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Litigation Governance: Taking Accountability Seriously

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Abstract

Both Europe and the United States are rethinking their approach to aggregate litigation. In the United States, class actions have long been organized around an entrepreneurial model that uses economic incentives to align the interest of the class attorney with those of the class. But increasingly, potential class members are preferring exit to voice, suggesting that the advantages of the U.S. model may have been overstated. In contrast, Europe has long resisted the U.S.'s entrepreneurial model, and the contemporary debate in Europe centers on whether certain elements of the U.S. model - namely, opt-out class actions, contingent fees, and the "American rule" on fee shifting - must be adopted in order to assure access to justice. Because legal transplants rarely take, this Essay offers an alternative "non-entrepreneurial model" for aggregate litigation that is consistent with European traditions. Relying less on economic incentives, it seeks to design a representative plaintiff for the class action who would function as a true "gatekeeper," pledging its reputational capital to assure class members of its loyal performance. Effectively, this model marries aspects of U.S. "public interest" litigation with existing European class action practice. Examining the differences between U.S. and European practice, this Essay argues none of these differences are dispositively prohibitive and that functional substitutes, including an opt-in class action and third party funding, could be engineered so as to yield roughly comparable results. Although the two systems might perform similarly in terms of compensation, the ultimate question, it argues, is the degree to which a jurisdiction wishes to authorize and arm a private attorney general to pursue deterrence for profit.

Keywords: Agency costs, aggregate litigation, American rule, class action, contingent fee, exit versus voice, entrepreneurial model, fee award, fee shifting, loser pays rule, opt-in, opt-out, plaintiff's attorney, private attorney general, third party funding, voice

JEL Classifications: K40, K41, K42, K22

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LITIGATION GOVERNANCE: TAKING ACCOUNTABILITY SERIOUSLY

John C. Coffee, Jr.[*]

Scholarship in the field of civil procedure has long been characterized by an incisive rigor---and a rule-bound tunnel vision. At its best, this research is tightly focused, richly historical, and infinitely nuanced,[1] but it tends to assume the persistence of the structural and organizational features that principally define the status quo. Thus, much like goldfish trapped in a bowl, even the best of procedural scholars may have difficulty envisioning alternative structures and organizational forms. This essay presents an alternative way to conceptualize the well-known problems of accountability in aggregate and class litigation: namely, as a governance problem that can be managed in much the same way as other governance problems.[2]

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[1] My colleague and friend, Henry Monaghan, has long been a master at this rule-based genre. See Henry Paul Monaghan, Antisuit Injunctions and Preclusion Against Absent Nonresident Class Members, 98 Colum. L. Rev. 1148, 1153 (1998) (arguing nonresident class members should not be precluded from litigating their substantive claims despite a prior class judgment purporting to bind them).

[2] Inherently, a governance perspective focuses on structural relationships, particularly those by which (1) the members of the organization or entity define their rights among themselves, and (2) authorize their agents to act for them. Most of corporate governance addresses the principal/agent relationships between shareholders and managers, and corporate law typically confers on shareholders the right to elect the board of directors and to approve certain fundamental transactions (such as a merger, sale of substantially all the corporation's assets, or amendment of the certificate of incorporation). In contrast, the Federal Rules of Civil Procedure are largely silent on these structural issues, requiring only that the court approving a class action settlement make certain requisite findings. See Fed. R. Civ. P. 23(e) (specifying that court must approve settlement of class action and that court must hold a hearing and find settlement to be "fair, reasonable, and adequate"). The Private Securities Litigation Reform Act of 1995, discussed infra notes 17, 32--33, 99--115 and accompanying text, presumptively makes the largest stakeholder in the action the vicarious representative for all class members in the case of securities class actions. 15 U.S.C. § 78u-4(a)(3)(B)(iii) (2006). But there is no corresponding rule governing non-securities class actions, which constitute the majority of class actions. Instead, all is left to judicial discretion. Although few would recommend that important issues facing the class be resolved by a majority vote (both because it is difficult to identify class members prior to the case's resolution and because small claimants tend to be rationally apathetic), civil procedure law has a void at its center to the extent that it only obliquely addresses the rights and remedies of class members.

From a governance perspective, a key issue on which this article focuses is whether class litigation should be organized around an entrepreneurial model, as it certainly is in the United States, or a non-entrepreneurial model, as Europe seems to favor, in which neither the attorneys nor the representative plaintiff will receive disproportionate benefits from the action. Assessing these alternative models in any depth requires a broader governance perspective.

The difference involves more than semantics. Despite recent scandals and even the criminal convictions of leading class action plaintiffs' attorneys,[3] traditional procedural scholarship has remained largely resigned to the accountability problems that clearly afflict the U.S. class action litigation system.[4] This is not because these scholars approve of opportunistic behavior by plaintiff's attorneys, but because they see no alternative that will retain the class action as an effective remedy for small claimants. Tradeoffs are inevitable, but they should be faced candidly. In order to protect small claimants, the United States has fashioned a unique system of "entrepreneurial litigation" that rests on at least three key elements:[5]

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[3] In my judgment, the two best known leaders of the plaintiffs' securities class action bar were William S. Lerach and Melvyn I. Weiss. Both have served or are now serving criminal sentences in federal prison for convictions in connection with concealing illegal payments to class action plaintiffs who in effect serviced their law firms as in-house clients. See Jonathan D. Glater, Class-Action Lawyer Given a 30-Month Prison Term for Hiding Kickbacks, N.Y. Times, June 3, 2008, at C-3 (discussing both convictions). In addition, Richard F. Scruggs, who may have been an even more famous plaintiff's attorney for his success in winning a multi-billion dollar settlement from the tobacco industry in the 1990s, was also sentenced in 2008 for attempting to bribe a Mississippi state court judge. See Abha Bhattarai, Class-Action Lawyer Given 5 Years In a Bribery Case, N.Y. Times, June 28, 2008, at C3.

[4] Some academics simply deny that there is an accountability problem in class actions. See Myriam Gilles & Gary B. Friedman, Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers, 155 U. Pa. L. Rev. 103, 104--05 (2006) (describing accountability problems as mostly a "mirage") (2006). More academics agree that there are problems, but still defend the securities class action as a necessary mechanism for enhancing shareholder monitoring or generating general deterrence. See generally The Continuing Evolution of Securities Class Actions Symposium, 2009 Wis. L. Rev. 151. In this Symposium, Professors Merritt Fox and Jill Fisch argue that the securities class action improves corporate governance, and Professor Lawrence Mitchell argues that it generates deterrence. See Jill E. Fisch, Confronting the Circularity Problem in Private Securities Litigation, 2009 Wis. L. Rev. 333, 345--48 (2009) (seeking to justify litigation remedy as compensating informed traders for losses stemming from fraudulent corporate representations); Merritt B. Fox, Why Civil Liability for Disclosure Violations When Issuers Do Not Trade?, 2009 Wis. L. Rev. 297, 310--18 (arguing mandatory disclosure regimes enhance corporate efficiency); Lawrence E. Mitchell, The "Innocent Shareholder": An Essay on Compensation and Deterrence in Securities Class Action Lawsuits, 2009 Wis. L. Rev. 243, 243 (arguing securities liability provides incentives for shareholders to take responsibility for market integrity). These academics are largely responding to new critiques, made by a number of academics, that the securities class action today yields little compensation or deterrence. See, e.g., John C. Coffee, Jr., Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation, 106 Colum. L. Rev. 1534, 1534 (2006) [hereinafter Coffee, Reforming the Securities Class Action] (arguing minimal deterrent and compensatory benefits from securities class actions). This Essay certainly does not seek to curtail class actions, but to survey the range of possibilities for their reform and to consider alternative starting points for other countries seeking for the first time to address aggregate litigation.

[5] The uniqueness of the American procedures for aggregate litigation is widely recognized. See Richard L. Marcus, Review Essay: Putting American Procedural Exceptionalism into a Globalized Context, 53 Am. J. Comp. L. 709, 735 (2005) (noting importance of class action in American civil procedure). The term "entrepreneurial litigation" was probably first coined by this author (or at least legal databases do not show earlier uses of the term in law reviews). See John C. Coffee, Jr., The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency

(1) the availability of the class action procedure, under which one allegedly injured plaintiff can bring suit so as to bind not only oneself, but all others similarly situated;[6]

(2) the contingent fee under which a successful plaintiff's attorney will receive a fee awarded by the court that is likely to be in the range of 15% to 30% of the settlement or judgment;[7] and

(3) the American rule on fee shifting under which each side normally bears its own legal costs (thus sparing the small claimant from exposure to the defendant's legal expenses, which may deter persons from serving as the representative plaintiff under the "loser pays" fee shifting rule that applies generally in Europe).[8]

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in the Large Class Action, 54 U. Chi. L. Rev. 877 (1987). In an even earlier work, I had modeled the plaintiff's attorney who handles an inventory of contingent fee actions as a risk-taking entrepreneur. 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, 701--24 (1986) (developing entrepreneurial model of contingent fee lawyering). Most who use the term entrepreneurial litigation see three elements as defining it: (1) the availability of the class action; (2) the contingent fee; and (3) the American rule under which each side bears its own legal fees. But there are actually three other important elements that facilitate entrepreneurial litigation in the United States: (1) the right to a jury trial in common law cases brought in federal court (which is guaranteed by the Seventh Amendment to the U.S. Constitution); (2) the availability of punitive damages; and (3) the "common fund" doctrine that entitles a successful plaintiff who has created a fund that benefits others to recover reasonable attorneys fees from the fund based on common law principles of restitution and unjust enrichment. See Boeing Co. v. Van Gemert, 444 U.S. 472, 478--81 (1980) (discussing common fund doctrine); Trustees v. Greenough, 105 U.S. 527, 527 (1881) (acknowledging principles underlying common fund doctrine). The first two of these elements cause defendants to fear the risk of large recoveries, which would be unlikely in other countries where judges impose damages and do not seek to punish the defendants for misconduct in civil cases; the third element, the common fund doctrine, eliminates the need for each class member to consent to the contingent fee. Effectively, it converts the contingent fee from something that is contractually permissible to a legal right.

[6] This development required not only a procedural rule (Rule 23 of the Federal Rules of Civil Procedure), but also a constitutional theory as to why one litigant could bind others who had not consented to the representation. In Phillips Petroleum Co. v. Shutts, the Supreme Court set forth the "due process minima" on such unconsented representation, identifying three requisite elements: (1) individual notice; (2) an opportunity to exclude oneself by opting out; and (3) adequate and unconflicted representation in the proceeding. 472 U.S. 797, 808--14 (1999).

[7] The contingent fee predates the class action and arose first in the United States, chiefly in personal injury litigation during the late nineteenth century. For a history of its acceptance in the United States, see James Moliterno, Broad Prohibition, Thin Rationale: The "Acquisition of an Interest and Financial Assistance in Litigation" Rules, 16 Geo. J. Legal Ethics 223, 229--30 (2003) (tracing history and rationales underlying U.S. rule on contingent fees). By 1876, the Supreme Court had declared that the lawfulness of contingent fees was "beyond legitimate controversy." See Stanton v. Embrey, 93 U.S. 548, 556 (1876) (discussing validity of contingent fees). For data on the typical plaintiff's attorney's fee in class actions, see infra notes 24, 56, 59.

[8] See Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 258--59 (1975) (citing cases affirming attorney's right to collect fee). The prevailing rule in the United States, known as the "American Rule," requires

Collectively, these elements do solve the problem of providing a feasible remedy for "negative value" claims---that is, those claims that, while meritorious, have an enforcement cost in excess of their individual value.[9] But this benefit comes at the cost of creating principal/agent problems that remain intractable despite repeated efforts by Congress and the courts to curb highly visible abuses. This uncertain tradeoff between the costs and benefits of conferring vast discretion on plaintiff's attorneys has led others, Europeans in particular, to resist any shift to U.S. style entrepreneurial litigation.[10]

But what is the alternative? This article considers two alternatives: (1) greater reliance on what it terms "exit-based" reforms as opposed to further "voice-based" reforms, in part in order to introduce greater competition into the market for class action legal services;[11] and (2) a non-entrepreneurial model for aggregate litigation that may be more compatible with legal cultures outside the United States.

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litigants to pay their own attorneys' fees and costs of litigation, absent special statutory provisions for fee shifting. See Thomas D. Rowe, The Legal Theory of Attorney Fee Shifting: A Critical Overview, 1982 Duke L. J. 651, 651--52 (1982) (analyzing various rationales for fee shifting rules). Limited exceptions to this rule exist where one side has acted in bad faith. See, e.g., Christianburg Garment Co. v. EEOC, 434 U.S. 412, 419 (1978) (discussing ability to award attorney's fees where plaintiff proceeds in bad faith). The opposing rule that the losing side should pay the winning side's reasonable fees is known as the "English Rule."

[9] Even courts of appeals critical of the class action have recognized that "the existence of negative value" claims constitutes the "most compelling rationale for finding superiority in a class action." See Castano v. American Tobacco Co., 84 F.3d 734, 748 (5th Cir. 1996) (discussing appropriate rationale for granting class certification). For a definition of the term "negative value claims" as "claims in which the costs of enforcement in an individual action would exceed the expected individual recovery," see In re Inter-Op Hip Prosthesis Liab. Litig., 204 F.R.D. 330, 348 (N.D. Ohio 2001).

[10] For a good and recent overview, see generally Christopher Hodges, The Reform of Class and Representative Actions in European Legal Systems (2008); Richard Nagareda, Aggregate Litigation Across the Atlantic and the Future of American Exceptionalism, 62 Vand. L. Rev. 1, 19--37 (2009) (providing comparative analysis of recent developments in Europe regarding aggregate litigation); Michael Gousgounis, Association-Driven Aggregate Litigation: Peanuts Effect and Democratization of Litigation Governance, 2--4 (2009) (unpublished manuscript, on file with *Columbia Law Review*), available at http://ssrn.com/abstract=1469046 (analyzing recent European developments).

[11] The terms "exit" and "voice" were first coined by the Harvard economist, Albert O. Hirschman, in 1970 to contrast rival strategies for influencing large organizations (including governments). Albert O. Hirschman, Exit, Voice and Loyalty 4 (1970).

Outside the United States, much of the world is actively seeking to develop new approaches to aggregate litigation. Although reformers have recognized the inadequacy of existing procedural mechanisms for aggregating claims, they remain reluctant to buy into "entrepreneurial litigation" and continue to search for intermediate options that stop short of adopting either the contingent fee or the opt-out class action. This has frustrated some U.S. academics, who have understandably opined in substance that "you-cannot-have-one-without-the-other". Without the contingent fee and the opt-out class action, they argue, no mechanism for aggregating negative value claims will be effective.[12] But is this necessarily true? Are intermediate compromises possible?

This Essay is premised on the belief that neither the optimality nor the transportability of the U.S. class action system should be assumed. Both the United States and Europe may in fact be unconsciously converging, the latter by cautiously opening the courthouse door to some forms of aggregate litigation and the former by rigorously tightening the standards for class certification in a manner that has increasingly closed the courthouse door. Both sides recognize that "entrepreneurial litigation" enables "negative value" claims to be litigated, but a debate continues on both sides of the Atlantic as to whether this benefit comes at an excessively high cost by conferring extraordinary leverage on an often unaccountable agent: the class action attorney. The defense bar has long protested (with obvious self-interest) that a consequence of this leverage is "extortionate" litigation in which even non-meritorious cases may obtain

[12] See Samuel Issacharoff & Geoffrey P. Miller, Will Aggregate Litigation Come to Europe?, 62 Vand. L. Rev. 179, 180--81 (2009) (arguing that need to incentivize class counsel and representative plaintiff requires the adoption in some form of American innovations, such as the contingency fee). Professors Issacharoff and Miller argue that European reformers are so reluctant to adopt the central elements of the American model that there is a danger "of throwing out the baby with the bathwater." Id. at 191. This line between the baby and the bathwater may often lie in the eye of the beholder.

substantial settlements.[13] Perhaps more importantly, an intense, low visibility competition has arisen for the coveted position of class counsel because the winner of this competition stands to capture significant rents. This competition has been the underlying cause of recent scandals within the plaintiff's bar. Although the nature of this competition has recently changed, its latest manifestation---pay-to-play contributions by plaintiffs' law firms to public pension funds---may enable some competitors to undercut the very reforms that Congress established to control class action abuses.[14] The vulnerability of these reforms, it will be argued, flows directly from the class action's special governance rules and reveals the dangers of relying primarily on "voice," rather than "exit."

From a governance perspective, European resistance to the transplantation of American class action rules should not be surprising. The history of attempts at legal transplantation reveals many more failures than successes. For example, after the break up of the Soviet Union

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[13] No sooner did the class action develop in the late 1960s than some proclaimed that it would lead to "legalized blackmail." See, e.g., Milton Handler, The Shift from Substantive to Procedural Innovations in Antitrust Suits---The Twenty-Third Annual Antitrust Review, 71 Colum. L. Rev. 1, 9 (1971). Both before and after then, an unending number of defense counsel (and some academics) regularly proclaimed securities and corporate litigation to be particularly subject to "extortion." One can trace this critique back well into the last century. See Note, Extortionate Corporate Litigation: The Strike Suit, 34 Colum. L. Rev. 1308 (1934) (discussing effects of "extortionate" securities litigation). Empirical support for this claim is less in evidence. However, in enacting the Private Securities Litigation Reform Act of 1995, Congress largely accepted the diagnosis that the scales of justice had been tilted too far in the direction of plaintiffs. The Conference Report accompanying that legislation emphasized the "abusive practices committed in private securities litigation," including "routine filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer." H.R. Rep. No. 104-369, at 31 (1995).

[14] Plaintiff's law firms today make substantial political contributions to the political officials responsible for, or with influence over, the public pension funds that typically serve as "lead plaintiffs" in securities class actions. Their goal appears to be induce these lead plaintiffs to select them as class counsel. This practice---known as "pay-to-play"---has been much discussed and reform legislation has been recently proposed. For an overview, see James D. Cox & Randall Thomas, Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions, 106 Colum. L. Rev. 1587, 1614--15 (2006) [hereinafter Cox & Thomas, Does the Plaintiff Matter?]. Professors Cox and Thomas discuss one well-known case in which the New York State Comptroller received $200,000 in political contributions from law firm partners (and the families of partners) at two law firms in the year following their selection as co-class counsel to the New York State Comptroller, which was serving as lead plaintiff in the action. Eventually, the two law firms received a $55 million fee award. Id. at 1611--12. Many public pension funds have internal governance structures, such as independent boards, that are designed to protect them from pay-to-play influences, and no universal criticism is here intended.

when corporate law reformers sought to transplant American rules to Russia and other transitional economies to facilitate privatization, they quickly found that the rules of Delaware corporate governance, while efficient in their own environment, did not work effectively in Russia or other developing economies.[15] Indeed, in general, scholars have found that transplanted legal rules tend to perform poorly, to be adopted incompletely, and to whither quickly unless the local culture is receptive.[16] Receptivity to the transplanted rule depends on its compatibility with the existing legal culture.

Part I of this Essay begins by mapping the legal terrain and surveying the range of organizational forms and governance rules employed to collect "negative value" claims for aggregate litigation. Part II then turns to the tools by which courts and legislatures can most feasibly assure accountability in aggregate litigation. It finds that "voice-based" reforms (including the "lead plaintiff" provision adopted by Congress to deal with abuses in securities class actions[17]) have had only a modest impact, but a less noticed and market-based development---namely, an increased rate of opting out by institutional investors---has

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[15] For one of the first and most influential statements of this thesis that corporate legal rules work only within specific institutional and cultural contexts, see Bernard Black & Reinier Kraakman, A Self-Enforcing Model of Corporate Law, 109 Harv. L. Rev. 1911 (1996). Their starting point is that "national contexts" shape corporate law. Id. at 1920--29. Cultural norms are very much part of this national context. For a similar critique of the idea that law can be standardized successfully, see Katharina Pistor, The Standardization of Law and Its Effect on Developing Economies, 50 Am. J. Comp. L. 97 (2002) (arguing that attempts at legal standardization impeded economic development).

[16] A rich literature in law and economics has explored the difficulties in transplanting legal rules (generally from developed countries to "emerging market" nations). See, e.g., Daniel Berkowitz, Katharina Pistor, & Jean-Francois Richard, The Transplant Effect, 51 Am. J. Comp. L. 163 (2003) (analyzing historical legal transplants and proposing that success of transplant depends more on process than content of legal rules). Although some transplanted legal rules do survive, these authors find that transplants generally only take when they are adapted to local conditions or when they find a receptive audience because that audience is already familiar with a similar underlying structure to the law. Id. at 167--68. This Essay posits that this same "transplant effect" will likely also limit the acceptance of exported litigation rules, just as it has in the case of corporate law rules.

