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Class Actions - Representative Proceedings

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Abstract

A class action is a representational lawsuit that binds all persons with related claims, including those who were not parties to the proceeding. The procedure enables parties and court systems to enjoy certain benefits that are lost when claims are heard separately. These include reduced litigation costs per claimant, cost-internalization, and improved litigation incentives. The procedure generates these benefits by eliminating the need for collective action and giving class counsel control over claims held by non-parties. Because market discipline is lacking and judges regulate class actions inappropriately, this transfer of control entails serious risks of agency failure and opportunism that are often dealt with inadequately. The contemporary challenge is to reform the procedure in ways that preserve its advantages while reducing its risks and costs.
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1. Introduction

Most litigation is representative in nature because it is handled by agents, typically though not always attorneys, who advocate and otherwise act on the parties' behalf. Ordinarily, parties hire their agents directly, using market pressures and contracts to encourage good performance and to mitigate the risks and costs that are predicted to beset any relationship of principal and agent (Stiglitz, 1987).

In a percentage of the cases, judges appoint attorneys in the absence of market transactions. This happens mainly when a party is a child, an incompetent, or a person in need of charity. It also happens in certain situations where bargaining impediments prevent lawyers and clients from coming to terms despite perceived opportunities for mutual gain or systemic needs to aggregate claims. The class action is the paradigm of judicial appointment of representation in this situation.

Numerically, class actions make up a small part of an average court's civil docket. Of the 272,027 civil lawsuits filed in all federal district courts in the United States in 1997, only 1,475 or one-half of one percent were class actions. If all 647 authorized judgeships had been filled, federal district court judges would have received an average of only two new class actions apiece in 1997 (Administrative Office of the United States Courts, 1997).

Though comparatively rare, class actions are disproportionately important. They consume far more of judges' time than other civil suits. Judges have been estimated to spend eleven times as many hours on certified class actions and twice as many hours on non-certified class actions as they do on non-class civil cases (Willging, Hooper and Niemic, 1996). Because class actions also involve far more claimants than other civil suits, these judicial investments can yield enormous economies of scale. Class actions brought to remedy economic harms often encompass thousands or even millions of consumers. Personal injury class actions can also be quite large, especially those that attempt to resolve claims held by persons who may become ill in the future. When judges' time is amortized across claimants, the economy of the class action is revealed (Bernstein, 1978).

Class actions also involve unusually large financial stakes. A study of securities class actions reported that the 105 lawsuits in its sample for 1995 generated settlements averaging US$10,619,174 and totaling US$1,115,013,250 (Martin et al., 1996). Many personal injury class actions have generated settlement funds or settlement offers of US$100,000,000 or more. In 1998, a single antitrust class action yielded a proposed settlement in excess of US$1,000,000,000.

Not all class actions seek money damages. Many are brought to achieve social, political, or legal reforms. Targets of reform lawsuits include mainly public and private institutions, such as school districts, large employers, manufacturing plants, welfare agencies, prisons and legislatures, whose operation affects large numbers of individuals.

Given their potential to transfer massive amounts of wealth and to reorganize important institutions, it should surprise no one that class actions are politically controversial. Although the federal rule that governs the conduct of these lawsuits in the United States retains the basic structure it received in 1966, there have been many attempts to reform the rule and to reduce the rate at which class actions are brought. Statutes now restrict prisoner class actions, securities cases, consumer cases and lawsuits by legal aid organizations that receive public support. Federal common law also deals with matters like subject matter jurisdiction, notice, and attorneys' fees in ways that make class actions more difficult to bring.

Reflecting the importance of class actions, the scholarly literature discussing them is enormous. The history of the procedure, which has its roots in England, its trunk in the United States, and new branches in other countries, has been carefully studied (Yeazell, 1987). Developments in the case law are followed closely. A large and growing empirical literature studies trends in filings, dismissals, settlements, and fee awards (Alexander, 1991; Garth, Nagel and Plager, 1988; Hensler et al., 1985; Martin et al., 1996; Rosenfield, 1976; Willging, Hooper and Niemic, 1996b). The impact of class actions on issuers of securities and securities markets has also been studied (Strahan, 1998; Bohn and Choi, 1996). Finally, a literature emphasizing microeconomics and game theory considers normative justifications for class actions, examines agency problems that arise in them, and suggests avenues for reform (Coffee, 1987b, 1995; Hay, 1997a; Macey and Miller, 1991; Perino, 1997; Rosenberg, 1984, 1987).

A. Legal Basics: What a Class Action is and How One Works

2. The Class Action is a Representational Device, Not a Joinder Device

The class action is a procedural device that expands a court's jurisdiction, empowering it to enter a judgment that is binding upon everyone with covered claims. This includes claimants who, not being named as parties, would not ordinarily be bound. A class-wide judgment extinguishes the claims of all persons meeting the class definition rather than just those of named parties and persons in privity with them, as normally is the case.

Judges and scholars sometimes treat the class action as a procedure for joining absent claimants to a lawsuit rather than as one that permits a court to treat a named party as standing in judgment on behalf of them. This is a mistake (Hutchinson, 1983). Class members neither start out as parties nor become parties when a class is certified.

3. How a Class Action Commences

A named party begins the process of having a class recognized by filing a pleading in which a class is preliminarily described. Later, a named party files a motion for certification. The motion refines the class definition and requests entry of an order allowing a class action to proceed. In theory, a named plaintiff can ask to have a class of plaintiffs or of defendants certified, and a named defendant has the same two options. In practice, requests by named plaintiffs to certify plaintiff classes greatly outnumber all other requests. Defendant classes comprise fewer than 1 percent of all certified class actions, and named defendants rarely ask judges to certify classes of any kind (Willging, Hoper and Niemic, 1996b).

A named plaintiff who seeks to stand in judgment for a class is called a putative or actual class representative, depending upon whether the motion for certification has been granted. An attorney appointed to act for a class is called class counsel. Usually, the attorney representing the named plaintiff is appointed class counsel in the order that certifies the class. A person who is not a named party but who falls within a class definition is called an absent class member or an absent plaintiff.

4. The Certification Decision

For a lawsuit to proceed on behalf of a class, a judge must certify that certain criteria are met. The named plaintiff must be a member of the class. It must be impracticable for the named plaintiff to join all absent plaintiffs to the lawsuit as named parties. Common questions of law or fact must connect the named plaintiff's claims with those of the absent plaintiffs. The named plaintiff must also be a typical claimant who, having no significant conflicts of interests with the absent plaintiffs and being assisted by competent counsel, can be relied upon to represent adequately all members of the class. These criteria are repetitive and overlapping.

At least one of the following additional criteria must also be met to secure class certification. There must be a risk that an opposing party will be subject to multiple, duplicative, or inconsistent obligations unless a class is certified. There must be a chance that an absent claimant's ability to protect his interests will be impaired unless a class is certified. The defendant must have subjected all class members to a common practice or course of conduct, justifying a class-wide grant of declaratory or injunctive relief. Or, questions of law or fact common to all class members' claims must predominate over any individual questions that may arise and the class action must be superior to other available procedures for handling the block of complaints.

Judges certify common question class actions far more often than they find any other criteria apply. Approximately two-thirds of all certified class actions fall into the common question category (Willging, Hooper and Niemic, 1996b), which is used for all manner of economic harm cases, including securities and insurance fraud and other deceptive trade practices. These cases typically involve large numbers of claimants who incurred small losses and require mainly evidence about the conduct of defendants (Issacharoff, 1997).

The law encourages judges to decide certification motions 'as soon as practicable' (Federal Judicial Center, 1995). Even so, judges usually decide dispositive substantive motions first. A plaintiff who prevails on a substantive motion will find the chances for certification greatly improved (Willging, Hooper and Niemic, 1996b). Judges also frequently consider class certification and settlement at the same time. This occurs in about one-third of all lawsuits where classes are certified (Willging, Hooper and Niemic, 1996b).

5. Post-Certification Procedures

Certification usually triggers additional procedures that are specific to class actions. In common question cases, absent plaintiffs are entitled to notice of the lawsuit and to an opportunity to exclude themselves from it. They also may appear in the lawsuit if they wish. When certification and settlement occur concurrently, absent plaintiffs are entitled to notice, to a complete description of the settlement including attorneys' fees and expenses that may be paid, to file objections, and usually to exclude themselves. Any settlement that is proposed also must be judicially approved for a judgment to bind all class members.

