act as regulating the allocation of power between the Supreme Court and Congress. See Stephen B. Burbank, Of Rules and Discretion: The Supreme Court, Federal Rules and Common Law, 63 Notre Dame L. Rev. 693, 700 (1988) (arguing that "there can be no doubt that the major purpose of those who wrote and defended the bill that became the Enabling Act was to allocate power to make federal law prospectively between the Supreme Court as rulemaker and Congress . . . ."); Stephen B. Burbank, The Rules Enabling Act of 1934, 130 U. Pa. L. Rev. 1015, 1106 (1982) ("Nothing could be clearer from the pre-1934 history of the Rules Enabling Act than that the procedure/substance dichotomy in the first two sentences was intended to allocate lawmaking power between the Supreme Court as rulemaker and Congress."); Karen N. Moore, The Supreme Court's Role in Interpreting the Federal Rules of Civil Procedure, 44 Hastings L.J. 1039, 1043 (1993) (agreeing with Professor Burbank's historical argument "that the major purpose of the limiting language in the Rules Enabling Act was to confine the Court to the procedural arena and restrain it from making substantive law, which was to remain the prerogative of Congress"); Note, The Conflict Between Rule 68 and the Civil Rights Attorney's Fees Statute: Reinterpreting the Rules Enabling Act, 98 Harv. L. Rev. 828, 834-35 (1985) ("The real purpose of the Enabling Act—allocating power between the Court and Congress—dictates that the Court not exercise its rulemaking authority to nullify 'important' statutorily created rights.").

The Supreme Court, however, has interpreted the Rules Enabling Act largely in the context of diversity cases, in which the conflict between a Federal Rule and some state rule, law, or practice raised federalism concerns. See Hanna v. Plumer, 380 U.S. 460 (1965); Sibbach v. Wilson & Co., 312 U.S. 1 (1941). Moreover, in West v. Conrail, 481 U.S. 35 (1987), the Court ignored the Rules Enabling Act in holding that when a

Some might argue that this interpretation of the Rules Enabling Act renders all class actions suspect because they inevitably abridge substantive rights under the antitrust laws by regulating how lawyers and others must conduct themselves in litigation, i.e., how participants in the system may compete. This argument misperceives the role of the Federal Rules of Civil Procedure. The Rules are a regulatory system. They regulate the rights of litigants in federal court. More important for our purposes, they regulate the conduct of lawyers in litigation. They tell lawyers what papers to file, what deadlines to meet, what motions to make, and so on. The Rules may incidentally affect various markets, even the market for lawyers, as long as the primary purpose of any Rule is to regulate litigation activity.

In this sense the Rules are like the zoning laws at issue in *City of Columbia v. Omni Outdoor Advertising*.[675] They restrict access to, and use of, the federal courts just as zoning laws restrict access to, and use of, land. Just as access to land is necessary for the provision of various goods and services, so access to litigation in federal court is necessary for the provision of various services.

Rule 23 restricts the right of people to bring suits individually in federal court by allowing these suits to be combined. But class actions are not antitrust violations. They "abridge" procedural rights which are themselves defined by the Rules in the first instance. Rule 23, like all the other Rules, is intended to further the fair and orderly administration of justice in the federal courts. With that aim it modifies to some extent the right to bring an individual suit, which is a right delineated by the other Federal Rules of Civil Procedure. It is just one in a series of restrictions on access to the courts that together make up the Rules, an overall sceme of regulated access akin to zoning regulation and no more violative of substantive antitrust rights than zoning laws are.

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federal court must borrow a statute of limitations from another federal statute, Rule 3 determines whether an action has been commenced within the borrowed limitations period, and so is not barred. Id. at 39. Although it is possible to read these decisions as rendering the Rules Enabling Act irrelevant in federal question cases, we have difficulty seeing how such a reading is either necessary to these cases or compatible with the language and intent of the statute.

[675] 499 U.S. 365 (1991).

On the other hand, as we argued above, the market for lawyer services in a private administrative system is not the same as the market for litigation in federal court. That does not mean that a court lacks the authority to approve a class action settlement that has effects in a market outside of litigation in federal court. Rather, it means that other law can regulate these effects. Thus, when a court approves a settlement that regulates lawyer fees outside of litigation in federal court, the validity of that provision of the settlement under the antitrust laws cannot, under the Rules Enabling Act, depend on the fact that the court approved it.

The question of class counsel fees is only slightly harder. Rule 23 allows the court to approve class counsel and set class counsel's fee. Moreover, Rule 23 does not require the court to adopt any particular method for appointing class counsel and setting fees, such as Judge Walker's auction method discussed above.[676] These decisions by the court affect procedural rights; they regulate by restricting access to the court.[677] But the court's approval cannot abridge the substantive right of competing lawyers and consumers to be free from collusion outside of litigation. If court reporters collude to fix prices, the fact that the court chooses one and pays the price does not immunize the conduct. If one lawyer breaks the knees of another and renders her unavailable to be class counsel, the court's appointment of the first lawyer to be class counsel does not immunize the wrongful conduct from prosecution. Similarly, if lawyers collude to rotate class counsel appointments, the court's appointment of the anointed lawyers cannot, under the Rules Enabling Act, immunize the anticompetitive conduct from antitrust scrutiny.

[676] See supra notes 148-152 and accompanying text.

[677] Some commentators have suggested that any judicial rulemaking on fees violates the Rules Enabling Act because it affects substantive rights. See Resnik, Curtis & Hensler, supra note 14, at 296, 328 n.99 (1996). Whatever the merits of that position, the argument we are making here does not depend on its acceptance.

D. Nor is it Noerr

Under the doctrine established in *Eastern R.R. Presidents Conference v. Noerr Motor Freight*,[678] private efforts to restrain trade by petitioning government officials are generally immune from antitrust liability.[679] The immunity applies whether the private actors petition the legislature, courts or administrative agencies.[680] Lawyers involved in anticompetitive conduct in seeking appointment as class counsel or in drafting class action settlements might claim that their submission of proposals to the court for approval constitute petitions to the government immune from the antitrust laws. Such a claim is untenable, however, in light of the purposes of the *Noerr* doctrine.

In *Noerr*, the Court unanimously held that "the Sherman Act does not prohibit . . . persons from associating together in an attempt to persuade the legislature or the executive to take particular action with respect to a law that would produce a restraint or a monopoly."[681] The immunity applies despite any anticompetitive purpose the private actors might have,[682] despite (at least in the legislative arena) any deceptive or unethical practices the private actors might use[683] and despite any "incidental" anticompetitive effects the private actors might "directly" cause.[684] The *Noerr* Court gave two reasons justifying this immunity. First, it found that applying the antitrust laws to "political activity" through which "the people . . . freely inform the government of their wishes" would "substantially impair the power of government to take actions through its legislature and executive that operate to restrain trade," a result that Congress did not intend.[685] In this sense, petitioning immunity is deriva-

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[678] 365 U.S. 127 (1961).

[679] Id. at 136.

[680] California Motor Transp. Co. v. Trucking Unlimited, 404 U.S. 508, 510 (1972).

[681] *Noerr*, 365 U.S. at 136.

[682] Id. at 138-40. The Court reaffirmed that anticompetitive intent alone is insufficient to defeat *Noerr* immunity in Professional Real Estate Invs. v. Columbia Pictures Indus., 508 U.S. 49, 55-60 (1993).

[683] *Noerr*, 365 U.S. at 140-41 (Although the means used by defendants was "one which falls far short of the ethical standards generally approved in this country," this did not affect the determination of whether the activity constituted an antitrust violation.).

[684] Id. at 142-44.

[685] Id. at 137.

tive of state action and federal regulatory immunity.[686] Second, the Court sought to avoid an interpretation of congressional intent that could result in a clash between the value of competition underlying the antitrust laws and the value of political participation underlying the First Amendment's right to petition.[687]

Noerr recognized one exception to petitioning immunity: the "sham" exception. The Court stated that there would be no immunity when petitioning activity, "ostensibly directed toward influencing government action, is a mere sham to cover what is actually nothing more than an attempt to interfere directly with the business relationships of a competitor."[688] The Court declined to apply the exception it had recognized on the facts in *Noerr* itself. The fact that a publicity campaign by railroads seeking legislation harmful to truckers was "not only genuine but also highly successful," demonstrated for the Court that the railroads' efforts were genuine, not a sham for cover.[689]

The Court now interprets the sham exception quite narrowly. It has defined sham activity, "in whatever forum," as "private action that is not genuinely aimed at procuring favorable government action."[690] In practical terms, this means that the sham exception can apply only when the alleged restraint is the act of petitioning itself and not the result of that petitioning; that is, sham activity must involve the "use [of] the governmental *process*—as opposed to the *outcome* of that process—as an anticompetitive weapon."[691]

In *California Motor Transport*, the Court held that the sham exception applied to a complaint alleging that a group of truckers filed repeated objections to competitors' license applications before an administrative agency "with or without probable

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[686] The *Noerr* Court in fact cited Parker v. Brown, 317 U.S. 341 (1943), twice, emphasizing the link the Court saw between the doctrines. *Noerr*, 365 U.S. at 136 n.15, 137 n.17.

[687] Id. at 138.

[688] Id. at 144.

[689] Id. at 144.

[690] Allied Tube & Conduit Corp. v. Indian Head, 486 U.S. 492, 500 n.4 (1988). The Court rejected a broader definition of sham activity as conduct by one "who 'genuinely seeks to achieve his governmental result, but does so *through improper means*.'" Id. at 508 n.10 (quoting Sessions Tank Liners v. Joor Mfg., 827 F.2d 458, 465 n.5 (1987)).

[691] City of Columbia v. Omni Outdoor Advertising, 499 U.S. 365, 380 (1991).

cause, and regardless of the merits of the cases."[692] Although the Court stressed the truckers' improper purpose to deny their competitors meaningful access to governmental entities,[693] its more recent view of the case is that the truckers could not reasonably have expected their filings to produce a result favorable to them.[694] In *Professional Real Estate*, the Court confirmed this newer and more restrictive understanding of the sham exception, holding that litigation could not be deemed a sham unless the lawsuit is "objectively baseless in the sense that no reasonable litigant could realistically expect success on the merits."[695]

Under this definition of sham, class action lawyers who seek court approval of a fee arrangement or settlement are not engaging in sham activity. Though their intentions might be to exclude competitors, they are genuinely seeking the "outcome" of the governmental process, namely, court approval. And assuming that the *Professional Real Estate* standard would apply to court approvals of class action settlements, the lawyers' petitions would almost never be "objectively baseless" in the sense that they could not realistically expect the court to approve the settlement.

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[692] *California Motor Transport*, 404 U.S. at 512.

[693] Id. at 512 (noting that the truckers had "sought to bar their competitors from meaningful access to adjudicatory tribunals and so to usurp that decisionmaking process" and referring to the truckers' "purpose to deprive ... competitors of meaningful access to the agencies and courts").

[694] See *Omni*, 499 U.S. at 380-82. "A classic example [of a 'sham'] is the filing of frivolous objections to the license application of a competitor, with no expectation of achieving denial of the license but simply in order to impose expense and delay." Id. at 380 (citing *California Motor Transport*). In *Omni*, the Court limited *California Motor Transport* to its facts, id. at 382, and held that the denial of "'meaningful access to the appropriate city administrative and legislative fora'" might "render the manner of lobbying improper or even unlawful, but does not necessarily render it a 'sham.'" *Omni*, 499 U.S. at 381.

[695] *Professional Real Estate*, 508 U.S. at 60. This rule is actually somewhat inconsistent with *California Motor Transport* in that the defendants in that case had actually prevailed in over half the cases filed. See Einer Elhauge, Making Sense of Antitrust Petitioning Immunity, 80 Cal. L. Rev. 1177, 1184 (1992). Professor Elhauge harmonizes the two cases somewhat by asserting that, although the defendants won 21 of 40 cases, "the crux of the complaint was that the defendants were instigating litigation automatically, without regard to whether the litigation had merit or not." Id. This, however, does not fully answer the inconsistency that most of the cases filed in *California Motor Transport* were probably not "objectively baseless" under the rule of *Professional Real Estate*.

The narrow "sham" exception is not, however, the only way around *Noerr*—a fact the Court has explicitly recognized.[696] The sham exception now applies only to conduct that is anticompetitive solely because it abuses some government process. But what if private parties engage in conduct that is anticompetitive apart from any government action, and seek to use government endorsement of that conduct to cloak the private conduct in petitioning immunity? The Court has held in two recent cases that even though such conduct does not qualify as "sham" petitioning, *Noerr* immunity does not apply.

In the first case, *Allied Tube & Conduit Corporation v. Indian Head*,[697] steel conduit makers stacked a meeting of the National Fire Protection Association, a private standard-setting association, to defeat the approval of rival plastic conduit for inclusion in the group's National Electric Code.[698] The Court held that this activity was not immune from antitrust liability, despite the fact that the association regularly submitted the code to state legislatures and local governments, which routinely adopted it with little or no change. The Court first held that the source of the restraint was "private action," because it was "imposed by persons unaccountable to the public and without official authority, many of whom have personal financial interests in restraining competition."[699] Next, the Court decided that the essential character of the conduct was not political, but rather that it was "commercial activity that has traditionally had its validity determined by the antitrust laws."[700] The steel conduit makers and their supporters were "economically interested part[ies] exercis[ing] decisionmaking authority."[701] Finally, the Court noted that the defendants "can, with full antitrust immunity, engage in concerted efforts to influence . . . governments through direct

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[696] See Allied Tube & Conduit Corp. v. Indian Head, 486 U.S. 492, 503 (1988) (noting that although the sham exception does not apply, "[w]e cannot agree with [the] absolutist position that the *Noerr* doctrine immunizes every concerted effort that is genuinely intended to influence governmental action.").

[697] 486 U.S. 492 (1988).

[698] Id. at 495-97.

[699] Id. at 502.

[700] Id. at 505.

[701] Id. at 509.

lobbying, publicity campaigns, and other traditional avenues of political expression."[702]

The second case, *Federal Trade Commission v. Superior Court Trial Lawyers Association*,[703] involved what was essentially a strike for higher wages by court-appointed lawyers representing indigent criminal defendants in Washington, D.C.[704] Holding the lawyers' conduct to be a per se illegal boycott,[705] the Court rejected the lawyers' claim to *Noerr* immunity in three short sentences. The Court stated that

> in the *Noerr* case the alleged restraint of trade was the intended *consequence* of public action; in this case the boycott was the *means* by which respondents sought to obtain favorable legislation. The restraint of trade that was implemented while the boycott lasted would have had precisely the same anticompetitive consequences during that period even if no legislation had been enacted. In *Noerr*, the desired legislation

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[702] Id. at 510.

[703] 493 U.S. 411 (1990).

[704] Id. at 414-18. Section 6 of the Clayton Act states:

> The labor of a human being is not a commodity or article of commerce. Nothing contained in the antitrust laws shall be constured to forbid the existence and operation of labor . . . organizations, . . . or to forbid or restrain individual members of such organizations from lawfully carrying out the legitimate objects thereof; nor shall such organizations, or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade, under the antitrust laws.

Clayton Act, ch. 323, § 6, 38 Stat. 731 (1914) (current version at 15 U.S.C. § 17 (1994)).

Section 20 of the Clayton Act provides:

> No restraining order or injunction shall be granted by any court of the United States . . . in any case between an employer and employees, . . . involving, or growing out of, a dispute concerning terms and conditions of employment . . . .
>
> And no such restraining order or injunction shall prohibit any . . . persons, . . . in concert, from . . . ceasing to perform any work or labor, or from recommending, advising, or persuading others by peaceful means so to do; . . . nor shall any of the acts specified in this paragraph be considered or held to be violations of any law of the United States.

Clayton Act, ch. 323, § 20, 38 Stat. 738 (1914) (current version at 29 U.S.C. § 52) These statutes represent the so-called "statutory labor exemption" from the antitrust laws. Hovenkamp, supra note 136, § 19.7, at 662. The lawyers did not try to argue that they qualified for this exemption. See Superior Court Trial Lawyers Ass'n v. Federal Trade Comm'n, 856 F.2d 226, 230 n.6 (D.C. Cir 1988). See also 1 Phillip Areeda & Donald F. Turner, Antitrust Law § 229c, at 195-98 (1978) (focus of Clayton Act only on bona fide labor organizations and not on independent contractors or entrepreneurs).

[705] *Trial Lawyers*, 493 U.S. at 422-23.

