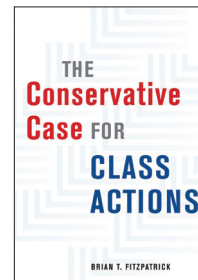


## The conservative case for class actions

### *SHOULD CONSERVATIVES EMBRACE CLASS ACTIONS AS THE ALTERNATIVE TO GOVERNMENT REGULATION FOR POLICING CORPORATE MISCONDUCT?*

Affection for the class-action lawsuit has typically split along political lines, with conservatives traditionally balking at the proliferation of class actions and liberals usually supporting, if not applauding, their employ. But a new book by **BRIAN FITZPATRICK** (top right), a professor at Vanderbilt Law School and a scholar on the subject, turns that assumption on its head. In *The Conservative Case for Class Actions* (University of Chicago Press, 2019), Fitzpatrick urges conservatives to instead embrace class actions as a private, market-based means of enforcing the law. During a discussion at the University of Miami Law School Class Action & Complex Litigation Forum in January 2020, Fitzpatrick discussed his thesis with **JOHN BEISNER**, leader of Skadden's Mass Torts, Insurance and Consumer Litigation group. Here, their animated conversation has been distilled to an abbreviated Q&A.



I think the conservative way to regulate our marketplaces, to police our marketplaces, is class-action lawsuits, not government enforcement of the law.

For an enforcement mechanism to be effective, there needs to be confidence that the enforcer — the prosecutor — is making decisions in the public interest, not the potential for personal profit.

#### What inspired you to write the book?

**FITZPATRICK:** I wrote the book because I believe that my fellow conservatives have been misled by the United States Chamber of Commerce into believing that the class action device is a bad way to hold companies accountable. I have no beef with the Chamber of Commerce in particular. I represented many big companies at Sidley Austin. I'm a big believer in capitalism. I'm very grateful for all the prosperity that big companies have given our country. But big companies have their own agenda. A lot of times it lines up with conservative principles, a lot of times it doesn't. Class-action law is one of those times when big companies are advocating positions that are adverse to conservative principles.

In *AT&T v. Concepcion*, the Chamber filed an amicus brief in the U.S. Supreme Court, telling Justice Antonin Scalia and the other conservatives, "Don't worry if the class action goes away. There's a better way to police our marketplaces." The Chamber's "better way?" *Federal regulators*. I don't think that's the solution. I think the conservative way to regulate our marketplaces, to police our marketplaces, is class-action lawsuits, not government enforcement of the law.

#### What are the traditional conservative arguments against the class action, and how do you respond to them?

**FITZPATRICK:** There are three particular challenges to our system we often hear from the U.S. Chamber, but they don't hold water.

First, the Chamber says we are drowning in meritless class-action cases being filed all the time. In the book, I slice the data on motion-to-dismiss rates, and the truth of the matter is this: It is easier now than it has ever been in American history to dismiss a meritless lawsuit, thanks to *Twombly* and *Iqbal*. I'm one of the few academic defenders of *Twombly* and *Iqbal*. If you cannot dismiss clearly frivolous lawsuits after *Twombly* and *Iqbal*, that is your fault, not the fault of our class-action system.

Second, I also take a look at the Chamber's own list of the 10 most frivolous lawsuits filed every year. There are a number of class-action lawsuits on those lists. But most of the U.S. Chamber's "most frivolous lawsuits" filed in America every year are not even frivolous. For example, one suit against Starbucks claimed Starbucks made its employees clock out before they closed the store every night. So, the last four minutes of every shift was not compensated. Four minutes is not a lot of time, but if you add it up over the course of a year, it's 17 hours, almost half of a work week. That's real money. That is not a frivolous lawsuit. I don't know if the plaintiffs should win or lose, but it's certainly a plausible case.