A class action that has been certified for all purposes proceeds toward trial much as any other lawsuit does, and trial rates for certified class actions are comparable to those for other civil suits (Willging, Hooper and Niemic, 1996). The named plaintiff uses ordinary discovery tools to gather information about the merits of class members' claims. Admissions and dispositive motions are used to remove factual and legal issues from dispute and to identify any remaining factual issues that must be tried. At the trial itself, the named plaintiff must offer evidence sufficient to prove all elements of his individual claim and to support favorable findings on all class-wide issues, including damages (Issacharoff, 1991). The stakes being larger in class actions than conventional lawsuits, the parties devote greater effort to these matters and incur greater expense, but the differences are matters of degree not of kind.

Settlement rates for certified class actions also are generally comparable to those for conventional lawsuits, with securities class actions settling more frequently than class actions involving other complaints (Martin et al., 1996; Willging, Hooper and Niemic, 1996b) . Empirical studies have not borne out the charge, often heard in policy discussions, that a judge's decision to certify a class forces even an innocent defendant to surrender (Priest, 1997).

As explained above, judges must review and approve class action settlements after giving absent plaintiffs notice and an opportunity to object. Historically, objections have been infrequent. Few absent plaintiffs take the trouble to attend fairness hearings. More file written objections, but the number who write in also is small. As might be predicted, these meager efforts rarely prevent settlements from proceeding. In the past, judges approved without alteration 90 percent of all proposed class settlements to which objections were filed (Willging, Hooper and Niemic, (1996b).

Recently, certain abusive or allegedly collusive class action settlements have received widespread press coverage and extensive academic scrutiny (Coffee, 1995a; In Camera, May-June 1993, July-August 1993; Koniak, 1995; Koniak and Cohen, 1996). As a result, judges, who are charged to act as guardians for absent class members, have begun to examine settlements more closely. They have paid special attention to proposed settlements that resolve immature claims of personal injury, that offer class members coupons or discounts instead of cash, or that abridge the right of dissenting class members to opt out. Although these settlements are not impermissible *per se* (Miller and Singer, 1998), they often signal that class counsel and a settling defendant colluded to the detriment of a class.

B. The Basic Microstructure of the Class Action

6. Separation of Ownership from Control

Class actions contain far more class members than class representatives. Consequently, most of the economic value of a class action is attributable to absent plaintiffs' claims. If a single class representative were to sue on behalf of ninety-nine absent plaintiffs with identical claims, the absent plaintiffs collectively would account for 99 percent of the value of the case.

Because representatives with minority interests manage class actions, it is useful to think of classes as litigation groups in which ownership and control of assets are in different hands (Jensen and Meckling, 1976). In this respect, classes resemble stock companies, mutual funds, and innumerable other economic undertakings in which investors play relatively passive roles (Coffee, 1998; Shapiro, 1998; Silver and Baker, 1998). Seeing this resemblance, judges have subjected named plaintiffs to fiduciary duties like those that customarily apply to managers of other enterprises.

Judges have also subjected class counsel to fiduciary duties. From an economic perspective, this makes sense. The regulation and incentivizing of counsel affects the likely success of class actions far more than anything having to do with named plaintiffs. As explained, a named plaintiff holds a tiny fraction of the entire economic interest possessed by a class. Often, a named plaintiff's claim is far too small to justify the expense of litigation, and it is always too small to motivate a named plaintiff to invest resources at a level that is optimal for a class. By comparison, class counsel's interest is usually far larger. Counsel is paid on a contingent basis an amount that reflects the value of the relief recovered by the entire class. In most cases, the fee is a fraction - between 20 and 40 percent - of the common fund (Lynk, 1990, 1994; Martin et al., 1996; Willging, Hooper and Niemic, 1996). Because class counsel holds the largest single stake, it is not surprising that class counsel is the primary decision-maker and the moving economic force in class litigation (Kane, 1987; Miller, 1998).

The concentration in class counsel's hands of economic interest and managerial control accounts both for the attractiveness of class action lawsuits and the risks associated with them. The attraction derives from the possibility of placing a large block of claims, including many that may be too small individually to warrant conventional lawsuits, under the control of someone who is in a position to maximize their value. The risks derive from the possibility that control will be abused for the benefit of the agent in charge.

7. Comparing Class Actions and Other Group Lawsuits

Class actions are involuntary or nonconsensual group lawsuits. They begin and, for practical purposes, end without class members' consent.

Other group lawsuits are consensual. They involve multiple clients all of whom contract for representation with the same attorneys. Small voluntary groups greatly outnumber large ones, but entrepreneurial attorneys have built enormous groups with tens of thousands of plaintiffs by using mass-marketing techniques and by actively working referral markets (Resnik, Curtis and Hensler, 1996; Silver and Baker, 1997; Spurr, 1988). Entrepreneurial lawyers play the same role in large voluntary group lawsuits that organizers play in other collective actions (Hardin, 1982). They also use the same techniques as organizers to reduce their costs. For example, they use existing associations, such as labor unions, trade associations, and homeowner groups, to recruit individual plaintiffs and to serve as representative plaintiffs.

Still other group lawsuits straddle the consensual/non-consensual divide. These lawsuits are called consolidations. Consolidation occurs when pending cases are routed to a single court for coordinated management. Usually, this occurs when lawsuits involve common facts. For example, claims arising out of airplane crashes, explosions, and other disasters are frequently consolidated. The perception is that such cases can be processed efficiently in tandem (Steinman, 1995a, 1995b).

Consolidations begin consensually. Plaintiffs employ attorneys and authorize them to file lawsuits. Thereafter, plaintiffs lose control. Judges frequently consolidate cases at defendants' request and over plaintiffs' objections. In effect, they force together plaintiffs who would rather remain apart. In federal multi-district litigation, a consolidation order may transfer cases to distant jurisdictions where plaintiffs' chosen lawyers rarely practice. Judges then subject transferred cases to the control of managing committees. These consist of several lawyers who are selected to handle most tasks for all plaintiffs, including the preparation of master complaints and motions, discovery and settlement negotiations. These lawyers receive supplemental compensation, usually as a result of judicial orders entitling them to shares of other lawyers' fees (Resnik, Curtis and Hensler, 1996; Silver, 1991b).

From an economic perspective, all three kinds of group lawsuit can be analyzed in similar terms. In all, control is separated from ownership and placed in the hands of lawyers with large financial interests. From a practical perspective, however, the three cases differ. When litigation groups form voluntarily, plaintiffs use contracts to govern them. They select attorneys, set their compensation, allocate responsibility for expenses, establish procedures to govern individual and group-wide decision making, create incentives to keep the collective action going, and otherwise take care of the group's constitutional needs. They also waive conflicts of interests, retain withdrawal rights, and can fire attorneys who perform poorly (Silver and Baker, 1997). By contrast, class actions and consolidations are created by regulation. Judges form them and decide how they will operate. Class actions and consolidations thus operate outside the reach of market forces. Absent plaintiffs cannot fire their appointed representatives when they are dissatisfied with their performance. They cannot sell their interests or join new groups when they disagree with fundamental strategies or decisions, as shareholders in publicly traded corporations can. Nor can they rely on anything analogous to the takeover market to police inefficient management of their claims. Consequently, agency problems can be far more serious in class actions and consolidations than in voluntary group suits (Silver and Baker, 1998; Silver, 1991b).

C. Advantages of Aggregation

Litigation groups offer plaintiffs several important advantages. These include economies of scale in litigation costs, greater leverage in settlement negotiations, and conservation of defendants' assets, all of which can increase plaintiffs' recoveries.

8. Economies of Scale

Group lawsuits enable plaintiffs to reduce litigation costs per capita by sharing the burden of litigation services that can be used by many plaintiffs. Plaintiffs who sue individually must separately pay for legal and factual investigations, for representation at trial and in settlement negotiations, and for litigation support services such as document preparation, expert witness testimony, and computer simulations. A group of plaintiffs need pay for these services only once, the services being non-rival goods insofar as members of the group are concerned. Plaintiffs who sue together also gain by taking advantage of the specialization of labor when performing tasks such as monitoring counsel's performance, answering interrogatories, and attending hearings and depositions. By assigning these tasks to claimants who can best handle them, performance can be improved and savings generated that make all plaintiffs better off than they would be if each were responsible for performing every task.

9. Enhanced Bargaining Leverage

Most group lawsuits settle. Bargaining power is therefore as important in group lawsuits as in conventional cases. In theory, plaintiffs can often gain leverage in settlement negotiations by joining forces. This happens, most straightforwardly, because groups of plaintiffs will often find it rational to litigate more intensively than individuals.

The impact of economies of scale on bargaining power is clearest when individual claims are too small to justify the expense of litigation. In this situation, claims pressed by individual plaintiffs have little settlement value because plaintiffs cannot make credible threats to try their cases. By comparison, the threat value, and therefore the settlement value, of groups of small claims may be relatively great, owing to the feasibility of trying small claims *en masse*.