> would have created the restraint on the truckers' competition; in this case the emergency legislative response to the boycott put an end to the restraint.[706]

In the remainder of the opinion, the Court rejected the lawyers' argument that their boycott deserved First Amendment protection because it was "political" and contained an "expressive component."[707]

Allied Tube and *Trial Lawyers* stand for exactly the same proposition for which we have argued the state action and federal regulatory immunity cases stand: namely, that private anticompetitive conduct does not become immunized from antitrust liability simply because a governmental entity approves the result of that conduct. Both *Allied Tube* and *Trial Lawyers* involved private anticompetitive conduct that was separable from petitioning conduct—"private" in the sense that the conspirators had a financial interest in restraining competition but no public authority to do so; "separable" in the sense that the anticompetitive conduct could be punished without at the same time punishing the type of petitioning that *Noerr* seeks to protect.[708] In *Allied Tube*, the Court condemned the steel conduit makers' self-interested corruption of a standard-setting association's decisionmaking process. As the Court noted, the steel conduit makers could lobby all they wanted for a statute banning plastic conduit.[709] In *Trial Lawyers*, the Court condemned lawyers'

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[706] Id. at 424-25.

[707] Id. at 429-32. The Court finally concluded that:

> In sum, there is thus nothing unique about the 'expressive component' of respondents' boycott. A rule that requires courts to apply the antitrust laws 'prudently and with sensitivity' whenever an economic boycott has an 'expressive component' would create a gaping hole in the fabric of those laws. Respondents' boycott thus has no special characteristics meriting an exemption from the *per se* rules of antitrust law.

Id. at 431-32.

[708] The source of this notion of "separability" is *Noerr* itself, in which the Court rejected the argument that an antitrust plaintiff could recover for "direct injury" that was an "incidental effect" of petitioning because holding the conduct causing the direct injury to be unlawful would "be tantamount to outlawing" the petitioning activity itself. *Noerr*, 365 U.S. at 143-44. Thus, as long as subjecting specific anticompetitive activities to the antitrust laws would not "be tantamount to outlawing" petitioning activity, *Noerr* does not stand in the way of the antitrust claim.

[709] *Allied Tube*, 486 U.S. at 510 ("Petitioner . . . can, with full antitrust immunity, engage in concerted efforts to influence . . . governments through direct lobbying, publicity campaigns, and other traditional avenues of political expression.").

concerted refusal to deal, which served their private financial interests. Nothing prevented the lawyers from lobbying to their hearts' content for higher wages. Thus, in neither case were the defendants punished for asking for something from the government; they were punished for doing something other than petitioning. The power to petition remained in both cases.

In this crucial respect, anticompetitive lawyer conduct in class actions strongly resembles the conduct at issue in *Allied Tube* and *Trial Lawyers*. Lawyers who rig bids in vying for the position of class counsel, and lawyers who write class action settlement agreements containing fee caps and other restraints, are economically interested actors engaging in anticompetitive conduct that is separable from petitioning activity. Condemning such activity would do nothing to hinder the ability of such lawyers to lobby state legislatures or Congress, or even supreme courts with rulemaking authority, for exactly the same types of anticompetitive restraints.[710]

The fact that the lawyers' self-interested activity affects petitioning activity that is protected under *Noerr*—the filing and litigating of class action lawsuits—does not in itself establish *Noerr* immunity. In *Allied Tube*, the fact that the steel conduit makers' self-interested activity affected the standard-setting association's code—the submission of which to state legislatures was protected under *Noerr*—was likewise insufficient. And in *Trial Lawyers*, the fact that the lawyers' self-interested activity affected the representation of indigent criminal defendants in court—certainly protected activity under *Noerr*—was also insufficient. In effect, *Allied Tube* and *Trial Lawyers* establish a kind of "*Noerr* standing" requirement. The steel conduit makers could not usurp the petitioning rights belonging to the standard-setting association by corrupting the association's decisionmaking process. The trial lawyers could not assert the constitutional rights of their clients to justify self-interested behavior that was at best imperfectly correlated with the clients' interests. Simi-

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[710] For example, if class action lawyers prevailed upon a bar association to lobby for a change in the state's Rules of Professional Conduct that permitted such restraints, this activity would be fully protected by *Noerr*. See Lawline v. American Bar Ass'n, 956 F.2d 1378, 1383 (7th Cir. 1992), cert. denied, 510 U.S. 992 (1993) (citing *Allied Tube*, 486 U.S. at 499, for the proposition that 'those urging the governmental action enjoy absolute immunity from antitrust liability for the anticompetitive restraint'").

larly, class action lawyers cannot piggy-back on their clients' petitioning rights to justify self-interested behavior. Moreover, these lawyers are exercising decisionmaking authority in a way that corrupts the procompetitive benefits of class actions (the amalgamation of small claims that could not be brought individually), just as the steel conduit makers exercised their ability to affect the decisionmaking process to corrupt the procompetitive benefits of private standard-setting associations.

There are, of course, differences between anticompetitive conduct in class actions and the conduct at issue in *Allied Tube* and *Trial Lawyers*. In particular, in *Allied Tube* and *Trial Lawyers*, the private restraint preceded, and caused harm independent from, the government action. In *Allied Tube*, the exclusion of plastic conduit from the National Electric Code preceded legislative approval of the code, and caused immediate, independent harm by stigmatizing plastic conduit. In fact, the Court decided the case based on the court of appeals' judgment that the plaintiff "did *not* seek redress for any injury arising from the adoption of the [Code] by the various governments,"[711] but merely for damages arising from the stigma that the restraint caused in states that allowed the plaintiff's product to be used. In *Trial Lawyers*, the boycott preceded the government's acceptance of higher wages, and caused immediate, independent harm by disrupting the normal functioning of the criminal defense system.[712]

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[711] *Allied Tube*, 486 U.S. at 498 n.2 (quoting *Allied Tube*, 817 F.2d 938, 941 n.3 (1987) [bracketed text and emphasis in original]. See also id. at 500 (noting that "no damages were imposed for the incorporation of th[e] Code by any government); id. at 502 (referring to petitioner's argument that "the effect that exclusion [from the code] had of its own force in the marketplace [was] incidental to a valid effort to influence government action"); id. at 509-10 (holding that "where, as here, an economically interested party exercise decision-making authority in formulating a product standard for a private association that comprises market participants, that party enjoys no *Noerr* immunity from any antitrust liability flowing from the effect the standard has of its own force in the marketplace").

[712] *Trial Lawyers*, 493 U.S. at 418.

> Within 10 days, the key figures in the District's criminal justice system 'became convinced that the system was on the brink of collapse because of the refusal of CJA lawyers to take on new cases.' [Shortly thereafter,] they hand-delivered a letter to the Mayor describing why the situation was expected to 'reach a crisis point' by early the next week and urging the immediate enactment of a bill increas[ing] all CJA rates . . . ."

Id. at 418.

In the class action situation, by contrast, the alleged anticompetitive harm does not precede governmental action and does not cause harm independent of the governmental action. In general, neither the charging of class counsel fees nor the charging of fees under the private administrative system occurs without court approval.[713]

In our view, these differences are not sufficient to create immunity in the class action context. Although the Court in *Allied Tube* emphasized that the only injury for which the plaintiff recovered was the stigmatizing effect of the defendant's anticompetitive conduct in states that had not adopted the code, much of the Court's reasoning is consistent with allowing damages even in states that had adopted the code.[714] Even if the Court intended to suggest it would not allow damages in states that had adopted the code, such a judgment might stem, not from *Noerr*, but from the fact that there would be serious difficulties trying to separate out damages caused by valid government action—the adoption of the code—from damages caused by the private action. But the more passive the government's role, the easier it would be to make this separation, because the chances are greater that, but for the anticompetitive private conduct, the government's action would be different.[715] Govern-

[713] In *Georgine*, the class action defendants were "operating to settle claims under the terms of the Stipulation" some seven months before the court approved the settlement agreement. *Georgine*, 157 F.R.D. at 286. Moreover, side agreements between the defendants and class counsel purported to bind class counsel to critical terms of the settlement regardless of court approval. See Koniak, supra note 15, at 1128-36.

[714] E.g., *Allied Tube*, 486 U.S. at 502 ("But where, as here, the restraint is imposed by persons unaccountable to the public and without official authority, many of whom have personal financial interests in restraining competition, we have no difficulty concluding that the restraint has resulted from private action."); id. at 505 (noting that "the context and nature of petitioner's activity make it the type of commercial activity that has traditionally had its validity determined by the antitrust laws themselves"); id. at 507 ("Although one could reason backwards from the legislative impact of the Code to the conclusion that the conduct at issue here is 'political,' we think that, given the context and nature of the conduct, it can more aptly be characterized as commercial activity with a political impact.").

[715] Professor Hovenkamp posits the following hypothetical variation on *Allied Tube*. Suppose all state legislatures simply adopted the code pursuant to statutes that said: "the standard for electric installations in this state is that promulgated by the National Fire Protection Association." Hovenkamp, supra note 136, § 18.5, at 647. He writes:

> The question then becomes whether those private market participants engaged

ment is at its most passive when its role is simply to evaluate private agreements. The fact that in *Allied Tube* the Court favorably cited *Pennsylvania R.R.*[716] suggests that *Noerr* does not bar suits when the government simply acts to approve private conduct.

As for the *Trial Lawyers* case, although the reasoning in that opinion does seem to emphasize the anticompetitive effect of the boycott before the government acted, it is hard to believe that the Court intended to suggest that such an independent effect is necessary when the government is buying goods and services,[717] as it is effectively doing in the *Oracle*-type bid rigging

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> in standard setting or rule making have a kind of "fiduciary duty" to the public—and, if so, whether the duty is to be enforced by the antitrust laws. As the degree of government abdication grows stronger, so does the case for denying *Noerr* immunity. . . . In [the hypothetical case posed above], corruption of the NFPA that results in the exclusion of plastic conduit should not enjoy *Noerr* immunity even if the injury results entirely from subsequent government "enactment" of the NFPA standard. The government's "pre-commitment" has effectively made its act nothing more than ministerial.

Hovenkamp, supra note 136, § 18.5, at 647. But cf. Massachusetts School of Law v. American Bar Ass'n, 937 F. Supp. 435 (E.D. Pa. 1996) (suit by law school denied ABA accreditation barred by *Noerr* on the ground that the only injury to the school stemmed from state statutes allowing only graduates from ABA-accredited schools to sit for their bar examinations). Professor Hovenkamp does not argue that reason for reduced *Noerr* protection in the "government abdication" case is that it would be easier to prove causation and damages, but that is one possible justification for his view. Whatever the justification, however, we note that Professor Hovenkamp's argument would have particular force for lawyers who engage in "rule making" in class action settlements, as these lawyers certainly owe a "fiduciary duty" to the class and face, in the form of the high settlement approval rate, a high degree of "government abdication."

[716] *Allied Tube*, 486 U.S. at 503. See also id. at 508 n.10 (stating that "the types of activity we describe *supra*, at 503-504, could not be immune under *Noerr*"). Of course, *Noerr* had not yet been decided at the time *Pennsylvania R.R.* was decided. But nothing in *Noerr* suggests the Court meant to cast any doubt on any of its prior cases. The citation of *Pennsylvania R.R.* in *Allied Tube* merely confirms this point.

[717] It is also hard to believe the Court meant what it said in *Trial Lawyers* when it said that the boycott "would have had precisely the same anticompetitive consequences during that period even if no legislation had been enacted." *Trial Lawyers*, 493 U.S. at 425. If by "that period," the Court meant the fixed number of days the boycott actually lasted, the statement is technically true, but misleading. If no legislation had been enacted, or if legislation unsatisfactory to the lawyers had been enacted, the boycott might have lasted longer, resulting in additional anticompetitive consequences. More important, the Court found that "[i]n *Noerr*, the desired legislation would have created the restraint on the truckers' competition; in this case the emergency legislative response to the boycott put an end to the restraint." Id. at

situation. If such an independent effect were necessary, the government could never sue for damages for price fixing against the government. But the Clayton Act specifically contemplates such an action.[718]

But even if the fact that the restraint preceded, and was independent from, governmental action really did matter in *Allied Tube* and *Trial Lawyers*, this fact should not matter in the class action context. In *Allied Tube* and *Trial Lawyers*, the defendants directed their alleged petitioning activity to legislative bodies,[719] which traditionally have enjoyed the strongest degree of *Noerr* immunity.[720] More important, in both cases, the relevant legislative body enacted legislation that enjoyed state action immunity. This fact provides an additional explanation of why the Court seemed to take pains in the two cases to separate the private conduct from the government conduct.[721]

In the class action context, however, the problem the Court implicitly recognized in *Allied Tube* and *Trial Lawyers* does not exist. Lawyers in class actions are not seeking anticompetitive legislation or rulemaking; they seek approval of private conduct from a court acting in a quasi-administrative capacity. We have already demonstrated why court approval in this context confers neither state action nor federal regulatory immunity. Thus, if

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425. Again, the Court's statement is a little misleading, because if, as the Court acknowledged later in the opinion, the lawyers were engaged in price fixing, the government action did not end the restraint (though it did end the boycott); rather, the governmental action adopted the restraint, namely the higher wages.

[718] Clayton Act, § 4A, 15 U.S.C. § 15a. Professor Hovenkamp argues that *Trial Lawyers* would not have come out any differently if the restraint had not occurred until the government acted. He sees the case as an example of the government as purchaser, and suggests that if a group of sellers to the government agreed to fix prices or engage in predatory pricing against competitors, *Noerr* immunity would not attach despite the fact that no private injury precedes the government decision. See Hovenkamp, supra note 136, § 18.2b, at 634-35.

[719] In *Trial Lawyers*, the lawyers were seeking to amend the District of Columbia Criminal Justice Act, D.C. Code Ann. § 11-2601 et seq. (1981), which, inter alia, set the fees for court-appointed lawyers representing indigent criminal defendants. *Trial Lawyers*, 493 U.S. at 414-17.

[720] See infra note 730.

[721] The lack of state action rationale also provides an alternative justification for Professor Hovenkamp's hypothetical discussed supra note 715. In his hypothetical, "government abdication" could be interpreted as "lack of active supervision," which means that the state action doctrine would not apply. In fact, *Allied Tube* itself could be viewed as a "lack of active supervision" case.

the difference between *Allied Tube* and *Trial Lawyers* and the class action context means anything, it cuts in favor of denying *Noerr* immunity in the class action context, not against it.

It is true that the Court has never explicitly decided whether *Noerr* immunity applies when private conduct separate from the use of governmental processes is the source of the restraint, and when the government approval of that conduct does not result in state action or federal regulatory immunity.[722] There can be little doubt, however, that *Noerr* immunity does not and should not apply in such cases. If it did, most of the cases denying state action or federal regulatory immunity would essentially mean nothing. In most of those cases,[723] the defendants "petitioned" an agency to take some action. The cases implicitly assume that once the governmental immunity claim was defeated, no further immunity related to the government action could bar the antitrust claim.[724] Moreover, the statements the

[722] It is important to note that we are not talking about cases in which the only private anticompetitive conduct alleged is the petitioning activity itself. In such cases, courts have held that the mere fact that the governmental action is not protected under the state action doctrine does not deprive the petitioning conduct of *Noerr* immunity, unless the sham exception applies. Using the antitrust laws to punish such conduct would threaten the type of petitioning activity *Noerr* sought to protect. See Hovenkamp, supra note 136, § 18.3e, at 644-45.

[723] See, e.g., Federal Trade Comm'n v. Ticor Title Ins. Co., 504 U.S. 621 (1992) (no state action immunity protection for private price-fixing arrangemetn where title insurance rates become effective only in not rejected by the agency within a set time); Cantor v. Detroit Edison Co., 428 U.S. 579 (1976) (denying state-action immunity claim that state regulation of public utilities authorizes monopolization in the market for electric light bulbs); United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963) (no federal regulatory immunity where proposed merger requiring approval was approved by Comptroller of the Currency); California v. Federal Power Comm'n, 369 U.S. 482 (1962) (no federal regulatory immunity for merger approved by Federal Power Commission where statutory grant of authority did not allow commission to enforce antitrust laws); United States v. Radio Corp. of Am., 358 U.S. 334 (1959) (no federal regulatory immunity for exchange of television stations approved by Federal Communications Commission where legislative history revealed that Commission approval was not intended to prevent enforcement of antitrust laws); Georgia v. Pennsylvania R.R. Co., 324 U.S. 439 (1945) (denying federal regulatory immunity claim that authority to fix joint through-rates with other carriers allows conspiracy and coercion in the fixing of those rates).