[17] See Securities Exchange Act of 1934 § 21D(a)(3)(B)(iii), 15 U.S.C. § 78u-4(a)(3)(B)(iii) (creating presumption in favor of class member seeking appointment as lead plaintiff who "in the determination of the court has the largest financial stake in the relief sought by the class"). This provision is discussed infra notes 32--33, 99--115 and accompanying text.

dramatically changed the landscape of securities litigation and may imply an eventual end to heterogeneous class actions that group large and small investors together.[18] Because, in this Essay's terminology, the lead plaintiff provision is the paradigm of a "voice-based" reform, whereas opting out is an "exit-based" reform, this discussion sets the stage for a broader comparison of "exit" versus "voice" as the key policy levers in litigation governance. Part III then turns to the European context and explores developments there involving alternative organizational structures for aggregate litigation. In particular, it finds that the perceived advantages of the opt-out class action over the opt-in may have been overstated. Accordingly, it proposes an alternative, non-entrepreneurial model for Europe that recognizes the need to incentivize risk-taking in connection with aggregate litigation, but does not rely on the attorney, as a self-appointed entrepreneur, to both fund and control the litigation. Instead, it seeks to draw upon the experience of U.S. public interest litigation to develop an alternative model in which reputational capital substitutes for economic incentive.

This Essay draws comparisons between "corporate governance" and "litigation governance." This is not based on any assumption that corporate law has solved the problem of accountability, but rather on the fact that corporate (and also law and economics) scholarship long ago developed a vocabulary for dealing with the issue of accountability that can be usefully applied to the litigation context. In particular, this Essay will focus on the concept of "agency

[18] In an earlier article, I surveyed this trend towards increased opting out in securities class actions. See John C. Coffee, Jr., Accountability and Competition in Securities Class Actions: Why "Exit" Works Better Than "Voice," 30 Cardozo L. Rev. 407, 425--29 (2008). This Essay seeks to place this development in a larger context and does not address (as the earlier article did) the options by which courts could encourage or discourage opting out.

costs"[19] and the tradeoffs between "exit" and "voice" as tools by which to regulate the behavior of agents in aggregate litigation.

I. *A Primer on Litigation Governance*

It is simplest to understand litigation governance by contrasting it with corporate governance. Corporate governance deals essentially with the relationships between investors and their agents: the directors, managers, and employees of the firm. Although litigation governance also comprehends all the principal/agent relationships affecting those who will be bound by a legal proceeding brought on their behalf, the United States adopts a fundamentally different rule to govern the relationship between the principals and the agents in this context. In the corporate governance context, an entrepreneur seeking to raise capital for a business venture must convince investors to "opt-in" and buy the securities of the entrepreneur's start-up corporation. This means that the entrepreneur bears the "agency costs" of the venture, because to the extent that investors are skeptical or uncertain about the entrepreneur's loyalty and readiness to act in their best interests, they will either decline to invest or will pay a lesser price for the securities.[20] In contrast, in the typical class action in the United States, a plaintiff's attorney will file a complaint that may broadly define the class to consist of thousands of persons and entities, without the attorney having the prior consent of more than the attorney's individual client. Thereafter, it is

[19] For the standard definition of "agency costs," see Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305, 308 (1976). Agency costs are defined as the sum of the preventive costs taken by firms to limit misappropriations by their agents, the bonding costs undertaken by agents themselves to demonstrate their loyalty, and the irreducible minimum of losses from agent misconduct that it is not efficient to seek to prevent. For an application of agency costs to class actions, see 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, 19--27 (1991).

[20] This is the key insight of Jensen and Meckling model: Namely, that the founders of a firm bear the agency costs of investor uncertainty. But as next discussed, this insight has less application to litigation governance.

up to the other class members to opt-out of the action.[21] Typically, the class members will neither have the right to select or replace the attorney nor to determine the attorney's fee (which will instead be set by the court).[22] In the case of "negative value" claims, the class members will have little rational reason to opt-out (because they cannot economically proceed on their own) and so they will predictably remain rationally apathetic, staying within the class.

This day-and-night difference between an opt-in rule for corporate governance and an opt-out for litigation governance means that the attorney/entrepreneur does not bear the agency costs of the clients' doubts or skepticism, as the entrepreneur in corporate governance does. Agency costs will thus predictably be higher because the attorney has less incentive to minimize them and the class members generally cannot.

To be sure, this does not mean that agency costs are entirely unconstrained. The court plays a monitoring role, and competition is likely among multiple counsel seeking to be named

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[21] Technically, there is only a right to "opt-out" (that is, to exclude oneself from the class so that the action's resolution is not binding on you) in the case of class actions certified under Rule 23(b)(3). See Fed. R. Civ. P. 23(c)(2)(B). Although a class certified instead under Rule 23(b)(1) or (b)(2) does not confer a right to opt-out, some decisions have suggested that the right to opt-out may be constitutionally required when class members have substantial monetary claims. See Molski v. Gleich, 318 F.3d 937, 950--53 (9th Cir. 2003) (mandatory class certification under Rule 23(b)(2) reversed because failure to provide notice or opportunity to opt-out denied due process); Beckert v. TPLC Holdings, Inc., 221 F.3d 870, 873--74, 881--82 (7th Cir. 2000) (due process requires right to opt-out of class "[w]here defendants have sufficient funds to compensate class members through individual litigation").

[22] Just how powerless even the class representatives can be is revealed by Lazy Oil Co. v. Witco Corp, 166 F.3d 581, 589-91 (3d Cir. 1999) (approving class action settlement and refusing to disqualify class counsel despite objections from lead plaintiff and other major class members). There, three of the four class representatives who had brought an antitrust class action became dissatisfied with the class counsel and its proposed settlement. Id. at 583. These class representatives were sophisticated oil companies who had originally planned the action. In addition, some 384 class members also opposed the settlement and filed objections. Nonetheless the district court and the Third Circuit permitted the case to be settled over their objections. Id. at 589-91. The lesson here is simple: Both courts and class counsel often have strong incentives to favor settlements, even when they are on terms that are unsatisfactory to sophisticated class members. For a similar view that the representative plaintiff has little role or impact, see Geoffrey P. Miller, Competing Bids in Class Action Settlements, 31 Hofstra L. Rev. 633, 634 n.2 (2003) (citing other sources that discuss the minimal role or impact of representative plaintiff).

Although class members may object to the attorney's fee awarded by the court, the fee award is a matter for judicial decision and discretion. See Fed. R. Civ. P. 23(h) (governing procedures for attorney fee awards and requiring judicial approval). The removal of class counsel is at the discretion of the court, and even the lead plaintiff in securities litigation does not have the power to remove class counsel. See Fed. R. Civ. P. 23(g).

class counsel. Hence, prior success and reputation remain relevant factors in the selection of class counsel, but so also may other factors, including pay-to-play contributions.[23] More importantly, whatever the fee formula officially used, the empirical evidence clearly demonstrates that the class attorney's fee will be a direct function of the size of the recovery obtained for the class; the bigger the recovery, the higher the fee.[24] Thus, the class attorney has a strong incentive to maximize the recovery. But this does not imply that the interests of class members are well aligned, either with each other or with their attorney.[25]

A. *A Typology of Aggregate Litigation Models*

The fact that the clients do not choose or control their attorney in class and representative litigation under the normal U.S. rules of litigation governance has proven a sticking point for other legal systems, which have so far largely declined to adopt U.S.-style class action procedures. From a comparative perspective, one can categorize existing approaches for organizing large-scale aggregate litigation as falling into one of the following five models.

1. *The "Opt-Out" Class*. --- The critical idea underlying the opt-out class action is that one affected individual should be able to bring an action on behalf of (and that will bind) all

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[23] A debate continues over the significance of pay-to-play. A recent investigation by the New York Daily News found that lawyers representing the State of New York received over $518 million in fee awards in class action cases over the last ten years and that the last three New York State Controllers had received over one million dollars in political contributions from plaintiffs' law firms. See Kenneth Lovett, "Pension Pay-To-Play: Law Firms Gave Controllers Big Bucks, Then Got $518M in Fees From State Fund," N.Y. Daily News, October 8, 2009. Others believe that the impact of "pay to play" has been overstated. See David H. Webber, Is Pay-to-Play Driving Public Pension Fund Activism in Securities Class Actions?: An Empirical Study 1, 2 (NYU Center for Law, Econ. & Org. Working Paper No. 09-28, 2009), available at http://ssrn.com/abstract=1432497) (on file with the *Columbia Law Review*). Nonetheless, when political contributions are made to state and municipal comptrollers by lawyers in a remote jurisdiction (as they often are), it is hard to imagine any plausible explanation other than a desire to influence the future selection of class counsel.

[24] For the fullest empirical study demonstrating this point, see Theodore Eisenberg & Geoffrey P. Miller, Attorney Fees in Class Action Settlements: An Empirical Study, 1 J. Empirical Legal Stud. 27, 28 (2004) (arguing size of fund is best predictor of fee, regardless of fee formula used).

[25] I have surveyed the range of conflicts that can arise between class counsel and class members elsewhere. See John C. Coffee, Jr., Class Action Accountability: Reconciling Exit, Voice, and Loyalty in Representative Litigation, 100 Colum. L. Rev. 370, 385--393 (2000).

similarly situated persons whose rights have been allegedly infringed by the defendant's same conduct. Breathtaking in scope, this unique governance rule is usually justified as necessary to solve collective action problems that render small claimants rationally apathetic. But it also confers enormous leverage on the class counsel. Effectively, Rule 23 of the Federal Rules of Civil Procedure allows this attorney, often using only a nominal client, to file an action that sets forth its own proposed definition of the class of persons who will be bound by it; then, it is up to the proposed class members to flee the class by opting out. The practical ability of the plaintiff's attorney to aggregate claims pursuant to Rule 23 is, however, subject to two important limitations: (1) certain due process minima must be observed;[26] and (2) if the action primarily seeks money damages, the class must be defined so that the common issue of law and fact "predominate" over the individual issues.[27] This predominance requirement enables courts to exercise considerable discretion in determining what causes of action are suitable on their facts for class-wide determination. Other prerequisites for class certification exist, but only two are likely to have any "real world" impact: (1) the class representative must be found "adequate" to represent the class,[28] and (2) the class representative must hold claims "typical" of those held by the class.[29] All told, these latter criteria are fairly minimal tests of class cohesion, and as a result

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[26] See Phillips Petroleum Co. v. Shutts, 472 U.S. 815 (1999) (PARENTHETICAL).

[27] See Fed. R. Civ. P. 23(b)(3). In recent years, the federal courts have tightened class certification requirements substantially, principally by interpreting this predominance standard more rigorously. For a review of these decisions, see John C. Coffee, Jr. & Daniel Wolf, Class Certification: Trends and Developments over the Last Five Years (2003-2008), *in* Class Action Litigation 2009: Prosecution and Defense Strategies (PLI [SECTION OF PLI], Course Handbook Series No. H-800, 2009).

[28] See Fed. R. Civ. P. 23(a)(4). The adequacy-of-representation requirement looks to both "(1) whether any substantial conflicts of interest exist between the representative and the class; and (2) whether the representative will adequately prosecute the action." See Busby v. JRHBW Realty, Inc., 513 F.3d 1314, 1323 (11th Cir. 2008) (reversing denial of class certification and assessing standards for certification under Rule 23).

[29] See Fed. R. Civ. P. 23(a)(3). Typicality is satisfied "when each class member's claim arises from the same course of events and each class member makes similar legal arguments to prove the defendant's liability." See Robinson v. Metro-N. Commuter R.R. Co., 267 F.3d 147, 155 (2d Cir. 2001) (reversing denial of class certification and analyzing standards under Rule 23).

Rule 23 effectively enables the plaintiff's attorney to file a class action covering potentially millions of class members, based only on the consent of a single class member with a nominal interest.

Nonetheless, the tide may be turning. Over the last decade, U.S. courts have proven increasingly reluctant to certify sprawling class actions, steadily rejecting more and more proposed classes based on the "predominance" standard of Rule 23(b)(3).[30] Still, in some areas, such as securities litigation, the common issues typically continue to be found to predominate over the individual issues,[31] and so large class actions asserting multi-billion dollar claims remain common in the securities context.

In securities class actions, an additional important governance rule applies: A rebuttable presumption was created by the Private Securities Litigation Reform Act of 1995 ("PSLRA") that the class member with the largest stake in the action who volunteers to serve as the class representative should be preferred over other proposed representatives with smaller stakes.[32] The class representative so selected (termed the "lead plaintiff" by the PSLRA) then chooses the class counsel.[33] In effect, this approach substitutes the economic self-interest of the lead plaintiff

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[30] For example, in tort cases, proximate causation is typically found to be an individual issue that prevents a finding of predominance; in fraud cases, the victim's reliance on the alleged misrepresentation is similarly an individual issue (except as explained in the next footnote), and in contract cases when multiple states' law apply, this variation in law is also an individual legal issue. See Coffee & Wolf, supra note 27, at 195--218 (reviewing recent decisions rejecting class certification for failure to satisfy predominance standard).

[31] In large part, this is because the Supreme Court in Basic, Inc. v. Levison adopted the "fraud on the market" doctrine, which eliminated any need for the class members to show individual reliance on the material misstatement or omission in cases where the security traded in an efficient market. 485 U.S. 224, 250 (1988). Because reliance would have been an "individual" issue, the need to prove reliance by each class member would have precluded a finding of predominance under Rule 23(b)(3). Id. at 229--30; see also Fed. R. Civ. P. 23(b)(3).

[32] See Securities Exchange Act of 1934, § 21D(a)(3)(B)(iii), 15 U.S.C. § 78u-4(a)(3)(B)(iii) (creating presumption in favor of person seeking appointment who "in the determination of the court, has the largest financial interest in the relief sought by the class").

[33] See Securities Exchange Act of 1934 § 21D(a)(3)(B)(v) ("Selection of Lead Counsel"), 15 U.S.C. § 78u-4(a)(3)(B)(v). This selection is, however, made expressly "subject to the approval of the court," which must satisfy

for a democratic selection process---based on the obvious logic that few class members will exercise any right to vote or express themselves.

2. *The Non-Opt-Out Class.* --- In the United States, the principal alternative to the opt-out class action accords even less rights to class members. Rule 23 of the Federal Rules of Civil Procedure permits a plaintiff to seek injunctive or equitable relief or to assert claims with respect to a "limited fund," without according fellow class members any right to opt-out.[34] The rationale here is that separate actions might lead to inconsistent results or might allow a plaintiff who opted out an opportunity to seize the limited fund, thereby depriving the others. Yet, despite this narrow rationale for the non-opt-out class, non-opt-out class actions may in some Circuits also assert claims for sizable monetary damages, so long as the action purports to primarily seek injunctive relief.[35] Effectively, this rule may enable the class attorney who is truly seeking money damages to outflank the normal class member's right to opt-out.[36]

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itself as to the adequacy of representation standard under Rule 23(a)(4), both with respect to the class representative and the class counsel. Id.

[34] By their terms, Rules 23(b)(1) and 23(b)(2) do not require either notice or a right to opt-out. Fed. R. Civ. P. 23(b)(1) & (2). Rule 23(b)(1) authorizes a mandatory non-opt-out class action, usually relating to a "limited fund." Fed. R. Civ. P. 23(b)(1)(B). A limited fund is essentially a fund that will be inadequate to satisfy the claims of all claimants. Such a limited fund may arise either when the litigation is over a specific asset (for example, a Rembrandt that various heirs to a decedent claim), or when the defendant's funds are inadequate to pay all claimants. In such instances, any individual recovery in a separate action might frustrate the class action by depleting the assets available, and hence Rule 23(b)(1)(B) authorizes a mandatory class from which class members may not opt-out. In Ortiz v. Fibreboard Corp., 527 U.S. 815, 838 (1999), the Supreme Court insisted upon a narrow definition of "limited fund," restricting the reach of Rule 23(b)(1)(B) to cases where the "totals of the aggregate liquidated claims and the fund available for satisfying them, set definitely at their maximums, demonstrate the inadequacy of the fund to pay all the claims." Much more frequently used than Rule 23(b)(1) is Rule 23(b)(2), which authorizes a class action seeking predominantly equitable or injunctive relief. Fed. R. Civ. P. 23(b)(2). Traditionally, only "incidental" money damages could be sought under this provision, but the Circuit Courts are now clearly split over the meaning of "incidental" money damages, as explained infra note 35.

[35] Both the Second and the Ninth Circuits have allowed class actions to seek compensatory damages under an "ad hoc balancing" test where "the positive weight or value [to the plaintiffs] of the injunctive or declaratory relief sought is predominant even though compensatory or punitive damages are also claimed." Robinson v. Metro-N. Commuter R.R. Co., 267 F.3d 147, 164 (2d Cir. 2001) (quoting Allison v. Citgo Petroleum Corp., 151 F.3d 402, 430 (5th Cir. 1998) (Dennis, J., dissenting)); see also Molski v. Gleich, 318 F.3d 937, 950 (9th Cir. 2003) ("In order to determine predominance, we have focused on the language of Rule 23(b)(2) and the intent of the plaintiffs in bringing the suit."). *Robinson*'s very broad test for when compensatory relief can be obtained under Rule 23(b)(2) looks to whether "(1) even in the absence of a possible monetary recovery, reasonable plaintiffs would bring the suit

3. *The Opt-In Class Action*. --- The polar opposite to the opt-out class is the opt-in model, under which each claimant must take some positive step to join the collective proceeding. The opt-in model appears to be the dominant approach in Europe.[37] In contrast, in the United States, the opt-in class action has been held to be unavailable.[38] In a leading case in which the district court had sought to fashion an opt-in class because no other procedure was available, the Second Circuit still rejected this attempt, finding that an opt-in class was simply not permitted by Rule 23.[39]

In contrast to the coolness shown by U.S. courts to the concept of the opt-in class action, Europe has been reluctant to accept any collective litigation remedy that does not require individual consent by class members. In 2008, the European Commission published both (i) a "white paper" on antitrust enforcement, which, after considering a variety of options, favored the

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to obtain the injunctive or declaratory relief sought; and (2) the injunctive or declaratory relief sought would be both reasonably necessary and appropriate were the plaintiffs to succeed on the merits." *Robinson*, 267 F.3d at 164. A number of other circuits have rejected this broad reading of Rule 23(b)(2) and permitted only the recovery under it of damages easily computed pursuant to a formula or statutory penalty. See Murray v. Auslander, 244 F.3d 807, 812 (11th Cir. 2001) (denying class certification under Rule 23(b)(2) because non-incidental damages were sought); Jefferson v. Ingersoll Int'l Inc., 195 F.3d 894, 897--98 (7th Cir. 1999) (same); Allison v. Citgo Petroleum Corp., 151 F.3d 402, 415-16 (5th Cir. 1998) (same).

[36] For example, the Ninth Circuit has upheld class certification in Dukes v. Wal-Mart, Inc., 509 F.3d 1168 (9th Cir. 2007), reh'g en banc granted, 556 F.3d 919 (9th Cir. 2009), even though the panel noted that the compensatory damages sought by the plaintiffs "may amount to billions of dollars." Id. at 1186. Even if *Dukes* is reversed on rehearing, a considerable conflict remains among the circuits over the scope of Rule 23(b)(2).

[37] See Hodges, supra note 10, at 119 (2008) ("The Model that has been adopted in most EU jurisdictions for court-based rules is that a claimant must take a positive step to assert their rights and formally join a coordinated procedure (opt-in)."). This study lists England, Sweden, Germany, and Italy as normally following this position, but notes that Portugal has adopted an opt-out procedure. See also Issacharoff & Miller, supra note 12, at 192 (also noting that Europe has resisted the opt-out class).

[38] See Kern ex rel Estate of Kern v. Siemens Corp., 393 F.3d 120, 124--26 (2d Cir. 2004), cert. denied, 544 U.S. 1034 (2005) (reversing class certification of an "opt-in" class consisting of heirs, beneficiaries, and personal representatives of victims who died in a ski train fire in Austria where district court had limited class to those who consented to be bound by any judgment).

[39] Id. at 120 ("Not only is an 'opt-in' provision not required, but substantial legal authority supports the view that by adding the 'opt-out' requirement to Rule 23 in the 1966 amendments, Congress *prohibited* "opt-in" provisions by implication."); see also Clark v. Universal Builders, Inc., 501 F.2d 324, 340 (7th Cir. 1974) ("[T]he requirement of an affirmative request for inclusion in the class is contrary to the express language of Rule 23(c)(2)(B).").

opt-in class action over the procedure,[40] and (ii) a "green paper" on consumer collective readiness,[41] which similarly contemplated an approach less sweeping than the American class action. The principal objection in Europe to the opt-out class is the perception that it invites abuse by giving a positive settlement value to non-meritorious actions that the defendant is compelled to settle, either because of high litigation costs of defense or the prospect, even if remote, of a recovery that would bankrupt the defendant.

4. *Representative Actions*. --- To date, actual experience with either opt-out or opt-in class actions in Europe is limited. But Europe has considerable experience with representative actions brought by special entities, such as ombudsmen,[42] private consumer organizations, or other nonprofit associations that seek to enforce particular statutes on behalf of consumers or others.[43] Traditionally, these actions were limited to injunctive relief, but the European Commission's 2008 White Paper on antitrust enforcement contemplated that representative actions by associations should be permitted for money damages for competition law violations as well.[44] Indeed, the White Paper proposed that the associational actions be viewed as a

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[40] See Commission White Paper on Damages Actions for Breach of the EC Antitrust Rules, at 4, COM (2008) 165 final (Apr. 2, 2008) [hereinafter, White Paper]. Under the European Commission's practice, a "white paper" is a follow-up document to an earlier "green paper" that outlines possible options. Thus, a "green paper" is a discussion document intended to stimulate debate and elicit specific proposals, whereas a "white paper" is an official set of proposals that is intended to lead to legislation. An earlier green paper on antitrust enforcement was published by the European Commission in 2005, which was then followed in 2008 by the above-noted white paper. See Commission Green Paper on Damages Actions for Breach of the EC Antitrust Rules, at [pincite] COM (2005) 672 final (Dec. 19, 2005). For a general discussion of the White Paper and the earlier Green Paper, see Hodges, supra note 10, at 170--81. For a critical review of the EC's decision to prefer the opt-inopt-in model to the American opt-out version, see Robert Gaudet, Jr., Turning a Blind Eye: The Commission's Rejection of Opt-Out Class Actions Overlooks Swedish, Norwegian, Danish and Dutch experience, 2009 Eur. Competition L. Rev. 107.