Third, the Chamber also complains about class-action lawyers getting too much money. But I have added up every dollar that defendants pay out in class-action settlements, and I've compared it to every dollar that judges award class-action lawyers, and do you know how much the lawyers are getting? Fifteen percent. Fifteen percent of settlements are going to the lawyers. That is much less than even the normal contingency fee. I argue in the book that, if we were good law and economics conservatives, we would actually be paying class-action lawyers more, not less. Now, it is true, the average fee in a class action is 25 percent, not 15 percent, because the judges get very miserly about attorney fees in the big billion-dollar cases so it drags down the overall number to 15 percent. But even 25 percent, the average fee, is still less than the normal contingency fee. Can you find some isolated cases where the class got nothing and the lawyers got everything? Of course, but again, those are extreme outliers. If you look at the data overall, the system is working. Judges are exercising their discretion wisely.

There is one thing the Chamber argues about our system that I have to agree with: The system is often not very good at compensating people, especially in consumer cases. The percentage of class members that get paid is low — the median claims rate in consumer cases, according to a study by ►

the Federal Trade Commission, is just 9 percent. That's low. It doesn't mean the other 91 percent goes to the lawyers, mind you. We split the money up among the 9 percent that file claims, or we give leftover money to charity. But 9 percent is not that high. It's not a great record for compensation in some of these cases. But remember the alternative here — federal agencies. As I explain below, federal agencies are no better — and usually worse — at finding victims and compensating them.

#### Should we use the class action as a primary means of enforcing civil law?

**BEISNER:** No. Brian argues that we would all be best served by a system in which our civil laws are enforced primarily through private litigation as opposed to government regulation. That theory may have some appeal if you're talking about individual plaintiff litigation, but I think that concept goes completely off the rails when you get into class actions.

I actually laid out this exact problem years ago in a *Stanford Law Review* article, *Class Action "Cops": Public Servants or Private Entrepreneurs?*, 57 *STAN. L. REV.* 1441 (2005): For an enforcement mechanism to be effective, there needs to be confidence that the enforcer — the prosecutor — is making decisions in the public interest, not the potential for personal profit. Where the system allows the prosecutor the discretion to make choices that result in personal financial benefit, there's good reason for the public to lack confidence in that enforcement system. That's particularly true where those choices can fail to afford redress for citizen injuries. As I discuss in that article, the private law enforcement you get from class actions is like letting self-appointed police officers roam the

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streets, pull over drivers whether or not they are speeding, and give those drivers the option of either (a) having their car impounded indefinitely or (b) resolving the problem by paying the police officer for his or her personal benefit. Of course, the self-appointed cops would argue that this would be an efficient system — after all, it would discourage speeding. But justifiably, the public would have no trust or respect for such a system of law enforcement.

To be clear, I'm not arguing that all class-action practitioners are succumbing to temptations of self-dealing in our current class-action system. Indeed, over the years, I've come to admire some opposing counsel who have been very concerned about making sure that the unnamed class members in their cases are compensated. And in no way am I saying that there's anything wrong with people profiting from lawyering. It's a business, after all. But what Brian proposes is really using our class-action system as the primary means of enforcing our laws.

With all due respect to the thoroughness of Brian's book, I think it papers over the many respects in which our current class-action system is fraught with the risks and the realities of counsel self-dealing — that is, the use of the

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class action device for private enrichment, not private enforcement. And in the end, I think that flaw prevents the class-action device from being a respected, trustworthy model for enforcing our civil laws.

**FITZPATRICK:** Yes, and certainly yes if you are looking at it from the conservative perspective. Conservatives like to privatize things. In the book, I identify six discrete reasons why we like private sector solutions. Two of them are most applicable here.

First: incentives. Government bureaucrats get a salary; they get the same pay no matter what they do every day. Conservatives would rather have profit-motivated actors doing the work. In this context, that means class-action lawyers who are paid only if they get results. This is a wonderful incentive to do a good job.

Second: Agency capture or "crony capitalism." The idea is that government is biased in favor of people who give money to the political party in power. This means government is compromised by the fact that it's looking to other considerations besides wrongdoing when making decisions

about whom to pursue. By contrast, the private sector is focused on one thing and one thing only, and that's those contingency fees. From my perspective, that's much purer than the government lawyers who are looking at many, many other things, many of which I think are illegitimate.