[724] In the words of one court of appeals, "[i]f extensive substantive regulation does not warrant an antitrust exemption, then surely an essentially procedural aspect of regulation—tariff filing—cannot." Litton Systems v. American Tel. & Tel. Co., 700 F.2d 785, 807 (2d Cir. 1983), cert. denied, 464 U.S. 1073 (1984). The court went on to state that "AT&T cannot cloak its actions in *Noerr-Pennington* immunity simply

Court has made are consistent with the notion that no *Noerr* immunity attaches when agency approval of private conduct does not create state action or federal regulatory immunity. With respect to state action immunity, a portion of *Cantor v. Detroit Edison Company*[725] joined only by a plurality of justices explicitly states that

> nothing in the *Noerr* opinion implies that the mere fact that a state regulatory agency may approve a proposal included in a tariff, and thereby require that the proposal be implemented until a revised tariff is filed and approved, is a sufficient reason for conferring antitrust immunity on the proposed conduct.[726]

Nothing in the opinions of the concurring justices disagreed with the plurality's interpretation of *Noerr.* With respect to federal regulatory immunity, the Court in *Allied Tube* cited *Georgia v. Pennsylvania R.R. Company*[727] as an example of a case in which

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because it is required, as a regulated monopoly, to disclose publicly its rates and operating procedures." Id.

[725] 428 U.S. 579 (1976).

[726] Id. at 601-02. Several courts of appeals have relied on this language to conclude that the mere filing of a tariff by a regulated firm does not confer *Noerr* immunity on private restraints. See, e.g., City of Kirkwood v. Union Elec. Co., 671 F.2d 1173, 1181 (8th Cir. 1982), cert. denied, 459 U.S. 1170 (1983) (claim that utility created a "price squeeze" through its rates submitted to and approved by state and federal agencies not barred by *Noerr*); *Litton Systems*, 700 F.2d at 806-09 (claim that AT&T monopolized the market by filing tariffs requiring customers to connect equipment made by rival companies to the telephone system only through an "interface device" made by AT&T not barred by *Noerr*).

Although two courts of appeals have implicitly suggested that tariff filings might enjoy *Noerr* immunity, these cases involved allegations that the act of filing and the ensuing delay were themselves the antitrust violations, in contrast to the allegations that could be made against lawyers in class actions. See MCI Communications Corp. v. American Tel. & Tel. Co., 708 F.2d 1081, 1153-58 (7th Cir.), cert. denied, 464 U.S. 891 (1983); Clipper Exxpress v. Rocky Mountain Motor Tariff Bureau, 690 F.2d 1240, 1251-54 (9th Cir. 1982), cert. denied, 459 U.S. 1227 (1983). Moreover, in both cases, the courts actually rejected the *Noerr* claim because they found the petitioning to be sham. Thus, the cases could actually be read to leave open the question of whether filing tariffs should ever enjoy *Noerr* protection. See *MCI*, 708 F.2d at 1155 n.114 (noting that "*Noerr-Pennington* might not apply if a tariff filing is only a *pro forma* publication perhaps required by law and not an exercise of the right to *petition* the government," and stating that "[w]e do not reach this issue").

[727] 324 U.S. 439 (1945).

Noerr immunity does not apply despite the fact that there was no "sham" activity.[728]

It is also true that the Court has never definitively decided whether the standards for immunity are different depending on which political body is being petitioned. *Allied Tube* does state that the scope of petitioning immunity depends on the "source, context, and nature of the anticompetive restraint at issue."[729] In addition, the Court has strongly suggested that petitioning immunity is broader in the legislative sphere then in the judicial or administrative spheres. For example, the Court has referred to the fact that in the legislative sphere "unethical and deceptive methods" are more tolerated than in the judicial and administrative sphere, where such methods may constitute abuse of process "that may result in antitrust violations."[730] But if *Noerr* has its roots in state action and federal regulatory immunity, the scope of immunity in the legislative sphere must be broader. Only the legislature can "restrain trade" in ways that would otherwise violate the antitrust laws. In general, the power of courts and agencies to restrain trade is entirely dependent on their authority from the legislature to do so, as is their ability to stop private restraints.

Another difference between the class action context and the *Allied Tube* and *Trial Lawyers* cases also suggests the case for denying *Noerr* immunity is stronger in the class action context. The steel conduit makers in *Allied Tube* did not violate association rules by stacking the meeting and did not do any harm to the association that the association could not itself remedy. The lawyers in *Trial Lawyers* were probably in the best position to petition on behalf of protecting their clients' Sixth Amendment

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[728] *Allied Tube*, 486 U.S. at 503.

[729] Id. at 499.

[730] Id. at 499-500 (noting that although antitrust immunity applies to "unethical and deceptive" conduct used to influence legislature, "in less political arenas, unethical and deceptive practices can constitute abuses of administrative or judicial processes that may result in antitrust violations"). See also *California Motor Transport*, 404 U.S. at 512-13 (noting that "unethical conduct in the setting of the adjudicatory process often results in sanctions" and that "[m]isrepresentations, condoned in the political arena, are not immunized when used in the adjudicatory process"). But cf. *Professional Real Estate*, 508 U.S. at 62 n.6 ("We need not decide here whether and, if so, to what extent *Noerr* permits the imposition of antitrust liability for a litigant's fraud or other misrepresentations.").

rights, and no one denied that the higher wages the lawyers sought would do just that. In the class action context, by contrast, if the anticompetitive allegations are correct, the lawyers are acting at the expense of their clients and, in particular, their clients' own right of petition under the First Amendment. One would think that if ever there were a case in which a court would hesitate to apply *Noerr* immunity, it would be when applying such immunity could harm the First Amendment rights of other petitioners to whom the defendants owed fiduciary obligations.

The one case that has considered the applicability of *Noerr* immunity in the context of settlement, though not an antitrust case, supports the interpretation we advocate here. That case is *Wright v. DeArmond*,[731] a successor case to the *Derrickson*[732] case discussed above in connection with collateral estoppel.[733] In *Wright*, a habeas corpus action, the Court of Appeals for the Seventh Circuit held that *Noerr* did not bar the state of Illinois from prosecuting city commissioners and the city's lawyer for violating state conflict of interest laws in negotiating a settlement on behalf of the city in a federal Voting Rights Act suit.[734] The officials had argued that because they submitted the settlement, which kept them on the city payroll as "administrators," to a federal district court for approval, they were engaging in protected "petitioning" activity analogous to the type of activity protected by *Noerr*.[735]

The court started from the proposition that the officials "were prosecuted because they participated in the negotiation of a settlement agreement which involved . . . their private employment interests."[736] It then held *Noerr* inapplicable for two reasons. First, the court found that the petitioning by the officials was analogous to sham petitioning. The officials had used their bargaining leverage "to obtain personal benefits" and because

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731 977 F.2d 339 (7th Cir. 1992), cert. denied, 507 U.S. 1051 (1993).

732 Derrickson v. City of Danville, 845 F.2d 715 (7th Cir. 1988)].

733 See supra text accompanying notes 296-305 (claim preclusion), 347-351 (issue preclusion), 358-359 (issue preclusion), 373-380 (equitable estoppel), 392-398 (equitable estoppel), 404-408 (equitable estoppel).

734 *Wright*, 977 F.2d at 345-49.

735 Id. at 344-45.

736 Id. at 345.

their "petition to the court was a petition for approval of this illegal and fraudulent act . . . [it amounted to] 'unethical conduct in the setting of the adjudicatory process,' analytically analogous to the sort of conduct held to be unprotected by the First Amendment in *California Motor Transport*."[737] Second, the court noted that the officials retained their rights to petition the government for jobs with the city, but could "not do so while simultaneously representing the interest of the government."[738]

Although the court's first argument misconstrues and misapplies the sham exception,[739] the reasoning and result of the case are consistent with Supreme Court precedent and the argument presented here. Like the defendants in *Allied Tube* and *Trial Lawyers*, the city officials in *Wright* engaged in unlawful, self-interested conduct that was separable from any petitioning activity. Nothing prevented the city officials from petitioning the government to further their own interests. The fact that the unlawful conduct did not cause harm that preceded or was independent from court approval of the settlement did not make *Noerr* applicable. Because the Voting Rights Act did not preempt or otherwise displace state conflict of interest rules (as the court implicitly held),[740] the mere fact that the officials asked a court to approve a settlement in a Voting Rights Act case did not create *Noerr* immunity. The *Wright* court also recognized the greater scope for condemning "unethical" methods in the judicial context that *Allied Tube* suggests. Finally, the officials

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[737] Id. at 348 (quoting *California Motor Transport*, 404 U.S. at 512).

[738] Id. at 348-49.

[739] As noted above, the Court has limited the sham exception to cases in which the petitioner is not seeking the result of the governmental action. See supra notes 690-695 and accompanying text. *Allied Tube*, which first articulated this notion of sham, had already been decided when *Wright* was litigated. The *Wright* court did try to shoehorn its holding into this notion of sham by focusing on the fact that the city officials "had no hope of successfully defending against" the Voting Rights Act suit. *Wright*, 977 F.2d at 348. But this fact had absolutely nothing to do with the "leverage" the court spoke of. In fact, as the dissenting judge correctly recognized, the settlement if anything avoided sham litigation. Id. at 349 (Bauer, C.J., dissenting). Nor was the assertion of sham relevant to the court's argument that the officials retained the petitioning rights *Noerr* sought to protect.

[740] The dissenting judge concluded that "[i]f the Illinois statutes are in conflict with the settlement, and I conclude they are not, then the state statutes should give way to the policy of the federal law." *Wright*, 977 F.2d at 349 (Bauer, C.J., dissenting). The majority did not respond directly to Judge Bauer's contention.

by writing a settlement that feathered their own nests might very well have acted at the expense of the interests of the city to which they owed fiduciary obligations. In all these respects, the conduct in *Wright* is analogous to the anticompetitive conduct we have identified in connection with class action settlements, and supports our argument that *Noerr* immunity should not apply to lawyer anticompetitive conduct in class actions.

Although the antitrust immunity doctrines we have discussed are varied and somewhat complex, our argument that they do not apply to lawyer conduct in class actions is straightforward and simple. The market in which lawyers compete is separate from any market the courts seek to regulate through the class action device. And there is no intention on the part of any authoritative government body, either at the state or the federal level, to restrict competition in those separate lawyer markets. This argument complements the argument in Part III concerning collateral estoppel. Just as lawyers are incidental to and separate from the litigational features of the class action for collateral estoppel purposes, so they are incidental to and separate from the regulatory features of the class action for antitrust purposes. Although lawyers may instigate, orchestrate, and dominate class actions, in the final analysis they are just lawyers—lawyers who may not cloak their unlawful conduct in judicial approval of a settlement in which they participate.

CONCLUSION

In the Preface to *Bleak House*,[741] Dickens reported a Chancery Judge's defense of his court: "though the shining subject of much popular prejudice [the court and its processes were] almost immaculate." Any "trivial blemish . . . was exaggerated and had been entirely owing to 'the parsimony of the public.'"[742] Dickens found this "too profound a joke to be inserted in the body of [the novel]."[743] But had he chosen to insert it in the

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[741] Charles Dickens, Bleak House (Signet Classic ed. 1980) (1853).

[742] Id. at vii.

[743] Id. Dickens explained that "everything set forth in [the novel] concerning the Court of Chancery [in which the Jarndyce case is set] is substantially true, and within the truth." Id. To back up his statement he described several cases pending in that court as of 1853 in which the money absorbed by the lawyers was exorbitant. One

mouth of some appropriately odious character, he said he might have coupled it with the following lines from Shakespeare:

> My nature is subdued
>
> To what it works in, like the dyer's hand:
>
> Pity me, then, and wish I were renewed![744]

We believe that those who claim that only trivial blemishes mar our system for settling class actions are as deluded, or as eager to delude, as was Dickens' Chancery Judge. We write to show the dyer his hand and to offer a scrub brush with which he might clean it.

EPILOGUE

Much has happened as this Article was proceeding through the editing process. With so much breaking news, we decided to append this Epilogue, which allowed us to include several last minute developments.

In the fall of 1995, Dexter Kamilewicz of Maine, his wife, Gretchen, and Martha Preston of Wisconsin (the *Kamilewicz* plaintiffs) filed a class action suit against Bank of Boston, its lawyers and class counsel, who had purported to represent them in the *Hoffman v. BancBoston Mortgage Corporation*[745] class action suit filed and settled in an Alabama state court. These plaintiffs, on behalf of themselves and the other class members in *Hoffman*, sued the bank, its lawyers and class counsel for negotiating a class settlement that allegedly cost many class members more money than they recovered from the settlement and allegedly resulted in all class members being charged in attorney's fees more than one-third of the economic benefit conferred on them by the suit.[746]

The *Kamilewicz* plaintiffs brought suit in federal district court in Chicago because that is where the two law firms that served

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case involved 30 or 40 lawyers and costs of 70,000 (1853) pounds had been thus far incurred; in the other, "more than double [that amount] has been swallowed up in costs." Id. at viii.

[744] Id. at vii (quoting, with slight alterations, William Shakespeare, Sonnet cxi).

[745] No. CV-91-1880 (Ala. Cir. Ct. Jan. 24, 1994).

[746] Kamilewicz v. Bank of Boston Corp., No. 95-C6341, 1995 U.S. Dist. LEXIS 18973, at *1-*9 (N.D. Ill. Dec. 15, 1995).

as lead counsel in *Hoffman* were located.[747] The suit alleged violations of RICO, a conspiracy to deprive the plaintiffs of their constitutional rights to due process and property, fraud, breach of fiduciary duty, and malpractice.[748] The defendants promptly filed a motion to dismiss the federal suit, but the *Hoffman* class counsel went further—all the way to Alabama. The *Hoffman* class counsel asked the Alabama court to order the *Kamilewicz* plaintiffs to show cause in Alabama state court as to why they were not bound by that court's approval of the class settlement and thus, inferentially, estopped from proceeding in federal court. The Alabama court scheduled a hearing on this order for December 18, 1995, while the motion to dismiss the federal suit was pending. The *Kamilewicz* plaintiffs responded by asking the federal district court in Chicago to enjoin the Alabama court from proceeding.[749]

The federal district court in Chicago scheduled a hearing for Friday, December 15, before the Alabama court's Monday morning show-cause hearing was to be held, and dismissed the plaintiffs' complaint. The district court held that it lacked subject matter jurisdiction over the complaint because the complaint was in the nature of an appeal from the state court approval of the settlement, and, under the *Rooker-Feldman* doctrine,[750] federal district courts lack jurisdiction over matters that are in essence appeals of state court rulings.[751] He thus refused to enjoin the Monday morning Alabama hearing. That hearing was held, although the *Kamilewicz* plaintiffs did not show up, refusing to submit to the jurisdiction of the Alabama court, which they claimed had no right to have ordered money withdrawn from their escrow accounts in *Hoffman* and now had no right to order them to forego their federal suit. The Alabama court proceeded without them.

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[747] Id. at *2-*3.

[748] Id. at *9-*10.

[749] Id. at *10-*11.

[750] The *Rooker-Feldman* doctrine, derived from Rooker v. Fidelity Trust Co., 263 U.S. 413 (1923), and District of Columbia Court of Appeals v. Feldman, 460 U.S. 462 (1983), holds that the only federal court authorized to exercise appellate review over a state court's civil litigation judgment is the Supreme Court of the United States.

[751] *Kamilewicz,* No. 95-C6341, 1995 U.S. Dist. LEXIS 18973, at *17.

The same Alabama state court judge who had approved the *Hoffman* settlement held the hearing and issued an opinion that stated he had two matters before him: the motion from Edelman to show cause, and the allegations in the federal complaint, which he decided to treat as if they had been made by the *Kamilewicz* plaintiffs in a motion for relief from a judgment under Alabama's Rule 60(b).[752] The Alabama judge decided that the allegations in the federal complaint were baseless; reaffirmed his prior ruling that the settlement was fair and the attorney's fees awarded were proper; and ended by ordering the *Kamilewicz* plaintiffs not to "reassert[ ] the claims dismissed in the Federal Class Action in *any* forum.[753]

The *Kamilewicz* plaintiffs, nonetheless, appealed the federal district court order to the Seventh Circuit. This time they were joined by nine state Attorneys General, who filed an amicus brief urging the court to reverse the district court's dismissal. The *Kamilewicz* plaintiffs and the Attorneys General argued that the *Kamilewicz* plaintiffs' allegations were not in the nature of an appeal, but were independent actions not subject to the *Rooker-Feldman* bar and that, in any event, *Rooker-Feldman* was inapplicable to any state court judgment entered without proper personal jurisdiction over the parties who now sought to challenge that ruling. The *Kamilewicz* plaintiffs claimed the jurisdiction of the Alabama court was defective under *Phillips Petroleum Company v. Shutts*[754] because the Notice they re ceived did not tell them that they might lose money or that attorney's fees might be well in excess of one-third of the economic benefit, and that they were consequently denied their constitutional right to opt out. Moreover, they claimed they could not be considered parties to the Alabama proceeding because they were absent class members denied adequate representation by their lawyers' self-dealing, and *Hansberry v. Lee*[755] says that without adequate representation absent class members are not to be considered parties to the class action.[756] Put an-

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[752] Ala. R. Civ. P. 60(b).