[41] See Commission Green Paper on Consumer Collective Redress, at [pincite] COM (2008) 794 final (Nov. 27, 2008).

[42] Hodges finds the consumer ombudsmen to be the "most developed public system to date" in Europe. See Hodges, supra note 10, at 228.

[43] See Issacharoff & Miller, supra note 12, at 192 (noting European "tendency to allow only organizations to represent consumers in class action cases").

[44] The White Paper appears to contemplate that damages would be awarded to the association for injury to its members, and that individuals would sue separately on an opt-in basis. See White Paper, supra note 40, at 3--4.

complementary procedure to the opt-in class action, with both being brought side-by-side in many cases. Its justification for such an integrated approach was that a pre-existing association would be both a more adequate representative than any individual litigant (particularly in cases where the monetary recovery might be marginal) because it would be incentivized by its organizational mission, membership support, and diminished fear of retaliation.[45] Logically, such associations would have standing to recover damages only to the extent of their members' losses, but they could be authorized by statute to sue more generally for all losses caused, or gains received, by the defendant, with the excess over their members' losses being held in escrow for claimants.[46]

Funding for actions by associations comes today from a variety of sources: state subsidies (for ombudsmen), contributions by trade groups, or dues paid by members of a consumer group. Because of Europe's "loser pays" rule, the association can at least anticipate recovering its legal expenses if it is successful. On balance, the representative action makes sense as a complement to class litigation precisely because it supplies a functional analogue to the lead plaintiff in U.S. securities litigation: namely, an organization with size and credibility that is potentially capable of monitoring class counsel.

5. *Public Interest Litigation.* --- Although the United States has little experience with associations suing for damages on behalf of their members, it is very familiar with a functionally similar pattern: litigation brought by non-profit organizations that seek to assert or defend

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[45] In a staff report accompanying the White Paper, the staff argued that associations would sue when individuals would not, because they were better prepared to accept the administrative burdens and did not need to fear alienating a business partner. See Commission Staff Working Document, Accompanying Document to the White Paper on Damages Actions for Breach of the EC Antitrust Rules, Impact Assessment, at 19--20, COM (2008) 165 final (Apr. 2, 2008).

[46] Some European nations already have this procedure. Spain permits consumer organizations to sue on behalf of both their members and unidentified victims. See Laurel J. Harbour & Marc E. Shelley, The Emerging European Class Action: Expanding Multi-Party Litigation to a Shrinking World, Prac. Litigator, July 2007, at 23, 28.

political or ideological positions on behalf of their members (and only incidentally and occasionally pursue monetary damages). Doctrinally, the Supreme Court has accepted "representational standing," recognizing that an organization can sue to protect its members' interests so long as (1) a member or members of the organization would have standing to sue in their own right; (2) "the interests it seeks to protect are germane to the organization's purpose"; and (3) "neither the claim asserted nor the relief requested requires the participation of individual members in the lawsuit."[47] Although these organizational plaintiffs---of which the ACLU, the Legal Defense Fund, and the Sierra Club are among the most prominent examples---usually, themselves, seek only injunctive or equitable relief, they may pursue money damages by acting as counsel to individuals in class actions.[48] Either way, their goal is usually less to obtain compensation for their clients or members than to advance legal positions in pursuit of long-term political or ideological goals. Because their funding comes from their members, such organizations may face a tension between their clients' interests and those of the contributors who fund them.[49] Hence, issues of accountability surface in this context as well.

B. *A Preliminary Evaluation*

If the only policy goal were to find a means to litigate "negative value" claims with maximum impact, then the superiority of the "opt-out" class action would seem obvious. But the

[47] Hunt v. Wash. State Apple Adver. Comm'n, 432 U.S. 333, 343 (1977); see also Int'l Union, United Auto., Aerospace & Agric. Implement Workers of Am. v. Brock, 477 U.S. 274, 290 (1986) (reaffirming *Hunt* principles and noting "[t]he very forces that cause individuals to band together in an association will thus provide some guarantee that the association will work to promote their interests").

[48] For example, in the earlier discussed case of Dukes v. Wal-Mart, Inc., 509 F.3d 1168 (9th Cir. 2007), the action was litigated by a combination of public interest firms and a traditional entrepreneurial plaintiff's law firm.

[49] These tensions can arise even in the standard context of a school desegregation case in which the NAACP may be representing the plaintiff schoolchildren and parents. For a candid discussion of these tensions, see Derrick A. Bell, Jr., Serving Two Masters: Integration Ideals and Client Interests in School Desegregation Litigation, 85 Yale L.J. 470, 505--11 (1976) (arguing for courts to be sensitive to disagreements in black communities over the type of school relief). For the fullest assessment of how these conflicts surrounding public interest litigation might be resolved, see William B. Rubenstein, Divided We Litigate: Addressing Disputes Among Group Members and Lawyers in Civil Rights Campaigns, 106 Yale L.J. 1623 (1997).

policy goal cannot be defined this simply. From a compensatory perspective, the fact that the opt-out class aggregates all the claims relating to a common set of facts and legal theories does not mean that these claimants receive compensation when the action settles. As will be seen, the same apathy that confounds the opt-in class action at the outset also arises at the back end of the opt-out class action when claims must be filed. As a result, neither action may succeed at effectively distributing compensation. From a deterrence perspective, the opt-out class action certainly better deters than the opt-in, but it may produce overkill: Namely, it aggregates so many claims that defendants cannot risk a trial on the merits, at least when there is a moderate risk (as there usually is) that plaintiffs will prevail. This too may make the merits of the litigation irrelevant and thereby distort outcomes in a manner that can be thought unjust. If we want the playing field in aggregate litigation to be more or less level so that cases are decided on their merits, then public policy may need to recognize that some optimum level of claim aggregation exists that is between all and none.

The case for an opt-in class is vulnerable, however, to the extent that holders of negative value claims can be expected to remain apathetic, with the result that only limited claim aggregation will occur. If so, the action will be underfunded. But the more pertinent question is not whether opt-in class actions can aggregate a similar level of claims to class actions (obviously, they cannot), but whether they can aggregate a sufficient level to be economically viable. Here, it is dangerous to jump from empirical data showing that opt-out levels are very low (around .2% in one study[50]) to the conclusion that opt-in levels will be similarly

[50] For this figure of 0.2% (or 2 in a thousand), see Theodore Eisenberg & Geoffrey Miller, The Role of Opt-Outs and Objectors in Class Action Litigation: Theoretical and Empirical Issues, 57 Vand. L. Rev. 1529, 1532 (2004) [hereinafter Eisenberg & Miller, Opt-Outs] (basing figure on a sample consisting of several thousand class actions between 1993 and 2003).

insignificant. The difference in context is important, because opting in is generally rational and opting out (at least in the case of a negative value claims) is generally irrational. As discussed shortly, some European experience suggests that an aggregate proceeding with a sufficiently credible leadership can attract a significant percentage of eligible claimants to opt-in.[51]

Equally important, the opt-in class need not stand alone, but could be integrated with a representative action on behalf of consumers or other injured claimants, as the European Commission's White Paper recently proposed.[52] Were the eligible claimants to be solicited by a credible not-for-profit organization, particularly one possessing significant reputational capital---the equivalent, for example, of the Sierra Club in an environmental action---such a marketing effort might be sufficient to overcome the rational apathy or skepticism of litigation of many small claimants. In fact, the United States has often seen functionally similar unions, as "public interest" lawyers have linked arms with entrepreneurial counsel to litigate major cases.[53] Although Europe has already seen some similar alliances struck between nonprofit groups and opt-in class members, the financing of such litigation remains problematic.

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[51] See infra notes 127--36 and accompanying text.

[52] See White Paper, supra note 40, at 4 (arguing for necessity of opt-in class actions and representative actions complementing each other).

[53] For example, in *Dukes*, 509 F.3d 1168 (9th Cir. 2007), the plaintiffs in this much noted employment discrimination case were represented by several public interest firms (The Impact Fund, Equal Rights Advocates, Public Justice Center) and by a traditional class action plaintiff's firm, Cohen, Milstein, Hausfeld & Toll. In the United States, however, there is little practical need for the representative plaintiff to possess high reputational capital because in opt-out class actions no reason exists either to solicit the entire class or to engage in other marketing activity in order to obtain universal inclusion of class members. To the extent that any marketing is done, it is largely focused on assembling a coalition of would-be lead plaintiffs with an aggregate ownership greater than that of rival coalitions.

Finally, changes in technology also make the opt-in class more feasible than in the past. Today, class counsel can solicit potential class members to opt in through web sites, emails, and electronic media. These techniques appear to be effective, and their cost is low.[54]

At present, Europe seems to be seeking to establish a stronger, better-financed system of opt-in class litigation led by consumer and other nonprofit organizations, while the United States continues to downsize its opt-out class action by rigorously applying its predominance standard. If both trends continue, the result could be functional convergence without doctrinal convergence. Neither side would agree on a common doctrinal position, but aggregate litigation might begin to look increasingly similar on both sides of the Atlantic.

More importantly, if a policy goal is fairer, more balanced litigation (and not simply maximum claim aggregation), so that neither plaintiffs nor defendants are precluded from going to trial by economic factors unrelated to the merits of the litigation, then such convergence seems attractive. One might sensibly pursue it by one or both of two alternative means: (1) one could seek to simplify and encourage the aggregation of claims in opt-in class actions; or (2) one could seek to downsize the opt-out class action by making opting-out more attractive. The first alternative is probably feasible today only outside the United States, while the second alternative is already in progress within the United States, as the next section will discuss. Neither route need be exclusive.

II. *A Governance Perspective: Exit Versus Voice*

A. *Exit and Voice Compared*

[54] These techniques are used today in cases brought under the Fair Labor Standards Act, which provides a mandatory opt-in procedure in wage and hour cases, which cases are becoming more common. See 29 U.S.C. § 216(b)(2006) (specifying opt-in procedure). See text and notes infra at notes 138 to 145.

From a governance perspective, a class action is an organization, often with thousands of members, that persists for an indefinite period, usually several years from the case's filing to its resolution. Over that period, critical issues---class definition, settlement proposals, and the fee award---arise where the interests of the class and its agents are likely to diverge. Similarly, the class itself may have internal divisions, both because different class members may hold claims of differing strength or value and because they may have different attitudes toward risk.[55]

From a traditional legal perspective, the court-awarded attorney's fee is the principal lever by which the law seeks to incentivize the agent to act in the class's interest. Few doubt that this is a powerful tool, which can be adjusted upwards or downwards by the court to reflect the risk assumed and the results achieved, but few believe that it is alone adequate.[56] Even if the adjustable fee can motivate, many cases reach the point at which the attorney has invested sufficient time and money in the action that the attorney is compelled to settle it, even on terms that may be unsatisfactory to most of the class.[57] For example, an attorney may simply be unable to finance the case any further and hence offers or accepts a settlement that benefits the attorney, but not the class. For a time, class action settlements for "coupons only" became notorious, until Congress severely restricted their use in the Class Action Fairness Act.[58] Although it can be

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[55] This is a less recognized reason why institutional investors may sometimes want the position of lead plaintiff. The longer the class period is defined to be, the more vulnerable it becomes to attack by defendants. Yet, a prominent institutional investor serving as lead plaintiff may insist that the class period's definition be stretched far enough to cover most or all of its losses. Its self-interest here may be in conflict with that of other class members.

[56] For one of the best treatments of the complex issues in fee award decisions and the limitations on the use of this policy lever, see John Leubsdorf, The Contingency Factor in Attorney Fee Awards, 90 Yale L.J. 473, 481 (1981). For the fullest recent judicial examination of the standards for attorney fee awards, see In re Enron Corp. Sec., Derivative & "ERISA" Litig., 586 F. Supp. 2d 732 (S.D. Tex. 2008).

[57] This is particularly true in mega-class actions, which may settle for amounts over $100 million. Because U.S. courts typically award fees on a declining percentage of the recovery, a point may often be reached after which increasing the settlement's size produces less and less benefit to the plaintiff's attorney. At this point, class counsel's self-interest will increasingly favor settlement.

[58] Coupon settlements are settlements in which class members are compensated with coupons giving them discounts off the price of products or services, rather than monetary awards. For an example of their misuse, see In re Gen.

reasonably debated whether such collusive settlements that benefit the plaintiff's counsel at the expense of the class are truly the product of the plaintiff's attorney's financial exhaustion, they certainly show that the interests of the class and its attorney are far from well-aligned. Congress has now discouraged the "coupon" settlement, but it has not diminished the forces that produce collusion. The simple reality is that the class action attorney in the United States funds the litigation's costs for a multi-year period and expects to receive a fee, if successful, that is likely to be between 10% and 30% of the recovery.[59] As a result, the attorney has much more at stake than any class member. Hence, the attorney is more likely to be risk averse and to prefer settlement over trial. In contrast, behavioral research suggests that the less the small claimant has at stake, the more the claimant is likely to prefer to gamble on trial and a large recovery.[60] In short, the principal and agent in class litigation are naturally likely to differ in their risk preferences.

Motors Pick-Up Truck Fuel Tank Prod. Liab. Litig., 55 F.3d 768, 780, 819--22 (3d Cir. 1995) (rejecting proposed settlement consisting of nontransferrable coupons entitling recipient to a $1,000 discount on purchase of a truck). The Class Action Fairness Act of 2005, Pub. L. No. 109-2, 119 Stat. 4 (codified in scattered sections of 28 U.S.C.), restricted the use of coupons in settlements by a variety of means, but chiefly by instructing courts to award attorney's fees to class counsel based only on the coupons redeemed by the class, not the coupons distributed to the class. See 28 U.S.C. § 1712(a) (2006).

[59] For an identical assessment (including the estimate that the fee award will be between 10% and 30%), see Issacharoff & Miller, supra note 12, at 186. During the early-to-mid 1990s, the standard fee award in securities class actions was higher and averaged 32% of the settlement. See Frederick C. Dunbar, et al., Nat'l Econ. Research Assocs., Recent Trends III: What Explains Settlements in Shareholder Class Actions (1995). For a later study, updating these results and also finding the average fee award to be 32% of the settlement, see Denise M. Martin et al., Recent Trends IV: What Explains Filings and Settlements in Shareholder Class Actions, 5 Stan. J.L. Bus. & Fin. 121, 141 (1999). More recently, the percentage fee has declined as settlements have soared over the billion dollar mark, reflecting the tendency for courts to follow a "declining percentage of the recovery" fee formula. See *In re Enron Corp.*, 586 F. Supp. 2d at 774--75 (collecting recent studies).

[60] Social scientists have coined the term "peanuts effect" to refer to the demonstrated tendency of small claimants to exhibit risk-seeking behavior. See Bethany J. Weber & Gretchen B. Chapman, Playing for Peanuts: Why Is Risk Seeking More Common for Low-Stakes Gambles?, 97 Organizational Behav. & Hum. Decision Processes 31, 31--32 (2005) [PARENTHETICAL]. On this basis, the plaintiff's attorney and negative value claimants may have interests that are often poorly aligned. For a fuller discussion of the peanuts effect and a criticism of the PSLRA's preference for the largest stakeholder in light of it, see Gousgounis, supra note 10, at 16--19.

This and other recurrent divergence between the interests of the agent and the principal suggest that the legal system cannot pin all its hopes on the attorney's fee award as the optimal incentive device. What alternatives then remain? Organizational theorists have long grouped organizational remedies under two basic headings: "voice" and "exit."[61] Voice-based remedies focus on participation in the group's decision-making, and thus they may give voting rights to the organization's members, or at least notice and an opportunity to be heard in court on critical decisions.[62] The "lead plaintiff" in securities class actions is a prototypical voice-based reform, which uses the plaintiff with the largest stake in the action as the vicarious voice of all class members to monitor the class attorney.

Exit-based remedies instead allow the individual to escape the group. Although they have been less frequently discussed in the litigation context,[63] they are well known to corporate governance. Opting out is the paradigmatic exit remedy, but procedural scholars have objected to proposals for the enhanced use of opting out, arguing that "practically speaking, opting out simply removes the class member from the debate."[64] This response misses the forest for the trees by assuming that the class action should be run as if it were a small democratic community, like some New England town meeting. In contrast, corporate governance scholars recognize that when dissatisfied shareholders sell their shares, their collective exit will drive down the market

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[61] For the origin of these terms, see Hirschman, supra note 11, at 3--5 [PARENTHETICAL].

[62] Civil procedure scholars have recurrently suggested reforms of class action practices that seek to improve or enhance the "voice" of class members. See, e.g., Patrick Woolley, Rethinking the Adequacy of Adequate Representation, 75 Tex. L. Rev. 571, 604 (1997) (proposing greater rights for class members to participate in litigation decisions).

[63] Some academics have discussed expanded "exit" options as a corrective for class action abuses. See Mark C. Weber, A Consent-Based Approach to Class Action Settlement: Improving *Amchem Products, Inc. v. Windsor*, 59 Ohio St. L.J. 1155, 1193 (1998).

[64] See Alexandra Lahav, Fundamental Principles for Class Action Governance, 37 Ind. L. Rev. 65, 82 (2003) [Parenthetical].

price of the stock, thereby desirably disciplining management.[65] In the litigation context, when class members opt-out, they thereby reduce the total number of claims aggregated in the class action and hence the settlement value of the case. Because fee awards are a function of settlement size, this in turn reduces the likely fee award to class counsel.

Traditionally, dissatisfied shareholders who sold their shares were said to be following the "Wall Street Rule" by preferring exit to voice (and avoiding any direct challenge to management). More recently, with the increasing institutionalization of share ownership, voice has become the more popular remedy, and groups of institutional investors frequently engage in dialogues with management that effectively pressure or induce corporate management to change plans and strategies. Still, even if voice-based reforms are becoming more popular in the world of corporate governance, there are compelling reasons why exit may be the more powerful tool in litigation governance. In the corporate context, when a dissatisfied shareholder sells shares, the shareholder does not withdraw capital from the corporation. Instead, the shareholder simply transfers existing shares to another party without forcing the corporation to return the capital received for those shares on their issuance; thus, the only impact is on the share price in the secondary market. In the litigation context, however, the class member who opts out reduces the aggregate claims represented by the class attorney, thereby reducing both the attorney's leverage against the defendants and the attorney's likely fee award. This impact is more direct, immediate and painful. In addition, the class member who opts out may seek representation from a different attorney by filing an individual action or joining a consolidated action with other former class members. This set of choices induces competition, which can also discipline the class attorney.

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[65] For the view that this is an effective remedy in corporate governance, see Alex Edmans, Blockholder Trading, Market Efficiency, and Managerial Myopia, J. of Fin. (forthcoming 2009), available at http://ssrn.com/abstract=946669 (manuscript at 2--4, on file with the *Columbia Law Review*).

These two factors---a reduced fee award and the prospect of competition---imply, at least in theory, that exit may outperform voice in the world of litigation governance. As next will be seen, this theory is borne out by the recent evidence.

B. *The Trend Toward Exit*

If exit should outperform voice in theory, empirical corroboration of this prediction had long been lacking. The rate of opt-outs from class actions has been low, around 0.2% in one well-known study.[66] The likely explanation for this low rate is that the membership of most classes is predominantly populated by small claimants, who have no reason to opt-out because they hold negative value claims. But there is at least one context where this generalization that class members hold small claims is not valid: securities class actions. Over recent decades, the ownership of securities has shifted from retail investors to institutional investors.[67] The latter tend to be indexed investors, holding sizable stakes in most public companies. Hence, if an institutional investor owned just one percent or more of the securities purchased during the class period, it would typically have a sizable loss that could justify individual litigation. But until recently, even these investors did not opt out. Why not? The most logical explanation is that they had little interest in, or knowledge about, securities litigation, or saw no viable alternative to the class action.

The strongest evidence of this apathy emerges in recent surveys that have found that institutional investors often did not even claim their share of securities class action settlements, failing to take as simple a step as filing a claim form after the settlement funds had been

[66] For a study of consumer class actions, finding that only two in a thousand opt-out, see Eisenberg & Miller, Opt-Outs, supra note 50, at 1532.

[67] For data showing that retail shareholders today own only about twenty-six percent of the stock of public corporations, see J. Choper, J. Coffee & R. Gilson, Cases and Materials on Corporations 15 (7th ed. 2008).

deposited.[68] This may represent irrational apathy, but such behavior probably reflected investment managers' lack of experience with legal proceedings (and even a likely disdain for them). Because the typical securities class action settles for only a modest percentage of the investors' losses (often between only two and three percent[69]), such immaterial recoveries may have been ignored by investment managers, who did not believe that these recoveries justified their investment of time and effort. Also, investment managers simply did not know plaintiffs' attorneys and may have regarded them as cynical shysters (as defense attorneys often portray them).