Indeed, there's actually a lot of empirical evidence to show that class-action lawyers do a better job than government lawyers when they go after corporate wrongdoing. You can compare the private securities-fraud bar to the SEC. And what you find is, in any given year, the securities-fraud bar recovers 10 times as much money as the SEC does from corporate wrongdoers. A lot of that is because the private bar has greater resources. They can go after more wrongdoers. But even when the SEC and the securities bar go after the exact same wrongdoers, the securities bar still recovers four times as much as the SEC does. Why? Because class-action lawyers have an incentive — they only get paid if they get results. The SEC lawyers get paid no matter what they do every day.

### **Is the class action salvageable as an enforcement mechanism despite the profit motives at play?**

**BEISNER:** At least as presently configured, our class-action system doesn't provide a mechanism of private enforcement in which we can be confident because it is simply too infected with both the risk and reality of private enrichment. I'm not saying the system is inherently bad. What I'm saying is it's a litigation system — it doesn't translate to being an enforcement system because of the potential for self-dealing. As I discuss further below, the power of lawyers threat-

ening to bring class actions, the high rate of voluntary dismissals, and the distribution of settlement proceeds all demonstrate this problem. So it would require a complete overhaul of the class-action device for it to actually work effectively as an enforcement mechanism — and it is hard to imagine such an overhaul that would still leave the principles of our civil justice system intact.

**FITZPATRICK:** Of course, it is possible for the profit motive to go too far; it is possible that contingency fees will drive lawyers to file too many lawsuits and to abuse the system. But that is possible with any profit motive, including the corporate profit motive. Our solution should not be to turn our industries over to the government. Our solution should be to put rules in place to harness the profit motive for good. We do that for corporations, and we can do it for class-action lawyers.

For instance, judges have a lot of discretion over whether to certify classes and what to pay the lawyers. John leaves that out of his story about the self-appointed police officer. That discretion can be exercised to put rules into place to harness the profit motive of class-action lawyers for good. I have some recommendations for judges on how they set fees to make sure we are aligning lawyers' incentives with the classes' recoveries. I also think we should take steps to make class actions less risky and less expensive to defend, so corporations don't feel compelled to settle everything and overpay in those settlements. But I argue in the book that judges are doing a pretty good job as it is. Our system is basically working. It needs tweaks; it doesn't need to be thrown out altogether.

### **What about mere threats to file class actions? Does that kind of activity vindicate enforcement goals?**

**BEISNER:** I call this the “class-action underworld,” and Brian's book does not address it. It's a realm that is totally invisible to our courts, receives very little if any media attention, and that is fully known only to class-action practitioners who wander into it. Yet it's a huge part of our class-action system. I'm referring to the substantial contingent of class-action lawyers whose practices focus on writing letters and threatening to file class actions. They spot an issue, often a product or service labeling they think may be misleading, and they write a letter to the business announcing their intention to file a class action. Usually these letters are styled as pre-litigation notices, as required by section 2-607 of the Uniform Commercial Code or by similar provisions in state consumer-protection statutes, but they have a little something extra. The attorneys writing such letters make clear that if the company wants to reach a very reasonable settlement right then and there, all will be forgotten. If you call up this counsel to explore the offer, you usually find that he or she has in mind a settlement in which thousands of dollars go to the attorneys, but there's no pursuit of any relief for the putative class members.

So, you may ask yourself, does any business actually agree to these pay-me-off-and-I'll-go-away demands? Clearly, the answer is yes, because numerous letters of this sort keep flowing into businesses every day. Presumably counsel wouldn't persist in sending them if the letters were not profitable. Now, in defense of the businesses who do pay in response to these letters, I note the following: The coun- ►

sel who send these letters are usually clever enough to identify potential claims that might survive a sanctions demand under Rule 11, but not so obvious and robust that other counsel may file similar actions — which would defeat the whole purpose of this business model. And the payment demands are normally in a range that a business might find rational. If the targeted business can escape the potential litigation for a price less than what it would need to pay a defense firm to try to get the action dismissed and conduct discovery in the meantime, it's arguably worth doing. And this whole approach may be particularly compelling for a smaller business not accustomed to litigation, for which the class action can be a scary experience and may raise the specter of bankruptcy.

In any event, what you have in this class action underworld is the use of Rule 23 not for private enforcement, but for private enrichment. Contrary to what Brian says, this is not a situation in which you get paid only if you win, and it's a pretty widespread phenomenon. I think if you talk to in-house counsel at major corporations or counsel at most class-action defense firms, you'll hear that they spend a fair amount of time dealing with these letters.