[753] Hoffman v. BancBoston Mortgage Corp., No. CV-91-1880, at 7, 10 (Ala. Cir. Ct. Jan. 30, 1996) (emphasis added) (on file with the Virginia Law Review Association).

[754] 472 U.S. 797 (1985).

[755] 311 U.S. 32 (1940).

[756] See Brief of Plaintiffs-Appellants at 14-32, Kamilewicz v. Bank of Boston Corp.,

other way, the *Kamilewicz* plaintiffs were saying that the Alabama state court judgment could not be given any effect through the doctrine of *Rooker-Feldman* or any other doctrine because out-of-state residents who are denied their rights under *Shutts* (and any absent class member denied adequate representation under *Hansberry*) must be treated as any out-of-state residents who lack minimum contacts with the forum state court; they are free to ignore the judgment of the state court because it is null and void as to them. An incontrovertible proposition, or so one would have thought.

The Seventh Circuit did not, however, think, or so it appears to us. In a unanimous opinion, the Seventh Circuit affirmed the dismissal, holding that *Rooker-Feldman* barred the action in federal court.[757] The opinion by Judge Evans, joined by Judges Cummings and Ripple, is remarkable for its failure to justify its conclusions. For example, the Attorneys General argued (as did the *Kamilewicz* plaintiffs) that the *Kamilewicz* plaintiffs were free to attack the Alabama judgment in any way they chose, just as a party is free to attack a default judgment entered against him without personal jurisdiction. The response by the court: "We see significant differences between default judgments and the judgment under attack here."[758] That's it. The panel chose to give no explanation of what those differences might be. The court did explain that Alabama had a procedure by which "a litigant can assert an independent action for fraud upon the court . . . . Alabama Rule 60(b)."[759] Of course, that assumes that these absent, out-of-state class members had been "litigants," a proposition that seems to assume the jurisdictional point at issue and to run counter to the teachings of *Shutts* and *Hansberry*.

Before the Seventh Circuit issued its opinion—indeed before the briefs were filed in the appeal—the *Hoffman* class counsel was back in Alabama, this time to file suit against the *Kamilewicz* plaintiffs for malicious prosecution and abuse of process for

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92 F.3d 506 (7th Cir. 1996) (No. 96-1019); Brief of Amici Curiae at 6-19, *Kamilewicz* (No. 96-1019).

[757] Kamilewicz v. Bank of Boston Corp., 92 F.3d 506, 512 (7th Cir. 1996).

[758] Id. at 510.

[759] Id. at 511.

their actions in connection with the federal suit. They also sued the lawyers for the *Kamilewicz* plaintiffs in the federal suit. The suit sought damages of $25 million or thereabouts.[760] Now the *Kamilewicz* plaintiffs needed another set of lawyers and their lawyers in the federal action needed lawyers too; by now it seemed clear to at least the authors of this Article that Alabama had its own notion of "justice" and so the Alabama suit needed to be taken quite seriously. This new set of lawyers for the *Kamilewicz* plaintiffs—the third since the beginning of this ordeal—asked the Alabama court to dismiss the malicious prosecution suit, hoping that even in Alabama a suit in federal court backed by nine Attorneys General and pending on appeal would be seen as a ridiculous candidate for a malicious prosecution suit. And then everyone waited.

The very day that the Seventh Circuit affirmed the district court's dismissal, the Alabama trial court ruled that the Alabama malicious prosecution case could proceed. Discovery was ordered and legal bills began to pile up in earnest. The *Kamilewicz* plaintiffs petitioned the Seventh Circuit for rehearing by the panel or en banc. With no dissent from the panel opinion, this appeared a long shot, but they decided to try. The day after the rehearing petition was filed, the Seventh Circuit ordered the federal defendants to reply. Someone up there was paying attention. Weeks passed: three, six, nine, twelve.

In the meantime, without knowing about the *Kamilewicz* case, another absent class member had filed suit against the Bank of Boston for the Bank's involvement in the *Hoffman* settlement. Ted Benn, a corporate lawyer from Dallas, Texas, filed suit in state court in Texas, alleging that the bank deducted about $144

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[760] See Complaint, Edelman v. Wildman, Harrold, Allen & Dixon, No. CV-96-91 (Ala. Cir. Ct.) (copy on file with the Virginia Law Review Association).

from his escrow account in connection with the settlement in Alabama and deposited zero dollars in recovery. He alleged that he had read the Notice, just as our fictional law professor had, had understood that he was in the subclass entitled to zero recovery and had figured that he would owe no attorney's fees because one-third of zero is zero. He had thus not opted out. Then, he alleged that he had over $100 deducted from his escrow account, as a miscellaneous disbursement, which turned out to be money paid to the class lawyers as attorney's fees. He tried to get the Bank to return this money to him and when the Bank refused, he sued.[761]

The Bank, fresh off its victory before the district court in Chicago, removed Benn's case to federal court and then—pay attention here—sought to have the federal district court in Dallas dismiss the suit *with prejudice*, on the grounds that under the *Rooker-Feldman* doctrine the suit could not be brought in federal court![762] Moreover, while this motion was pending, the Bank, taking a page from the *Hoffman* class counsel's book, petitioned the Alabama state court for relief, arguing that Benn, like the *Kamilewicz* plaintiffs, was bound not to challenge the Alabama judgment in any other court. Once again, the Alabama court obliged,[763] although Benn, like the *Kamilewicz* plaintiffs, refused to recognize the Alabama court's right to order him to do anything and did not show up for the hearing in Alabama on the Bank's motion—a motion in effect for Alabama to enjoin a Texas citizen from proceeding against the Bank in any federal court *or* in Texas state court, which motion the Alabama court granted, a fact we repeat because it may be difficult to believe.

When Benn asked the federal district court in Texas to enjoin the Bank from proceeding against him in Alabama, the district court judge apparently became as eager to rid herself of this case as the district judge in Chicago had been when the *Kamilewicz* plaintiffs made a similar request of him. She

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[761] Benn v. BancBoston, No. 3:96-CV-0974-J, at 2-4 (N.D. Tex. Oct. 4, 1996) (Order Denying In Part Defendant's Motion to Dismiss) (on file with the Virginia Law Review Association).

[762] Id. at 4-5.

[763] Hoffman v. BancBoston Mortgage Corp., No. CV-91-1880 (Ala. Cir. Ct. Oct. 17, 1996) (on file with the Virginia Law Review Association).

promptly issued an opinion, tracking that of the panel in the Seventh Circuit, but refused the request to dismiss with prejudice and remanded the fraud and breach of fiduciary claims filed by Benn back to Texas state court.[764] Back in state court, Benn decided to join Fannie Mae as a defendant, alleging, inter alia, that Fannie Mae, the owner and holder of Benn's mortgage, was responsible for the actions of the bank, its agent—the servicer of the mortgage. That addition landed Benn back in federal court. Fannie Mae removed the case again, the district court's recent opinion that it lacked subject matter jurisdiction notwithstanding. Moreover, according to Benn, the bank consented to this removal in writing. Fannie Mae apparently removed to federal court with the further plan to have the case transferred to Chicago, where cases involving escrow practices across the nation have been transferred for consolidation by the panel on Multi-District Litigation.

Benn intends to argue that his case is essentially about fraud in the course of a settlement, not escrow practices, and to fight transfer to Chicago. He also intends to argue that the law of the case is that the federal court lacks subject matter jurisdiction over this dispute under the misguided application of *Rooker-Feldman*. Just as Benn was ordered back to federal court for the second time, the Seventh Circuit finally decided the rehearing petition in *Kamilewicz*.

The petition was denied.[765] The *Kamilewicz* plaintiffs learned of that order on November 22, 1996, the day it was issued. But there was a dissent. Finally, some support, and formidable support it was. Judge Easterbrook, joined by Chief Judge Posner and Judges Manion, Rovner and Wood, filed a forceful and detailed dissent, which took serious issue with the panel's failure to see the *Kamilewicz* plaintiffs as analogous to those against whom a default judgment had been entered. Judge Easterbrook first considered the federal plaintiffs claims against the bank, which he apparently considered to be in the nature of a collateral attack on the state judgment:

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[764] Benn v. BancBoston, No. 3:96-CV-0974-J, at 12.

[765] Kamilewicz v. Bank of Boston Corp., No. 96-1019, at 2 (7th Cir. Nov. 22, 1996) (Order denying Petition for Rehearing En Banc) (on file with the Virginia Law Review Association).

> Collateral attacks based on lack of personal or subject-matter jurisdiction are proper, no less in class actions than in other cases—indeed, they are especially appropriate where class members are stunned to find that, although aligned as plaintiffs, they are net losers, just as if the original defendants had filed and prevailed on a counterclaim of which they received no notice and over which the state court had no jurisdiction. In effect, though not in name, this was a defendant class, attempting (unbeknownst to its members) to fend off predatory lawyers' claims to the balances in the escrow accounts.[766]

We agree, although we have also argued that, questions of personal and subject matter jurisdiction aside, the claim against the bank should not be collaterally estopped. Because Judge Easterbrook was analyzing this case under *Rooker-Feldman*, which the Seventh Circuit has held is not coextensive with the doctrines of claim and issue preclusion,[767] his analysis does not conflict with our argument on estoppel. On the other hand, we did not consider whether *Rooker-Feldman* barred challenges in federal court to state court settlements because frankly that issue did not even occur to us until the defendants raised it in the district court. Once it was raised, we decided not only that *Rooker-Feldman* properly applied should not bar federal courts from taking jurisdiction (as Judge Easterbrook and his four colleagues said), but that the issue was not worth separate discussion because even if federal courts lacked jurisdiction over state court settlements, state courts would not. Thus, some court could entertain the later suits we were discussing as long as we showed that issue and claim preclusion did not bar such suits.

And Judge Easterbrook's dissent supports our preclusion argument as to malpractice actions against class counsel as we wonld have predicted from his opinion in *Derrickson v. City of Danville*.[768] In his *Kamilewicz* dissent from the denial of rehearing, he wrote:

> Next consider plaintiffs' claim against the *Hoffman* class counsel, which is not a collateral attack on a judgment. It takes

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[766] Id. at 5 (Easterbrook, J., dissenting).

[767] See, e.g., GASH Associates v. Village of Rosemont, 995 F.2d 726, 728-29 (7th Cir. 1993), and cases cited therein.

[768] 845 F.2d 715 (7th Cir. 1988).

the judgment as a given—indeed, it is only so long as the judgment stands that the litigant has a compensable loss. Neither state nor federal law requires a malpractice suit to be filed in the same court that handled the initial litigation. The *Rooker-Feldman* doctrine therefore does not apply to malpractice suits, which may be litigated in federal courts without regard to the location of the initial case. If the panel is right, no malpractice suit growing out of state litigation in which the judge awarded attorneys' fees—maybe no malpractice suit, period—may be brought in federal court, even if all requirements of the diversity jurisdiction have been satisfied. This holding is sufficiently troubling and affects so many other cases that it is worth the time of our court to consider the subject en banc.

. . . .

. . . The attorneys representing the *Hoffman* class were not parties to the Alabama case. Neither were the class members. Absent class members are represented by the named plaintiffs and their lawyers, but they aren't parties, a point reflected in federal litigation by disregarding their citizenship. They are ignored in negotiating settlements as well. A real party's lack of assent means that there is no settlement; but the missing class members don't sign the settlement, and their objection is not dispositive. It is crammed down the throats of objectors, which cannot be done to real parties. . . . For some purposes missing class members are treated *like* parties, but only if the named plaintiffs adequately represent the interests of the class, and only if the unnamed members of the class receive adequate notice and elect not to opt out—which in this case is the very thing in dispute! It gets the cart before the horse to reject, as barred by a judgment, an effort by the absent class members to show that they were not properly brought into the state case and therefore are not affected by the judgment.

From all of this it follows that a malpractice action is not affected by the *Rooker-Feldman* doctrine. Does the fairness hearing required to approve the settlement of a class action make a difference? I think not. For the reasons just explained, absent class members (*especially* those who deny the state court's jurisdiction over them) are not parties and cannot be treated as bound by the findings implicit in the approval of the settlement and the award of fees to attorneys. . . .

> All jurisdictional doubts to one side, a settlement followed by a fairness hearing remains more like a contract than like litigation. Accordingly there is even less reason to apply the *Rooker-Feldman* doctrine than in a normal malpractice case, where the loss ensues from a genuine contest. Representative plaintiffs and their lawyers may be imperfect agents of the other class members—may even put one over on the court, in a staged performance. The lawyers support the settlement to get fees; the defendants support it to evade liability; the court can't vindicate the class's rights because the friendly presentation means that it lacks essential information. . . .
>
> The Kamilewicz class asserts that it suffered harm from the *Hoffman* class lawyers' breach of their duties of care and loyalty in negotiating the settlement, which was concealed from the Alabama judge (and the class) by a further breach of the duty of loyalty in drafting the notice about the settlement. The notice not only didn't alert the absent class members to the impending loss but also pulled the wool over the state judge's eyes. Suing faithless agents is far from the core of the *Rooker-Feldman* doctrine, which should not be extended to block suits like this. . . .
>
> . . . If the *Rooker-Feldman* doctrine applies to suits by the absent class members because a malpractice action is a collateral attack on the order approving the settlement and awarding attorneys' fees, then the law of preclusion (res judicata) should bar malpractice actions in any court, state or federal, and without regard to which judicial system handled the first case. Yet no one thinks that. A malpractice suit is an independent action. A (potential) defense of issue preclusion is defeated by the very theory of the claim: that the first judgment is unreliable because of the attorney's bungling. The bungler cannot point to the adverse judgment produced by his own incompetence to ward off the client's demand. The Kamilewicz class may fail in its proof, or it may encounter other obstacles, but the *Rooker-Feldman* doctrine does not close the door of the federal courthouse.[769]

The *Kamilewicz* plaintiffs must now decide whether to risk further repurcussions in Alabama by seeking certiorari from the Supreme Court. Mr. Benn has to fight transfer and decide what

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[769] *Kamilewicz*, No. 96-1019, at 6-11 (Easterbrook, J., dissenting) (citations omitted).

position to take on *Rooker-Feldman* in this second round for him in federal court. That is the stage of play as we go to press.

And what do we make all of this? A significant number of judges, as we feared, prefer to twist the law out of all recognizable shape and subject ordinary citizens to outrageous treatment at the hands of foreign courts and unwanted "champions" rather than face the reality of class action abuse and improperly approved class settlements. We have in mind particularly the majority of judges on the Seventh Circuit who, despite a powerful dissent, were willing to leave Dexter and Gretchen Kamilewicz, Martha Preston, and the lawyers who tried to help them by bringing suit in federal court to the not-so-tender mercies of the Alabama court system, which had already harmed the Kamilewicz's and Preston—at least in their eyes. On the other hand, five judges did dissent. We can only hope that the publication of this Article will help more judges see what needs to be done and will help tear down the facade of estoppel law that some would use as an excuse not to do it.

EXHIBIT H

DO CLASS ACTIONS BENEFIT CLASS MEMBERS?

An Empirical Analysis of Class Actions

December 11, 2013

Prepared for the U.S. Chamber Institute for Legal Reform by
Mayer Brown LLP

Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions

By Mayer Brown LLP

Executive Summary

This empirical study of class action litigation—one of the few to examine class action resolutions in any rigorous way—provides strong evidence that class actions provide far less benefit to individual class members than proponents of class actions assert.

The debate thus far has consisted of competing anecdotes. Proponents of class action litigation contend that the class device effectively compensates large numbers of injured individuals. They point to cases in which class members supposedly have obtained benefits. Skeptics respond that individuals obtain little or no compensation and that class actions are most effective at generating large transaction costs—in the form of legal fees—that benefit both plaintiff and defense lawyers. They point to cases in which class members received little or nothing.