But the passage of the PSLRA in 1995 ended this social isolation, at least in the case of public pension funds. As public pension funds gradually accepted the role of lead plaintiff, they began to interact with, and to be solicited by, the large plaintiff law firms. Concomitantly, "pay-to-play" practices began to develop, because for the first time plaintiffs' law firms saw a reason to make political contributions to officials who controlled, or at least influenced, public pension funds. As competition for the position of lead plaintiff developed, circumstances necessarily arose in which one team of law firms and pension funds would be defeated by another team of institutions that had assembled a larger block in the subject corporation. As a result, the losing plaintiffs' team faced a decision that the PSLRA never envisioned: Should they accept defeat

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[68] See James D. Cox & Randall S. Thomas, Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements, 58 Stan. L. Rev. 411, 413 (2005) [hereinafter Cox & Thomas, Slip Through Your Fingers] ("[L]ess than thirty percent of institutional investors with provable losses perfect their claims in [securities class action] settlements."); see also James D. Cox & Randall S. Thomas, Leaving Money on the Table: Do Institutional Investors Fail to File Claims in Securities Class Actions, 80 Wash. U. L.Q. 855, PINCITE (2002) [hereinafter Cox & Thomas, Leaving Money].

[69] According to the National Economic Research Associates, a consulting firm, the ratio of securities class action settlements to investor economic losses in 2002, 2003, and 2004 was 2.7%, 2.9%, and 2.6%, respectively. See Elaine Buckberg, et al., Nat'l Econ. Research Assocs., Recent Trends in Shareholder Class Action Litigation: Are WorldCom and Enron the New Standard? 6 (2005), available at http://www.nera.com/Publication.asp?p_ID=2544&login=6923124 (on file with the *Columbia Law Review*). The highest percentage they find was 7.2% in 1996. This ratio appears to be decreasing as the size of the potential damages increases, possibly because defendants are insolvency constrained.

graciously and remain in the class? Or, should they listen to their own attorneys and opt out? Clearly, it was in the unsuccessful attorney's interest to solicit its clients to opt out, because otherwise that counsel would be unlikely to receive any fee, even though it may have already expended substantial time on the action.

The response of institutional investors is now clear: They followed their attorneys and opted out. Their motives are debatable. Some public pension funds may have been influenced by "pay-to-play" political contributions. Others may have simply followed the advice of counsel that---in the wake of the PSLRA---they had come to know and respect. The irony then is that although the PSLRA intended a voice-based reform, it fostered relationships between institutional investors and plaintiffs' attorneys that supplied the preconditions for their reliance instead upon an exit-based reform (i.e., opting out)---and on an unprecedented scale.

This trend toward increased opting out began in the wake of the WorldCom litigation, and the ironic instigator of this revolt against traditional class action practices was the titular dean of the securities class action bar, William Lerach.[70] After his firm lost the contest to become class counsel in the *WorldCom* class action to the Bernstein, Litowitz firm (largely because the New York State Pension Fund, represented by Bernstein, Litowitz, held a very large position in WorldCom's bonds), Mr. Lerach convinced some sixty five investors to opt out of the WorldCom action.[71] Although the WorldCom class action eventually settled for $6.2 billion, at

[70] See Kevin LaCroix, Opt-Outs: A Worrisome Trend in Securities Class Action Litigation, Insights (Oakbridge Ins., Beechwood, OH), Apr. 2007, at 1, available at http://www.oakbridgeins.com/newsletters/April_sAWorrisomeTrendinSecuritiesClassActionLitigation.pdf (on file with the *Columbia Law Review*) [Hereinafter LaCroix, Worrisome Trend].

[71] Id.

the time a record amount, the opt-outs appear to have done much better than those who remained in the class.[72]

If *WorldCom* signaled the institutional community that they might do better by opting out, the case that truly proved this thesis was the *AOL Time Warner* class action, which settled on a class basis in 2006 for $2.4 billion---again a near record settlement. This time, Mr. Lerach convinced more than one hundred investors to pursue individual opt-out actions.[73] Based on a variety of press reports, these institutional opt-outs did significantly better than if they had stayed in the class, as shown by the following chart:

The AOL Time Warner Differential

	Opt-Out Settlement	*Estimated Improvement over Share of Class Recovery*
University of California[74]	$246 million	16--24 times better than class
Ohio Pension Funds[75]	$175 million	$9 million (over 19 times better than class)
CalPERS[76]	$117.7 million	17 times better than class

[72] Three large California pension funds---CalPERS, CalSTRS, and the Los Angeles County Employee Retirement System---announced in 2005 that they had settled their actions for $257.4 million. Id. at 3. Five New York City pension funds similarly opted out and settled their $130 million in claims for $78.9 million, and their counsel announced that this settlement amounted to "three times more than they would have recovered if they had joined the class." Id. For similar estimates, see David Lenckus, Individual Suits Likely Over Subprime Losses; Some Investors Expected to Opt-out of Class Actions, Business Ins., Nov. 19, 2007.

[73] See Josh Gerstein, Investors Opt Out of Time Warner Class Action Suit, N.Y. Sun, Feb. 8, 2006, at 5.

[74] See LaCroix, Worrisome Trend, supra note 70, at 2; Gilbert Chan, CalPERS' Time Strategy Pays Off: The State Pension Fund Gets $117.7 Million After Opting Out of Class Action Against Media Giant, Sacramento Bee, March 15, 2007. Christopher Patti, an in-house counsel for the University, provided the "16 to 24 times" estimate. Id.

[75] See Time Warner Settles Lawsuit for $144 Million, L.A. Times, March 8, 2007, at C6 (quoting Ohio Attorney General Marc Dann that Ohio received $135 million more than they would have received under the settlement). Ohio received a total of $175 million, because its legal fees of $31 million were paid by Time Warner in addition to the $144 million paid to it. Assuming that Ohio would have received only $9 million under the class action (i.e., $144 million minus $135 million), this translates into better than a 19:1 disparity.

CalSTRS[77]	$105 million	7 times better than class
State of Alaska Funds[78]	$50 million (on $60 million claim)	80%+ recovery was "50 times better than class recovery"

Not only did the opt-outs do better, but they received recoveries that sometimes approached their total claimed losses.[79] Such recovery levels (between 80% and 90% of losses in the cases of Alaska and CalPERS) dwarf the typical 2% to 3% recovery rate in most securities class actions (or the recovery levels in any other form of private litigation).[80]

Conceivably, these estimates by pension funds of their relative success through opting out may marginally overstate the degree to which these institutions improved on their likely class recovery. This is because their actual recovery necessarily depends on how many class members ultimately file claims at the post-settlement stage at which funds are disbursed. Thus, a CalPERS or a CalSTERS may represent five percent of the class, but they could receive significantly more than five percent of the recovery if other class members fail to file claims.[81]

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[76] CalPERS's General Counsel described its settlement as "approximately 17 times what we would have recovered if we stayed in the class," estimating that it would have received roughly $6 million under the class action. See Chan, supra note 74 (quoting Peter Nixon, CalPERS' general counsel).

[77] CalSTRS estimated that it would receive only $15 million under the class action. Id.

[78] Josh Gerstein, Time Warner Case Finds a Surprise, N.Y. Sun, December 7, 2006 at 1; LaCroix, Worrisome Trend, supra note 70, at 2.

[79] For example, the State of Alaska settled its $60 million claim for $50 million and said that it had done "50 times what we would have recovered from the class." Gerstein, supra note 78, at 1; see also LaCroix, Worrisome Trend, supra note 70, at 2. CalPERS claimed losses of approximately $129 million, so its settlement for $117.7 million represents a seeming 90% recovery rate.

[80] For this estimate of the average recovery in securities class actions, see supra note 69.

[81] Conceivably, if small claimants did not file, the institutional investors that did file could receive 100% or more of their claims. For studies finding that even large claimants often fail to file significant claims in a securities class action settlement, see Cox & Thomas, Slip Through Your Fingers, supra note 68, at 412; see also Cox & Thomas, Leaving Money, supra note 68, at 855, 870--78. Formerly, class action settlements often contained a reversionary provision under which unclaimed amounts in the settlement fund reverted to the defendant, but such reversionary settlements are now rare in securities class actions because they have been discouraged by the PSLRA. See infra note 147. As a result, the beneficiaries today of a low claims filing rate are the larger institutions that do file claims.

Still, even if institutional investors may receive a disproportionate share of the settlement if other claimants do not file, they cannot by definition receive more than the entire settlement fund. Thus, one incontrovertible measure of the relative success of these opt-outs is that their total recovery has sometimes exceeded the class recovery. The *Qwest* class action settled in 2005 for $400 million,[82] but Qwest has disclosed payments of $411 million to opt-outs.[83] Because most institutional investors have no obligation to disclose their settlements with a defendant (and because the defendant has strong reasons for insisting on confidentiality), it is possible that in earlier cases (such as *AOL Time Warner*) the total opt-out recovery might similarly have approached or exceeded the class recovery.

What will be the impact of increased opting out in securities class actions? Clearly, everyone cannot opt out of the class because small retail investors still hold negative value claims. As a matter of choice, some large pension funds may decide to remain in the class to serve as lead plaintiff (either because they wish to serve the public interest or because of "pay-to-play" incentives). But the traditional heterogeneous class action, comprised of large and small investors, could become less common; indeed, the securities class action could become the vehicle of last resort for only those smaller claimants who cannot economically afford to opt out.

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[82] The stipulation of settlement was filed on November 23, 2005. See In re Qwest Communications Int'l Inc. Sec. Litig., 2006 U.S. Dist. LEXIS 71267, at *8 (D. Colo. Sept. 26, 2006).

[83] See Robert Elder, Retired Teachers System, Qwest Reach Settlement, Austin Am. Statesman, Dec. 6, 2007, at D-1; see also Kevin LaCroix, Opt-Outs, Claims Severity and D&O Insurance Limits, The D&O Diary, Feb. 5, 2007, at http://dandodiary.blogspot.com/2007/02/s-claims-severity-and-d-o.html [hereinafter LaCroix, Claims Severity] (discussing how the class action settlement was only one of several settlements Qwest has reached). In November, 2007, the Alaska Attorney General issued a press release announcing that its state's various funds had settled their $89 million in claims in the *Qwest* litigation for a net recovery (after attorneys' fees) of $19 million and that this recovery contrasted with a payment of only $427,000 that they would have received under the class settlement. See Press Release, Department of Law Announces $19 Million Settlement in Securities Fraud Claims Against Qwest Communications, (Nov. 21, 2007). This is roughly a 45:1 ratio. Similarly, the Teachers Retirement System of Texas announced a $61.6 million net recovery and contrasted it with a $1.4 million payment that it would have received under the class action settlement. See Elder, supra, at PINCITE. This would be better than a 40:1 ratio. CalSTRS settled for $46.5 million and announced that it was receiving "about 30 times more than it would have recovered if it had taken part in the class action." See LaCroix, Claims Severity, supra note 83.

Below some minimum level of damages, it becomes uneconomic for a class member to opt out because its losses are too small to justify individual litigation. Where is this breakpoint? Today, some estimate that the minimum losses necessary to make opting out viable may be as low as $10 million,[84] but it is too early to project confidently. As more institutions and counsel experiment with individual litigation (and as competition intensifies), this minimum damages level may fall further.

The larger question will be the impact of opt-outs on defendants. Will they insist on settling the class action for a lower amount per claimant because they expect to pay more to opt-outs? Although defendants will certainly wish to reduce the class settlement, class counsel know that any reduction in the per-claimant recovery will likely further motivate those class members at the margin to opt out. Thus, class counsel has increased reason to resist a weak settlement. Still, if the per-claimant recovery does fall as the result of increased opting out, then the gain to opt-outs can be said to come at the expense of the smaller class members, thereby complicating the issue of whether public policy should seek to encourage opting out.

C. *Why Do Opt-Outs Outperform the Class?*

The pattern under which opt-outs seemingly receive a multiple of the class recovery requires some causal explanation. A variety of legal reasons can be offered as possible explanations: (1) opt-outs have certain timing advantages and may be able to get to trial quicker;[85] (2) opt-outs may sue in their own states and thereby gain a "home court" advantage;[86]

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[84] The estimate was given by Stuart Grant, a founding partner of Grant and Eisenhofer, at an American Bar Association's Litigation Section Conference on May 2, 2009 (responding to a question posed by the author who was the moderator of the securities litigation panel). The Grant and Eisenhofer law firm has represented many institutional opt-outs in securities litigation.

[85] If the opt-out plaintiff can obtain a trial date prior to the resolution of the class action, it can virtually compel the defendants to settle with it on favorable terms. This is because a favorable verdict at trial in the individual action may make it difficult or impossible for the defendants to settle the class action on a cheaper per claimant basis; in

and (3) by suing in state court, opt-outs may be able to escape many of the PSLRA restrictions that apply only to federal court actions.[87] Finally, by suing on an individual or consolidated basis, the opt-outs also escape the increasingly complex issues surrounding class certification, which have recently resulted in the denial of certification even in the case of securities class actions.[88]

Still, although these reasons could explain why some class members opt out, they have in fact almost nothing to do with the recent wave of opt-outs in securities cases. In the cases just discussed, large numbers of opt-outs departed the class, but only following the announcement of the proposed class settlement. Those class members who opted out were obviously dissatisfied

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contrast, a favorable settlement with the individual opt-out can be kept confidential and so will not disrupt the class settlement. This fear that a successful plaintiffs' verdict in the opt-out action could disrupt the class settlement has led federal courts to enjoin such an early trial under the "All Writs Act." See In re Baldwin-United Corp., 770 F.2d 328, 335 (2d Cir. 1985) (state trial may be enjoined under All Writs Act where it would disrupt settlement negotiations before the district court). More recently, the Second Circuit has marginally curbed this power. See Ret. Sys. v. J.P. Morgan Chase & Co., 386 F.3d 419, 429--31 (2d Cir. 2004) (reversing injunction granted by federal district court against state trial where settlement was not clearly imminent).

[86] By opting out, a state or municipal pension fund may be able to bring suit in state court in its home jurisdiction and thereby escape the jurisdiction of the Judicial Panel on Multidistrict Litigation to assign all related cases to one federal district. See infra notes 94--95 and accompanying text. Once so assigned, cases rarely escaped. A state court may be a more attractive forum as local jurors may empathize more with the local plaintiffs (for example, the local teacher or police pension fund), and plaintiff's attorneys may be able to elicit resentment against a distant corporate defendant.

[87] The provisions of the PSLRA relating to pleading, discovery and fee-shifting are set forth in Section 21D ("Private Securities Litigation") of the Securities Exchange Act of 1934, 15 U.S.C. § 78u-4 (2006). Section 21D applies only to a "private action . . . that is brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure." 15 U.S.C. § 78u-4(a)(1). The principal exception to this generalization that opting out evades the reach of federal courts' ability to halt or deny discovery is that the Securities Litigation Uniform Standards Act ("SLUSA") does authorize a federal court to stay discovery in a state court "upon a proper showing," even in a non-class action. Section 21D(b)(3)(D) of the Securities Exchange Act of 1934 authorizes a federal court as follows: "Upon a proper showing, a court may stay discovery proceedings in any private action in a State court, as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this paragraph." 15 U.S.C. § 78u-4(b)(3)(D). This provision is less automatic than the PSLRA's stay, which requires no special showing.

[88] See, e.g., Oscar Private Equity Investments v. Allegiance Telecom, Inc., 487 F.3d 261, 266--70 (5th Cir. 2007) (plaintiff must establish loss causation at the class certification stage by a preponderance of all admissible evidence); Regents of the Univ. of Cal. v. Credit Suisse First Boston (USA), Inc., 482 F.3d 372, 385-90 (5th 2007) (reversing class certification for failure to satisfy prerequisites of "fraud on the market" doctrine and an adequate deceptive act); In re Initial Public Offering Sec. Litig., 471 F.3d 24, 27 (2d Cir. 2006) (rejecting "some showing" standard and requiring district judge to make determination that each Rule 23 requirement is met).

with the proposed settlement and were not seeking to gain timing or other tactical advantages, which they would have needed to pursue at an earlier stage.

But why did these opt-outs think they could do better on their own, having first waited to see what the class settlement would be? Here, three reasons, each more economic than legal in nature, seem to explain their decisions.

1. *Insolvency Constraints*. --- A defendant's last resort when faced with very high damages may be to threaten bankruptcy. This may cause class counsel to moderate its demands, as plaintiff shareholders fare poorly in a bankruptcy reorganization of their corporation. But this threat to file bankruptcy is far less credible in the case of an individual action. An opt-out action, or even a wave of them, simply does not represent sufficient damages to induce a large corporation to file for bankruptcy. In contrast, a "mega" securities class action in federal court may hypothetically seek $5 billion in damages, and the defendants' strongest argument may truly be that the corporation simply cannot pay such an amount and would file for bankruptcy before doing so. In this light, corporate defendants are vulnerable to the tyranny of small decisions: They can deter class counsel from making "unreasonable" demands, but not individual opt-outs, because no individual opt-out believes that its decision will trigger bankruptcy.

2. *Agency Costs*. --- Opt-outs may do better because they face greatly reduced agency costs. Most obviously, each opt-out selects its own counsel and can monitor it closely, demanding at least as good a settlement as the class and other opt-outs received. If unsatisfied, it can go to trial. An absentee class member has no similar choice.

This is an inherent problem in the class action, because its disparate members may have very different preferences, expectations, and estimates. Even an ideally loyal class counsel cannot satisfy all their diverse preferences. In an individual action, agency costs can be further

reduced by specially tailored compensation formulas for the attorney. In particular, the plaintiff's attorney in a class action will likely be compensated on the basis of a declining percentage of the recovery, which reduces its incentive to hold out for a larger recovery. In contrast, the plaintiff's attorney in the individual action can negotiate its fee with its clients, and sometimes even an increasing percentage of the recovery formula may be used.

3. *Economic Leverage and Voting Power*. --- Institutional investors often hold significant voting power. Suppose three large California pension funds opt out together, holding collectively five percent of the firm's stock. This voting power gives them leverage, as they can vote this stock against management or potentially team up with a Carl Icahn-style insurgent to threaten management with a proxy fight. Thus, management has reasons to placate them that do not apply to smaller shareholders, and this leverage can translate into a higher settlement.

More generally, the large indexed institutional investor---such as a CalPERS or a TIAA-CREF---is understood by management as a permanent presence in their corporate governance that must be dealt with. Knowing that they will have to negotiate with and solicit such a shareholder recurrently in the future on voting and governance matters, the corporation has more reason to placate such a shareholder. As a result, litigation often need not even be commenced before a settlement is reached.

4. *Evaluation*. --- The foregoing analysis suggests that securities class actions are not unique and that the factors that enable opt-outs to outperform the class may apply to other litigation contexts as well---at least in those contexts where some class members hold sufficiently sizable claims to justify individual litigation.

In fact, evidence from outside the securities litigation context supports this hypothesis. In antitrust price fixing litigation, large commercial buyers (who presumably have the greatest

damages) have repeatedly opted out of the class and sued in individual actions, sometimes combining to file a consolidated complaint.[89] In one of the largest antitrust class action settlements on record, the major vitamin producers first pleaded guilty to antitrust price fixing charges and then paid $1.17 billion in an antitrust class action settlement. Again, over 200 corporations, including large firms such as Tyson Foods and Quaker Oats, chose to opt-out of the class of more than 4,000 plaintiffs and sue individually.[90] These opt-outs were reported to account for over 70% of the class in terms of the volume of their purchases.[91] The likelihood is high that in opting out these sophisticated plaintiffs made an intelligent decision about their own best interests. Logically, one should assume that, when 70% of the claims opt out, this was not a complete surprise to class counsel; rather, both sides may have structured the class action as the vehicle for compensating the residual and less sophisticated plaintiff.

In another very different litigation context---mass torts---opting out is an even more established pattern. Some 90,000 persons opted out of the diet drug (or "Fen-Phen") settlement

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[89] Useful examples are provided by two major antitrust class actions brought against Archer-Daniels-Midland Co. ("ADM"). In 1997, following its criminal conviction for price fixing, ADM reached a civil settlement with class action plaintiffs in a suit alleging price fixing in the citric acid market under which ADM paid $86 million, but some of the largest purchasers---including Proctor & Gamble, Quaker Oats, and the Kraft Foods unit of Philip Morris Cos.---opted out. See P&G, Quaker Oats, Unit of Philip Morris Sue Archer-Daniels, Wall St. J., June 11, 1997, at B15. A year later, ADM was forced to reveal that it had paid $36 million to four of these opt-out firms. One careful study has estimated that the opt-outs received "*from 2.0 to 3.5 times more* damages (per dollar of citric acid purchased) than did the settling class." See John M. Connor, Archer Daniels Midland: Price-Fixer to the World 73 (Purdue Univ. Dept. of Agric. Econ., Staff Paper 00-11, 4th Ed. 2000), available at http://ageconsearch.umn.edu/bitstream/28664/1/sp00-11.pdf (on file with the *Columbia Law Review*).

Earlier, ADM had also been independently sued for price fixing in the lysine acid market (lysine acid being an amino acid used by food companies and feedlots to promote quick growth in hogs and chickens). Again, it settled the class action for $45 million (after paying a $70 million criminal fine to the Department of Justice), but again some twenty-five large customers opted out. See Thomas M. Burton, Several ADM Clients Won't Participate in a Proposed Price fixing Settlement, Wall St. J., July 10, 1996, at B2. While the actual amounts paid to these opt-outs is not known, one study has estimated that they would receive "about $20 million"---again outperforming class members. See O'Connor, supra note 89, at 73.