**FITZPATRICK:** What John is talking about is plaintiffs settling a case on their own without fully going through with the class-certification process. That's not a beef with the class action, because those settlements are not class actions. Those are individual settlements that clients are agreeing to pay. Now, they may be agreeing to pay because the cost of filing a motion to dismiss is so much bigger than the settlement amount. I was in private practice for a number of years. Motions to dismiss are not that expensive to file — you don't do any dis-

covery for those, you just put together a few legal arguments. But if you're paying out a lot of \$20,000 settlements to avoid \$25,000 in expenses for the motion to dismiss, then maybe we need to adopt some kind of loser-pays rule, which is indeed one of the rules I recommend in the book.

**Will federal agencies do a better job of returning money to victims than class-action lawyers do?**

**FITZPATRICK:** No, and here's why. When the federal government goes after corporate wrongdoing, most of the time it is prohibited by law from returning the money to victims. The government has to put the money in the U.S. Treasury. So, that's a zero percent claims rate when the government does it. Occasionally, the government is allowed to return money to victims by statute. What do you think they do to get the money back to victims? They hire the same settlement administration firms the class-action lawyers hire. The government's claim rate is 9 percent, too. So, the government is no better at this compensation problem.

**BEISNER:** Particularly in the consumer class-action arena, I don't think federal agencies could do much worse than class-action lawsuits at returning money to victims. Earlier, I was talking about class-action counsel sending letters threatening class actions, but then ultimately not doing so by requesting a settlement under which they keep all the cash that is paid. So in that exercise, class-action lawyers by design do not return any settlement money to victims. But there are also settlements that occur after the lawsuit is filed but before class certification is addressed. In my experience, what happens in such settlements is that a

very small amount is paid to the named plaintiff, a substantial amount is paid to class counsel — often in the six-figure range, maybe higher — and the unnamed putative class members get nothing. Not a dime. The named plaintiff and the class counsel who filed the lawsuit proclaimed in their complaint that they would champion the rights of the allegedly injured putative class members. But in that “individual” class settlement, they receive payments to abandon their promised representation of the putative class members. They use their purported representation of the class to get themselves a profitable deal and then they renounce the class representation. No disclosures are made to the court about such deals, because Rule 23(e) requires court approval of dismissals only where a class has been certified.

Now let me be clear: The defendants agree to this. Paying off the plaintiff's counsel to make the litigation go away is distasteful, but doing so avoids the higher cost of continuing to litigate the matter and potentially incurring litigation risk or adverse publicity.

The data suggest that such settlements are a large component of our current class-action system. A study conducted several years ago looked at class actions filed in the federal court system during a particular year, to see what happened to them over the ensuing five-year period. (Mayer Brown LLP, “*Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions*” (2013).) At the five-year point, 28 percent of the class actions had been dismissed by courts on the merits, 28 percent were settled on a class basis, and 14 percent were still pending. But the most surprising finding was that 30 percent of the class actions—the largest percentage—had been voluntarily dismissed. Voluntary



dismissal usually signals there was a settlement of the sort I just described. So the data suggest that in perhaps for upwards of one-third of federal class actions, essentially all of the money that changes hands as a result of the litigation goes to the class counsel. These cases thus represent another major reason why class actions wouldn't work as a private enforcement mechanism.

**Do class actions effectively deter corporate wrongdoing?**

**FITZPATRICK:** Yes. To be honest, I've never been that concerned about compensation, and that's because of the deterrence value that class actions bring. The reason we sue is not just to compensate, but to discourage wrongdoers from taking things from us to begin with. The Chamber says deterrence is just a theory and there's no evidence for it, but in the book I go through five very good empirical studies — one antitrust, four securities fraud — that show that as the class-action threat goes up, corporate wrongdoing goes down. Each one of the studies' statistically significant effect shows the exact same thing: Deterrence works. Class actions work. There are zero studies pointing in the other direction. So, it's not just a theory. It is a proven theory, as far as I am concerned. I do think that we can justify the class action on deterrence alone.