Economies of scale can increase the settlement value of large claims too. On the standard economic model of the decision to settle or sue, a plaintiff's minimum demand falls as litigation costs rise. Because aggregation reduces plaintiffs' litigation costs per capita, it should increase their minimum demands and, correspondingly, the settlement value of their claims.

Aggregation also can increase plaintiffs' demands by increasing the expected value of claims at trial. A claim's expected value is partly a function of the probability that a plaintiff will prevail in a trial against a defendant. In turn, the probability of winning is a function of the level and quality of litigation support services obtained. If members of plaintiff groups save money by sharing the cost of non-rival litigation services, they can afford to purchase more services or services of better quality than plaintiffs who sue by themselves. They can thereby raise the expected value of their claims at trial and improve their prospects in settlement. This may explain why class members have won sizeable settlement payments on claims that failed to generate payments in conventional cases. The class action can bring 'compensation and closure' to persons who are otherwise poorly served by the tort system (Tidmarsh, 1998).

Even when plaintiffs sue separately, their fortunes often intertwine. Plaintiffs' attorneys share information about trials and settlements. Factual findings, legal rulings, and verdicts in decided cases inform assessments of the settlement value of cases yet to be resolved (Hensler and Peterson, 1993). Predictably, these connections between separate lawsuits give defendants an edge in litigation. A defendant facing a test case knows that the stakes are greater than just the amount likely to be won by the litigating plaintiff. The amount paid in settlement or lost at the trial of the test case will affect the value of claims held by other plaintiffs who are waiting in the wings. The defendant may therefore find it rational to invest far more in the lawsuit than the litigating plaintiff's claim alone would warrant. Manufacturers of tobacco products maintained an unbroken record of success in personal injury litigation for four decades by outspending the opposition.

When claim values intertwine, a defendant almost certainly will find it economically rational to outspend an attorney who represents a single client. Ordinarily, a plaintiff's attorney's fee is a percentage of the client's recovery Clermont and Currivan (1978). This compensation arrangement gives an attorney no incentive to spend even an amount equal to the expected value of the plaintiff's claim, the expected fee being far smaller. By itself, the possibility that the trial or settlement of a test case may affect the value of other plaintiffs' claims will not induce the attorney to spend more. Unless other plaintiffs or their attorneys agree to share litigation expenses, these external effects will be ignored.

Aggregation brings the parties' stakes more nearly into balance and improves the incentives of plaintiffs' counsel as well. When all claimants participate or are represented in a single lawsuit, the defendant's exposure is the sum of the expected values of all the claims (or the defendant's total assets, whichever is less). As a group, the plaintiffs' stake is the same amount. The investment incentives are still unequal because the attorney representing the plaintiff group stands to earn only a fraction of the plaintiffs' recovery, usually one-third (Martin et al., 1996). Even so, the plaintiffs' attorney can credibly threaten to invest significant resources in litigation services that, from the plaintiffs' perspective, are joint goods. If, as seems likely, litigation investments have declining marginal value, the threat to spend heavily will give the defendant pause.

Group counsel's predominant financial interest is and must be the economic force that drives group litigation. The expectancy of receiving a fee that far exceeds the typical class member's recovery motivates attorneys to make the enormous financial commitments these lawsuits require and to incur the correlative risks. Even so, the size of counsel's interest has sparked political controversy. Because counsel's interest dwarfs that of all but the largest class members, for example, institutional investors in securities fraud cases, it often seems that group lawsuits have more to do with paying attorneys than compensating victims.

From an economic perspective, this imbalance is not a source of concern. Attorneys who manage large litigation groups are not distinguishable from managers of widely held companies or mutual funds. It would be foolish to limit a manager's compensation to the amount any individual investor earns in a given period. It would be equally unreasoning to limit class counsel's fee to the amount recovered by the largest claimant. Such a limitation would undermine counsel's incentive to invest. This would harm group members, not help them.

Of particular concern to a defendant facing a group lawsuit is the possibility that a single trial will adjudicate its entire liability. Ordinarily, a defendant can handle risk far more easily than a plaintiff can. The plaintiff will have an undiversified risk of loss associated with a claim that may be his single largest asset. By contrast, the defendant will face hundreds or thousands of claims, some of which will succeed, some of which will fail, and none of which taken individually will pose a serious threat to the defendant's solvency. In this situation, the defendant can more easily tolerate the risk of trying cases than can any individual plaintiff. Aggregation turns the tables on defendants. It puts them in the position of being rendered insolvent by a single trial (a high variance event), thereby saddling them with a large, undiversifiable risk. It also forces defendants to go to trial knowing that plaintiffs' attorneys have strong incentives to invest. Many defendants are willing to pay large sums to avoid facing the prospect of a real trial followed by liquidation.

10. Conservation of Defendants' Assets

When a defendant's assets (including insurance) are insufficient to cover all plaintiffs' claims, a group lawsuit can make plaintiffs better off by conserving the defendant's resources and preserving the going concern value of the defendant's operations. When claims are litigated in separate forums, defendants must retain local counsel in each venue, pay experts to testify concerning the same scientific issues at each trial, suffer the expense of repetitive depositions of managerial personnel, and bear other duplicative costs. These expenditures, which can be reduced when plaintiffs sue in a single proceeding, consume resources, making them unavailable for transfer to plaintiffs.

The value of a defendant's assets also can be diminished when a defendant's business is liquidated piecemeal rather than as a unit, so that the value of the operation as a going concern is lost. Speaking less than strictly, competing plaintiffs participate in an *n*-person Prisoner's Dilemma. If each strives independently for a share of the defendant's resources, the defendant's operations will be liquidated piecemeal, going-concern value will be lost, and plaintiffs as a group will net a smaller recovery than they could have realized by keeping the defendant's operations intact. Just as the possibility of avoiding this race to judgment supports some scholarly justifications of bankruptcy laws (Jackson, 1982), the same prospect may be said to weigh in favor of group lawsuits in cases involving limited funds.

11. A Paretian Defense of Aggregation

Figure 1 The Normative Economics of Group Litigation

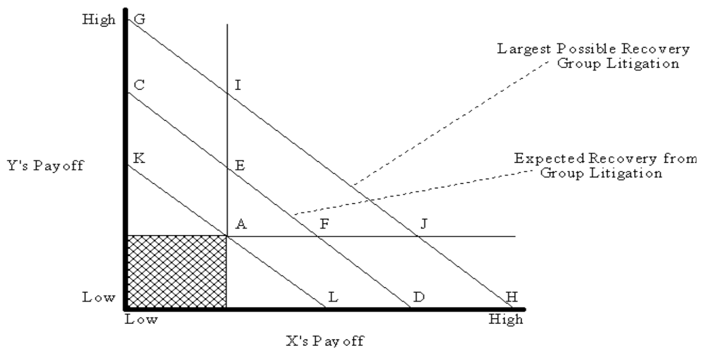

Figure 1 displays the basic economic logic of group litigation. Where X and Y are potential co-plaintiffs, point A represents their expected joint payoff if each sues the common defendant in a separate lawsuit. The space defined by triangle OGH contains all possible joint payoffs if X and Y combine forces and sue as a group. The smaller triangle AIJ within OGH is the set of possible payoffs from group litigation that are Pareto Superior to A. Curve

CD contains all possible divisions between X and Y of the expected joint payoff from group litigation. EF is the set of possible divisions of the expected joint payoff that are Pareto Superior to A. A simple normative economic argument for group litigation is that, by joining forces and sharing costs, co-plaintiffs hope to move themselves from A to a point on EF.

12. Why Require Participation? Transaction Costs and Free-Riding

Figure 1 raises an important question about non-consensual group lawsuits. Why are they permitted? When plaintiffs stand to gain by joining forces, they can be expected to form groups voluntarily. Presumptively, a plaintiff's refusal to join a litigation group would indicate that, in the plaintiff's opinion, any gains that may to flow from cooperation fail to offset the expected costs and risks. It is therefore reasonable to ask why class suits and consolidations should ever occur without the consent of absent plaintiffs.

One answer is that class actions and consolidations facilitate mutually beneficial cooperation that is normally frustrated by the high cost of transacting. Transaction costs are a serious problem when a wrongdoer's conduct inflicts small losses on the members of a large victim population. For example, suppose that a credit card company overcharges millions of cardholders a few dollars apiece by calculating interest incorrectly. For cardholders as a group, the loss is large enough to be worth pursuing, but no individual cardholder has an incentive to organize the group. The prospect of recovering a few dollars would not justify the time or effort even if the likelihood of winning were great.

The same problem arises in injunctive cases where litigation may prevent small harms from occurring. Suppose that the members of a large population are exposed to individually small health risks when a toxic substance is disposed of improperly. A lawsuit brought to force the wrongdoer to clean up the waste would protect the entire community and be cost-justified in view of the risk. However, the expected gain to any individual will likely be too small to motivate anyone to bear the expense of organizing a community-wide lawsuit.