Rather than simply relying on anecdotes, this study undertakes an empirical analysis of a neutrally-selected sample set of putative consumer and employee class action lawsuits filed in or removed to federal court in 2009.[1]

Here's what we learned:

- In our entire data set, ***not one of the class actions ended in a final judgment on the merits for the plaintiffs***. And none of the class actions went to trial, either before a judge or a jury.
- The vast majority of cases produced ***no benefits to most members of the putative class***—even though in a number of those cases the lawyers who sought to represent the class often enriched themselves in the process (and the lawyers representing the defendants always did).
    - ***Approximately 14 percent of all class action cases remained pending four years after they were filed***, without resolution or even a determination of whether the case could go forward on a class-wide basis. In these cases, class members have not yet received any benefits—and likely will never receive any, based on the disposition of the other cases we studied.
    - ***Over one-third (35%) of the class actions that have been resolved were dismissed voluntarily by the plaintiff***. Many of these cases settled on an individual basis, meaning a payout to the

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[1] For information about our methodology, see Appendix C.

individual named plaintiff and the lawyers who brought the suit—***even though the class members receive nothing***. Information about who receives what in such settlements typically isn't publicly available.

- ***Just under one-third (31%) of the class actions that have been resolved were dismissed by a court on the merits***—again, meaning that class members received ***nothing***.

- ***One-third (33%) of resolved cases were settled on a class basis.***
  - This ***settlement rate is half the average for federal court litigation,*** meaning that a class member is far less likely to have even a chance of obtaining relief than the average party suing individually.
  - ***For those cases that do settle, there is often little or no benefit for class members***.
  - What is more, ***few class members ever even see those paltry benefits—particularly in consumer class actions***. Unfortunately, because ***information regarding the distribution of class action settlements is rarely available***, the public almost never learns what percentage of a settlement is actually paid to class members. But of the six cases in our data set for which settlement distribution data was public, ***five delivered funds to only miniscule percentages of the class: 0.000006%, 0.33%, 1.5%, 9.66%, and 12%.*** Those results are consistent with other available information about settlement distribution in consumer class actions.
  - Although some cases provide for automatic distribution of benefits to class members, automatic distribution almost never is used in consumer class actions—only ***one of the 40*** settled cases fell into this category.
  - Some class actions are settled without even the potential for a monetary payment to class members, with the settlement agreement providing for ***payment to a charity or injunctive relief that, in virtually every case, provides no real benefit to class members***.

The bottom line: The hard evidence shows that class actions do not provide class members with anything close to the benefits claimed by their proponents, although they can (and do) enrich attorneys. Policymakers who are considering the efficacy of class actions cannot simply rest on a theoretical assessment of class actions' benefits or on favorable anecdotes to justify the value of class actions. Any decision-maker wishing to rest a policy determination on the

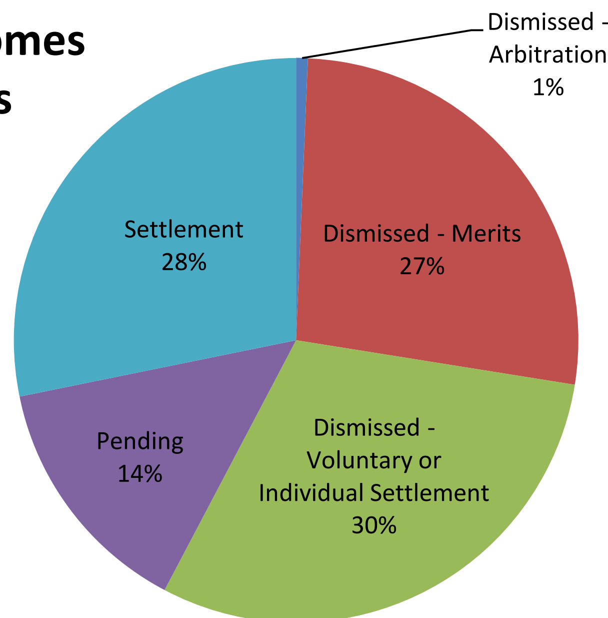
claimed benefits of class actions would have to engage in significant additional empirical research to conclude—contrary to what our study indicates—that class actions actually do provide significant benefits to consumers, employees, and other class members.

Results

Overall Outcomes

Of the 148 federal court class actions we studied that were initiated in 2009, 127 cases (or nearly 86 percent) had reached a final resolution by September 1, 2013, the date when the study closed.

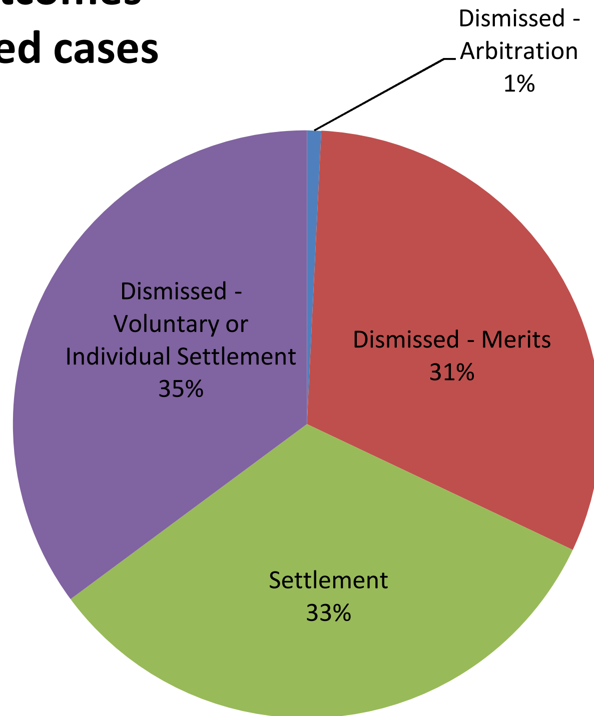
Figure 1: Outcomes in 148 cases



Zero* cases resulted in a judgment on the merits**. Of the 148 cases in our sample set, ***not one had gone to trial—either before a judge or jury. And, as of the closing date of our study, ***not one resulted in a judgment for the plaintiffs on the merits***.

Unlike ordinary (non-class) disputed cases, some of which end with a judgment on the merits in favor of the plaintiffs or defendants, class actions end without any determination of the case's merits. The class action claims that make it past the pleadings stage and class-certification gateway virtually always settle—regardless of the merits of the claims.

Figure 2: Outcomes in 127 resolved cases



Indeed, Justice Ruth Bader Ginsburg has recognized that "[a] court's decision to certify a class * * * places pressure on the defendant to settle even unmeritorious claims."[2] Then-Chief Judge Richard Posner of the U.S. Court of Appeals for the Seventh Circuit explained that certification of a class action, even one lacking in merit, forces defendants "to stake their companies on the outcome of a single jury trial, or be forced by fear of the risk of bankruptcy to settle even if they have no legal liability."[3] And Judge Diane Wood of the Seventh Circuit has explained that certification "is, in effect, the whole case."[4] That may be why another study of class

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[2] *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 559 U.S. 393, 445 n.3 (2010) (Ginsburg, J., dissenting).

[3] *In re Rhone-Poulenc Rorer Inc.,* 51 F.3d 1293, 1299 (7th Cir. 1995).

[4] Hon. Diane Wood, Circuit Judge, Remarks at the FTC Workshop: Protecting Consumer Interests in Class Actions (Sept. 13–14, 2004), in *Panel 2: Tools for Ensuring that Settlements are "Fair, Reasonable, and Adequate,"* 18 Geo. J. Legal Ethics 1197, 1213 (2005).

actions reported that "[e]very case in which a motion to certify was granted, unconditionally or for settlement purposes, resulted in a class settlement."[5]

Fourteen percent of the class actions filed remain unresolved. Even though our study period encompassed more than 44 months since the filing of the last case in our sample (and 55 months from the filing of the first case), a significant number of cases—21 of the 148 in our sample, or 14%—remained pending with no resolution, let alone final judgment on the merits.[6]

And there is no reason to believe that these cases are more likely to yield a benefit for class members than the cases that have been resolved thus far. In 15 of these cases either no motion for class certification has been filed or the court has not yet ruled on the motion, and in another 2 the court denied certification. In a significant proportion of these pending cases, it seems likely that class certification will be denied or never ruled upon before the case is ultimately dismissed. After all, prior studies indicate that nearly 4 out of every 5 lawsuits pleaded as class actions are not certified.[7]

Over one-third of the class actions that have been resolved were dismissed voluntarily by the named plaintiff and produced no relief at all for the class. Forty-five cases were voluntarily dismissed by the named plaintiff who had sought to serve as a class representative or were otherwise resolved on an individual basis. That means either that the plaintiff (and his or her counsel) simply decided not to pursue the class action lawsuit, or that the case was settled on an individual basis, without any benefit to the rest of the class. These voluntary dismissals represent 30 percent of all cases studied, or 35 percent of cases that reached a resolution by the beginning of September 2013.[8]

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[5] Emery G. Lee III et al., *Impact of the Class Action Fairness Act on the Federal Courts: Preliminary Findings from Phase Two's Pre-CAFA Sample of Diversity Class Actions* at 11 (Federal Judicial Center 2008), http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/Preliminary%20Findings%20from%20Phase%20Two%20Class%20Action%20Fairness%20Study%20%282008%29.pdf (discussing 30 such cases).

[6] These results are broadly consistent with other studies of class actions. *See, e.g., id.* at 6 (noting that 9% of cases remained pending after at least 3.5 years).

[7] *See* Thomas E. Willging & Shannon R. Wheatman, *Attorney Choice of Forum in Class Action Litigation: What Difference Does it Make?*, 81 Notre Dame L. Rev. 591, 635-36, 638 (2006).

[8] In one of the cases we studied, the court compelled arbitration of the named plaintiff's claims—a determination that almost always precludes class treatment of the case.

In fourteen of the cases that were voluntarily dismissed—approximately one-third of all voluntary dismissals in the data set—the dismissal papers, other docket entries, or contemporaneous news reports made clear that the parties were settling the claim on an individual basis, although the terms of those settlements were not available. Many of the remaining voluntary dismissals also may have resulted from individual settlements.

These settlements often provide that the plaintiff—and his or her attorney—receive recoveries themselves, even though the rest of the class that they sought to represent receive ***nothing***. When parties settle cases on an individual basis, those settlements often are confidential, and the settlement agreements therefore are not included on the court's public docket.[9]

Just under one-third of the class actions that have been resolved were dismissed on the merits. In addition to the 45 cases dismissed voluntarily by plaintiffs, 41 cases were dismissed outright by federal courts, through a dismissal on the pleadings or a grant of summary judgment for the defendant. The courts in these cases concluded that the lawsuits were meritless before even considering whether the case should be treated as a class action. These represented 27 percent of all cases studied, and 31 percent of resolved cases.

In other words, ***in over half of all putative class actions studied—and nearly two-thirds of all resolved cases studied—members of the putative class received zero relief***. These results are depicted in Figures 1 and 2, which appear below. And these results are broadly consistent with other empirical studies of class actions. If anything, for reasons explained in Appendix C, abusive, illegitimate class actions are probably under-represented in our sample, and the sample therefore probably significantly ***overstates*** the extent to which class

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[9] Unlike class settlements under Federal Rule of Civil Procedure 23, which must be publicly disclosed and approved by the court, individual settlements of lawsuits in federal court need not be disclosed publicly, nor is court approval required. Typically, parties that agree to settle claims on an individual basis in a lawsuit pending in federal court—whether or not those claims are part of a class action—enter into confidential settlement agreements, a condition of which is that the named plaintiff will voluntarily dismiss his or her individual claims with prejudice; remaining claims that were purported to have been brought on behalf of a class may be dismissed without prejudice with respect to other class members, who may or may not assert the claim in subsequent litigation.

members benefit from the class action. For comparison, another study found that ***84% of class actions ended without any benefit to the class***.[10]

Fewer than thirty percent of the cases filed were settled. All of the remaining class actions that have been concluded were settled on a class-wide basis: The parties reached settlements in 40 cases—28% of all cases studied, or 33% of all resolved cases.[11]

This subset of class actions is the only one in our study in which it is possible that absent class members could possibly receive any benefit at all. As we next discuss, however, the benefits claimed to be associated with such settlements are largely illusory.

Class Settlements

Class actions have a significantly lower settlement rate than other federal cases. The settlement rate for our sample of cases—33% of resolved cases—is much lower than for federal court litigation as a whole. One study of federal litigation estimated that "the aggregate settlement rate across case categories" for two districts studied was "66.9 percent in 2001-2002."[12] Even the least frequently settled case category in that study—constitutional litigation—had a higher settlement rate (39%) than the 33% for the class action cases we studied.[13]

Thus, ***class actions are significantly less likely to produce settlements, and therefore significantly less likely to produce any benefit to class members, than other forms of litigation.*** Settlement is the only resolution that produces even the possibility of a benefit to class members, because class actions are virtually never resolved though judgments on the merits, a fact that our study corroborates. And the settlement rate in our sample set is not an outlier: a study of

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10 *See, e.g.,* Lee et al., *supra* note 5, at 6 (noting that in cases not remanded, 55% of cases were voluntarily dismissed without class certification or class settlement, and another 29% were dismissed by the court).

11 This category includes one case in which the parties have announced a class settlement and sought preliminary approval; five cases in which the court has granted preliminary approval (but has not yet finally approved it); one case that resulted in a settlement to fewer than all plaintiff class members; and two cases in which appeals are pending.

12 Theodore Eisenberg and Charlotte Lanvers, *What is the Settlement Rate and Why Should We Care?,* 6 J. Empir. Leg. Stud. 111, 115 (2009).

13 *Id.* at 133.

class actions brought in California state court in 2009 reported a similarly low settlement rate of 31.9%.[14]

Moreover, the fact that 40 of our sample cases were settled says nothing about the extent of the benefit, if any, that those settlements conferred on class members.

Many class settlements—and virtually all settlements of consumer class actions—produce negligible benefits for class members. It is a notoriously difficult exercise to assess empirically how class members benefit from class action settlements. These settlements fall generally into three basic categories:

- "Claims-made" settlements, under which class members are bound by a class settlement—and thereby release all of their claims—but only obtain recoveries if they affirmatively request to do so, usually through use of a claims form.[15] Funds not distributed to claimants are returned to the defendant or, in some cases, distributed to a charity via the *cy pres* process (which creates significant additional problems, as we discuss below). They are not given to class members. Most settlements fall into this category.
- Injunctive relief/*cy pres* settlements, in which the relief provided to settling class members involves only injunctive relief (which may provide little or no benefit to class members) or *cy pres* distributions (in which money is paid to charitable organizations rather than class members).
- "Automatic distribution" settlements, in which each class member's settlement is distributed automatically to class members whose

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[14] Hilary Hehman, *Class Certification in California: Second Interim Report from the Study of California Class Action Litigation*, Judicial Council of California: Administrative Office of the Courts, at Tables D1-D2 (Feb. 2010), http://www.courts.ca.gov/documents/classaction-certification.pdf (observing that 410 of 1294 resolved cases were settled); *see also* Patricia Hatamyar Moore, *Confronting the Myth of "State Court Class Action Abuses" Through an Understanding of Heuristics and a Plea for More Statistics*, 82 UMKC L. Rev. 133, at 165 & n.192 (2013).

[15] *See* 4 *Newberg on Class Actions* § 12:35 (4th ed. 2013) ("[A] common formula in class actions for damages is to distribute the net settlement fund after payment of counsel fees and expenses, ratably among class claimants according to the amount of their recognized transactions during the relevant time period. A typical requirement is for recognized loss to be established by the filing of proofs of claim. . . .").

eligibility and alleged damages could be ascertained and calculated—such as retirement-plan participants in ERISA class actions.

The parties typically have no meaningful choice among these methods of structuring a settlement. Automatic distribution settlements are feasible only if the parties have the names and current addresses of class members as well as the ability to calculate each class member's alleged damages. But companies typically lack the information needed to settle cases using an automatic distribution mechanism—especially in consumer cases, where purchase records may be incomplete or unavailable, and/or class members' claimed injuries may vary widely and unpredictably.

Thus, consumer class actions are almost always resolved on a claims-made basis, and the actual amount of money delivered to class members in such cases almost always is a miniscule percentage of the stated value of the settlement. That is because, in practice, relatively few class members actually make claims in response to class settlements: many class members may not believe it is not worth their while to request the (usually very modest) awards to which they might be entitled under a settlement. And the claim-filing process is often burdensome, requiring production of years-old bills or other data to corroborate entitlement to recovery.

The class members' actual benefit from a settlement—if any—is almost never revealed. Remarkably, the public almost never has access to settlement distribution data. One study found that settlement distribution data were available in "fewer than one in five class actions in [the] sample."[16] Companies and their defense lawyers are hesitant to reveal how much a company has been required to pay out to class members, and plaintiffs' counsel have strong incentives to conceal the information because requests for attorneys' fees based on a settlement's face value will appear overstated when compared to the actual value. Judges are often happy to have the case resolved, and therefore have little to no interest in requiring transparency in the settlement distribution process.