[90] See Carlos Tejada, Quaker, Tyson, Other Plaintiffs Quit Price-Fixing Pact with Vitamin Firms, Wall St. J., Feb. 18, 2000, at A1. For a discussion of the opt-out procedures in this case, see In re Vitamins Antitrust Class Actions, 327 F.3d 1207, 1208--09 (D.C. Cir. 2003); see also In re Vitamins Antitrust Class Actions, 215 F.3d 26, 28 (D.C. Cir. 2000) (discussing additional case background).

[91] See Tejada, supra note 90, at A1.

reached by Wyeth.[92] Characteristically, such opt-outs have above average value claims, and, in mass tort cases, the variation in claim value can be particularly great, based on the highly variable physical injuries suffered by the plaintiffs. As a result, the class action in the mass tort context became the repository for two categories of plaintiffs: (a) those whose claims either had evidentiary, factual or legal problems that make it undesirable to proceed individually, and (b) future claimants who had not yet sustained injury.[93]

This same pattern then seems to prevail across a variety of contexts: opt-outs either hold higher value claims or are sufficiently credible litigants that they can demand a larger settlement. Even if the reasons are not fully understood, it should not surprise us that "big" litigants do better than "small" litigants, even though the class action permits small litigants to combine forces. Possibly, the defendants recognize that large, well-financed opt-outs will simply not allow their counsel to settle cheaply and thus prefer to settle these cases outside the class action.

D. *The Limited Impact of Voice-Based Reforms*

Most efforts to improve the position of the individual class member in a class action have ignored exit and focused on enhancing voice. But as this section will discuss, although well-intentioned, these reforms have only had a modest impact. Why have these very logical reforms not changed the landscape of securities litigation? This essay does not suggest that voice-based reforms cannot work; instead, it hypothesizes that they have less impact than anticipated because they fail to encourage competition among counsel. As will be seen, the clearest impact of the "lead plaintiff" provision has been to induce class counsel to form a larger coalition of firms in

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[92] See Scott Hensley, Wyeth Says 90,000 Opt Out of 'Fen-Phen' Pact, Wall St. J., May 16, 2003, at B4.

[93] The special problems of future claimants probably best explains why the Supreme Court rejected the class settlement in Amchem Prod. Inc. v. Windsor, 521 U.S. 591, 598, 601 (1997) ("Settlement talk thus concentrated on devising an administrative scheme for disposition of asbestos claims not yet in litigation."). It has today made mass tort cases largely uncertifiable. Future claimants are inherently apathetic because each has only a low base expectancy rate of suffering injury in the indeterminate future.

order to win the competition for class counsel. By itself, this transition to a larger number of firms handling the case does little to benefit the class members (and may simply represent featherbedding). But it was a predictable reaction to the incentives created by the PSLRA: The larger the number of plaintiffs assembled as a team, the greater their chance of winning the competition for the "lead plaintiff" designation.

To understand this point and contextualize it, it is necessary to go back to the period before passage of the PSLRA in 1995. Back then, securities class actions and antitrust class actions were organized in a basically similar fashion. Typically, a multiplicity of actions would be filed in district courts all over the country, and the Judicial Panel on Multidistrict Litigation ("JPML") would determine to which district court it would refer these actions for pre-trial coordination and discovery.[94] Such a referral was necessary because otherwise the first settlement with the defendants would bar the other suits, as it (and the release of claims for the entire class incident to that settlement) would carry preclusive effect.[95]

Suppose then that the JPML assigns the case to a specific district court judge. What happens next? The classic folklore was that the first to file would be named lead counsel and thus have control over the settlement process. But this oversimplifies, because no judicial decision or rule ever articulated such a standard.

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[94] The JPML was created in 1968, roughly the same time as the modern class action rules were formalized. See Multidistrict Litigation Act, Pub. L. No. 90-296, § 1, 82 Stat. 109 (codified as amended at 28 U.S.C. § 1407 (2006)). The impact of the JPML referral was diminished by the Supreme Court in Lexecon v. Milberg Weiss Bershad Hynes & Lerach, which held that, after discovery was completed, the case had to be transferred back to the original court in which it was filed. 523 U.S. 26, 28 (1998).

[95] Today, this danger that the first team to settle wins has been largely mitigated by the JPML, which moves all the competing actions to the same court and thereby discourages races to settlement, but the danger of a "reverse auction" under which defendants force plaintiffs' attorneys to compete on the basis of which plaintiff's team will offer or accept the cheapest settlement still arises when overlapping class actions are pending in state and federal court. For the rare case in which a federal court has awoken to the dangers of such a "reverse auction," see Reynolds v. Beneficial Nat'l Bank, 288 F.3d 277, 282--83 (7th Cir. 2002) (defining "reverse auction").

What actually happened was more complex. The court to which the JPML assigned the case might find that it had ten to twenty different complaints before it, each seeking discovery or pretrial relief. The logical first step for the court was to organize the action, establishing committees of counsel to deal with various issues. Recognizing that the court would eventually appoint a lead counsel, the participating law firms usually sought to preempt the court from choosing counsel by organizing their side of the case themselves and electing their own lead counsel. Few courts were sufficiently strong-minded to reject their choice of lead counsel, particularly when this saved the court work.

As a result, an informal political convention was typically convened at which all the participating plaintiffs' attorneys would elect a lead counsel and a steering committee. Often, this caucus might be held in a hotel room a day or so before plaintiffs' counsels' first appearance before the court. As in all political conventions, political horse trading occurred. In order to win votes to be elected class counsel, a candidate had to negotiate deals under which those counsel supporting the candidate would be placed on the action's steering committee and effectively promised that they would be assigned billable work for which they could earn fees (if the action settled). The losing side in these contests would receive no such promises and might be excluded from work assignments; thus, they might receive no fees, because the court awarding fees will usually defer to the fee allocation among counsel made by the elected steering committee---an ad hoc law firm of sorts. The incentive for many counsel to participate in this political process was that it assured them of some participation in the action and a share of the fee award if the case settled. In contrast, if the court simply selected the lead counsel, the counsel so selected would thereafter have little incentive to invite redundant counsel to

participate in the litigation. Thus, the predictable consequence of the brokered selection of class counsel was feather bedding and inefficiency.

Not only did this system produce overstaffing, but overstaffing in turn reduced the likely fee award to those counsel who had most contributed to the action's success. Because courts will not permit the fee award to exceed some maximum percentage of the recovery (typically, twenty-five to thirty-five percent),[96] overstaffing implied that those litigators who actually carried the case to settlement would have to share the judicial fee award with the patronage appointments that a political system inevitably produced. In turn, this undercut the incentive to invest time in the action, as all knew they had to share the expected return with redundant attorneys.

Another consequence of this brokered system for organizing the class action was that it eliminated open competition. Although there were occasional struggles within the plaintiff's camp that broke into the open,[97] plaintiffs' attorneys did not want these battles publicized, and most could not afford to make enemies within the plaintiffs' bar for fear that they would be excluded from future plaintiffs' teams. Smaller and new entrant firms learned, just like junior Congressmen, that one got along by going along. Overstaffed and undermotivated, the traditional "ad hoc" plaintiff's law firm was a model of inefficiency.[98]

The PSLRA changed this picture dramatically, but it only marginally increased competition. Being "first to file" no longer made much sense, because the PSLRA gave

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[96] During prior decades, the average fee award in securities class actions was around thirty-two percent of the recovery. See supra note 59. Hence, the plaintiff's attorneys knew that they had little chance of receiving a forty percent award.

[97] For a detailed examination of one such episode (involving an antitrust class action), see 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, 252--61 (1983) [herinafter Coffee, Rescuing].

[98] For discussions of patronage systems in which committee positions and leadership roles in the class action were awarded in return for support in the election of lead counsel, see id. at 256--59.

effective control of the securities class action to the class member or members with the largest losses, even if this shareholder or shareholder group never filed an action. Instead, a large institutional investor could take control of the class action simply by volunteering to serve as lead plaintiff---without ever filing any lawsuit or seeking the support of others. Quickly, the plaintiffs' bar learned to develop relationships with public pension funds, unions and other organizations that held large stock positions. Milberg, Weiss, the long-time leader of the securities class action bar, moved relatively slowly towards this new system, hoping to continue to compete by assembling large aggregations of small plaintiffs. The SEC opposed such large aggregations, however, on the grounds that they could not adequately monitor the attorney and so were inconsistent with the PSLRA's statutory intent.[99] As a result, because it changed its position more slowly than its rivals, Milberg Weiss's near monopoly position eroded, and some other firms secured important lead counsel positions.

Although contests for lead plaintiff certainly arose under this system, the participants soon learned a new way to conduct them. Law firms could and did solicit institutions (typically public pension funds) to serve as lead plaintiff (with the understanding that the law firm would be chosen by the institution as its class counsel), but predictably other law firms could respond by assembling a rival and larger consortium of pension funds and thereby win the contest. Even the eventually winning team had to fear up to the last possible moment that some rival firm or firms would either enter the competition or assemble a larger consortium of clients. As a result, the logical strategy was not to proceed on a "lone wolf" basis, but instead to assemble groups of

[99] The SEC expressed its opposition to a large number of shareholders sharing the position of lead plaintiff in In re Baan Co. Sec. Litig., 186 F.R.D. 214, 216--17 (D.D.C. 1999) (noting SEC position that "'a court generally should only approve a group that is small enough to be capable of effectively managing the litigation and the lawyers'" (quoting Memorandum of the SEC, as Amicus Curiae supporting [respondents/petitioner], at In re Baan Co. Sec. Litig., 186 F.R.D. 214 (D.D.C. 1999) (Civ. No. 98-2465))). Since that time, few law firms have attempted to assemble more than five or six shareholders to serve collectively as lead plaintiffs.

law firms in order to combine their clients into a larger consortium of institutions. Put differently, it was in the interest of law firm *X* not to compete with law firm *Y*, but rather to pool their institutional clients so that they could stave off the threat from still other potential competitors. This means, of course, that the problem of overstaffing again resurfaces.

Professors Choi and Thompson have provided empirical support for this hypothesis, finding that the number of cases with a solo lead plaintiff law firm fell from 31.9% in the pre-PSLRA period to 19.6% immediately after passage of the PSLRA.[100] Previously, consortiums of more than two law firms had been rare, but Choi and Thompson identified, out of a sample of 219 post-PSLRA suits, some seventy-eight cases (or nearly thirty-six percent) in which three, four, five or even more law firms shared the lead counsel position.[101] Once again, the better political brokers could knit together large coalitions that would hold larger equity stakes.

In theory, law firms might share the lead counsel position for other reasons than the need to assemble the largest equity stake---for example, to create a synergistic combination of legal skills or to achieve efficient risk diversification. But while these could be secondary motives, the driving force in the real world was the need to protect one's position against potential larger coalitions that might arise at the last minute. Although law firms could always combine to serve as co-class counsel, sharing a single client, actual cases of co-counsel sharing a single client have proven rare, both before and after the PSLRA. This pattern suggests that synergy and risk diversification were not the primary motivators behind law firm coalitions. Rather, the cement that held together law firm coalitions was the need to assemble a client mass that would preempt competitive efforts by other teams of attorneys. As just noted, Choi and Thompson found that

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[100] Stephen J. Choi & Robert B. Thompson, Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA, 106 Colum. L. Rev. 1489, 1520--21 (2006).
[101] Id. at 1521 tbl.4.

only in 19.6% of the post-PSLRA cases did law firms proceed on a solo basis, and these cases probably consisted of either (1) those that were too small in terms of the expected recovery to attract competition or (2) those in which the solo firm represented a client of preemptive size (for example, CalPERS).

As firms and investors have gained experience with contests over the lead plaintiff position, Choi and Thompson find that "repeat relationships" have developed "between lead plaintiff law firms and institutional investors" and that "institutional investors that potentially act as lead plaintiffs tend to develop repeat relationships with only a handful of the top-tier plaintiff law firms."[102] Choi and Thompson express uncertainty at what forces were behind these "repeat relationships," but certainly political campaign contributions were likely one such force---and competition on this score obviously favors the larger and entrenched law firm. To be sure, such "repeat relationships" could also be based on the institutions' successful prior experience with some law firms, but once these "relationships" formed, they became a barrier to new entrants.

At least in the case of the public pension funds, much anecdotal evidence suggests that inter-firm competition for class counsel is largely waged on a basis that does little for absent class members. Even apart from pay-to-play practices that exchanged political contributions for legal business, it became the common practice for the larger plaintiffs' firms to entertain, often lavishly, the officials of public pension funds. Marketing is, of course, something that all law firms engage in, but the PSLRA focused plaintiffs' firms on the need to form alliances with public pension funds. Anecdotal evidence shows the impact. In one well-known major class action, the New York State Comptroller was estimated to have received $200,000 in political contributions from two law firms (and the families of their partners) in the year following their

[102] Id. at 1529.

selection as co-class counsel in a case in which the two firms eventually received a $55 million fee award.[103] Eventually, scandals erupted, and individuals in the New York State Comptroller's office have recently been indicted for their involvement in pay-to-play arrangements.[104]

In fairness, many of these contributions may have been defensive in character; that is, one plaintiffs' law firm makes a contribution in order to keep pace with its rivals and not be excluded from consideration as class counsel. Nonetheless, the net result of this pay-to-play system of exchanging political contributions for lead plaintiff designations is to rent the pension fund as a lead plaintiff to the highest contributors. It may do little damage to the pension funds, but it does effectively exclude smaller firms and new entrants who have not previously made contributions.

Viewed in terms of a traditional antitrust concentration analysis, the overall concentration level within the securities plaintiffs' bar neither rose nor declined significantly after the enactment of the PSLRA in 1995. Professors Choi and Thompson estimate the market share percentage of the top five plaintiffs' firms before and after the PSLRA, as follows:[105]

Pre-PSLRA Market Share Percentages

Milberg, Weiss	27.9%
Wolf Haldenstein Adler Freeman & Herz	11.0%
Bernstein Litowitz Berger & Grossman	8.1%
Berger & Montague	4.8%

[103] See Cox & Thomas, Does the Plaintiff Matter?, supra note 14, at 1611--12 (2006) (describing incident). For a fuller sense of the total amount of these "pay to play" payments, see Lovett, supra note 23 (finding law firms representing New York State to have received over $518 million in fee awards in such cases over past ten years).
[104] For an overview of this scandal, which resulted in the indictment of Hank Morris, a polical consultant, and employees of the New York State Comptroller's office, see Mike McIntire, Pension Inquiry Reveals a Power Broker's Web, N.Y. Times, May 14, 2009, at A1; Chris Smith, Follow the Pension Money, N.Y. Mag., Aug. 3, 2009, at 18. These scandals have not involved plaintiffs' law firms, whose political contributions are fully disclosed, but they do show a norm of reciprocity at work: those who want business must contribute.
[105] Choi & Thompson, supra note 100, at 1515 tbl.3.

Abbey & Ellis/Abbey Gardy	4.4%
Total:	*56.2%*

Post-PSLRA Market Share Percentages

Milberg, Weiss	27.4%
Bernstein Litowitz Berger & Grossman	9.0%
Wolf Popper	5.7%
Wolf Haldenstein Adler Freeman & Herz	5.4%
Barack Rodos & Bacine	*4.7%*
Total:	*52.2%*

In short, some firms rose and others fell, presumably in line with their ability to win lead plaintiff designations, but in total there has been only a small (4%) decline in the concentration level. Moreover, this modest shift toward greater competition may have been more than offset by the increased need for plaintiffs' law firms to pool their clients to win the coveted lead plaintiff status. From a competitive standpoint, the market for class counsel services has basically remained static before and after the PSLRA.

Of course, the modest nature of the above changes would mean little if lead plaintiffs were doing more for the class, achieving either larger settlements or recovering a higher percentage of the class members' losses. Such data, however, seems largely lacking. Professors Cox and Thomas found in 2006 that the ratio of settlement amounts to estimated provable losses

in securities class actions has actually declined since the passage of the PSLRA[106] and that settlement size also did not increase following the PSLRA.[107] Although they found some evidence that institutional lead plaintiffs did better for their class members in terms of settlement size as compared with other categories of lead plaintiffs,[108] this finding was more than offset by their more pessimistic finding that "institutional lead plaintiffs have the lowest average and median recovery percentages of any group."[109] Taken together, these twin facts suggest that institutional lead plaintiffs simply gravitate towards larger cases.

Equally striking was Professors Cox and Thomas's finding that individuals continue to be lead plaintiffs in the plurality of cases. They report that single institutions and combinations of institutions with individuals accounted for only eighteen percent of the cases in their post-PSLRA sample, while groups of individuals accounted for forty-one percent of post-PSLRA settlements.[110] This suggests that the desire of institutions to serve as lead plaintiff has been largely limited to public pension funds (and even then only in the larger and more publicized cases).

What then is the bottom line? Once they controlled for all obvious variables, Professors Cox and Thomas noticed that "post-PSLRA settlements are not statistically different from those in the pre-PSLRA period."[111] Thus, they conclude that "[t]hese results suggest that the

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[106] See Cox & Thomas, Does the Plaintiff Matter?, supra note 14, at 1627.
[107] The mean settlement size did increase from $9,734,000 to $15,728,000, but the median settlement size rose only from $5,500,000 to $5,745,000. Id. at 1624. Both these shifts may be largely the consequence of inflation and the increased size of the market capitalization of defendant corporations in the post-PSLRA period. Cox and Thomas find that overall settlement size did not change in any statistically significant way. Id. at 1628--29.
[108] Id. at 1624. Explaining this finding is probably the fact that institutional plaintiffs tend to serve in larger cases against larger defendants. Id. at 1625-26.
[109] Id. at 1627.
[110] Id. at 1623.
[111] Id. at 1637.

enactment of the PSLRA had no significant impact on settlement size."[112] Worse yet, they find that "[i]nvestors appear to be recovering a smaller percentage of their losses today than they did before the passage of the PSLRA."[113] Although more visible battles for control of the class action may occur now than under the pre-PSLRA system, the problem is that this competition is for the loyalty and favor of those institutions that can serve as lead plaintiff; it is not a competition aimed at improving the recovery of individual class members.

Nor does it appear likely that institutions will eventually serve as lead plaintiffs in most cases. Institutional lead plaintiffs, Cox and Thomas conclude, are "very selective" in their choice of cases, agreeing to serve as lead plaintiffs only in the largest cases with the greatest potential damages.[114] In effect, institutions seem to be "cherry picking," taking the largest and most attractive cases. This may reflect their status as public bodies with elected officials who may wish to be visibly engaged in high-profile litigation on behalf of investors. Whatever the motive, institutions appear to leave the less attractive, less visible cases for others to serve as lead plaintiff. Practices may evolve still further, but at present, even optimistic commentators appear agreed that "the lead plaintiff rules have not significantly changed the environment" of securities litigation.[115]

E. *An Evaluation*

On the evidence considered so far, exit seems to be outperforming voice. Still, three considerations must be kept in mind before any final assessment can be fairly reached:

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[112] Id. at 1629.
[113] Id. at 1637.
[114] Id. at 1629. These largest cases may also be the ones with the highest public profile, reflecting the fact that public pension funds often have politically prominent leaders who may enjoy, and benefit from, the attention and publicity in such cases.
[115] See Issacharoff & Miller, supra note 12, at 197 ("Entrepreneurial attorneys continue to dominate securities class action practice today as they did in prior years.").

1. *The Exit Threshold.* --- Although the "exit" option appears to have been preferred by investors in several highly publicized, mega-class actions, these were largely cases in which the defendants had presumptive liability and in which the enormous size of the opt-outs' losses motivated these institutions to deviate from their normal passivity. Thus, these cases do not imply that opting out will necessarily be an equally attractive strategy in the much more common class action that settles for considerably less than $100 million. At some point, there is a floor beneath which opting out will not be economically viable. Also, opting out may not be attractive in high risk cases or in cases where institutional investors may be subject to special defenses or burdensome discovery.

In addition, because the defendant can typically afford to go to trial against the individual opt-out plaintiff (whereas it will rarely risk trial in the case of a much larger class action), the institution's decisional calculus as to whether to opt out must factor in the possibility of an expensive trial and even a litigated loss. Sometimes, the institution may prefer to hide within the herd in the class action than face an individual trial. Still, today's boundary line for opting out may decline further, as both the plaintiff's bar and institutional investors learn to economize on the costs of such litigation.

2. *The Impact on Small Claimants.* --- The impact of opt-out plaintiffs on the remaining class members remains debatable. Will the remaining class members' per share recovery shrink to offset the gain in the opt-outs' recovery? In principle, class counsel should be motivated by the fear of increased opt-outs to seek an improved class settlement, because a weak settlement will motivate increased opt-outs and hence a reduced fee award for class counsel. But defendants can be expected to resist paying twice: once to the class and again to the opt-outs. Defendants will predictably try to deter opting out and, failing that, to reduce the class settlement

to reflect the opt-outs. But, precisely because opt-outs typically do better than the class, defendants will need to disproportionately reduce the class settlement in order to protect themselves from the future and likely superior opt-out settlements. For example, if we assume that opt-outs, on average, did twice as well, then defendants, to stay even, might need to reduce the class action settlement by twenty percent to reflect opt-outs by ten percent of the class.