Class action rules enable plaintiffs to avoid start-up costs that prevent litigation groups from forming. A single named plaintiff can initiate a class action on behalf of all persons with similar claims just by filing an appropriate complaint. However, in keeping with the belief that non-consensual lawsuits are permissible only when start-up costs are high, the rules permit named plaintiffs to use this gambit only when it is impracticable to join absent plaintiffs as parties voluntarily. This may be because the group's members are numerous and geographically dispersed, because claims are too small to motivate anyone to bear the cost of locating and bargaining with potential plaintiffs, or because group members identities are unknown or change over time. By minimizing transaction costs, class action rules enable named plaintiffs to wage advantageous group lawsuits that would not otherwise be brought.

Free-riding can also impede the formation of voluntary groups when the object of litigation is a non-exclusive good, that is, a good that will be available to group members and non-members alike. Structural reform lawsuits and other injunctive actions provide the best examples. Structural reforms, including improvements in public housing conditions, increased funding for public schools, and changes in hiring and promotional practices by an employer, automatically benefit everyone who suffered under prior arrangements. Consequently, potential plaintiffs may find it economically rational to free-ride on the efforts of others in these cases. If the lawsuit succeeds, the free-rider obtains the benefit without charge. If the lawsuit fails, the free-rider foregoes the benefit but avoids litigation costs, including the risk of being singled out for recrimination or retaliation by people who oppose the lawsuit. Either way, the free-rider is better off not cooperating. The exceptional case in which a free-rider's contribution can make the difference between the success and failure of a group lawsuit occurs too rarely to worry about.

Free-riding can also be a rational strategy when plaintiffs seek damages, even though a money judgment is an exclusive good. Suppose that X, who is one of one thousand claimants, believes that it is important to preserve the going-concern value of a defendant's operations, and that X also believes that piecemeal liquidation will not occur if any group containing at least 500 claimants forms. These beliefs may lead X to regard his own participation in a litigation group as inessential and to remain apart from a group if there is any advantage to doing so. If all claimants think like X, there may be no litigation group despite the opportunity for collective gain.

Opportunities to gain free information may also cause free-riding. Suppose that X and Y are both injured by the same defective product, that X sues the manufacturer, and that X invites Y to join the suit. If Y is confident that X will prosecute the lawsuit whether or not Y joins, Y may decide to let X sue alone. X's lawsuit then will be a valuable source of information for Y. Whether X wins, recovers a substantial settlement, or loses, Y will be better able to assess the value of Y's claim. Y may also be able to take advantage of favorable factual or legal rulings made in the course of X's suit, as in times past the class action device enabled Y to recover under the judgment obtained by X. The possibility of capitalizing on X's lawsuit creates opportunities for Y to gain an advantage by waiting on the sidelines.

13. Non-Paretian Justifications for Non-Consensual Proceedings

One also can argue for non-consensual group lawsuits on a variety of non-Paretian grounds. An obvious alternative is a Kaldor-Hicks approach on which the gains of some, be they group members or others, more than offset any losses some plaintiffs incur. The Kaldor-Hicks standard is often described as a potential Pareto improvement (Cooter and Ulen, 1988).

An argument of this sort can be grounded in the desire to conserve the resources of the legal system. The claim here is that one would squander judges' time by requiring them to process related claims individually. The force of this argument is a function of the number of claims and the extent to which they are related. The larger the number and the closer the factual and legal connection, the more society can gain through aggregation (Bernstein, 1978). This insight has spurred many efforts to consolidate related tort lawsuits, such as those arising out of occupational exposure to asbestos (Hensler et al., 1985).

The judicial efficiency argument has merit when plaintiffs' claims are large enough to justify the expense of separate lawsuits. Then, economies of scale can be gained by using a class action or a consolidation to streamline the processing of claims. When plaintiffs' claims are small, however, the judicial efficiency argument may or may not be persuasive, depending on how it is framed. The distinctive contemporary function of the class suit is to facilitate litigation by claimants who hold small shares of a large controversy, shares that are too small to be litigated individually (Kalven and Rosenfield, 1941). By performing this service, class actions consume judicial resources that would otherwise be spared, it being irrational for individual plaintiffs to sue on their own. A single-minded concern save judicial resources would therefore cause one to oppose small-claim class actions. A slightly different and socially more appropriate concern - a desire that judges' time be used efficiently would lead to the opposite conclusion. As explained above, certified class actions consume eleven times as many hours as conventional lawsuits, but they increase the rate at which judges can resolve claims hundreds or thousands of times, more than offsetting their marginally greater cost (Willging, Hooper and Niemic, 1996).

One must also consider other social costs that would be incurred if wrongs that visit small losses on large numbers of individuals were not policed. Losses imposed on third parties are externalities that producers will ignore unless forced to account for them. By bringing widely dispersed losses home to producers, the class action discourages them from acting in ways that are socially inefficient. It forces them to consider public as well as private production costs (Rosenberg, 1984, 1987; Wright, 1969).

The cost-internalization function of the class action is independent of its compensatory function and may be served when the latter cannot. Difficulties relating to the identification of class members, the measurement of their individual damages, or the cost of fine-tuning payments, may make it impossible or impracticable to restore claimants to the positions they would have come to but for the wrong. Even so, it may often be possible to deter wrongdoers by measuring aggregate social costs and imposing them on malfeasant defendants. It being as important to avoid losses as it is to compensate victims, an inability to compensate should not by itself prevent a class action from proceeding. Alternatives such as fluid class recoveries and escheat of unclaimed funds should instead be explored.

D. A Digression on the Law of Restitution

14. Why Pay Class Counsel?

The preceding sections examined the propriety of drawing plaintiffs into class actions without their consent. This section considers a related issue: why require absent plaintiffs to pay attorneys they never agreed to hire? The answer may seem simple. Unless attorneys are paid to represent absent plaintiffs, they will not do so and there will be no class actions. However, in a legal system committed to freedom of contract, more must be said than this. The usual rule is that people need not pay for services they do not ask to receive. Restitution is rarely required, especially when a provider acts pursuant to a contract with another, as an attorney representing a named plaintiff does. B, who enjoys looking at A’s beautiful yard, has no duty to compensate A’s gardener. The gardener’s only right is to receive the contracted for amount from A.

It has been seriously maintained that the practice of allowing class counsel to recover fees from common funds over and above the amounts they agree to accept from named plaintiffs violates the law of restitution (Dawson, 1975). The argument has not persuaded judges to abandon the practice, which is as entrenched as ever. The desire to cure unjust enrichment has led judges to permit attorneys to claim compensation in limited circumstances. Their efforts must confer benefits on non-clients. It must be infeasible or impracticable for them to bargain with non-clients in advance. And it must be difficult for them to prevent non-clients from deriving benefit from their work. These requirements often are met when an attorney brings a class action to a successful close (Silver, 1991a; see also Levmore, 1985).

The restitutionary approach caps class counsel’s fee at the market rate or the size of the recovered fund, whichever is less. It allows judges to use any payment formula employed in the private market, including percentages, hourly rates, and hybrids of the two. Percentage compensation has long been the norm in common fund class actions. Federal judges began a shift to the hourly-rate based lodestar method in the 1970s, but the experience proved disappointing and most federal courts have shifted back to the percentage approach. The emerging practice is to base fee awards on an established benchmark, usually 25 percent of the recovered fund, and to use the lodestar to make small deviations from this figure in exceptional cases.

E. Disadvantages of Aggregation

15. Paretian Misfires

Group lawsuits often have the potential to make litigants worse off than they would expect to be suing on their own. In Figure 1, A represents the expected joint payoff if X and Y wage separate lawsuits. A thus serves as a boundary for Paretian claims about the affects of group lawsuits, but it is not a practical boundary of any kind. It does not restrict the actual allocation of relief. Figure 1 shows this in two ways. First, OGH, the set of possible outcomes of group litigation, includes points that are Pareto Inferior to A. The darkened area to the southwest of A is the set of possible Pareto Inferior payoffs. That such points exist when plaintiffs' claims have positive expected values in conventional litigation is not controversial. Second, OGH also includes many points that are Pareto Noncomparable to A. When a group secures relief equal to or greater than A, the fruits can be divided between X and Y in a manner that leaves one of them worse off than he or she would have been at A. Thus, X is worse off at C than at A, and Y is worse off at D than at A, even though the expected recovery from group litigation is obtained at both C and D. The rectangles AKGI and ALHJ are the sets of possible Pareto Noncomparable results.