While third-party claims administrators often possess direct information about claims rates, they are routinely bound by contract to maintain the confidentiality of that information in the absence of party permission, a court order, or other legal authority.[17] This may be a function of the incentive shared by class

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[16] Nicholas M. Pace & William B. Rubenstein, *How Transparent are Class Action Outcomes? Empirical Research on the Availability of Class Action Claims Data* at 3, RAND Institute for Civil Justice Working Paper (July 2008), billrubenstein.com/Downloads/RAND%20Working%20Paper.pdf.

[17] *Id.* at 31-32 (explaining that in a survey of class action participants, only 25% of "chief executive officers" at settlement administrators responded to the survey, and even those only "did so solely to inform [the researchers] that the information

counsel and defense counsel to avoid facilitating grounds for a class member to object that a settlement was unfair because it provided too little tangible benefit to the class.[18] Indeed, "[h]ow many people were actually members of this class, how many of these class members actually submitted a claim form, and how much they were actually paid appear to be closely held secrets between the class counsel and the defendant."[19]

In rare cases in which class-settlement distribution data was available, few class members received any benefit at all. In our data set, ***18 cases were resolved by claims-made settlements***—44% of the total. ***We were able to obtain meaningful data regarding the distribution of settlement proceeds in only six of the 18 cases***, which is not surprising given the well-established and widespread lack of publically available information regarding the extent to which class members actually benefit from settlements. ***Five of the six cases resulted in minuscule claims rates: 0.000006%, 0.33%, 1.5%, 9.66%, and 12%.***[20] These

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that they held was 'proprietary' to their clients, namely the attorneys that had hired them to oversee the class action claiming process"); *cf.* Deborah R. Hensler, et al., *Class Action Dilemmas: Pursuing Public Goals for Private Gain* 163-64 (2000) (noting difficulty in obtaining "information about the claiming process and distribution" from a "settlement administrator," who "declined to share distribution figures, suggesting that we talk to the attorneys involved with the case," and noting further that the plaintiffs' and defense attorneys had agreed between themselves "not to discuss or divulge matters related to . . . the actual distribution to the class").

[18] *See* Christopher R. Leslie, *The Significance of Silence: Collective Action Problems and Class Action Settlements*, 59 Fla. L. Rev. 71, 93 (2007) (explaining that when a "notice do[es] not estimate the size of the class, . . . class members are unable to calculate their own individual recoveries" and therefore lack "sufficient bases for objecting to the proposed settlement"); *see also Thorogood v. Sears, Roebuck & Co.*, 547 F.3d 742, 744-45 (7th Cir. 2008) (Posner, J.) ("The defendants in class actions are interested in minimizing the sum of the damages they pay the class and the fees they pay the class counsel, and so they are willing to trade small damages for high attorneys' fees. . . . The result of these incentives is to forge a community of interest between class counsel, who control the plaintiff's side of the case, and the defendants. . . . The judge . . . is charged with responsibility for preventing the class lawyers from selling out the class, but it is a responsibility difficult to discharge when the judge confronts a phalanx of colluding counsel.") (citations omitted).

[19] Hensler, *supra* note 17, at 165.

[20] The lone outlier—a case with a 98.72% claims rate—involved the settlement of an ERISA case involving claims about the Bernie Madoff Ponzi scheme for which potentially enormous claims could be made. The math explains why an "astonishing

extremely small claim-filing rates are consistent with the few other reports of claim rates in class action settlements that have come to light.

As one federal court observed, "'claims made' settlements regularly yield response rates of 10 percent or less."[21] In fact, the claims rate frequently is ***much lower***—in the single digits. Appendix A contains a list of more than 20 additional cases for which information about distributions is available, all of which involved distributions to less than seven percent of the class and many of which involved distributions to less than one percent of the class.

There is thus ample evidence to infer that ***the extremely small claims rates for cases in our sample is representative of what happens in class actions generally, and particularly in consumer class actions***.[22] And although documents filed in the remaining 12 of the 18 claims-made settlements lacked information about claims rates, there is every reason to believe that class members made claims at the small rates ordinarily observed in such cases. While some may argue that parties should use automatic distribution mechanisms instead

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98.72%" of the 470 members of the damages class filed claims in this $1.2165 billion settlement. Final Order at 11, *In re Beacon Assoc. Litig.*, No. 09-cv-777 (S.D.N.Y. May 9, 2013), PACER No. 77-2. Because each class member's individual claim was worth, on average, over $2.5 million, it is unsurprising that over 460 of the class members decided to submit a claim. Needless to say, virtually no consumer or employment class actions settle for anything approaching such a large amount per class member.

[21] *Sylvester v. CIGNA Corp.*, 369 F. Supp. 2d 34, 52 (D. Me. 2005).

[22] Some earlier studies purported to assess the benefits received by class members, but they examined "only what defendants *agreed to pay*" in settlements, rather than "the amounts that defendants *actually paid* after the claims administration process concluded." Brian Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. Empirical Legal Stud. 811, 826 (2010) (emphasis added); *see also* Theodore Eisenberg & Geoffrey Miller, *Attorney's Fees and Expenses in Class Action Settlements: 1993-2008*, 7 J. Empirical Legal Stud. 248, 258-59 (2010) (using same approach).

Moreover, because Fitzpatrick studied only settlements (*see* 7 J. Empircial Legal Stud. at 812), his study failed to take into account that most putative class actions are dismissed or otherwise terminated without any benefits for class members. And Eisenberg and Miller ignored settlements that promised *only* nonpecuniary relief (such as coupons or injunctive relief) to class members. An earlier version of their study—which laid the methodological groundwork for the later expanded study in 2010 (*see id.* at 252)—appears to have counted cases involving such "soft relief" only when it was "included" along with pecuniary relief. Theodore Eisenberg & Geoffrey Miller, *Attorney Fees in Class Action Settlements: An Empirical Study*, 1 J. Empirical Legal Stud. 27, 40 (2004).

of "claims-made" settlements to resolve class actions, the reality is that automatic distribution is difficult, if not impossible, to achieve in many (perhaps most) consumer class actions.

Only *one* consumer class action settlement was resolved through automatic distribution. Of the remaining 22 settled cases in our sample, 13 involved ***settlements with automatic distribution of settlement proceeds.*** Ten of these 13 involved claims by retirement plan participants in ERISA class actions, in which the class members' eligibility and alleged damages could be easily ascertained and calculated based on their investment positions. The plans of distribution in these 10 cases generally involved lump-sum payments to the plan, which would then be allocated directly to plan members' accounts.

The other three automatic-distribution settlements were reached in consumer and employment class actions. In each case—atypical of most class actions—the defendant was in a position to ascertain and calculate class members' eligibility and alleged damages:

- In one, an employer settled claims that it conspired with health care providers and insurers to dictate medical treatment provided to about 13,764 employees injured on the job, whose identities were readily known to the defendant employer; employees who were treated by one health-care provider received a check for $520, while injured employees treated by another provider received a check for $50.[23]
- In a second settlement, a credit-card issuer settled claims that it improperly raised the minimum monthly payment and added new fees in connection with promotional loan offers. The defendant issued class members a flat-rate payment of $25, plus (for certain customers) a share of the remaining settlement fund calculated by taking into account the ways the class member had used the promotional loan and had been charged fees.[24]
- Finally, as we explain in more detail below, a third settlement resolved privacy claims against a mobile-phone gaming app developer in

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[23] Plaintiffs' Unopposed Motion for Order Preliminarily Approving Class Action Settlement at 8, *Gianzero v. Wal-Mart Stores, Inc.*, No. 09-cv-00656 (D. Colo. Nov. 21, 2011), PACER No. 464 ("*Gianzero* Preliminary Approval Motion").

[24] Plaintiffs' Motion for Preliminary Approval of Class Settlement at 5-7, *In re Chase Bank USA, N.A. "Check Loan" Contract Litigation*, No. 09-md-2032 (N.D. Cal. July 23, 2012), PACER No. 338.

exchange for 45 in-game "points" that were automatically distributed to users so they could advance through the game's levels.[25]

Thus, only two consumer cases involved automatic distributions, and in one the distribution involved "game points." ***Only a single settled consumer class action—one of 127 class actions resolved—conveyed real benefits to anything more than a small percentage of the class.***

Cy pres **awards and injunctive relief serve primarily to inflate attorney's fee awards—and benefit third parties with little or no ties to the putative class.** The final group of 9 settled cases largely involved ***injunctive relief or cy pres distributions.*** Because these cases involve no monetary compensation to class members, it is difficult for outsiders to assess the claimed benefit. Certainly, ***in many cases "injunctive relief" has little or no real-world impact on class members, but is used to provide a basis for claiming a "benefit" to class members justifying an award of attorneys' fees to class counsel*** (as we detail below). The injunctive-relief-only settlements we reviewed included the following:

- Plaintiff subscribers of America Online ("AOL") claimed that it embedded advertisements at the bottom of the subscribers' email messages without their permission. After an early settlement was vacated on appeal for improper *cy pres* awards to unrelated charities, the parties again settled the claims, with AOL promising to tell subscribers how to opt out of email advertisements if it restarted the challenged practice.[26]
- In a class action involving claims that a social-networking app developer failed to protect properly the personally identifiable information of 32 million customers from a data security breach, the settlement provided that the defendant will undergo two audits of its information security policies with regard to maintenance of consumer records, to be made by an independent third party. The settlement explicitly reserves the rights of the plaintiff class to sue for monetary relief.[27]
- Plaintiffs brought false advertising claims against Unilever, contending that it had misrepresented the health or nutritional characteristics of "I Can't Believe It's Not Butter." As part of the

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[25] *See* notes 44–46 and accompanying text.

[26] Revised Class Action Settlement Agreement ¶¶ 20-22, *Bronster v. AOL, LLC*, No. 09-cv-3568 (C.D. Cal. July 31, 2013), PACER No. 66-10. The settlement also proposes a *cy pres* award to a more related charitable organization. *Id.* ¶ 23.

[27] Settlement Agreement and Release at 4, *Claridge v. RockYou, Inc.*, No. 09-cv-6032 (N.D. Cal. Dec. 15, 2011), PACER No. 55-1.

settlement, Unilever was to remove all partially hydrogenated vegetable oils from its soft spreads by December 31, 2011, and from its stick products by December 31, 2012, and keep those ingredients out of those products for 10 years. Although they did not receive monetary compensation, class members released all monetary and equitable claims other than claims for personal injury.[28]

- Finally, in a class action alleging the violation of consumer protection laws arising out of the marketing of Zicam supplements (sold as a way of combating the common cold), the parties provided for a number of non-pecuniary "benefits"—all in the form of labeling changes. These include: (1) indicating that the FDA has not approved the supplements; (2) disclosing that customers with zinc allergies or sensitivities should consult a doctor; (3) informing customers that the products are not intended to be effective for the flu or for allergies; and (4) removing language recommending that customers continue to use the products for 48 hours after cold symptoms subside. If the court approves the settlement and requested attorneys' fees, the defendant will pay plaintiff's counsel up to $1.75 million in fees in one case, and another $150,000 in a related MDL proceeding.[29]

Like injunctive relief settlements, ***the* cy pres *doctrine is being used by plaintiffs' lawyers to inflate artificially the purported size of the benefit to the class in order to justify higher awards of attorney's fees to the plaintiffs' lawyers***. In four of the cases we examined, the settlement provided that one or more charitable organizations would receive either all monetary relief, or any remaining monetary relief after claims made were paid out.

Courts often assess the propriety of an attorneys' fee award in the settlement context by comparing the percentage of the settlement paid to class members or charities with the percentage of the settlement allocated to class counsel.[30] That

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[28] Notice of Joint Motion for Final Approval of Class Settlement and Memorandum of Points and Authorities in Support Thereof at 4, *Red v. Unilever United States, Inc.*, No. 10-cv-387 (N.D. Cal. June 6, 2011), PACER No. 153.

[29] Plaintiffs' Memorandum in Support of Motion for Final Approval of Class Action Settlement at 4-5, *Hohman v. Matrixx Initiatives, Inc.*, No. 09-cv-3693 (N.D. Ill. May 26, 2011), PACER No. 81.

[30] *See, e.g., Strong v. BellSouth Telecommunications, Inc.*, 137 F.3d 844, 851 (5th Cir. 1998) (affirming the district court's decision to compare the "actual distribution of class benefits" against the potential recovery, and adjusting the requested fees to account for the fact that a "drastically" small 2.7 percent of the fund was distributed); *see also Int'l Precious Metals Corp. v. Waters*, 530 U.S. 1223, 1223 (2000) (O'Connor, J., respecting the denial of certiorari) (noting that fee

approach has been endorsed by the Manual for Complex Litigation.[31] If no funds are allocated to the class, or a small portion of the amount ostensibly allocated to the class is actually distributed and the remainder of the funds returned to the defendants, the relative percentages could be disturbing to a court reviewing the fairness of the settlement. But if the amount not collected by class members is contributed to a charity that can be claimed to have some tenuous relationship to the class, then the percentage allocated to attorneys' fees may appear more acceptable.

The result, as one district court has warned, is that attorney fee awards "determined using the percentage of recovery" will be "exaggerated by *cy pres* distributions that do not truly benefit the plaintiff class."[32] As Professor Martin Redish has noted, the *cy pres* form confirms that "[t]he real parties in interest in . . . class actions are . . . the plaintiffs' lawyers, who are the ones primarily responsible for bringing th[e] proceeding."[33] One district court has noted that when a consumer class action results in a *cy pres* award that "provide[s] those with individual claims no redress," where there are other "incentives" for bringing individual suits, the class action fails the requirement that the class action be "superior to other available methods" of dispute resolution.[34]

Lawyers (as opposed to class members) were the principal beneficiaries of the remaining settlements in our study. For the "*cy pres*" settlements in our data set, and the "claims made" settlements for which there is no distribution data,

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awards disconnected from actual recovery "decouple class counsel's financial incentives from those of the class," and "encourage the filing of needless lawsuits where, because the value of each class member's individual claim is small compared to the transaction costs in obtaining recovery, the actual distribution to the class will inevitably be small").

[31] *See* Federal Judicial Center, *Manual for Complex Litigation (Fourth)* § 27.71 (2004).

[32] *SEC v. Bear Stearns & Co.*, 626 F. Supp. 2d 402, 415 (S.D.N.Y. 2009).

[33] Testimony of Martin H. Redish at 7, U.S. House of Representatives, Committee on the Judiciary, Subcommittee on the Constitution, *Hearing: Class Actions Seven Years After the Class Action Fairness Act* (June 1, 2012), available at http://judiciary.house.gov/hearings/Hearings%202012/Redish%2006012012.pdf.

[34] *Hoffer v. Landmark Chevrolet Ltd.*, 245 F.R.D. 588, 601-04 (S.D. Tex. 2007) (Rosenthal, J.). In one of the cases in our sample, the same district judge cautioned that *cy pres* awards "'violat[e] the ideal that litigation is meant to compensate individuals who were harmed,'" but ultimately approved the award because prior court precedents had authorized the use of *cy pres*. *In re Heartland Payment Sys., Inc. Customer Data Sec. Breach Litig.*, 851 F. Supp. 2d 1040, 1076 (S.D. Tex. 2012) (Rosenthal, J.).

publicly available information provides further support for the conclusion that little in the way of benefit flows to class members. Examples from our data set include:

- ***Disproportionate allocation of settlement funds to attorneys' fees.*** Plaintiffs brought a class action alleging that the defendants improperly interfered with the medical care of injured employees in violation of Colorado law.[35] Under the settlement agreement, the defendants (who denied wrongdoing) were required to make an $8 million fund available to compensate more than 13,500 class members. But class counsel received over $4.5 million out of the $8 million—more than 55 percent of the fund.[36]
- ***Named plaintiffs object to the settlement***. In a class action against the National Football League, retired players alleged that the league was using their names and likenesses without compensation to promote the league. The NFL and some players settled the class-wide claims under federal competition law and state right of publicity laws. But the original named plaintiffs who spearheaded the litigation objected to the settlement, arguing that it provided ***no direct payout to the retired players***.[37] Rather, it created an independent organization that would fund charitable initiatives related to the health and welfare of NFL players—and would create a licensing organization that would help fund the independent organization. Meanwhile, "[p]laintiffs' lawyers would receive a total of $7.7 million under the proposed agreement."[38]
- ***Low recovery for class members.*** Plaintiffs alleged in eight consolidated class actions that their employer, a bank, violated the federal Employee Retirement Income Security Act (ERISA) by offering its own stock as a retirement plan investment option while hiding the true extent of the bank's losses in the mortgage crisis.[39] The class

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[35] *Gianzero* Preliminary Approval Motion at 4.