**BEISNER:** I suppose there may be some instances in which the threat of class actions may deter bad behavior. But the legal system can deter undesirable behavior only if it clearly draws lines — only if the system distinctly defines what behavior is deemed unacceptable. I question the deterrence value of class actions because so many are based on off-the-wall theories or technical,

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“gotcha” non-compliance allegations that a defendant could not have anticipated. For that reason, the idea that class actions play a major role in influencing corporate behavior is a dubious proposition.

At times, Brian's book sounds like it interprets Rule 23 as a private attorney general statute — it repeatedly suggests that Rule 23 authorizes counsel to roam around trying to recover every nickel allegedly obtained improperly by a defendant, without any regard for delivering monetary relief for the allegedly injured class members. The flaw in that assertion is that the statutes and common law doctrines that form the basis for class-action claims countenance only persons suing to recover their own losses. Typically, those laws do not authorize third parties to assert claims and seek for their own benefit (or for disinterested *cy pres* entities) recovery for losses sustained by others. They do not countenance actions in which the plaintiff has no intent or means of delivering any recovery to the aggrieved parties. Thus, Rule 23 would have to be the source of any such mandate. But such an interpretation of Rule 23 would blatantly violate the Rules Enabling Act's requirement that federal procedural rules “shall not abridge, enlarge or modify any sub-

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stantive right.” 28 U.S.C. § 2072. One cannot justify penciling into laws additional terms simply because they are supposedly consistent with the promulgators' “motivations.” That's why I think most of your fellow conservatives would part company with your effort to read a private attorney general power into class actions.

**FITZPATRICK:** To begin with, I think our substantive laws — forget Rule 23 — our substantive laws are motivated both by a compensatory purpose and a deterrence purpose. So, the fact that you're achieving deterrence through Rule 23 is just passing through the purpose from the substantive law. It's not adding a new purpose to it. Moreover, it is not true that the statutes and common law doctrines that form the basis of class-action claims foreclose *cy pres* payments. *Cy pres* is itself a longstanding substantive common law doctrine that has never been abrogated by the legislature. In fact, in many places it has been codified by legislatures. I explain all this in a recent article. See Brian T. Fitzpatrick, *Why Class Actions* ►

*Are Something both Liberals and Conservatives Can Love*, 73 VAND. L. REV. 1147 (2020).

**Many of the arguments about the enforcement and deterrence power of class actions depend on where the settlement money goes. What does the data show on that point?**

**BEISNER:** Empirical research Brian reported in a 2010 article makes the case that although plaintiffs' counsel were paid over \$5 billion over a two-year period (2006–2007), the settlements extracted over \$33 billion from defendants. See Brian T. Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. EMPIRICAL LEGAL STUD. 811 (2010). But that assertion makes a key assumption: that the face value of a settlement (that is, the maximum amount that a defendant theoretically might pay under a settlement based on its terms) equals the amount the defendant actually ends up paying.

In some cases, particularly securities class actions, I think face value may be a fair number. Money gets paid into a fund, it automatically gets distributed to the putative class members, and there's transparency about that. But in a lot of class actions, particularly in the consumer-protection context, the settlements are of a "claims-made" variety. That means a class member gets paid only if he or she submits a claim. The rates of claims in these cases is quite low — the FTC says 10 percent, but some prior studies indicate that the number is frequently much lower. Indeed, there's evidence that in many — if not most — consumer class settlements, the fees awarded to class counsel exceeds the total amount paid to all class members combined.

In his 2010 article, Brian candidly noted this limitation on empirical research exploring how money actually moves in class action settlements. He said in that article that the face values of class-action settlements "only reflect what defendants *agreed to pay*. They do not reflect the amount that defendants *actually* paid after the claims administration process concluded." *Id.* at 826 (emphasis in original). But Brian's new book walks away from that critical qualification, offering three reasons for that shift.

First, the book says that the vast majority of class-action money is distributed in what is known as the pro rata method, and that with only minor exceptions, the face value of settlements do reflect what class members actually end up receiving. But all Brian cites for this proposition are securities class actions, which do not tell us whether the other kinds of class actions operate in the same way.