The Pareto noncomparable and Pareto inferior outcomes are more than academically interesting. There is good reason to fear they often occur. Empirical evidence shows that class actions often settle for amounts that seem small in relation to the losses claimants incur (Carleton, Weisbach and Weiss, 1996; Martin et al., 1996). Anecdotal evidence further suggests that judges frequently approve distribution plans that divide settlement funds other than in proportion to the size and strength of class members' claims (Coffee, 1998, 1987a; Koniak, 1995).

16. Agency Failures and Sub-Optimal Recoveries

Whether the goal is compensation or deterrence, the importance of regulating class actions in ways that encourage attorneys to maximize the value of plaintiffs' claims is clear. If class suits settle too cheaply or plaintiffs lose at trial more often than they should, wrongdoers will escape some of the social costs of their behaviors. Undercompensation and underdeterrence will be the results.

A central thesis in the literature is that class actions often settle for too little (Coffee, 1986; Hay, 1997a). There also is evidence that defendants win class-wide trials more often than one would expect. Both results are thought to be due to agency failures that plague class actions. These failures have several sources, including defective incentives, inadequate monitoring, economic asymmetries that favor defendants, lack of market discipline, certification for settlement of classes that could not be certified for trial, and conflicts involving settlements of inventories of signed clients.

17. Defective Incentives and Opportunism

The impact of fee arrangements on lawyers' incentives has been widely studied (Clermont and Currivan, 1978; Johnson, 1980-81), and there is broad agreement that many shortcomings of class action practice can be traced to judges' use of inappropriate fee arrangements. The lodestar fee formula, which bases compensation on time expended and hourly rates, is a primary culprit. By rewarding effort instead of results, it discourages lawyers from maximizing the value of plaintiffs' claims and encourages sweetheart deals that make class counsel and defendants better off at absent plaintiffs' expense (Coffee, 1986, 1995a; Silver, 1992).

An ideal fee arrangement would be self-policing. It would harmonize the interests of absent plaintiffs and lawyers, making it in lawyers' interest to prosecute class actions zealously, as duty requires. The lodestar method fails to align interest with duty. It relies on monitoring to encourage superior performance instead of incentives.

A self-interested class member would want to maximize his recovery net of expenses. He would be perfectly willing to pay a larger fee when this would yield a larger expected net recovery. Otherwise, he would prefer to keep for himself money that could be transferred to his attorneys.

The lodestar method does not reflect this preference. It transfers money from a class member to an attorney whenever the attorney works more, whether or not the exchange of time for money leaves the class member better off. Moreover, under the lodestar method, even a class member who profits from a forced transaction may have a valid complaint. Work by the hour can be done poorly or well, and class members may find it advantageous to pay far more for the latter than the former. Suppose a class could offer a lawyer $1000 for an hour of top-quality work that would increase its expected recovery by $5000 or $200 for an hour of mediocre work that would yield an expected return of $201. Both transactions would leave class members better off, but they would rationally prefer a surplus of $4000 to a surplus of $1. Unfortunately, the lodestar prevents class members from choosing between these exchanges. By holding compensation per hour constant, it motivates a lawyer to perform at the lowest quality level sufficient to generate the stipulated fee.

The conventional wisdom is that class members often lose by exchanging money for time when the lodestar method is employed. When a judge decides which hours will be compensated and the hourly rate exceeds a lawyer's opportunity cost, a lawyer's incentive is to bill as many hours as a judge is likely to allow. For example, suppose that a lawyer with an opportunity cost of $150 per hour expects a judge to authorize payment at $200 per hour for up to 1000 hours of work. It would be irrational for the lawyer to charge for less than the full 1000 hours. Any time diverted from the class action to other matters would cost the lawyer $50 an hour. The incentive to bill the entire 1000 hours will exist even if the last 100 hours contribute nothing of value to the class.

In the example just described, the lawyer could do even better by committing fraud. If the lawyer spent 900 hours on the class action, billed the class for 1000, and spent the 100 hours saved on other cases, the lawyer would gain an additional $15,000 by working on the other cases. Thus does the lodestar method encourage lawyers to falsify billing records and create a related need for monitoring.

Unfortunately, if also understandably, in most class actions no one is likely to monitor class counsel closely or well. Judges are reluctant to make careful evaluations of fee records, expenses and lawyers' activities, especially in the absence of serious complaints from absent plaintiffs. The task is subjective, arbitrary and time-consuming. Absent plaintiffs also lack incentives to bear the cost monitoring entails, and they confront the logic of collective action as well.

Scholars have proposed many improvements on the lodestar method, the simplest of which is increased use of contingent percentage compensation arrangements and decreased use of the lodestar. Unfortunately, certain ways of applying the percentage-based approach share the lodestar's defects because they too sever the connection between reward and return. When class actions settle, attorneys are always paid in cash but absent plaintiffs sometimes receive discount coupons or other in-kind relief (Miller and

Singer, 1998). The economic value of this relief is difficult to gauge, especially when coupons are not actively traded. To help judges assign the relief a value and justify their requested fees, plaintiffs' attorneys offer experts' assessments. Often, these are based on assumptions about utilization rates that are wildly optimistic. Coupon settlements typically benefit class members far less than experts predict (Borenstein, 1996; In Camera, May-June 1993, July-August 1993).

By weakening or severing the connection between fees and results, the lodestar method and coupon settlements create opportunities for 'sweetheart deals' that are good for defendants and class counsel but bad for absent plaintiffs. Suppose that class counsel expects to win a judgment for $10 million at trial, $2.5 million of which will be paid to counsel as fees. Now suppose the defendant, who privately agrees with the $10 million estimate, offers coupons worth $5 million in settlement of class members' claims and an additional $3 million in fees. By making the offer, the defendant can save $2 million. By accepting the offer, class counsel can gain $500,000. The loss comes at the expense of class members whose recovery net of fees fall from $7.5 million to $5 million. Not knowing that the negotiators think the case is worth $2 million more, the judge is likely to go along with the deal, especially when expert testimony inflating the value of the coupons is offered.

An alternative to the coupon deal is an early settlement at a low price. Suppose a defendant who expects to lose $20 million at trial offers $10 million in settlement, including $3 million in fees, shortly after the complaint is filed. The defendant also threatens to litigate aggressively if the offer is declined. Class counsel will find the offer attractive. Why risk $3 million in fees today in order to win a somewhat larger amount, say, $5 million, two years from now after an expensive fight? If the lawyer has not logged hours sufficient to justify a $3 million fee, announcement of the settlement can be delayed, allowing time for more discovery.

A third type of sweetheart deal expands the class definition or broadens the release to make a settlement more valuable for a defendant. When settling, a defendant naturally wants to free itself from liability to the fullest possible extent. To accomplish this, a defendant may ask class counsel to bring additional claimants into a class or to release claims a class was not asserting. For example, a defendant may want to include personal injury claimants in the settlement of a property damage class action, or a defendant may want claims released over which other courts have exclusive jurisdiction. In return, the defendant will offer a small fee increase that, from class counsel's perspective, will be an unearned bonus (Coffee, 1995a).

A fourth type of sweetheart deal uses a reversion to make a defendant's obligation appear larger than it is. A defendant promises to make a large fund available, say, $20 million, subject to the condition that funds not claimed by class members revert to the defendant. The attorneys' fee is then based on the $20 million. Because claim rates in class actions tend to be low, the defendant is likely to keep a good deal of its money and the attorneys' fee per dollar of relief actually received by class members is likely to be high.

Percentages that vary inversely with settlement size also discourage lawyers from maximizing claim values. Suppose that a lawyer would receive 30 percent of the first $10 million won by a class, 25 percent of the second $10 million, and 20 percent of the third $10 million. Now suppose the defendant offers $20 million in settlement but that class counsel thinks the case is worth $30 million. To reject the offer, class counsel must be willing to risk $5.5 million in fees to win an additional $2 million. On the reasonable assumptions that the higher dollars are riskier than lower dollars, the gamble will attract only risk-preferring attorneys.

As a group, plaintiffs' attorneys are risk-averse. Consequently, they must be paid more to recover risky dollars than dollars that are easy to come by. They must also be paid more in large cases that require great financial commitments and that entail risks that are hard for plaintiffs' attorneys to diversify. A good fee arrangement would therefore vary directly with the amount of the recovery rather than inversely to it, increasing the fee percentage at the margin as the recovery grows (Stock and Wise, 1993). Such an arrangement would also partially offset the declining marginal value money has for attorneys, a problem of great importance in cases where hundreds of millions or billions of dollars in damages are at stake.

A final but fundamental incentive-related shortcoming derives from the possibility of parallel litigation, which prevents class counsel from obtaining a property right in a certified class action. To appreciate this problem, it must be understood that the first class action to settle moots all other similar class actions and that only the attorney handling the settled case is likely to earn a fee.