Class counsel will, of course, resist such disproportionate reductions, but need only resist selectively. Here, their self-interest is not well aligned with that of all class members. Although class counsel cannot allow the class settlement to appear less attractive to those marginal class members who are capable of opting out and securing individual representation, a self-interested class counsel need not worry about those "negative value" claimants who cannot opt out because their individual claims are not economically viable. Thus, public policy needs to be concerned about practices that amount in substance to price discrimination---that is, that allow large claimants to recover more than small claimants because only the former opt out.

How could class counsel and defendants collude to discriminate against small claimants who cannot opt out? Some techniques seem predictable. The class settlement could, for example, impose more complex procedures for filing and proving claims. Such procedures will not deter most institutional investors, who generally keep accurate records, but it might deter individual retail claimants whose record-keeping may be more informal. If the amounts not claimed by the small individual claimants went by default to those larger (and largely institutional) investors who did file and prove their claims, these larger class members would do better in the class settlement and have less incentive to opt out. Alternatively, if these unclaimed amounts instead reverted to the defendant, which is today the less common practice, then the defendant would be less injured by, and could live with, a large, but illusory, class settlement that

is not fully paid out. Either way, small claimants may be at risk because of the increased pressure placed on class counsel by opt-outs.

Because there is a possibility that opt-outs will reduce the per share recovery of the remaining class members, a normative policy question needs to be faced: Should opt-outs be restricted on fairness grounds? Should society be concerned that smaller investors might lose precisely to the extent that institutional investors do better? Here, three different arguments need to be considered.

First, although principles of distributive justice may lead one to disfavor a system under which wealthy investors receive greater per share recoveries than less well off investors, it is far from clear how such egalitarian preferences should be applied. Even if institutional opt-outs adversely affect the investors who remain in the class, these smaller investors in the class are still typically wealthy and diversified. In contrast, the beneficiaries of pension plans (and particularly public pension plans, which have been the most frequent opt-outs) are characteristically poorer retirees who are dependent on their pensions for retirement income. Thus, if public policy is to be guided by a Rawlsian desire to favor the worst off, individual investors do not necessarily merit any preference over pensioners or the beneficiaries of other institutional investors.

Second, even if opt-outs do injure the residual class members in the short run, they may benefit them in the long run. Over the long run, increased opting out will place class counsel under increased competitive pressure to improve the class settlement. Faced with competition and a risk that a "cheap" settlement will produce a higher rate of opt-outs, class counsel should seek to reach a superior settlement in order to avoid the fee reduction that follows from a smaller class size.

Third, opt-outs should reduce the smaller class member's recovery only when defendants negotiate disproportionate reductions to reflect the opt-outs or impose complex and onerous claim filing requirements. Such tactics are, however, subject to judicial control if courts are alerted to them. The better way to protect the class is not to discourage opt-outs, but to limit any reduction of the class recovery to an amount proportionate to the opt-outs' claims. Litigation governance is vulnerable to the risk that defendants and large claimants could collude to the detriment of smaller claimants, but such a failure is not inevitable. Rather, understanding this vulnerability should lead courts to focus their scrutiny on signs of such collusion in reviewing class action settlements.

3. *Judicial Economy*. --- The last consideration that must be weighed in evaluating the "exit versus voice" tradeoff is the value of judicial economy. More opt-outs mean more work for courts. It also means that the class action settlement process will be slower and more difficult, because the defendant does not achieve finality. Lacking finality, defendants may be slower to settle, fearing that the settlement may trigger a wave of opt-outs, and may on occasion even go to trial, thereby resulting in greater work and delay for courts.

Still, the evidence to date is that these opt-outs from securities class actions have settled quickly, sometimes without an action even being filed. In the future, opt-out cases might often be resolved through arbitration. To be sure, if the minimum level at which opting out were feasible were to decline to a much lower level (say, $500,000 in losses), more actions would mean more trials and more work for courts. It was precisely for this reason that federal district courts long resisted opt-outs, seeking to encourage instead a global final settlement. But the law

has changed significantly over the last decade in ways that have restricted courts' ability to discourage opt-outs.[116]

Other factors have also increased the volume of individual securities litigation. The 2008 financial crisis grew out of problems in the debt markets. Because the debt markets are normally not considered to be efficient, the "fraud on the market" doctrine has been held not to apply to them, thus requiring plaintiffs to show individual reliance, which in turn precludes a finding of "predominance" under Rule 23 of the Federal Rules of Civil Procedure.[117] The bottom line is that plaintiffs in cases involving debt securities need to sue on an individual or consolidated basis, thereby again downsizing the role of the class action. Moreover, as individual securities actions become more common, the dominance of the large class action plaintiffs firms may decline, and greater competition seems likely.

Ultimately, litigation governance cannot rely exclusively on exit or voice, but must balance the two. Exit does, however, seem to encourage a competition that directly benefits the class member, whereas the "lead plaintiff" provision (a prototypical voice-based reform) appears today to mainly cause counsel to curry favor with a limited number of institutional investors. Given the still developing state of the law and practice in this field, this Essay will content itself with the modest conclusion that as exit becomes more common, strains will appear in the legal

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[116] Once, federal courts could and did enjoin state court trials involving opt-outs where the federal court believed that the state trial might disrupt a pending settlement of the class action in federal court. See, e.g., In re Baldwin-United Corp., 770 F.2d 328, 335 (2d Cir. 1985)(discussing authority for issuance of injunction). More recently, this broad power has been curtailed. See Ret. Sys. v. J.P. Morgan Chase & Co., 386 F.3d 419, 430--31 (2d Cir. 2004) (rejecting claim that All Writs Act authorizes district court to enjoin state court trial merely because state action would delay scheduled trial in federal court).

[117] See Teamsters Local 445 Freight Div. Pension Fund v. Bombardier, Inc., 546 F.3d 196, 196 (2d Cir. 2008) (finding predominance requirement not to be satisfied in case involving debt securities). The Second Circuit has also found that the market for initial public offerings (or IPOs) is generally not efficient and so individual reliance may also need to be established in this context, which again would encourage institutional investors to turn to individual actions, rather than seek class certification. See In re Initial Public Offering Sec. Litig., 471 F.3d 24, 42--44 (2d Cir. 2006).

system. Predictably, defendants will seek ways to discourage opt-outs or to penalize the remaining class members for the opt-outs greater success. Nonetheless, greater competition seems to be coming, and that will impose some burdens on courts.

III. *ALTERNATIVE GOVERNANCE STRUCTURES FOR AGGREGATE LITIGATION: A GLOBAL PERSPECTIVE*

From a governance perspective, the oldest maxim is: "One size doesn't fit all."[118] No one structure of corporate governance is optimal for all firms. The same is likely true for litigation governance where legal systems and legal cultures differ markedly. Thus, as Europe in particular explores the need for new means by which to deal with aggregate litigation, it makes sense to explore the range of governance models that might feasibly be employed. Watching Europe begin this exploratory process, U.S. commentators have largely divided into two camps: (a) those who believe that Europe, by one means or another, must adopt the key features of U.S. entrepreneurial litigation (in particular, the opt-out class and the contingency fee),[119] and (b) those who want to warn Europe of the dangers in moving to a U.S. style system of entrepreneurial litigation.[120]

This Essay does not intend to endorse either position. Rather, its focus is on alternative models and the availability of functional substitutes. For example, if Europe does not want to adopt the contingent fee, what alternatives are possible to fund aggregate litigation and how

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[118] For representative critiques of the "one size fits all" fallacy, see Steven M. Davidoff, Regulating Listings in a Global Market, 86 N.C. L. Rev. 89, 97, 160 (2007) (criticizing fallacy of "one size fits all"); Gerald Hertig, On-Going Board Reforms: One Size Fits All and Regulatory Capture, 21 Oxford Rev. Econ. Pol. 269, 269--70 (2005) (criticizing tendency of European countries to follow U.S. on a "me too" basis).

[119] Professors Issacharoff and Miller, two of the most astute scholars of class actions, fall into this camp. See Issacharoff & Miller, supra note 12, at 180--81 (applauding current European reforms partly based on "American experience" and "simple economics of incentive systems").

[120] Professor Richard Nagareda, also a respected scholar, seems to fall into this camp. See Nagareda, supra note 10, at 2 (noting widespread view that U.S. litigation rules "generate a considerable and undesirable drag on the U.S. economy").

would their impact be different? In sequence, this Part will first focus on the alternatives to the opt-out class and then turn to the topic of litigation funding. Ultimately, its basic claim is that if Europe wishes to resist the U.S. entrepreneurial model and if a voice-based democratic model is simply infeasible, it should consider a model that largely parallels U.S. public interest litigation; this model could be fitted to the existing institutional structure in Europe with only modest adjustments.[121]

A. *Opting In Versus Opting Out*

With only a few exceptions, existing European class action procedures employ an opt-in rather than an opt-out procedure.[122] Motivating this preference is partly the jurisprudential idea that a litigant should not be bound by agents that the litigant has not authorized to act on the litigant's behalf and partly a strong aversion to American-style entrepreneurial litigation. But observers both in the United States and Europe have expressed skepticism that opt-in classes are feasible for at least three distinct reasons: (1) participation rates will be low, with the result that neither deterrence nor victim compensation is achieved;[123] (2) a "free rider" problem will discourage anyone from volunteering to serve as the representative plaintiff, because the passive class member shares in the gains, but not in the possible losses that flow from the common European "loser pays" rule;[124] and (3) opt-in classes deny defendants the virtue of finality.[125] All these claims have some merit, but they still may be overstated.

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[121] Professor Rubenstein has described a similar model as an "expertise model." See Rubenstein, supra note 49, at 1663--69. This Essay will not adopt that term, because Rubenstein's primary concern is with ideological and political divisions within public interest litigation, which are less likely to arise in consumer, antitrust, securities, and environmental litigation. These latter areas are those in which Europe wishes to modestly encourage aggregate litigation. Unlike Rubenstein's proposal, which allows those with expertise to censor insurgents, the model here proposed intends greater competition.

[122] See supra note 37.

[123] See Issacharoff & Miller, supra note 12, at 203--06.

[124] Id. at 203--04.

1. *Participation Rates*. --- Leading U.S. scholars have estimated that the rate of opt-outs in consumer cases between 1993 and 2003 was, on average, less than 0.2%---less than two in a thousand.[126] But there is danger in relying on this statistic to determine the likely participation in an opt-in class, because opting out makes no sense for a person holding a "negative value" claim, while opting in is entirely rational. The incidence of rational behavior is not well estimated by looking to the rate of irrational behavior.

A better measure of likely participation comes from the actual experience in those European countries that have actively employed an opt-in procedure. Professor Henrik Lindblom of Sweden has surveyed the experience under his country's recent opt-in class action procedure, which was adopted in 2002.[127] As of 2007, he found nine examples, several of which are next discussed briefly.

- In a 2003 case, an airline went bankrupt after having received payments from passengers for tickets. An individual brought suit on behalf of himself and some 700 other passengers. After the court with jurisdiction over the case notified these 700 passengers, 500 opted in, and the case settled for roughly 70,000 euros.[128] Because the value of each individual action for ticket payments was modest, these were quintessential "negative value" claims.
- In a 2004 case, a nonprofit corporation was formed by prospective litigants to sue a life insurance company that transferred substantial assets to its parent, allegedly

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[125] Id. at 206--07.
[126] See Eisenberg & Miller, supra note 50, at 1532.
[127] See Henrik Lindblom, The Globalization of Class Actions: Group Litigation in Sweden (Dec. 6, 2007) available at http://www.law.stanford.edu/display/images/dynamic/events_media/Sweden_National_Report.pdf (unpublished manuscript, on file with the *Columbia Law Review*).
[128] Id. at 21--22 (discussing *Bo Åberg v. Elfeterios Kefales ("Air Olympic")*, Stockholm District Court, case number T 3515 (2003)).

for inadequate consideration.[129] Out of 1.2 million policy holders, some 15,000 individuals opted in and also paid membership dues of fifteen euros, allowing the non-profit organization to amass capital of over 200,000 euros to fund the litigation.[130] Although this percentage may seem low, it must be remembered that no actual loss was experienced by these class members and that they also had to make a cash payment to opt in.

- In 2004, the Swedish consumer ombudsman brought a class action on behalf of 7,000 customers of a utility for failure to supply electricity, as agreed, under a fixed price contract.[131] This was the first public enforcement action under the Swedish class action statute.[132]
- In 2007, the residents of a suburb adjoining an airport formed a non-profit organization, which then sued the Swedish Airports and Air Navigation Service for damages resulting from aviation noise on behalf of some 20,000 residents.[133] At least 7,000 individuals in the area affected by the aviation noise opted into the class.[134]

Few other European countries appear to have had the same depth of experience as Sweden with opt-in class actions. But in Belgium, which also mandates opt-in classes, some 5,000 minority shareholders (out of an identified total of 11,000) were convinced to opt in to a

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[129] Id. at 22--33 (discussing *Grupptalan mot Skandia v. Forsakringsaktiebolaget Skandia*, Stockholm District Court, case number T 97 (2004).
[130] Id. at 22.
[131] Id. at 23--24 (discussing *The Consumer Ombudsman v. Kraftkommission i Sverige AB*, Umel District Court, T 5416 (2004)).
[132] Id. at 23.
[133] Id. at 25 (discussing *Carl de Geer et al. v. The Swedish Airports and Air Navigation Service*, Nacka District Court, case number M 1931 (2007)).
[134] Id.

class action against a major corporation by a consumer organization and a consulting firm specializing in the representation of minority shareholders.[135] This roughly forty-five percent opt-in ratio is even more impressive because many of these shareholders also had to advance legal fees to join the action.[136]

Anecdotal as this experience is, both the Swedish examples and the Belgian case seem noteworthy because of the lack of any prior relationship or community among the class members in these cases. Commentators have opined that opt-in procedures might work in cases where the potential class members had a pre-existing relationship (such as employees in the same office in a case involving a workplace dispute).[137] But customers of a utility, defrauded minority shareholders, airline passengers, insurance policy holders, or residents of a large suburb have little in common. Nor is it likely that most of these class members who opted in considered any of these disputes to be matters of urgent importance to them. This experience suggests that if clear notice is given individually to class members and a credible non-profit consumer organization or public ombudsman leads the action, rates of participation in the range of one third to over one-half are possible. While class members rarely respond to the notices they are

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[135] See Matthias E. Storme & Evelyne Terryn, Belgium Report on Class Actions 6 (Dec. 13, 2007), available at http://www.law.stanford.edu/display/images/dynamic/events_media/Belgium_National_Report.pdf (unpublished manuscript, on file with the *Columbia Law Review*). Of these 5,000 shareholders that did opt in, some 2,000 were members of the consumer organization Test-Aankoo), and the rest were clients of the consulting firm Deminor.

[136] The consumer organization had greater success in convincing its members to join the action because its members did not have to bear legal fees, which were advanced by their organization. In contrast, the clients of Deminor were required "to advance a limited sum to cover the costs of the proceeding." Id. Thus, although the overall opt-in rate was slightly over forty-five percent (i.e., 5,000 out of 11,000), only about one third of the clients of Deminor ultimately authorized the firm to represent them in the action. Id. This disparity suggests that any obligation to advance legal costs will deter opt-ins even more than the tendency of small claimants to be rationally apathetic. It also underscores the obvious utility of using consumer organizations in the role of lead plaintiff in jurisdictions that forbid contingency fees, at least to the extent that such organizations are willing to bear all or most of the litigation's expenses.

[137] See Issacharoff & Miller, supra note 12, at 204--05 (describing workplace litigation as a "specialized context" where "class members have many opportunities to communicate with one another about the litigation"). But see infra note 147 (noting opt-in rate in workplace litigation could be unrepresentatively low because of deterrent effect of employer-employee relationship).

given in U.S. class actions, this may be in part a product of the fact that class counsel has no need to induce them to respond in an opt-out system and may even hope that they remain quietly passive.

Some U.S. experience also shows that opt-in rates can reach or exceed fifty percent under favorable circumstances. Several U.S. statutes---most notably the Fair Labor Standards Act ("FLSA"),[138] but also the Discrimination in Employment Act ("ADEA")[139] and the Equal Pay Act[140]---employ a mandatory opt-in procedure. A 1996 study by the Federal Judicial Center calculated the opt-in rates for three FLSA cases and found them to be 39%, 61%, and 73%.[141] A more recent study of some 21 FLSA cases found the average opt-in rate to be considerably lower at 15.71%,[142] but it also found that if the two actions with the highest and lowest rates were excluded as outliers, this rate rose to 23.34%.[143] In one case, 204 out of 228 claimants, or 89.5%, opted in, showing that at least under some circumstances a high percentage of claimants can be induced to opt in.[144] Moreover, as plaintiff's attorneys become more adept in using websites and email solicitations to reach potential class members, participation rates seem likely to rise.[145]

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[138] See 29 U.S.C. § 216(b)(2006) (specifying opt-in requirement for FLSA).
[139] See 29 U.S.C. § 626(b) (similar opt-in requirement for ADEA).
[140] See 29 U.S.C. § 216(d) (mandating that opt-in procedure for the FLSA also apply to the Equal Pay Act).
[141] See Thomas Willging et al., Federal Judicial Ctr., Empirical Study of Class Actions in Four Federal District Courts 54 (1996), available at http://www.fjc.gov/public/pdf.nsf/lookup/rule23.pdf/$File/rule23.pdf (on file with the *Columbia Law Review*).
[142] See Andrew C. Brunsden, Hybrid Class Actions, Dual Certification, and Wage Law Enforcement in the Federal Courts, 29 Berkeley J. Emp. & Lab. L. 269, 294 (2008) (discussing low opt-in rate of 15.71 percent in FLSA cases).
[143] Id. at 294 n.129.
[144] Id. at 293 (displaying opt-in rate of 89.5 percent in *Lindsay v. Gov't Employees Ins. Co.*).
[145] Attorneys at the Texas law firm of Starzyk & Associates, P.C., which specializes in FLSA cases, inform me that they use a web site for each FLSA action to alert employees of a defendant company and that they send emails to all employees in the relevant job descriptions that are the subject of the FLSA litigation. They also alerted me to one recent California class action in which two hundred and fifty-six out of the three hundred and sixty-four persons eligible to participate in a "wage and hour" settlement elected to do; this represents a 70.33% participation rate. See "Declaration of Monica Balderrama in Support of Motion for Final Approval of Class Action Settlement" (dated September 14, 2008) at p. 16, paragraph 52 in Winzelberg v. Liberty Mutual Co., Case No. CV 07-460 GAF (C.D. Cal.) (copy of file at Columbia Law Review). In this light, historic participation rates in the fifteen to twenty-three

This evidence can be read in different ways. Clearly, the likely participation rate for eligible claimants will be significantly below the automatic 100% participation rate in an opt-out class action. But, as next discussed, class members who do not opt out in an opt-out class action may still go uncompensated because they often do not file claims post-settlement; in contrast, opt-in class members, having elected to participate, are unlikely to be so indifferent. Although opt-in levels can sometimes exceed fifty percent, proponents of the opt-out class still argue that the U.S. experience is largely with workplace litigation, which is arguably unrepresentative, because workplace litigation tends to involve smaller and more closely knit groups.[146] Even if this is true,[147] the Swedish and Belgian examples discussed above suggest that participation rates will be higher when the action is lead by an organization that has an established reputation for leadership in the field (and possibly a willingness to subsidize some of the action's costs). The greater credibility of such a representative plaintiff may be able to close much of the gap in participation rates between opt-in and opt-out class actions.

More importantly, the great fallacy in contrasting the high or universal participation rate in opt-out class actions with the lower rate in opt-in actions is that this comparison looks only at the front end and ignores the back end of the proceeding. Although the opt-out class action includes everyone, relatively low percentages of the class may actually file claims after a settlement is achieved. Professors Cox and Thomas found that less than thirty percent of the

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percent range, as discussed in the text, may understate the potential for the opt-in class when internet solicitation techniques are utilized.

[146] Id.; see also Issacharoff & Miller, supra note 12, at 204--05 (discussing specialized context of workplace litigation and factors contributing to increased participation rates).

[147] This claim that potential class members in workplace litigation will be more prepared to sue, either because they know each other or because they share some common identity, overlooks the fact that in workplace litigation plaintiffs are typically suing their employer. Few will be deterred from suing a manufacturer of a defective product with whom they have no contact, but many more will be cautious about suing their employer. Hence, the opt-in rate in workplace litigation could even be unrepresentatively low.

institutional investors in the securities class actions that they studied filed claims after a settlement had been reached.[148] In some special contexts, the rate is even lower and may fall to one percent or lower.[149] Because institutional investors generally hold claims for significant amounts (at least in proportion to the minimal cost of filing a claim) and because they are generally thought to be sophisticated, this evidence suggests that proponents of the opt-out class have overstated their case and that the presumed difference in participation may be largely illusory. Even if the opt-out class action includes the passive holders of negative value claims, these negative value claimants do not actually benefit from such an action where, for whatever reason, they fail to file a claim. In short, apathy reemerges at the back end of the opt-out class action where a procedure resembling the act of opting in remains necessary if the class member is to receive compensation.