Second, the book suggests that the face value of class settlements reflects the real amount paid by a defendant because virtually all settlements have "no reversion" clauses that prohibit the return to the defendant of any residual monies that remain in a settlement fund once a settlement process concludes. But the book offers no empirical evidence for that proposition. In my experience, "no reversion" clauses are used frequently. In a lot of class settlements, however, the defendant agrees to a minimum payout, which is subject to a "no reversion" clause. But since the defendant agrees to pay all submitted claims even if the total exceeds the minimum, the maximum amount the defendant may pay is deemed the face value of the settlement. Of course, that face value typically will dramatically exceed what the defendant will actually pay because, as discussed

previously, the claims rate is typically very low. And there are yet other settlements in which no fund is created — instead, the defendant simply says, "we'll pay directly out of pocket the specified amount to anybody who sends in a claim." In short, there is no need for a "no reversion" clause because the defendant has agreed to pay all comers. For fee application purposes, the court typically assumes that the defendant will pay out the specified amount to all potential claimants, even though only a small percentage will actually file a claim. Thus, again, in such cases, the settlement's face value is many times greater than the amount the defendant actually pays.

Third, Brian's book asserts that any uncertainty about the amount defendants actually pay in claims-made settlements has disappeared because "[t]hese days many courts wait to see how many class members apply for money before awarding fees." But in support of that contention, the book cites only two settlements. In my experience, federal courts rarely wait to award attorney fees until after claims are paid. Brian's book correctly observes that in the class-action section of the *Manual for Complex Litigation, Fourth*, there is the following recommendation: "[F]ee awards should be based only on the benefits actually delivered. It is common to delay a final assessment of the fee award and to withhold all or a substantial part of the fee until the distribution process is complete." I respectfully submit that is among the least followed recommendation in the *Manual*. Back in 2017, the U.S. House of Representatives considered codifying that provision from the *Manual* in a bill known as the Fairness in Class Action Litigation Act. The House ultimately passed that provision, but only after intense criticism by

many plaintiff's counsel and academics who contended it would radically change existing practice and serve only to delay compensation of plaintiff's counsel. No one on either side of that debate suggested that provision reflected the prevailing regime in class-action practice. So, I see no basis for the idea that federal courts are regularly deferring fee awards until they see the total amount of claims paid.

**FITZPATRICK:** To your first point, the reason I can say that the vast, vast, vast majority of settlement money is distributed pro rata by only citing two securities studies for that proposition is because securities cases are the vast, vast, vast majority of class-action money. Seventy-five percent of all class-action settlement money comes from securities fraud settlements. So, what does that mean? That means even if you assume that, in the consumer and employment cases,

zero percent is going to class members and 100 percent is going to the lawyers, that assumption doesn't change significantly the overall percentage that is going to the class action lawyers. As I explained above, class-action lawyers are currently getting 15 percent. Thus, if we throw out the one-quarter of the denominator that is attributable to the non-securities cases, but keep the fees from those cases in the numerator, it means that class-action lawyers are still getting only 20 percent of the total paid out by defendants (i.e., 15/75 rather than 15/100).

But, of course, it's not zero percent going to class members in the consumer and employment cases. I don't think claims-made settlements are the typical way that consumer and employment cases are settled. But I have to admit, we don't have empirical data on that yet. I'm in the process of a new empirical study where we are tracking that, and I predict it will show

that claims-made settlements are still a small minority of class-action settlements, and that most settlements include some guaranteed payment by the defendant, on which we can base fee awards.

I will say this, though: Under U.S. Supreme Court precedent in the Boeing case, *Boeing Co. v. Van Gemert*, 444 U.S. 472 (1980), judges are allowed to give lawyers a percentage of the face value of the settlement, even if the defendant doesn't end up paying all that money. That is legal right now. I advocate in the book for changing that. It is one of the changes I recommend to make sure we have rules in place to align the lawyers' incentives with the results they achieve, to make sure we're giving lawyers only a percentage of the *actual* amounts that are paid out and not the *potential* amounts are paid out. So, to the extent reversionary settlements are the least bit common, I'm in favor of using fees to discourage them.



## ONE SET OF SHARED PROFESSIONAL VALUES

Jones Day congratulates Bolch Judicial Institute of Duke Law School for its scholarly contributions to the field of law through its publication of *Judicature*.