Suppose that two class actions alleging the same violations and brought on behalf of the same individuals are filed in separate courts against the same defendant. Now suppose the defendant makes two low-ball settlement offers, one in each case, subject to the condition that when either offer is accepted the other lapses. Unless the plaintiffs' attorneys handling the cases collude, a race to settle is likely to occur because only the attorney who accepts first will be paid.

To make matters worse, collusion is nearly impossible. If both attorneys reject the low-ball offer, the defendant can simply find a third lawyer, offer him the deal, and agree to settle a class action filed by that lawyer. For collusion to work, it must involve all plaintiffs' lawyers, an impossibly large coalition.

It may seem unlikely that a defendant would search for an attorney to represent a class. Yet the phenomenon has happened often enough to have a name: the reverse auction (Coffee, 1995a). The name reflects the defendant's desire to find the attorney who will sell it immunity from litigation at the lowest price. In a reverse auction, the low bidder gets the sale.

18. Inadequate Monitoring

No incentive arrangement can wholly eliminate opportunities for agents to benefit at principals' expense. It is therefore important for principals to monitor agents. In class actions, absent plaintiffs are unlikely to monitor class counsel as carefully as they should. Monitoring by absent plaintiffs may also lead to undesirable results when it occurs. For these reasons, judges have a duty to examine how class actions are handled. Unfortunately, even they miss many instances of opportunism.

There are only four candidates for the job of monitor in a class action: the defendant, the named and absent plaintiffs, the presiding judge, and third parties, such as uninvolved attorneys, who may keep track of the case.

The defendant can be ruled out immediately. A party that stands to gain from class counsel's opportunistic acts cannot be trusted to police them.

Nor are named plaintiffs necessarily good monitors. Having chosen or been chosen by the attorneys who lead the class, named plaintiffs may too often give them the benefit of the doubt. Named plaintiffs also, and properly, benefit disproportionately from class settlements. They often receive incentive payments that are intended to compensate them for special risks and costs they incur (Krislov, 1990; Solovy, Kaster and Jiganti, 1990). The availability of these payments may color their judgment.

Although harmed by opportunism, absent plaintiffs also cannot be expected to monitor class counsel efficiently. Many or most absent plaintiffs hold stakes that are too small to warrant the expense. It would be irrational to spend $100 monitoring a lawsuit in which one has a $100 interest, but to oversee class counsel effectively an investment of thousands could be required. When expected recoveries are small to begin with, as in class actions they usually are, only class members who ignore economic factors will monitor class counsel actively.

Class members with sizeable claims may also be discouraged. First, they often learn that class actions are pending late in the day when settlement notices are delivered. They then face the daunting and expensive task of reconstructing events and finding signs of collusion, an undertaking in which they can expect no help from class counsel or the settling defendant. Second, an absent plaintiff who uncovers wrongdoing cannot privatize the entire return. If the size of the settlement should ultimately increase, all class members will share the gain. The private cost of monitoring may exceed the expected private gain even when the expected class-wide return would be far greater. Third, the inability to privatize returns on monitoring creates a free-rider problem within a class. When any absent plaintiff bears the cost of monitoring, all profit. Why, then, should any particular absent plaintiff bear the expense instead of free-riding on others who choose to do so?

A further difficulty with relying on absent plaintiffs is that they too can be bought off. A class member who takes a special interest in a case can be made a named plaintiff by class counsel and offered an incentive bonus. Or a defendant can offer to allocate settlement benefits in a way that favors an involved class member. Because the interests of particular plaintiffs always diverge from those of others, an absent plaintiff who serves as a monitor may himself have to be watched.

In theory, judges could be excellent monitors. They understand legal and factual issues better than claimants are likely to, and they are increasingly likely to have experience managing complex litigation. In practice, the quality of judicial monitoring is uneven because judges lack appropriate incentives and have limited fact-gathering capabilities. Many judges are overworked, underpaid, and subjected to strong institutional pressures to move cases along. It is unreasonable to expect them to divert time from live matters to class actions that are all but settled. Judges also have to rely on others for most of their information. Yet their usual sources class counsel and defendants - cannot be relied upon to pinpoint evidence that would scuttle a deal. To make matters worse, in many cases the data judges need to answer the crucial question - Is the money enough? - do not exist. The history of previously settled cases may be thin or no one may have collected it. Often, the most comparable cases are other settled class actions that also may be tainted.

Many judges are poorly placed to serve as monitors because they are architects of the agreements they are asked to review. Often, judges structure rulings to encourage settlement negotiations, they (and the magistrates or masters they appoint) become deeply involved in the negotiation process, and they use powerful signals about future rulings to soften plaintiffs' and defendants' bargaining positions (Resnik, 1982; Schuck, 1986, 1987). This behavior may be motivated by a jumble of forces, including solicitude for plaintiffs facing extraordinary trial delays, pressure to clear dockets, personality quirks, and a desire for the prestige enjoyed by judges who settle big cases. Because trial judges who orchestrate settlements can be expected to approve them, the primary monitors of such settlements must appellate judges.

Judicial scrutiny of fee requests is also uneven. Monitoring is crucial under the lodestar method, which encourages lawyers to inflate hours and claim excessive hourly rates. It is also tedious and time consuming (Silver, 1992; Tomkins and Willging, 1986). Judges must cast themselves as auditors and examine lawyers' time sheets and expenses line by line. Many judges short-circuit this process. They either approve fee applications as submitted or they make rough-cut reductions. Some judges also intentionally deviate from market standards when setting hourly rates, believing that market rates are too high. Judicial monitoring is not an especially good means of policing fee-related misconduct (Coffee, 1986; Silver, 1992).

Finally, consider other third parties. These may be attorneys whose clients are absent class members who object to a settlement. Or they may be public interest lawyers or public officials, such as attorneys general or consumer protection agencies. There are many cases in which third parties have become beneficially involved, but as a general matter they are in short supply. Class members usually lack incentives to get them engaged. Moreover, private lawyers can usually protect clients with large claims by opting them out. This being the cheaper course, it is the one usually taken.

The participation of third parties also can raise several difficulties. First, public officials may intervene to advance political agendas or interests that have little to do with claimants' welfare. For example, they may oppose certain kinds of lawsuits and, assuming the guise of consumer advocates, they may challenge fee awards to discourage lawyers from bringing more cases. Second, class counsel may co-opt third parties, especially lawyers representing claimaints, by making them co-counsel and offering them fees. Third, third parties may intervene solely to be bought off. There are many lawyers, colloquially referred to as 'bottom feeders', who use objections to extort payments. They hold up settlements unless and until class counsel offers to share fees with them, effectively paying them to withdraw. Public officials can also extort payments. They may want settling parties to place funds under their control or to assist them with other endeavors by donating services or cash. One can never be certain that third parties' motives are pure.

Because none of the available candidates has incentives to monitor appropriately, it should not be surprising that objections to proposed class settlement are both rare and rarely successful. Judges approve settlements without modification in 90 percent of the cases where objections are filed. This is true whether an objection concerns the adequacy of a settlement or a proposed award of attorneys' fees (Willging, Hooper and Niemic, 1996b). What the statistics cannot show may be equally important. Many objections that succeed in altering or forestalling settlements may be strategic or otherwise unwarranted.

19. Unresolved Economic Asymmetries

Fee awards in class actions average just above one-third of the amount recovered. Rarely do they exceed 50 percent (Martin et al., 1996; Willging, Hooper and Niemic, 1996b). Many judges also reduce the size of a fee as a percentage as the size of the recovery rises (Lynk, 1990, 1994). These practices tend to tip the balance of economic power against claimant groups and in favor of defendants.

As a practical matter, class members can spend only about 33 cents out of every dollar in controversy to prosecute a lawsuit. This is the amount they can offer their lawyers as fees. By contrast, defendants can spend 100 cents on the dollar or more. Judges do not control defendants' spending. Because the amount one spends affects one's chances of winning, free-spending defendants will predictably gain an edge over class members. This advantage should manifest itself at trial, where plaintiffs should lose relatively often, and in settlement, where bargains reflect one's prospects at trial.

Differences in ability to diversify risks and manage litigation costs should strengthen the spending advantage defendants enjoy. Plaintiffs' attorneys practice mainly in small firms of 10 or fewer lawyers. Plaintiffs' firms with 25 or more lawyers are exceedingly rare (Stock and Wise, 1993). Firms of this size have limited capital to invest and great difficulty diversifying large risks. For them, class actions, which require cash outlays of $500,000 on average, demand lawyer time worth far more, and take longer than conventional lawsuits to settle, can be bet-the-firm cases. To protect themselves, plaintiffs' attorneys spend conservatively and otherwise minimize their financial commitments to class actions. They are low-cost operators because they have to be (Coffee, 1986).