Little is known about why so few eligible claimants file claims.[150] In some contexts, the typically modest recovery rate may be so low that class members simply remain indifferent to

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[148] Cox & Thomas, Slip Through Your Fingers, supra note 68, at 413.

[149] Extremely low participation rates have been reported in the case of coupon settlements, where the rate appears to fall below one percent. See James Tharin & Brian Blockovich, Coupons and the Class Action Fairness Act, 18 Geo. J. Legal Ethics 1443, 1448 (2005). For recent examples, see Yeagley v. Wells Fargo & Co., 2008 U.S. Dist. LEXIS 5040 at *5 (N.D. Cal. Jan. 18, 2008) (finding that less than one percent of the class responded to the settlement notice); Figueroa v. Sharper Image, 517 F. Supp. 2d. 1292, 1327 (S.D. Fla. 2007) (rejecting proposed settlement, in part because "very low numbers of class members" expressed interest in the $19 coupon, which was the principal component of the proposed settlement).

[150] Of course, the most obvious hypothesis is that class counsel in opt-out class actions are not motivated to pay for, or accept the delay incident to, the use of more costly notice procedures that will elicit higher participation rates. Because some Federal Circuits base the fee award on the settlement size and not the portion of the settlement actually paid out, the plaintiff's attorney in these Circuits has little economic incentive to encourage class members to file claims. See Masters v. Wilhelmina Model Agency, Inc., 473 F.3d 423, 437 (2d Cir. 2007) (favoring fee award based on total settlement fund). Another possible explanation for low participation rates is that institutional investors have little interest in funds being expended to attract retail investors to participate and thus share the recovery with them. The lead plaintiff may thus have a conflict with smaller class members. I have discussed this issue of participation rates with the professional "claims administrators" of class action settlements (including the largest of these, which is the Garden City Group, Inc.) and have been advised that participation rates are highly variable, often falling below ten percent, but can reach much higher percentages when individual class members will receive a cash payment of several hundred dollars or more. Nonpecuniary relief, such as a coupon settlement, elicits much lower levels of participation.

what they see as only nominal compensation. Or, it may be that defendants or sophisticated claimants find ways to discourage less experienced claimants from filing by making the proof of claim process demanding (in order to maximize the recovery for themselves).[151] But in terms of actual compensatory benefits, the opt-out class action appears to have been oversold by its proponents, at least in terms of its ability to benefit small claimants. In truth, U.S. class action procedures may do at the back end what European procedures do at the front end. That is, procedures for filing claims in the United States may screen out smaller claimants as effectively as the opt-in requirement in European class actions does at the front end of litigation.

In this light, the truer advantage of the opt-out class over the opt-in class involves not their relative compensatory benefits, but the greater deterrent threat that the opt-out class generates by aggregating more claims. Still, this asserted advantage raises in turn an important issue: How much deterrence from private enforcement is desirable? True as it may be that the opt-out class action generates greater deterrence, the corollary of this point is that the opt-out class action may also unfairly distort the outcomes in litigation by generating an "extortionate" pressure to settle. This topic will be returned to shortly.

2. *The Free Rider Problem and the Representative Plaintiff.* --- Logically, rational parties should be reluctant to serve as the representative plaintiff (or "lead plaintiff" in the PSLRA's parlance). In both opt-out and opt-in class actions, the absent class members who do

[151] Where the settlement contains no reversion provision, all of the settlement goes to those class members who do file. Reverter clauses entitling defendants to unclaimed settlement funds were once common. Cf. Geoffrey P. Miller & Lori S. Singer, Nonpecuniary Class Action Settlements, Law & Contemp. Probs. Autumn 1997, at 97, 106. But they are today disfavored because sophisticated courts have come to recognize that reverter clauses produce illusory settlements. Such clauses were discouraged by the PSLRA, which requires that the fee award to the class attorneys be based only on damages "actually paid to the class." See Securities Exchange Act of 1934 § 21D(a)(6), 15 U.S.C. § 78u-4(a)(6) (2006). This reversed (but only for securities class actions) the prior rule of *Boeing Co. v. Van Gemert*, 444 U.S. 472, 481--82 (1980), which permitted attorney fees to be paid based on the total funds made potentially available.

file a claim receive the same proportionate recovery of their losses as the representative party, but the representative must bear unreimbursed costs and face exposure to potential fee shifting. This exposure is exacerbated in Europe by the general prevalence of a "loser pays" rule.[152] But, even in the United States, the PSLRA mandates a presumption in favor of fee shifting in securities actions as a penalty for plaintiff's failure to plead in compliance with the federal rules.[153] Given the lead plaintiff's potential exposure to fee shifting, institutional investors might logically prefer to remain free riders and undertake no role that could give rise to such liability. To this extent, opt-out and opt-in classes differ only marginally; rather, the more critical variable is the risk of adverse fee shifting, which is higher outside the United States.

Logical as this theory may be that everyone should free ride, the empirical evidence is to the contrary: persons and entities do in fact accept this role of lead plaintiff. Why? In the United States, the practice is clear: the entrepreneurial plaintiff's attorney implicitly agrees to assume all expenses and to hold the representative plaintiff harmless from any fee shifting. To the extent that U.S. judges shift fees, which they are generally reluctant to do, they typically shift against class counsel and not the lead plaintiff.[154] Because of the general absence of a contingent fee in Europe, it is less likely that the non-entrepreneurial attorney in Europe would commit to assume these costs (or that European courts would see the class counsel as the logical target of fee shifting).

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[152] The so-called "English rule" under which the loser pays the winner's reasonable legal expenses prevails across Europe, but there is disagreement in Europe as to whether the class members who opt-in to a class should be liable (or only the representative plaintiff). See Hodges, supra note 10, at 126--27. Where class members are liable, it is likely that few will opt in.

[153] See Securities Exchange Act of 1934 § 21D(c)(3) (creating "Presumption in Favor of Attorneys' Fees and Costs" in certain circumstances). In particular, section 21D(c)(3)(A)(ii) makes fee shifting presumptive for any "substantial failure of any complaint to comply with any requirement of Rule 11(b)." Because plaintiffs, not defendants, draft the complaint, the risk of such a sanction falls more heavily on plaintiffs.

[154] Section 21D(c)(2) expressly states that the court can shift fees and impose them on either the party or the party's attorney for failure to satisfy its pleading standard. See 15 U.S.C. § 78u-4(c)(2).

Another possible reason for public pension funds accepting the role of lead plaintiff is the desire of their leaders to receive political contributions from plaintiff's law firms (i.e., pay-to-play). Again, this is unlikely to be a motive in Europe, where entrepreneurial law firms have not developed in the absence of the contingent fee and where campaign contributions play a lesser role in politics. But other reasons could motivate some entities to serve as the representative party even in a world in which fee shifting under a "loser pays" rule was likely. These would include:

1. *The desire for voice*. If the class member has large losses, accepting the role of representative plaintiff may give it the ability to influence the litigation and have a de facto veto over settlement offers. This may well be a factor in U.S. securities class actions as well, where the institution serving as lead plaintiff may want to influence issues such as the scope of the class period (to ensure that most of its losses are covered).
2. *Insurance*. Fee shifting and the "loser pays" rule can be dealt with through insurance. If all class members who opt in would contribute a modest amount (or if a nonprofit representative plaintiff would advance the cost of the premium against later reimbursement), insurance should be available so that the representative plaintiff would bear no more than minimal risk.
3. *Nonprofit immunity*. As the Swedish experience shows, class members can organize a nonprofit association and use it to serve as the representative plaintiff. This gives other class members immunity (to the extent that only the representative plaintiff has liability for fee shifting). Alternatively, a recognized consumer association or other

public interest group may accept this role, confident that under local law or practice it will have limited exposure to fee shifting.

Probably the most likely pattern in Europe will be the continued use of consumer groups and other associations committed to special public interest missions (for example, protection of the environment). These groups will assume the risks of litigation because that is the purpose for which their members joined and for which they pay dues, but increasingly they will turn to insurance to mitigate the impact of a "loser pays" rule. Predictably, the insurance industry should welcome the additional business.[155] An additional impact of a "loser pays" rule may be to encourage such plaintiffs to undertake a stronger screening role, refusing to bring actions that have questionable legal merit (even if they offer high potential damages). In turn, this may make the introduction of class actions more politically acceptable in Europe.

All said, the bottom line is still that it will be more difficult to find a representative plaintiff in Europe, but those candidates that do elect to serve are more likely to exercise a restraining discretion. On the positive side of the ledger, the European context is not likely to see the nominal plaintiffs who are controlled by entrepreneurial law firms (which was the recurring fact pattern in recent U.S. criminal prosecutions of plaintiffs' attorneys).[156] How these two problems---incentivizing a lead plaintiff to serve and holding it accountable---should be balanced can be reasonably debated, but the more representative plaintiff has its reputational capital at stake, the more that problems of accountability are reduced.

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[155] Indeed, because D&O insurers typically insure the litigation costs of corporate defendants and their officers and directors, it would make obvious economic sense for them also to insure the plaintiffs against the risk that these costs would be shifted to them under a "loser's pays" rule. Economically, the same insurer might want to insure both sides, thereby receiving premiums from both sides for the same risk. A single insurer might also increase the pressure to keep litigation costs down to reasonable levels.

[156] See supra note 3 and accompanying text.

3. *Finality*. --- An opt-in class does not result in global peace on its settlement. The defendant who settles an opt-in class action must still worry that a favorable settlement, if publicized, may elicit the filing of other class and individual actions. In contrast, given the low rate of opt-outs in U.S. class actions, an opt-out class action's settlement did traditionally confer finality. Thus, the defendant's dilemma in the opt-in setting is not unlike that discussed earlier in connection with the "exit versus voice" tradeoff: Defendants do not know what their total exposure will be. The higher the class settlement in this opt-in context, the greater the possibility that additional litigants will emerge from out of the woodwork to commence suit.

Although defendants may prefer finality, this preference should hardly lead them to favor the opt-out class action, because the opt-out class inherently multiplies the damages that can be asserted and thus gives class counsel greater leverage. Instead, the participant that most bears the cost of reduced finality (and is thus more likely to resist opt-in procedures) is the court, because more and duplicative actions are likely to be litigated under opt-in procedures. From the court's perspective, this wastes scarce judicial resources.

Still, the social cost accounting is more complex and mixed. Reducing the prospect of finality also reduces the prospect of collusion. The defendant has less incentive or ability to seek to exchange a high fee award for a modest settlement in the case of an opt-in class, both because the stakes are smaller and because the opt-in class has greater control over its counsel. Also, the opt-in class encourages competition within the plaintiff's bar, as multiple firms can seek to assemble and actually litigate opt-in class actions dealing with the same defendants and subject matter. Competition ultimately benefits class members through reduced fees and improved performance. In short, it is difficult to conclude that the opt-out class action is unambiguously superior to the opt-in class action simply on the grounds that it confers finality.

In any event, finality and judicial economy can be given limited protection by other means. Arguably, an opt-in class might not be certified unless a specified minimum percentage of the eligible claimants elected to participate. Similarly, after an opt-in class is certified, there might be a shortened statute of limitations within which parallel actions had to be brought (either on a class or individual basis).

B. *Litigation Finance*

From a governance perspective, finance is central. The funder that can best evaluate the action's prospective merits and monitor the attorney's efforts should be willing to provide more funding and at lower cost than others. In this regard, the contingent fee system of financing U.S. class actions has some clear efficiency advantages. First, attorneys have obvious expertise in evaluating the meritoriousness and settlement value of litigation whereas other potential funders would need to hire lawyers to conduct this inquiry for them. Second, attorneys are likely to be involved in multiple lawsuits and can naturally realize the benefits of portfolio diversification; this should enable them to reach litigation decisions in a more objective, risk-neutral fashion. On the other hand, when the attorney finances the action, the possibility is lost that alternative funders might monitor the attorney's performance. Arguably, attorney-financed litigation is less optimal because class members lose the benefit of such an arm's length party monitoring their attorney. To be sure, the PSLRA did respond to this monitoring problem by deliberately creating an agent (the lead plaintiff) to monitor class counsel, but this model can only be safely extended to the relatively few litigation contexts where individual plaintiffs are likely to hold sufficiently large stakes to induce them to monitor.

Quite apart from any efficiency arguments, much of the world has long resisted the contingent fee (and only recently have there been small steps taken towards liberalizing this

restriction).[157] The concern behind this resistance has not been efficiency, but ethics---namely, the fear that contingent fee financing compromises attorney loyalty and results in conflicts between the attorney and client. Although American commentators believe this concern has been overstated,[158] the prevalence of this concern underlines the need to consider functional substitutes. Clearly, other potential sources of litigation finance are available. For example, hedge funds, which increasingly invest in all forms of illiquid investments and have long made higher risk investments and could easily fund many class actions. Indeed, as next discussed, specialized litigation funding firms with large investment portfolios have already arisen and prospered in Australia and have begun to appear in the U.K. and Canada. Nonetheless, issues remain.

1. *The Australian and British Experiences.* --- In Australia, which does not permit contingent fees,[159] litigation funding by private firms has become a large and accepted financial service industry---largely since 2000.[160] Some five firms now dominate the Australian market,

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[157] England and Wales have allowed the "conditional fee," which allows the attorney to waive attorney's fees if the action is not successful and permits an enhanced fee if the action is successful. But this fee is not based on a percentage of the recovery. This change was largely motivated by a desire to finance personal injury litigation, not class actions. For an overview, see Richard Abel, An American Hamburger Stand in St. Paul's Cathedral: Replacing Legal Aid with Conditional Fees in English Personal Injury Litigation, 51 DePaul L. Rev. 253 (2001). Sweden also permits "risk agreements" between the representative plaintiff and the class counsel. In one recent case, this agreement provided that class counsel would be paid twice its usual hourly fee if successful and only one half that fee if the case was lost. Lindblom, supra note 127, at 21--22. This is a far milder enhancement or reduction than is common in the United States, where the fee is fully contingent on success and may sometimes exceed thirty percent of the recovery. See note 59 and accompanying text.

[158] Cf. Issacharoff & Miller, supra note 12, at 197--202 (highlighting usefulness of contingent fee system). This author tends to agree that this criticism has often been overstated, but also believes that there is a case for insulating the class attorney, as the key professional, from the conflicts of interest that arise when the attorney finances the litigation.

[159] Under Australian law, an attorney can receive a normal fee plus an agreed uplift (which is a percentage of its normal fee that is contingent on winning the case). Recent legislation has capped this uplift at twenty-five percent in most Australian jurisdictions. See Stuart Clark & Christina Harris, The Push to Reform Class Action Procedure in Australia: Evolution or Revolution?, 32 Melb. U. L. R. 775, 789 (2008).

[160] For overviews, see Susan Lorde Martin, Litigation Financing: Another Subprime Industry That Has a Place in the United States Market, 53 Vill. L. Rev. 83, 107-112 (2008); Virginia Marsh, Australian Companies Pioneer

and the largest is listed on the Australian stock exchange.[161] The scale of these firms is shown by the fact that the largest held a portfolio of litigation investments (as of early 2007) with a total value of A$1 billion.[162] Unlike U.S. funding firms (which invest almost exclusively in individual personal injury cases), the Australian firms regularly invest in class actions, and the largest regularly charges about thirty percent of the net proceeds of the case plus litigation costs---a fee that roughly approximates what U.S. plaintiffs' attorneys traditionally received in class actions.[163] As of the end of 2006, the litigation funding industry in Australia was investing about A$20 million annually to support plaintiffs' litigation, and the industry seemed to be profitable.[164]

The key policy issue in litigation finance is whether the funder will interfere with the attorney/client relationship between counsel and the actual plaintiffs, thereby stripping the client of control. Thus, in the still small U.S. litigation funding industry, the funding firm does not make litigation decisions.[165] In contrast, Australian litigation funders do appear to take an active role in the litigation, often selecting the law firm and making important litigation decisions.[166] They justify this involvement by arguing that they do no more than do insurance companies on

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Approach, Fin. Times, Jan. 5, 2007 at 3; Nikki Tait, Lawyers Test Litigation Funding Waters, Fin. Times, Jan. 5, 2007, at 3.

[161] See Martin, supra note 160, at 107--08. The largest, IMF, went public in 2001 and is listed on the Australian Stock Exchange.

[162] Id. at 107.

[163] Id. For the comparable percentage fees charged by U.S. plaintiffs' attorneys in securities cases, see Martin et al., supra note 59, at 141 (finding thirty-two percent to be the average fee award during the 1990s).

[164] Martin, supra note 160, at 109. Professor Martin estimates that the largest Australian litigation funding firm (IMF) earned A$8 million between 2002 and 2006, or a roughly seven percent return per annum on its capital. Id. at 108.

[165] For a discussion of U.S. litigation funding practices involving third party lenders, see Julia H. McLaughlin, Litigation Funding: Charting a Legal and Ethical Course, 31 Vt. L. Rev. 615 (2007). The major litigation funding firms in the United States entered into a settlement with the New York Attorney General in 2005, which establishes a number of protections for the consumer/litigant. Id. at 654--55; see also Martin, supra note 160, at 109 (noting that in United States, "litigation funders agree not to make any decisions about the lawsuits").

[166] See Martin, supra note 160, at 109 (noting that in Australia "litigation funders provide the same services as insurance companies," who typically make key litigation decisions for defendants).

the defense side of the litigation.[167] In this view, the litigation funder is the functional equivalent of the insurer (although insurance companies negotiate typically with a sophisticated corporate client, while plaintiff's attorneys do not).

Following Australia, the United Kingdom, which also restricts contingent fees, has also recently seen a litigation funding industry develop.[168] The leading U.K. firm charges between twenty-five percent and fifty percent of the proceeds of a case,[169] so that it is clearly a joint venturer with the clients in the litigation. Hedge funds have also become active in the U.K. litigation funding business.[170]

In both these countries and also in South Africa, the practice of third party litigation funding has received judicial acceptance.[171] But the practice does not appear yet to have crossed the English Channel to Europe. Nonetheless, it could.[172] Because European class actions often have a consumer association or other nonprofit body serve as the representative plaintiff, such an institution could serve as the logical party to negotiate the funding contract with the financier. Such a contract would not seemingly violate the European rule against contingent fees, which applies uniquely to attorneys.

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[167] Id.
[168] Id. at 112--13.
[169] Id. at 113 (describing normal practice of IM Litigation Funding, which was founded in 2002).
[170] Id. at 113 (noting that in the United Kingdom, both hedge funds, insurers, and private investors were funding litigation).
[171] The leading Australian decision is Campbells Cash & Carry Pty. Ltd. v. Fostif Pty. Ltd. (2006) 229 A.L.R. 58. See Lee Aitken, Before the High Court--'Litigation Lending' After Fostif: An Advance in Consumer Protection or a License for 'Bottomfeeders'?, 28 Sydney L. Rev. 171, 171 (2006) (describing potential problems with allowing litigation funding). In the United Kingdom, the Civil Justice Council, an advisory public body, has concluded that litigation funding provides a necessary role in assuring access to justice. See Martin, supra note 160, at 112. The Supreme Court of South Africa in 2004 upheld a litigation funding agreement against the claim that it was contrary to public policy. See Price Waterhouse Coopers, Inc., et al. v. Nat'l Potato Co-op Ltd. 2004 (6) SA 66 (SCA) at 79--80; see also Martin, supra note 155, at 113--14 (analyzing decision).
[172] Professor Christopher Hodges of Oxford University advises me that insurance companies in Europe are prepared to finance litigation costs on a "before the event" basis for both plaintiffs and defendants, and he views insurers as the most likely candidates to become third party funders of litigation in Europe. See also Hodges, supra note 10, at 227-228 (discussing prospects for third party funding).

2. *The Issues in Third Party Funding*. --- On an abstract level, little distinguishes the contingency fee from funding by a third party. Nor is the involvement of a third party in litigation decisions unprecedented, as insurance companies do regularly monitor the progress of the litigation in cases they are funding. But some differences do exist. First, the attorney as funder is subject to professional rules and culture that insist on loyalty to the client. Nothing similarly constrains a hedge fund as a source of litigation funding. Second, at least in some litigation contexts, such as environmental law, employment discrimination, and civil rights, injunctive and equitable relief may be as important to the class as money damages (or more so). Predictably, a third party funder will be interested only in the economic return, whereas the attorney may gain reputational value from a litigation victory, even if the damages are modest. Hence, third party funding may affect the balance of monetary versus non-monetary relief in settlements.

Use of a third party funder also increases the number of agents with a self-interest in the case that is distinct from the client's. Is this good or bad? A plausible case can be made that if the funder is restricted in terms of the control that it can exercise over the case, this is a less troubling relationship than having the attorney fund the case because the attorney will always have a controlling influence over litigation decisions. One can at least imagine a structure under which third party funding is permitted, but the class counsel is instructed that all litigation decision must be made in the interest of the class. Because class counsel would be denied a contingent fee under this structure, it might prove more loyal to the class than it is today when its economic interests and fiduciary duty sometimes point in divergent directions. The conventional wisdom about large contingent fees is that they can motivate the attorney to settle prematurely. A third party funder might also have such an incentive, but if the attorney were paid on a non-

contingent basis, it would have little, if any, incentive to settle early (and may even wish to stretch out the litigation, so long as the attorney is paid on an hourly rate basis). Hence, the attorney's self-interest would counterbalance those of the litigation funder.