[36] *Id.* at 10.

[37] The Dryer Plaintiffs' Opposition to Preliminary Approval of the Proposed Settlement Class, *Dryer v. Nat'l Football League*, No. 09-cv-2182 (D. Minn. Mar. 20, 2013), PACER No. 264.

[38] Alison Frankel, Retired NFL stars reject settlement of their own licensing class action, REUTERS (Mar. 25, 2013), available at http://blogs.reuters.com/alison-frankel/2013/03/25/retired-nfl-stars-reject-settlement-of-their-own-licensing-class-action/.

[39] Class Action Complaint at 2, 24-25, *In re Colonial Bancgroup, Inc. ERISA Litig.*, No. 2:09-cv-792 (M.D. Ala. Aug. 20, 2009), PACER No. 1.

settlement established a $2.5 million common fund that was ostensibly designed to compensate the employees for their losses arising from the bank's alleged breach of fiduciary duty.[40] But commentators note that, when all of the allegations in the various complaints were taken into account, plaintiffs had alleged more than $50 million in losses, meaning that class members would recover no more than five cents on the dollar.[41] And according to the plan of allocation, members of the settlement class who were calculated to have suffered damages less than $25 would receive *nothing*[42]—meaning that their claims were released without even the opportunity to receive something in exchange. Meanwhile, the plaintiffs' attorneys received a fee award amounting to 26% of the common fund ($645,595.78), plus $104,404.22 in expenses.[43]

- ***Settlement requires further use of defendant's services.*** A plaintiff filed a class action alleging that certain mobile-phone gaming apps were improperly collecting and disseminating users' mobile phone numbers.[44] Under the terms of the settlement agreement, class members were not entitled to any monetary payment. Instead, they were slated to receive 45 in-game "points" (with an approximate cash value of $3.75) per mobile device owned; the points could be used to advance through the gaming apps' levels.[45] These points could be redeemed or used only within the defendant's apps.[46] Unsurprisingly, the plaintiffs' counsel were not paid in points, but instead were awarded $125,000 in attorneys' fees.

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[40] *See, e.g.*, Final Judgment at 2-3, *In re Colonial Bancgroup, Inc. ERISA Litig.*, No. 2:09-cv-792 (M.D. Ala. Oct. 12, 2012), PACER No. 207 ("*Colonial Bancgroup* Final Judgment").

[41] Bill Donahue, *Colonial Bank Execs Pay $2.5m to Dodge ERISA Claims*, Law360 (June 18, 2012), available at http://www.law360.com/articles/350930

[42] Plan of Allocation at 3, *In re Colonial Bancgroup, Inc. ERISA Litig.*, No. 2:09-cv-792 (M.D. Ala. Sept. 14, 2012), PACER No. 192-1.

[43] *Colonial Bancgroup* Final Judgment at 8.

[44] First Amended Complaint at 2, *Turner v. Storm8, LLC*, No. 4:09-cv-05234 (N.D. Cal. June 22, 2010), PACER No. 27.

[45] Motion for Final Approval of Class Action Settlement Agreement at 3, *Turner v. Storm8, LLC*, No. 4:09-cv-05234 (N.D. Cal. Nov. 11, 2010), PACER No. 32.

[46] Settlement Agreement at 8, *Turner v. Storm8, LLC*, No. 4:09-cv-05234 (N.D. Cal. June 22, 2010), PACER No. 26-1.

- ***Attorneys seek fees far exceeding class recovery***. Class counsel in a case involving allegedly faulty laptops found their fee request chopped down from $2.5 million to $943,000.[47] The settlement resulted in a recovery of $889,000 to claimants, plus $500,000 in additional costs for administering the settlement—meaning that the attorneys were seeking just under ***three times*** the amount that would have gone directly to the class—and even after the fees were cut down, they still represented 106 percent of the class's direct recovery.

These characteristics are not unique to the sample cases. To the contrary, results are consistent with a significant number of class action settlements that produce minimal benefits for the class members themselves. We summarize additional examples of such settlements—taken from outside our data set—in Appendix B.

Other studies of class settlements and attorneys' fees confirm that these examples are not outliers: Such settlements commonly produce insignificant benefits to class members and outsize benefits to class counsel. A RAND study of insurance class actions found that attorneys' fees amounted to ***an average of 47% of total class-action payouts***, taking into account benefits actually claimed and distributed, rather than theoretical benefits measured by the estimated size of the class. "In a quarter of these cases, the effective fee and cost percentages were 75 percent or higher and, in 14 percent (five cases), the effective percentages were over 90 percent."[48]

In other words, for practical purposes, counsel for plaintiffs (and for defendants) are frequently the only real beneficiaries of the class actions.

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[47] Attorney's Fees Slashed in Faulty Laptop Class Action, *BNA Class Action Litigation Report*, 14 Class 1497 (Oct. 25, 2013), available at http://news.bna.com/clsn/CLSNWB/split_display.adp?fedfid=37476946&vname=clasnotallissues&jd=a0e2t3w1f0&split=0. This case was among the ones we studied, but the court's decision awarding a reduced amount of attorneys' fees was issued after the closing date of our study.

[48] Nicholas M. Pace et al., *Insurance Class Actions in the United States*, Rand Inst. for Civil Just., xxiv (2007), http://www.rand.org/pubs/monographs/MG587-1.html. Another RAND study similarly found that in three of ten class actions, class counsel received more than the class. *See* Deborah R. Hensler et al., *Class Action Dilemmas: Pursuing Public Goals for Private Gain* (Executive Summary), Rand Inst. for Civil Just., 21 (1999), http://www.rand.org/pubs/monograph_reports/MR969.html.

Conclusion

This study confirms that class actions rarely benefit absent class members in whose interest class actions are supposedly initiated. The overwhelming majority of class actions are dismissed or dropped with ***no recovery*** for class members. And those recoveries that class settlements achieve are typically minimal—and obtained only after long delays. To be sure, not every class action is subject to these criticisms: a few class actions do achieve laudable results. But virtually none of those were consumer class actions. Certainly our analysis demonstrates—at a bare minimum—that the vast majority of class actions in our sample set cannot be viewed as efficient, effective, or beneficial to class members.

Appendix A: Additional Examples of Settlements With Payments to a Very Small Percentage of Class Members

- The Seventh Circuit vacated an order approving a class action settlement so that the district court could "evaluate whether the settlement is fair to class members," where (among other problems with the settlement) only "a *paltry* three percent" of the quarter-million-wide proposed class "had filed proofs of claim."[49] And the Third Circuit recently noted that "consumer claim filing rates *rarely* exceed seven percent, even with the most extensive notice campaigns."[50]
- One affidavit analyzed 13 cases for which data had been disclosed (and in which the settlement was approved). The median claims rate was 4.70%. The highest claims rate in those cases was 5.98%, and the lowest non-zero claims rate was 0.67%. In two cases, the claims rate was 0%—reflecting that not a single class member obtained the agreed-on recovery.[51]
- A class action alleging antitrust claims in connection with compact disc "music club" marketing settled, with only 2% of the class making claims for vouchers (valued at $4.28) for CDs.[52]
- Indeed, in many cases, the claims rate may be well under 1 percent.
  - Fair Credit Reporting Act case: court noted that "less than one percent of the class chose to participate in the settlement."[53]
  - Case alleging that a software manufacturer sold its customers unnecessary diagnostic tools: court approved settlement despite the fact that only 0.17% of customers made claims for a $10 payment, because "the settlement amount is commensurate with the strength of the class' claims and their likelihood of success absent the settlement."[54]

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49 *Synfuel Techs., Inc. v. DHL Express (USA), Inc.*, 463 F.3d 646, 648, 650 (7th Cir. 2006) (emphasis added).

50 *Sullivan v. DB Investments, Inc.*, 667 F.3d 273, 329 n. 60 (3d Cir. 2011) (en banc) (emphasis added; quotation marks omitted).

51 Declaration of Kevin Ranlett in Support of Defendants' Amended Motion to Compel Arbitration at 8, *Coneff v. AT&T Corp.*, No. 2:06-cv-00944 (W.D. Wash. May 27, 2009), PACER No. 199. Mr. Ranlett is a Mayer Brown lawyer.

52 *In re Compact Disc Minimum Advertised Price Antitrust Litig.*, 370 F. Supp. 2d 320, 321 (D. Me. 2005).

53 *Yeagley v. Wells Fargo & Co.*, 2008 WL 171083, at *2 (N.D. Cal. Jan. 18, 2008), *rev'd*, 365 F. App'x 886 (9th Cir. 2010).

54 *LaGarde v. Support.com, Inc.*, 2013 WL 1283325, at *6 (N.D. Cal. Mar. 26, 2013). The court approved a proposed modified settlement under which the class

- Case involving product liability claims related to alleged antenna problems with Apple's iPhone 4: court approved settlement noting that the "number of claims represents somewhere between 0.16% and 0.28% of the total class."[55]
- Class action alleging fraud in the procurement of credit-life insurance: Supreme Court of Alabama noted that "only 113 claims" had been made in a class of approximately 104,000—or a response rate of 0.1%.[56]
- Action alleging that restaurant chain had printed credit-card expiration dates on customers' receipts: "approximately 165 class members" out of 291,000—or fewer than 0.06% of the class—"had obtained a voucher" for one of four types of menu items worth no more than $4.78.[57]
- Class action alleging that Sears had deceptively marketed automobile-wheel alignments: "only 337 valid claims were filed out of a possible class of 1,500,000"—a take rate of just over 0.02%.[58]
- Class action alleging that video game manufacturer had improperly included explicit sexual content in the game: ***one fortieth of one percent*** of the potential class (2,676 of 10 million) made claims.[59]
- Class action involving allegations that a Ford Explorer was prone to dangerous rollovers: only 75 out of "1 million" class members—or ***less than one hundredth of one percent***—participated in the class settlement.[60]

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members "who made a claim" after having been "offered a $10 cash payment * * * will now receive a $25 cash payment, rather than $10." *Id.* at *4.

[55] *In re Apple iPhone 4 Prods. Liab. Litig.*, 2012 WL 3283432, at *1 (N.D. Cal. Aug. 10, 2012).

[56] *Union Fid. Life Ins. Co. v. McCurdy*, 781 So. 2d 186, 188 (Ala. 2000).

[57] *Palamara v. Kings Family Rests.*, 2008 WL 1818453, at *2 (W.D. Pa. Apr. 22, 2008).

[58] *Moody v. Sears, Roebuck & Co.*, 2007 WL 2582193, at *5 (N.C. Super. Ct. May 7, 2007), *rev'd*, 664 S.E.2d 569 (N.C. Ct. App. 2008).

[59] *In re Grand Theft Auto Video Game Consumer Litig.*, 251 F.R.D. 139 (S.D.N.Y. 2008).

[60] Cheryl Miller, "Ford Explorer Settlement Called a Flop," *The Recorder* (July 13, 2009), http://www.law.com/jsp/article.jsp?id=1202432211252.

Appendix B: Additional Examples of Settlements Providing Negligible Benefits to Class Members

- ***Class members receive extended membership in buying club.*** In a class action against DirectBuy—a club for which customers pay a membership fee to purchase goods at lower prices—the plaintiffs alleged that the defendant had misrepresented the nature of the discounts that were available through the club.[61] The settlement afforded class members nothing other than discounts for renewal or extension of their memberships in the very club that was alleged to have tricked them into joining in the first place. Meanwhile, the attorneys for the class "could receive between $350,000 and $1 million."[62]
- ***$21 million for the lawyers, pennies and coupons for the class members.*** One Missouri class settlement in a case against a brokerage house alleging breaches of fiduciary duties provided $21 million to class counsel, but only $20.42 to each of the brokerage's former customers and three $8.22 coupons to each current customer. And most of the coupons are unlikely to be redeemed.[63]
- ***Class members receive right to request $5 refund, lawyers take (and fail to disclose sufficiently) $1.3 million in fees.*** Under the settlement of a class action in which the plaintiffs alleged that Kellogg's had misrepresented that Rice Krispies are fortified with antioxidants, class members could request $5 refunds for up to three boxes of cereal purchased between June 1, 2009, and March 1, 2010.[64] Class counsel sought $1.3 million in attorneys' fees on a claim fund valued at $2.5 million to be paid out to class members.[65]

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[61] Michelle Singletary, *Class-action Coupon Settlements are a No-Win for Consumers*, Wash. Post, Apr. 28, 2011 at A14.

[62] *Id.*

[63] *See* Stipulation of Settlement of Class Action, *Bachman v. A.G. Edwards, Inc.*, No. 22052-01266-03 (Mo. Cir. Ct. St. Louis Feb. 18, 2010), http://www.agedwardsclassactionsettlement.com/bach_20100219094521.pdf; *see also* Daniel Fisher, *Lawyer Appeals Judge's Award of $21 Million in Fees, $8 Coupons for Clients*, FORBES.COM (Jan. 10, 2011), http://blogs.forbes.com/danielfisher/2011/01/10/lawyer-appeals-judges-award-of-21-million-in-fees-8-coupons-for-clients ("The judge didn't even see fit to inquire into the lawyers' valuation of the coupon portion of the settlement, despite strong evidence that less than 10% of coupons in such cases are ever redeemed").

[64] Stipulation of Settlement at 2-8, *Weeks v. Kellogg*, No. 2:09-cv-8102 (C.D. Cal. Jan. 10, 2011), PACER No. 121.

[65] Memorandum of Law in Support of Plaintiffs' Motion for Award of Attorneys' Fees, Expenses, and Plaintiff Service Awards at 4, *Weeks v. Kellogg*, No. 2:09-cv-8102 (C.D. Cal. July 18, 2011), PACER No. 135-1.

- ***Class receives opportunity to attend future conferences.*** In a 2009 settlement in the District of Columbia, a court approved a settlement against a conference organizer that failed to deliver promised services to those who had paid to attend. The settlement provides class members with nothing other than coupons to attend future events put on by the same company alleged to have bilked them in the first place; class counsel will take $1.4 million in fees.[66]

- ***Class members receive nothing, class counsel take $2.3 million.*** In a $9.5 million settlement of a class action against Facebook over the disclosure to other Facebook users of personal information about on-line purchases through Facebook's "Beacon" program, the class members received no remedy whatever for the invasions of their privacy and were barred from making future claims for any remedy. Instead, approximately $6.5 million went to create and fund a new organization that would give grants to support projects on internet privacy; a few thousand dollars went to each of the named plaintiffs as "incentive payments"; and class counsel received more than $2.3 million.[67] Meanwhile, although Facebook agreed to end the Beacon program—which it had actually already ended months before—it remained free to reinstitute the program as long as it didn't use the name "Beacon."[68] As one federal appellate judge put it (in a dissent from a decision upholding the settlement):

> The majority approves ratification of a class action settlement in which class members get no compensation at all. ***They do not get one cent***. They do not get even an injunction against Facebook doing exactly the same thing to them again. ***Their purported lawyers get millions of dollars***. Facebook gets a bar against any claims any of them might make for breach of their privacy rights. The most we could say . . . is that in exchange for giving up any claims they may have, the exposed Facebook users get the satisfaction of contributing to a charity to be funded by Facebook, partially controlled by Facebook, and advised by a legal team consisting of Facebook's counsel and their own

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66 *See* Memorandum Opinion at 3-5, 8, *Radosti v. Envision EMI, LLC*, No. 1:09-cv-887 (D.D.C. June 8, 2010), PACER No. 40; Order at 1-2, *Radosti v. Envision EMI, LLC*, No. 1:09-cv-887 (D.D.C. Jan. 19, 2011), PACER No. 45.

67 *Lane v. Facebook, Inc.*, 696 F.3d 811 (9th Cir.), *reh'g en banc den.* 709 F.3d 791 (9th Cir. 2013), *cert. denied*, 134 S. Ct. 8 (2013).