Defendants find class actions easier to manage. Only large businesses, governmental entities, and other well-heeled institutions are likely to be targets for class actions because only they have the resources or insurance needed to pay large judgments. But the size and wealth that make them attractive targets also enable them to tolerate and diversify litigation risks more easily than plaintiffs' attorneys can.

Being relatively wealthy, defendants usually pay lawyers to defend class actions wholly or partly on the basis of hourly rates. They also reimburse their lawyers for expenses. With their clients absorbing the costs and risks of litigation, defense lawyers have every incentive to turn class actions into protracted lawsuits and frequently do. Every motion a defense lawyer files, every discovery objection and request, every interlocutory appeal, and every other dilatory tactic forces plaintiffs counsel to consume scarce resources. The incentive to force plaintiffs' counsel to bankrupt themselves may partly explain why class actions consume so much more of judges' time than other lawsuits.

Defendants also can take advantage of political connections that are not available to plaintiffs. For example, insurance companies faced with class actions have sought protection from insurance regulators and legislators. In effect, they have sought to cut short litigation by acting in other forums where they enjoy significant advantages. When success outside the courtroom can be a 'silver bullet' that puts a conclusive end to litigation, plaintiffs' attorneys have to respond. But doing so requires more political savvy, greater financial resources and better connections than many of them possess.

There are some economic asymmetries that favor plaintiffs. For example, plaintiffs who survive early dispositive motions are entitled to discovery on the merits, and defendants usually possess far more discoverable information than group members do. By requesting this information via discovery requests that are themselves inexpensive to produce, plaintiffs' attorneys can force defendants to bear the considerable cost of locating, reviewing, and producing it. Particularly costly to defendants is lost managerial time that interrupts its business.

Defendants can do little to expose group members to offsetting costs, which means that once discovery gets underway, plaintiffs possess unique leverage. Recognizing this, defendants work hard to prevent discovery from starting and, when their efforts fail, they often settle to avoid discovery costs, whatever the merits of plaintiffs' claims may be. This threat advantage is a temporary one - it decreases in size as discovery is taken and future costs are converted to sunk costs. Its size also bears no necessary relation to the value of class members' claims. Finally, defendants can offset plaintiffs' leverage somewhat by producing documents and witnesses in volume. A plaintiffs' attorney who is swamped with information may lack the resources needed to sort the wheat from the chaff.

20. Lack of Market Discipline

Many of the forces that encourage agents to represent principals well in other contexts are absent from class actions and consolidations. For example, claimants have little or no power to hire or fire lead attorneys or to decide how much they will be paid. Claimants may not control the settlement decision. They cannot sell their claims when they are disappointed with counsel's performance, as owners who are dissatisfied with managers can sell their shares. Nor in the litigation realm is there an analogue to the takeover market. Attorneys who fail to maximize the value of assets cannot easily be dethroned.

Because so many market checks are missing, the quality controls that do exist must operate especially well. Primary among these are the choice of counsel itself and counsel's compensation arrangement. As explained, the latter often misfires because judges use the lodestar method or otherwise fail to compensate counsel appropriately.

It is difficult to overstate the importance of the attorney chosen to lead a litigation group. This person must marshal the resources needed to prosecute a case, see that they are used efficiently, and decide important matters of strategy. When a consensual litigation group is built via a referral market, there is reason to expect a qualified person to be given these tasks. Referring lawyers, who serve as brokers for their clients, have an interest in selecting competent lead lawyers who will maximize referral fees by maximizing claimants' recoveries. Referring lawyers also are potential monitors and sources of future business. Lead lawyers who shirk or settle cheaply can expect criticism from referring lawyers. Lead lawyers who develop bad reputations can expect to be denied future work (Resnik, Curtis and Hensler, 1996; Spurr, 1988).

When a judge selects a lead attorney, the danger is greater that an unsuitable individual will be chosen. A judge has no stake in the amount class members recover. Consequently, a judge has no particular interest in selecting a lawyer who can be expected to maximize the value of their claims. Absent a contest for control, a judge has no reason to do other than appoint the attorney who files the class action complaint.

Sometimes, it is safe to assume that the attorney who files a complaint is the wrong lawyer for a class. This is true, for example, when *a defendant* recruits lead counsel. Defendants facing large numbers of individual claimants sometimes see the class action as a means of resolving all their legal difficulties in a single forum at a bargain price. With this goal in mind, they approach one plaintiffs' firm after another until they find a lawyer who is willing to negotiate a cheap package deal. This is another example of the reverse auction.

The law requires judges to cure the problem of inadequate lead counsel. More accurately, it permits them to allow class actions to proceed only when absent plaintiffs are adequately represented. This includes representation by adequate counsel. It is clear that judges can appoint substitute counsel when a defect of counsel is all that stands in the way of class certification.

Judges are reluctant to assert this power, for several reasons. First, they rarely see lawyers they recognize as bad apples. Lawyers tend to file lawsuits in courts where they are liked and respected. They also enlist respected local lawyers as co-counsel when they are forced to litigate in unfamiliar courts. A lawyer who is a judge's favorite or has a judge's favorite in tow stands a high likelihood of winning appointment.

Second, many judges like lawyers who are deferential and respectful and who help them by settling cases. It is unreasonable to expect these judges to prefer aggressive lawyers to passive ones. The preference for cooperative attorneys may explain why judges so often give the role of lead counsel to plaintiffs' lawyers who negotiate settlements before seeking class certification. One study reported that 'a proposed settlement was submitted to the court before or simultaneously with the first motion to certify' in 49 percent of class actions certified for settlement (Willging, Hooper and Niemic, 1996b). It also may explain why judges frequently re-appoint certain prominent lawyers who are notorious for settling quickly (Tidmarsh, 1998).

Third, judges are rightly concerned about denying lawyers who uncover wrongdoing the reward of serving as class counsel. Unless lawyers are compensated for time spent inventing liability theories and investigating misconduct, they will be discouraged from doing so. The privilege of being appointed class counsel and the contingent right to compensation that comes with the position maintain the incentive to police wrongdoing.

Some judges have attempted to stimulate competition for the role of lead counsel and to reduce attorneys' fees by auctioning the right to represent a class (Macey and Miller, 1991, 1993). The results have been mixed. A judge cannot sell a class action to the highest bidder, a transaction that might be predicted to identify the attorney who can derive the greatest value from a set of claims. They can auction only the right to control the class and, in the event of success, to be paid. The temptation is to sell the lead counsel position to the lawyer willing to handle a case for the smallest fee.

This is a serious mistake. The cheapest lawyer is likely to be the one whose opportunity cost is lowest because he cannot attract other business. Such a lawyer would be a poor candidate to represent a class.

An attorney who represents an individual client with a large stake, such as an institutional investor, would be better suited for the task. Sophisticated clients with large claims are likely to pick good lawyers. Because they can be expected to perform quality control for themselves, they can provide the same service for a class. A lawyer who represents a large number of clients with small stakes could also be a good choice. The lawyer's success in the referral market would show that other attorneys think he or she has the ability to run a group suit. Great financial wealth, a history of committing significant resources to lawsuits, and a record of success in high-stakes litigation are also important. Judges should consider indicia of quality in addition to price.

Two other quality controls that remain in most class actions are the right to object to proposed settlements and the right to opt out. These rights are not especially meaningful.

Absent plaintiffs are likely to object only when the cost of objecting is less than the expected gain. The cost of making anything more than a perfunctory objection can be quite large. An absent class member must retain counsel to canvass the record, attempt discovery of class counsel, and argue against approval of a settlement in court. By contrast, the expected payoff from objecting usually is small. It is the difference between the amount being offered and the amount one might recover under a more favorable settlement or trial judgment. Because objectors rarely succeed in changing settlements, the gain is likely to be worth the cost only for plaintiffs whose claims are very large. Even they may be discouraged by the logic of collective action, which creates pressure to free-ride.

In most situations, procedural rules entitle absent claimants to exclude themselves from class actions by filing opt out forms. This opt out right bears the same relation to objecting that exit bears to voice (Hirschmann, 1970). In theory, claimants could use their opt out right to guarantee themselves at least the expected value of their claims in conventional litigation (A in Figure 1). Some claimants have significantly increased their recoveries by opting out of class actions and filing conventional lawsuits (Tidmarsh, 1998).

The right to opt out may be more efficacious than the right to object, but it generally means that a claimant must litigate alone rather than as part of a second class action that is more efficiently run. For plaintiffs with small claims, this is impracticable, and for plaintiffs with large claims it may be disadvantageous. The empirical findings that class members rarely opt out and that those who do so overwhelmingly have large claims and are represented by counsel are not surprising (Willging, Hooper and Niemic, 1996b). Finally, by opting out absent plaintiffs protect only themselves. Other class members remain exposed to exploitation.