A structure in which the class has both a class counsel and a separate litigation funder is inherently one in which "agents are watching agents."[173] This has advantages, as the litigation funder would be in a position to monitor the attorney, while both the representative plaintiff (often a nonprofit organization in Europe) and class counsel could negotiate the financial arrangement with the third party funding firm.

C. *Deterrence*

Much commentary has emphasized that the principal rationale for the class action is deterrence, not compensation.[174] In this regard, the opt-out action obviously outperforms the opt-in action---unless there can be too much of a good thing. Clearly, the opt-out action can aggregate more claims and at lower cost, giving the plaintiff's attorney greater negotiating leverage. But maximizing the leverage of the plaintiff's attorney without limit may not always be desirable.[175] Consider the following hypothetical involving an ordinary securities class action. The stock of XYZ Corporation, a publicly traded firm, falls thirty percent over a two to

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[173] Some argue that this is a desirable structure, because the self-interest of the agents motivates them to watch each other. See Bernard S. Black, Agents Watching Agents: The Promise of Institutional Investor Voice, 39 UCLA L. Rev. 811, 817--18 (1992) (assessing potential for oversight of corporate managers by institutional money managers).

[174] For representative arguments, see Coffee, Reforming the Securities Class Action, supra note 4, at 1536, 1547--56 (discussing deterrence rationale for securities class actions); Mitchell, supra note 4, at 246--48 (same).

[175] When the tide began to turn against broad class certification in the mid-1990s, one of the most influential decisions arguing against liberal certification standards was written by Judge Richard Posner. See In re Rhone-Poulenc Rorer Inc., 51 F.3d 1293, 1299, 1304 (7th Cir. 1995) (granting mandamus order to decertify multibillion dollar class action because of intense settlement pressures and danger that single jury verdict could destroy industry). He stressed that class certification in a mass tort case placed defendants "under intense pressure to settle," even when the litigation merits seemed weak. Id. at 1298. He added, however, that this pressure had to be "balanced against the undoubted benefits of the class action." Id. at 1299. Presumably, he was referring chiefly to the problem of "negative value" claims. This Essay agrees that a balance needs to be struck, and neither the opt-in nor the opt-out class action inherently achieves such a balance.

three day period, resulting in a total market capitalization decline of $2 billion. The cause of this decline may have been accounting irregularities and fraud, or it may have been the market's panicky reaction to adverse developments in the firm's industry or general macroeconomic problems. Let us assume further that there is only a thirty percent possibility that XYZ Corporation can be held liable for securities fraud. But if an opt-out class action seeking $2 billion is certified and survives pretrial motions to dismiss, XYZ Corporation will likely feel compelled to settle because it cannot take the risk of a jury imposing liability in that amount, which would bankrupt it. Hence, it is compelled to settle, with the negotiations largely focusing on how much it can pay and at what point it would prefer to file for bankruptcy.

Next, assume this same case arises in a jurisdiction that permits only opt-in class actions, and that, after active solicitation by class counsel, twenty-five percent of the shareholders who have standing to sue opt in. Now XYZ Corporation faces a maximum liability of not $2 billion, but $500 million (i.e., twenty-five percent of the total eligible claimants). As a result, it may be prepared to risk going to trial. At the same time, because claims equal to $500 million have been aggregated, this is hardly a case in which "negative value" claimants are at the mercy of defendants because they cannot afford to sue. This action is economically viable, but not so overwhelming in scale that the defendant is compelled settle. Of course, one could change these facts and posit that only 10% of the eligible claimants opt-in to the class, and at this point the action might not be viable or the resulting damages or the likely settlement might be insufficient to deter. Ultimately, the bottom line is that, depending on how we design the class action, a middle zone could be created between underdeterrence and overdeterrence.

The dilemma here is compounded by the fact that public policy is essentially seeking to deter corporate managers from defrauding the corporation's shareholders by imposing large

financial damages on the corporation. Because these damages are borne in turn by the shareholders, there is a perverse circularity to such a system.[176] Moreover, because the gain from fraud to these managers is certain to be far less than the total gain to the corporate entity, it should in theory logically be easier and more efficient to focus on deterring managers. In any event, to the extent that the corporation is made the target of deterrence and the damages borne by it are not fully shifted to fall on the responsible managers, it is never clear at what point the expected penalty is sufficient to overcome their incentive to commit fraud. At best, adequate deterrence will be a matter of happenstance and contingencies and does not follow automatically from corporate liability.

Within the United States, there is no prospect of a change away from an opt-out class to an opt-in system. But in Europe and elsewhere, where there is little experience with private enforcement, few see it as necessarily desirable that the opt-out class action aggregates damages to the multi-billion dollar level, simply because class members failed to opt out. If one believes that the merits of the case should determine the outcome, it is a virtue of the opt-in structure that it is less likely to overwhelm defendants by the pressure of damages.

D. *Legal Culture and Constitutional Structure*

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[176] For a fuller discussion of this circularity problem, see Coffee, Reforming the Securities Class Action, supra note 4, at 1556--61.

The United States has long accepted the concept of the private attorney general,[177] but the idea is novel and unfamiliar to Europe. From the U.S. perspective, the private attorney general is a desirable failsafe mechanism: If regulators are "captured" by special interests, private litigation through class actions can still vindicate the rights of citizens. In this sense, the private attorney general is another check on the abuse of governmental power in a constitutional system committed from its outset to the need for checks and balances.[178] Empowering private attorneys general enables direct access to a judiciary that is expected to resist overreaching. But this concept of an active judiciary---one prepared to resist abuses of power by the other branches of government---is far from universally held. Although the United States emphasizes checks and balances, Europe (including the U.K.) places greater faith in legislative supremacy, and thus it is uncomfortable with an activist style of judicial review, which it fears as antidemocratic.[179] The role of the judiciary in civil law countries is more to implement the government's policies than to

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[177] The term "private attorney general" was coined by Judge Jerome Frank in Associated Industries of New York State, Inc. v. Ickes, 134 F.2d 694, 704 (2d Cir. 1943). For a historical and contemporary overview of the term's use and misuse, see generally William B. Rubenstein, On What A "Private Attorney General" Is---And Why It Matters, 57 Vand. L. Rev. 2129 (2004). Despite the relatively recent origin of the term, the concept of private enforcers using civil litigation to supplement public enforcement dates back to the early days of the Republic, and the qui tam action (in which an enforcer who has not suffered an injury sues to recover primarily on behalf of the government, who will in turn compensate it with a portion of the recovery) can be traced back to the fourteenth century in England. For a review of the historical antecedents to the modern "private attorney general" concept, see Trevor W. Morrison, Private Attorneys General and the First Amendment, 103 Mich. L. Rev. 589, 599--602 (2003). The "bounty hunter" of the nineteenth century American West is but one example of the concept, as is the treble damages action authorized by the federal antitrust laws. Few parallels, if any, to the private attorney general exist in Europe.

[178] Some American legal scholars, however, do reject the private attorney general concept on the ground that it has not been legislatively authorized (in most cases) and so represents a usurpation of legislative power. See Martin H. Redish, Class Actions and the Democratic Difficulty: Rethinking the Intersection of Private Litigation and Public Goals, 2003 U. Chi. Legal F. 71, 81--83 (objecting to absence of legislative authority for "bounty hunter" model of private enforcement). This Essay does not take this position, but acknowledges the connection between one's constitutional theory and one's view of the private attorney general.

[179] Professor Mark Tushnet has distinguished two models of constitutionalism that have evolved over the last century: (1) a legislative model of parliamentary supremacy, and (2) the U.S. model of "constrained parliamentarianism," in which a written constitution limits both the legislature and the majority. Mark Tushnet, New Forms of Judicial Review and the Persistence of Rights- and Democracy-Based Worries, 38 Wake Forest L. Rev. 813, 813--14 (2003). The private attorney general fits much less comfortably within the former system (in part for the reasons stressed by Professor Redish). See Redish, supra note 178, at 84--93 (discussing ways in which class actions conflict with "precepts of democratic theory").

review or resist them. Given this fundamental difference in starting points, it follows predictably that Europe will be less prepared to accept the case for the private attorney general---particularly when the private attorney general manifests itself as the aggressively profit-seeking bounty hunter (which is how Europe perceives the American class action plaintiff's bar).

Against this backdrop, the difference between the opt-in and the opt-out class action for Europe is the difference between evolution and revolution. To be sure, some transition may occur. Given Europe's familiarity with aggregate litigation led by associations---e.g., consumer groups and nonprofit organizations---it may become acceptable for such a representative plaintiff to contract with counsel for a contingent fee.[180] So long as all class members who subsequently opt-in have notice of the contingent fee's terms, opting in on this basis would amount to an implied-in-fact consent, thus distinguishing this fee arrangement from the American form of contingent fee. Alternatively, litigation funding firms may enter Europe. Viewed optimistically, this would imply additional monitoring of class counsel's performance. Viewed pessimistically, it could mean a new set of agency costs and conflicts. It is simply too early to make confident predictions.

E. *A Non-Entrepreneurial Model*

Europe seems likely to continue to resist entrepreneurial litigation because it sees the critical actor in this model---the plaintiff's attorney---as both self-appointed and self-interested. Yet, at the same time, a democratic or communitarian model relying on voice-based governance would be hopelessly unrealistic, both because (1) there is little natural community among

[180] This appears to have already happened to a degree in Australia, the United Kingdom, and Sweden. See supra notes 157 & 159 and accompanying text. But the risk-adjusted contingent fee in these countries is not based on a percentage of the recovery and hence is far more modest than the typical fee award in U.S. securities litigation. See Martin et al., supra note 59, at 141 (finding average fee award in securities class actions to be thirty-two percent of the recovery during the 1990s).

unrelated and dispersed consumers, and (2) the holders of negative value claims will often remain rationally apathetic.

So what is left? The model that might be applied to the European context with the least strain and distortion to its existing institutional structure is the model that currently applies to public interest litigation in the United States. This model relies not on a lead plaintiff (i.e., the volunteering class member who has experienced the most severe injury), but instead on a nonprofit organization that has attracted membership support based on its expertise, commitment, and past success. Although the lead plaintiff can be objective and neutral, as CalPERS and other large pension funds typically have been, it cannot be the committed advocate that an ACLU, NAACP, or Sierra Club can be. Uniquely, public interest and consumer organizations have at least three obvious advantages over the large investors who today serve as lead plaintiffs in the United States: (1) they can credibly solicit potential class members to opt in; (2) they possess greater expertise about the subject matter of the litigation than lead plaintiffs; and (3) they can look beyond the individual case and develop a long-term litigation strategy.[181] Beyond these differences, there is an even larger advantage: the typical public interest or nonprofit body has reputational capital and desires to protect it. In contrast, the lead plaintiff in securities litigation in the United States may have a large financial stake, but as a public or union pension fund, it does not necessarily possess reputational capital. Even where the typical lead plaintiff has some reputational capital (i.e., its identity is known and respected), it does not inherently pledge that capital to assure class members that it will be loyal to their interests. After

[181] Historically, public interest organizations, such as the NAACP Legal Defense Fund, did formulate long term litigation strategies, sometimes fashioning plans that took a decade or more to implement. See Rubenstein, supra note 49, at 1627--44 (discussing disputes among ground members and lawyers in civil rights campaigns); see also Mark V. Tushnet, The NAACP's Legal Strategy Against Segregated Education 1925-1950, at 138--66 (1987) (noting legal tactics NAACP lawyers used in complex litigation).

all, pension funds are expected to manage money, not protect the public interest. Put simply, reputational capital is a solution to problems of accountability because the public interest plaintiff inherently pledges it to assure class members of its loyal and competent performance.[182]

Opt-in class actions necessarily require a more passionate champion if they are to work. Such champions do exist, as Europe has representative groups prepared to play such a role by using litigation as a means toward their broader aims of consumer or environmental protection. In contrast, alternative candidates for class action leadership roles, such as the U.S. lead plaintiff, are unlikely to transplant well to Europe. Not only will the neutral and objective lead plaintiff be unlikely to entice opt-ins, but, outside the special context of securities litigation, few class members hold sufficiently large stakes to have any interest in playing this role. Instead, the class may be entirely composed of "negative value" claimants. Hence, even the claimant with the largest stake may still have only a modest financial claim, and such claimants are easily captured by entrepreneurial attorneys. Public interest organizations are, however, more accountable to their members, from whom they receive their primary financial support.

To be sure, public interest organizations are also subject to conflicts of interest, and some have feared that delegating the control of class actions to them could infringe on individual liberty.[183] But the opt-in class action minimizes this danger. By definition, such an action is less

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[182] The plaintiff's attorney in a class action is a form of "gatekeeper" on whom dispersed class members must rely for services that they cannot perform or closely monitor themselves. Such "gatekeepers" are often relied upon in the financial markets and they essentially function as "reputational intermediaries" who pledge a reputational capital that they acquire over many years and many clients to assure their clients of their loyal performance in an individual case. The classic example would be the auditing firm, for whom the gain in auditing fees from acquiescing in its client's fraud cannot normally exceed the loss in reputational capital and future business. See John C. Coffee, Jr., Gatekeepers: The Professions and Corporate Governance, 2-5 (2006) (explaining role of gatekeepers in the capital markets). Thus, the bottom line assertion here is that a representative plaintiff with greater reputational capital than the typical lead plaintiff would make a superior gatekeeper.

[183] See Rubenstein, supra note 49, at 1663--64 (noting danger of "elitist subversion of democratic equality" and "infringement on individual liberty"). The fear here is largely that the representative group, for political or

likely to infringe on individual liberty because it requires individual consent. Also, such an approach permits multiple groups to pursue the same or similar litigation goals contemporaneously, each making the arguments of their choice.[184] Under this model, individual litigants opt in because of the credibility and prior track record of the representative plaintiff.

This model is not, however, premised on democratic or communitarian principles, which apply poorly to collections of dispersed individuals lacking any inherent sense of community. No votes would be taken, but those dissatisfied could opt out at some point prior to judicial resolution of the action. The representative would hire and could, subject to judicial supervision, fire class counsel. The representative could also negotiate litigation funding arrangements with third party funders, in effect assigning them some portion of the proceeds up to a ceiling. These arms-length negotiations with the financial entrepreneur would not, however, place the entrepreneur in control of the action or enable it to make litigation decisions. That is a key advantage: the entrepreneur does not control the litigation.[185] The representative plaintiff could deduct all its costs from the action proceeds, but it would be limited to no more than a modest profit in order to ensure that its entrepreneurial incentive not trump its ideological commitment. Class counsel might negotiate an enhanced or reduced fee based on success (or failure), but would not function as the entrepreneurial risk-taker that it does in the United States.

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ideological reasons, may decline to represent legally meritorious claims or may refuse to assert legally valid, but politically objectionable legal theories, thus leaving potential class members without effective representation.

[184] In this sense, this model does not realize the goals that Professor Rubenstein favors, because his "expertise model" allows the experts to screen out and censor legal arguments that the experts consider either frivolous or premature. Instead, under the variant here proposed, all that would be required is that one of potentially multiple representative groups would be willing to adopt the particular legal theory.

[185] This could make litigation funding more expensive, as the third party funder might demand a larger percentage of the proceeds for being denied control rights. The goal is not to restrict the funder's profit, but its control, as control would typically remain with the nonprofit organization.

In summary, the advantages of a system built around a nonentrepreneurial nonprofit organization serving as the lead plaintiff are:

(1) Such an organization would be generally available to serve, particularly in those "negative value" class actions where no large stakeholders exist or are willing to take on that role;[186]

(2) It would have more experience with the policy issues in the field than the typical pension fund which serves as a lead plaintiff in the U.S.; by definition, it is a repeat player with an experienced in-house legal staff and it should be capable of a long-term view extending over multiple cases;

(3) Inherently, as a committed advocate of a particular cause (whether the environment, minority rights or consumer protection), it is pledging its reputational capital, thereby both attracting potential class members to opt in and assuring them of its loyalty; a pension fund or other U.S.-style lead plaintiff could not hope to match its demonstrated commitment;

(4) It would be less vulnerable to most economic conflicts of interest (such as those engendered by "pay-to-play" practices); and

(5) It should be open and receptive to non-pecuniary relief, which in environmental and anti-discrimination litigation may be as important (or more so) than maximizing the monetary recovery.

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[186] Institutional shareholders face a number of conflicts that often make them reluctant to serve. Sometimes, for example, they hold stock in both the bankrupt corporation which is the subject of the litigation and other defendants. Thus, their recovery may be offset by the reduction in value of other stocks in their portfolio. Professors Cox and Thomas provide an example of such a case in the WorldCom litigation (where Citigroup was the principal defendant). See Cox & Thomas, supra note 14, at 1600--01 (discussing frustrations experienced by those with a continuing ownership).

On the other side of the ledger, because the aggregate damages are lower in an opt-in class action, the deterrent threat is reduced. From a deterrent perspective, such a proceeding would threaten a civil penalty, not bankruptcy. But it is at least arguable that this change is desirable, as profit-motivated entrepreneurs should not be allowed to threaten economic nuclear destruction. Also, less driven by the pursuit of the maximum damages, such a non-profit plaintiff might screen its cases more carefully, exercise some prosecutorial discretion in the choice of cases, and seek to develop a long term litigation strategy extending over years and multiple actions. Ultimately, the political acceptability of this model might be its primary advantage, and over the long run its lesser vulnerability to corruption and conflict of interest would tend to ensure its survival.

To implement this model, the critical step would be to require as a precondition for class certification a finding by the court that the representative plaintiff possessed adequate expertise, experience and commitment to protect the interests of the class members. The certifying court might consider rival applications for this position, but would not permit defendants to appear or object at this stage. Other rival opt-in classes could also be certified if they were also headed by a similarly qualified representative plaintiff, and they could engage in competitive solicitations for class members. Over time, some real competition might thereby develop.

CONCLUSION

From a litigation governance perspective, the critical questions about aggregate litigation involve basic issues of governance. If one desires to structure the governance system for aggregate litigation so as to achieve a balance under which the litigation merits are not overwhelmed by either the threat of astronomic liability or the certainty of transaction costs that exceed the individual litigant's expected recovery, one must address some central questions:

(1) How much power can safely be accorded to private enforcers? Power corrupts, and the class counsel in the traditional opt-out class action had virtually unaccountable power. To be sure, this enforcer was generally motivated to maximize the aggregate recovery, but sometimes it found ways to profit at the expense of the class. In the opt-in class action led by a public interest organization, the key enforcer will be more accountable and will in effect be pledging its reputational capital as a true gatekeeper.

(2) How much claim aggregation is desirable? Although aggregation is necessary to enable the "negative value" claimant to have access to the courts, the contemporary opt-out class carries this idea to the limits of its logic (and perhaps beyond) by threatening astronomic liability.

(3) How entrepreneurially driven should aggregate litigation be? This translates into three subsidiary questions: Should the attorney fund such litigation? Or is it safer to maintain the attorney's professional independence and rely upon third party funders (as Australia now does)? Finally, to what degree should the entrepreneur be restricted in its control over the litigation?

(4) How can the law best minimize principal/agent conflicts in aggregate litigation? This Essay has suggested that greater reliance should be placed on both competition and the use of reputational capital to achieve greater accountability.

This Essay does not purport to have solved any of these problems, but it has suggested intermediate positions along a continuum. Its specific suggestions have been modest: First, exit may outperform voice, chiefly because the former encourages competition while also disciplining the class counsel who negotiates a weak settlement. Second, alternative designs for

aggregate litigation---including the opt-in class action and third party litigation funding---are not as implausible as some U.S. commentators have deemed them. Finally, one size does not fit all; legal environments differ; and rules that work well in one system may transplant poorly to another. Just as corporate governance in the United States, with its characteristic system of dispersed stock ownership, is different from corporate governance in Europe, with its characteristic system of concentrated ownership, so too will the procedural forms for aggregate litigation differ across legal cultures. In the last analysis, Europe does not accept the private attorney general model that has long dominated U.S. legal thinking and, as a result, Europe will likely insist that the attorney remain an agent and not become an entrepreneur.

Even litigation run by public-regarding representative plaintiffs who are primarily accountable to their members still needs to be financed, and thus someone must make cost/benefit decisions. But just as bankers finance small companies without determining their business decisions, it is certainly possible (and possibly desirable) to divorce the litigation funder from a control position with respect to litigation decisions.

The most likely scenario for the future is that Europe and the United States will experience functional convergence without doctrinal convergence. Differences will remain. Europe's opt-in class action will never be the potent threat that the United States' opt-out class action has long been; nor will third party litigation funding develop overnight (although its impact has already been felt); finally, insurance may only slowly overcome the disincentive toward litigation that Europe's common "loser pays" rule creates. But over time, functional substitutes could emerge that reduce the sharp disparities that today exist in litigation practices between the United States and Europe.

At the same time, the United States is witnessing growing judicial disenchantment with the large class action, and the last decade has seen an almost unbroken tide of decisions making it increasingly difficult to certify a class action in a number of litigation contexts. This growing resistance to class certification is less a response to express doctrinal limitations clearly set forth in the federal rules and more a reaction to evidence of corruption and a widespread sense that no one truly benefits from many class action settlements. As a result, as Europe seeks to develop a procedural mechanism for aggregate litigation and as the United States seeks to control the mechanism that it has, both legal systems could meet at some intermediate point in the not too distant future. Neither side would be seeking convergence, but both might arrive there, starting from opposite poles and driven by a common need to strike a balance.

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