68 Petition for Certiorari at 11-13, *Marek v. Lane*, No. 13-136 (filed July 26, 2013), 2013 WL 3944136.

> purported counsel whom they did not hire and have never met.[69]

The Supreme Court ultimately declined to review the Ninth Circuit's decision approving the settlement. As Chief Justice Roberts explained in a rare statement addressing the court's denial of certiorari, the objectors had challenged "the particular features of the specific *cy pres* settlement at issue," but in his view had not addressed "more fundamental concerns surrounding the use of such remedies" and the standards that should govern their use. Such concerns, he pointed out, would have to await a future case.[70]

- ***Court reduced attorneys' fees because of lack of benefit to class members.*** The Sixth Circuit upheld a district court's decision to reduce class counsel's requested fees from $5.9 million to $3.2 million in a settlement of a class action involving auto-insurance benefits.[71] In affirming the decision, the Sixth Circuit pointed out that the district court "did not believe that the class members received an especially good benefit [because] Class Counsel chose to pursue a relatively insignificant claim" as opposed to "other potential claims, . . . and [they] agreed to a settlement mechanism which yielded a low claims rate[.]"[72] Although the court noted that "the settlement makes available a common fund of $27,651,288.83 less any attorney fee award, costs, and administrative expenses," for individual class member benefits up to a maximum of $199.44, "only a small percent of eligible class members have made claims" totaling approximately $4 million—or 14% of the total common fund available.[73] What is more, class counsel represented in their fee motion that they provided notice to 189,305 class members and received "well over 12,000" claims—in other words, a claims-made rate of just over six percent.[74]

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[69] *Lane*, 696 F.3d at 835 (Kleinfeld, J., dissenting) (emphasis added).

[70] *Marek*, 134 S. Ct. at 9 (Roberts, C.J., respecting the denial of certiorari).

[71] *Van Horn v. Nationwide Prop. & Cas. Ins. Co.*, 436 F. App'x 496 (6th Cir. Aug. 26, 2011).

[72] *Id.* at 500.

[73] Opinion and Order at 10-11, *Van Horn v. Nationwide Prop. & Cas. Ins. Co.*, No. 1:08-cv-605 (N.D. Ohio, Apr. 30, 2010), PACER No. 308.

[74] Class Counsel's Supplemental Memorandum in Support of Class Counsel's Motion for Award of Attorney's Fees and Reimbursement of Litigation Expenses at 3-4, 7, *Van Horn v. Nationwide Prop. & Cas. Ins. Co.*, No. 1:08-cv-605 (N.D. Ohio Mar. 19, 2010), PACER No. 296

Appendix C: Study Design and Methodology

Identifying the Study Sample

The first step in studying putative class actions was to select a suitable pool of cases. Identifying every putative class action filed during 2009 would be impracticable—not least without extensive resources and staff support.[75] We instead used two commercial publications—the *BNA Class Action Litigation Reporter* and the *Mealey's Litigation Class Action Reporter*—to identify cases for inclusion in the study. These publications cover a wide array of developments in class action litigation, and therefore provide a diverse sample of filed class action complaints. The publications have an incentive to report comparatively more significant class actions out of all class actions filed, without wasting readers' time and attention on minor or obviously meritless suits. If anything, the sample would be skewed in favor of more significant class actions filed by prominent plaintiffs' attorneys—which should be *more meritorious on average* than a sample generated randomly from all class actions filed.

We reviewed issues of BNA and Mealey's published between December 2008 and February 2010 in order to identify cases filed in 2009. The reason for that limitation was the importance of analyzing "modern" cases that were filed after the passage of the Class Action Fairness Act of 2005, but long enough ago to track how the cases have actually progressed and whether they have been resolved. From those publications, we identified a pool of putative class actions brought by private plaintiffs that were either filed in federal court or were removed to federal court from state court in 2009. To begin with, because data about state court cases is much more difficult to obtain, we excluded a number of cases, such as those brought in state court initially (where the BNA or Mealey's report did not mention that the case was removed). We also excluded one case that was removed to federal court and then remanded to state court. This left us with 188 cases.

Nineteen of these eventually became part of eleven other consolidated cases that were also part of our data set—whether under the multidistrict litigation

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[75] *See, e.g.,* Deborah Hensler, et al., *Class Action Dilemmas: Pursuing Public Goals for Private Gain* § 4.60 (RAND Institute for Civil Justice, Monograph MR-969/1-ICJ) (1999) ("Enormous methodological obstacles confront anyone conducting research on class action litigation. The first obstacle is a dearth of statistical information. No national register of lawsuits filed with class action claims exists. Until recently, data on the number of federal class actions were substantially incomplete, and data on the number and types of state class actions are still virtually nonexistent. Consequently, no one can reliably estimate how much class action litigation exists or how the number of lawsuits has changed over time. Incomplete reporting of cases also means that it is impossible to select a random sample of all class action lawsuits for quantitative analysis.").

("MDL") procedure, 28 U.S.C. § 1407, or otherwise (for example, cases are often consolidated when they are pending in the same federal district court). When multiple putative class actions appearing in our data set were consolidated, we treated the consolidated case as a single action to avoid the risk of "overcounting" lawsuits.[76] And when a case in our data set was consolidated with other cases not in our data set, we considered activity reflected on the docket of the "lead" consolidated case that was attributable to the individual case as filed. If after consolidation the case was resolved together with the "lead" case—such that we could not trace outcomes for the individual case separate from the "lead" case—we considered activity attributable to the "lead" case. This approach dovetails with the practical mechanics of consolidation: After cases are consolidated into an MDL, for example, the judge to whom the MDL proceeding is assigned will resolve pretrial motions presented in all the consolidated cases. And more generally, to the extent that courts treat a number of separately filed cases together as a single unit for purposes of adjudication, we have followed the courts' lead.[77] Excluding the cases that became part of other consolidated cases in our data set left us with 169 cases.

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[76] By way of example, four cases—*Sansom v. Heartland Payment Sys., Inc.* No. 09-cv-335 (D.N.J.); *Lone Summit Bank v. Heartland Payment Sys., Inc.* No. 09-cv-581 (D.N.J.); *Tricentury Bank v. Heartland Payment Sys., Inc.* No. 09-cv-697 (D.N.J.), and *Kaissi v. Heartland Payment Sys., Inc.* No. 09-cv-540 (D.N.J.)—eventually were consolidated into *In re: Heartland Payment Sys., Inc., Customer Data Security Breach Litigation*, No. 4:09-md-02046 (S.D. Tex.).

[77] The decision to treat these consolidated cases along with the lead case had little effect on our data. A comparison of statistics on outcomes reveals that, if anything, treating consolidated class actions as a single action rather than separately tended to overstate the benefits of class actions.

In our full 188-case sample set (including the consolidated cases), 99 cases (54%) were dismissed, whether on the merits by the court, by the plaintiff voluntarily, or as an inferred settlement on an individual basis; 31 cases (16%) remain pending; 55 cases (29%) were settled on a class-wide basis; and 3 cases (2%) were dismissed after the court granted a motion to compel arbitration. By comparison, in the 169-case sample set (excluding the consolidated cases), 99 cases (57%) were dismissed, whether on the merits by the court, by the plaintiff voluntarily, or as an inferred settlement on an individual basis; 23 cases (14%) remained pending; 47 cases (28%) were settled on a class-wide basis; and 1 (1%) was dismissed after the court granted a motion to compel arbitration.

Similarly, this methodology ensures that me-too actions—cases filed by other attorneys after a complaint in a different case, raising materially identical claims—that are routinely dismissed after consolidation without any award or settlement will instead be treated as sharing in any benefits to class members that were actually obtained.

Our next goal was to identify a set of class actions consisting of claims resembling those asserted by consumers—because that is the area under study by the CFPB. We therefore excluded three non-Rule-23 putative class actions brought by the Equal Employment Opportunity Commission.[78] We also excluded nine Fair Labor Standards Act cases.[79] Finally, we excluded nine securities cases, because the stakes and nature of those claims are very different from the claims asserted in consumer class actions, and because they are litigated in a different manner because of the procedural checks imposed by federal laws governing securities litigation.[80] Excluding these 21 EEOC, securities, and FLSA cases had next to no effect on the statistical results of our study.[81]

Accordingly, the statistics about the total number of class actions filed in 2009 are based on a set of 148 putative class actions.

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[78] The Supreme Court has held that the EEOC may pursue enforcement actions under Title VII § 706 without being certified as a class representative under Federal Rule of Civil Procedure 23. *See Gen. Tel. Co. of Nw., Inc. v. EEOC*, 446 US. 318 (1980). The Supreme Court's reasoning would appear to apply equally outside the context of Title VII. Because the EEOC does not need to pursue a Rule 23 class, the dynamics of EEOC class-wide enforcement actions differ markedly from those in Rule 23 actions.

[79] Class actions under the FLSA are certified conditionally as "opt-in" classes. Section 216(b) of the FLSA permits a right of action against an employer by an employee on behalf of "other employees similarly situated," who must have opted in by providing and filing with the court "consent in writing" to become a plaintiff. 29 U.S.C. § 216(b). These cases present different incentives for plaintiffs' counsel than consumer class actions, because they typically involve statutory attorneys' fees to prevailing plaintiffs and may involve large backpay and overtime pay awards.

[80] As one academic study explained, securities class actions "are managed under a set of class action rules distinct from those used for other Rule 23(b)(3) classes—and . . . the plaintiffs with the largest losses have a significant role in the litigation (including choosing class counsel and defining the terms of the settlement) and can hardly be thought of [as] an 'absent' class member." Pace & Rubenstein, *supra* note 16, at 20; *see*, *e.g.*, Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-76, 109 Stat. 737 (1995); Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998).

[81] Recall that our 169-case sample set, which included these cases, resulted in 57% of cases dismissed, 14% pending, 28% settled on a class-wide basis, and 1% dismissed after an order compelling arbitration. *See supra* note 77. After excluding them, our 148-case sample set resulted in 57% of cases dismissed, 14% pending, 28% settled on a class-wide basis, and 1% dismissed after an order compelling arbitration. *See* Figure 1.

Constructing the Data Set

We identified and coded a number of variables about each case. Using the federal courts' Public Access to Court Electronic Records ("PACER") system, we evaluated the filings on each case's docket. Where criteria for a case could be coded in more than one way, we scrutinized the underlying filings and rulings to determine whether the criteria better fit one or another category. For administrative purposes, we treated September 1, 2013, as the date on which our study period closed. We did not code filings and events that were entered onto the docket after that date.

Among the data collected for each case were: jurisdiction; date filed; plaintiffs' firm; assigned judge; cause of action (as reported by PACER); nature of suit (as reported by PACER); whether the case was a lead or related case (if it was in a consolidated action);[82] whether the court granted class certification; whether the case was voluntarily dismissed,[83] settled, settled but on appeal, dismissed, otherwise disposed of, or still pending; the current posture of the case;[84] and the date of the last action on the case.

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[82] If a case was a related case in a consolidated action, we collected information based on what happened in the lead case.

[83] If a case was voluntarily dismissed, we attempted to discern from filings (and from sources external to the docket) whether the dismissal should be attributed to a settlement on an individual basis—such as when the filings refer to a settlement, or when the named plaintiff sought to dismiss her own claims with prejudice but without prejudice to absent members of the putative class. On one hand, this is likely to understate the rate at which individual plaintiffs settle their claims individually, which in any event results in no recovery to other absent members of the putative class unless another lawsuit moves forward. On the other hand, we were often not able to discern whether the claims in a lawsuit dismissed voluntarily would continue to be litigated (or settled) by another named plaintiff under a different case caption. Thus our decision to select a readily accessible sample of class actions may understate the extent to which members of a putative class may have their claims dismissed on the merits, or alternatively settled, in a class action under a different docket.

[84] The data set includes two certified class actions in which motions for summary judgment are pending. The data set also includes an additional certified class action in which the court granted summary judgment to the plaintiffs on their claim for injunctive relief, and granted summary judgment to the defendants on all remaining claims. At the time our study closed, on September 1, 2013, the parties proposed text for an injunctive order that would resolve the parties' remaining claims on a class-wide basis.

For cases involving settlements, we also collected information about the date of dismissal or final settlement approval; the terms of the settlement agreement; any attorneys' fees, expenses, and incentive payments to lead plaintiffs; and the presence of any *cy pres* provision in the settlement agreement.

There are, of course, limitations to the data we collected. First, our conclusions are based on the cases that we reviewed. While there is good reason to believe that generalizations can be made to all class actions, the sample is undoubtedly smaller than the total number of class actions filed in 2009. Attempting to estimate that number reliably—let alone to examine those cases—would have exceeded the scope of our review. On the other hand, the sample includes cases from across the country and is drawn from sources that are likely to report on significant class actions—those that are of comparatively greater importance or quality than those actions that neither BNA nor Mealey's considered worth reporting. Because the BNA and Mealey's reporters do not present a random sample of all class actions filed in 2009, it would not be useful to calculate a margin of error or otherwise attempt to quantify the extent to which the sample differs randomly from the population of all class actions filed in 2009.

EXHIBIT I

The Consumer Financial Protection Bureau is a government agency built to protect consumers. Our free resources help you have the information you need to make informed financial decisions.

UPDATED AUG. 04, 2016

What are the main differences between federal student loans and private student loans?

Answer: Federal student loans are loans made or guaranteed by the Department of Education. Private or non-federal student loans are any other type of student loans.

While both federal student loans and private student loans allow you to borrow money to pay for education expenses, there are some distinct differences.

Federal student loans can be better for students in several important ways:

- In some cases, the federal government will subsidize - pay the interest on - your federal student loan while you are in school.
- Your interest rate for a federal student loan is generally fixed, not variable; most private student loans carry variable interest rates.
- Federal student loans allow you to limit the amount you must repay each month based on your income.
- For borrowers pursuing careers in public service, loan forgiveness on federal student loans may be available after 10 years.

Federal student loans also feature other important borrower protections, including:

- Options to delay or temporarily forgo payments (like deferment and forbearance)
- Discharge upon a borrower's death
- Discharge upon permanent disability (with certain limitations)

But the consequences for defaulting on a federal student loan are pretty serious:

- Your wages may be garnished without a court order; and
- You can lose out on your tax refund or Social Security check (funds would be applied toward your defaulted student loan).

Private student loans are any student loans that are not federal student loans. These loans do not offer the flexible repayment terms or borrower protections featured by federal student loans. Private student loans are not funded or subsidized by the federal government; instead, they are funded by banks, credit unions, or other types of lenders.

The bank or lender – not the federal government – sets interest rates, loan limits, terms, and conditions of private student loans. Your ability to qualify for and borrow a private student loan may be based on numerous factors that can include your credit history, whether or not you choose to have a co-signer, your co-signer's credit history, your choice of school, and your course of study.

While private student loans are all structured differently, they are generally different from federal student loans in several ways and may include:

- Variable interest rates that can rise when interest rates rise during the life of the loan — which can substantially increase your payment
- Fewer options to reduce or postpone payments
- Less flexible repayment options

Ask CFPB provides general consumer information. It is not legal advice or regulatory guidance. The CFPB updates this information periodically.

Ask CFPB includes links or references to third-party resources or content. The CFPB does not endorse the third-party or guarantee the accuracy of this third-party information. There may be other resources that also serve your needs.

Careers

CFPB Ombudsman

FOIA

Plain Writing

Privacy

Website Privacy Policy & Legal Notices

Open Government

Administrative Adjudication

Accessibility

Office of Civil Rights

No FEAR Act Data

Tribal

USA.gov

Office of Inspector General

An official website of the United States Government

EXHIBIT J

Politco*Pro*

https://www.politicopro.com/education/whiteboard/2017/05/devos-says-shell-process-already-approvedstudent- debt-relief-claims-088261

Devos Says She'll Process Already-Approved Student Debt Relief Claims

By Michael Stratford
05/24/2017 02:16 PM EDT

Education Secretary Betsy DeVos said today that she will honor the student debt relief claims that were approved by the Education Department during the Obama administration.

DeVos testified before a House appropriations subcommittee that her agency is in the process of moving to expunge the student loans of borrowers for whom the Education Department approved loan forgiveness on the grounds that they were defrauded by their college.

"Those to whom we've made a commitment, we are going to make good on that commitment and that is in process," DeVos said.

The Education Department announced in January that it had sent emails to tens of thousands of borrowers, informing them that their debt relief claims had been approved. The department said at the time that it would carry out the loan forgiveness within 120 days, a deadline that expired earlier this month.

A department spokeswoman earlier this month called the 120-day deadline an "arbitrary one set by the Obama administration." In her testimony today, DeVos did not commit to a timeline for when the department would carry out the promised loan forgiveness.

DeVos also did not address whether her department plans to sift through the backlog of debt relief claims that have not yet been decided. Those claims would be handled under the existing rules for debt relief that have been on the books since the Clinton administration.

The Obama administration proposed new standards for debt relief when students are defrauded by their college, and those "borrower defense to repayment rules" are currently slated to take effect on July 1.

"That is something that we are studying carefully and looking at and we will have something further to say on that within the next few weeks," DeVos said of the Obama-era rules.