21. Certification of 'Settlement-Only' Classes

Class actions often are certified and settled at the same time. In approximately one-third of all cases where certification is granted, it is for settlement only (Willging, Hooper and Niemic, 1996b).

The set of class actions that are certified for settlement contains two subsets: class actions that would be certified for trial because they meet all the criteria for certification, and class actions that would not be certified for trial because they do not meet the criteria. For shorthand, the latter will be referred to as 'settlement-only classes'. Sell-outs are especially likely in these cases.

To see why, one must understand that plaintiffs' attorneys need defendants' cooperation to get settlement-only classes certified. These cases do not meet the requirements for certification. Consequently, certification would be denied in these cases if defendants were to object. To obtain defendants' acquiescence, plaintiffs' attorneys must make concessions.

The magnitude of the concession depends on the size of the fee interest putative class counsel has in the individual cases that will proceed in the absence of a class action. Assume the following: 100 individual plaintiffs will file cases; the attorney seeking to act as class counsel will represent 10 of these; each plaintiff's case has a settlement value of $500,000; and the attorney will contract with each plaintiff for a 25 percent contingent fee. In this example, the attorney expects to earn $125,000 in fees per case times 10 cases, a total of $1.25 million. The attorney will make nothing off the remaining 90 cases because other lawyers will handle them. Clearly, a class-wide settlement of all 100 cases yielding a fee greater than $1.25 million would be better for the attorney. For example, a fee award of $2.5 million in a class action would be an increase of 100 percent.

Therein lies the rub. At a rate of 25 percent, a class-wide recovery in the amount of $10 million would generate a $2.5 million fee. But a $10 million settlement would grossly undervalue the 100 claims, which would generate $50 million in winnings if tried separately. Settlement-only classes create opportunities for defendants to pay class counsel huge premiums while saving themselves enormous sums.

Defendants' opportunities to save money and to purchase class counsel's cooperation are especially great in so-called 'futures' class actions. These lawsuits cover persons whose injuries are latent. For example, persons exposed to a disease-causing substance who are asymptomatic could fall within a futures class. Although many of these persons can be predicted to sue after their injuries ripen, few are likely to retain counsel during the latency period. A futures class action offers a defendant an opportunity to settle all possible claims cheaply before any symptoms appear. By offering a bribe to an attorney who is willing to serve as class counsel, a defendant can settle immature claims for pennies on the dollar.

22. Settlements of Inventories of Signed Clients

Attorneys who handle class actions often have inventories of signed clients. In principle, this is good. An attorney who manages to build a client base in a litigation area where other lawyers are competing for business has convinced the market that he is a competent lawyer. The inference of quality is especially strong when an attorney has acquired clients by referral from other lawyers.

Concerns arise when an attorney settles a client inventory apart from and on terms that differ from those he negotiates for a class. This is accomplished by excluding the attorney's signed clients from the class action. For example, the class definition may cover only persons who file complaints after a certain date. If class counsel's signed clients filed before that date, a class-wide settlement would not cover them.

When a class action and a block of signed clients settle separately, there is reason to fear that one group may benefit at the other's expense. Usually, the worry is that the signed clients will exploit the unsigned class members. A wealth transfer from the latter to the former will benefit counsel if fees in the signed clients' cases are higher than those typically awarded in class actions. A transfer may also smooth the process of settling the client inventory by creating a surplus that can be used to buy off disgruntled clients or to reward lawyers or organizations, such as labor unions, who provided referrals (Coffee, 1995a; Koniak, 1995; Nagareda, 1996b).

23. Maximization-Related Conflicts

A subject neglected in the scholarly literature on class actions is the inevitability of conflicts in the process of preparing cases for trial. Although class counsel can often advance all absent plaintiffs' interests concurrently by supplying them with joint goods, even related claims invariably have idiosyncratic aspects that require individual attention and targeted expenditures. By devoting time and resources to these issues, class counsel neglects the interests of class members who claims lack these characteristics and who would prefer that counsel's time and resources be spent in ways more likely to be of benefit to them (Rhode, 1982a; Silver and Baker, 1998).

Resource allocations on common issues can also require inter-claimant trade-offs, and usually do. Class members with small compensatory claims, such as employees who were recently hired at discriminatorily low wages, may be best off if litigation resources are devoted mainly to the pursuit of punitive damages, pay increases and promotions. This use of resources may not appeal to class members with large compensatory claims, such as long-time employees. They may benefit most from efforts to model the impact of wage discrimination on their lifetime income and retirement plans. Other class members, such as future job applicants, may care only about new job openings.

By rejecting a settlement offer, class counsel also trades off the interests of some class members against those of others. Every litigation group contains members with different attitudes toward risk, with different views on the time-value of money, and with different desires for relief. By pursuing a high-risk/high-reward approach to litigation or a low-risk/low-reward approach, class counsel necessarily decides which class members' preferences will be favored. Class counsel does the same thing by deciding to settle for a larger amount tomorrow instead of a smaller amount today and by pressing for dollars rather than in-kind relief or symbolic vindication. Every decision to use time or money for one purpose rather than another or to adopt one litigation strategy instead of another necessarily resolves conflicts among class members' interests.

Maximization-related conflicts inhere in all class actions because there is nothing like the stock market that claimants can use to ameliorate them. Shareholders can freely and cheaply move between different companies and different investments so that their portfolios accommodate their risk preferences, attitudes toward the time value of money, and so on. Claimants cannot move from one class action to another to achieve the same result.

F. Inappropriate Settlement Allocations

A recovery can be allocated equitably or inequitably. From a Paretian perspective, allocations on CE and FD in Figure 1 would be inequitable despite being efficient. They would leave some class members worse off than they would have expected to be had they sued on their own.

A nascent but developing literature examines the equity of settlement allocations in class actions and other group lawsuits (Coffee 1998; Hay, 1997b; Hazard, 1995; Koniak, 1995; Menkel-Meadow, 1995; Silver and Baker, 1998). Even scholars who care mainly about deterrence agree that it is important to compensate plaintiffs fairly when that can be done at reasonable expense (Rosenberg, 1987, 1996).

There is a tendency in the literature to run allocation issues and efficiency issues together. When certain claimants are shortchanged, it may be because others receive too much, because a settlement fund is too small, or because others receive too much and a settlement is was too small. The unique contribution of equity is to set standards for dividing funds, not for overall fund size.

24. Allocation-Related Conflicts Inhere In All Class Actions

When it comes to dividing settlement funds, class members' interests always conflict. In Figure 1, X and Y share an interest in moving away from A in the direction of GH, but they have opposing preferences concerning where on GH they wind up. X prefers divisions to the northwest; Y prefers divisions to the southeast. A group lawsuit is a mixed-motive game in which the interest in cooperating for mutual gain is in tension with the interest in getting as much as possible for oneself. The tension exists whether a group seeks injunctive or monetary relief.

The number of ways of allocating recoveries and the conflicts they generate make clear the need for standards. If a class containing only members X and Y were to recover $1000, the entire range of options from ($1000,$0) through ($0,$1000) would be available. If member Z were added to the group, the number of possible allocations would expand exponentially. To avoid arbitrariness, judges and lawyers require normative allocation guidelines.

Unfortunately, there is no widely accepted, general account of the equity of class action settlements. There are instead many assessments of particular allocations that commentators either found deficient or wished to defend. Many of these assessments rest on deeper principles of equity or distributive justice that are neither made explicit nor carefully examined. For example, a scholar may criticize an allocation plan for ignoring differences in the size and strength of claims without explaining why these differences should matter.

Also missing is a cost-benefit analysis of equity. It is more expensive to pay claimants amounts that roughly reflect the size and strength of their claims than it is to engage in damages averaging and pay them equal amounts, and it is more expensive still to distribute payments that reflect fine differences between claimants (Coffee, 1987a, 1998; Silver and Baker, 1998). One therefore wants to know how much cost should be borne to obtain a marginal increase in equity. There is general agreement that the importance of equity increases with claim size. There is also a growing consensus that because class settlements yield less than $400 per claimant on average, often the game is not worth the candle. Between the extremes of large claims and small recoveries, however, there is little agreement as to how much equity is enough. This dissensus has important practical ramifications.

25. Causes of Arbitrary Allocations

Class counsel and defendants design allocation plans. In effect, they serve as agenda setters, deciding which of many possible allocations are presented to courts and claimants for consideration. Like other agenda setters, they have considerable power to control outcomes.

On the surface, this power may seem wasted on class counsel. Because allocation formulas do not affect the size of fee awards, class counsel might not seem to care how relief is divided. Reality is more complicated than this. Class counsel will receive no fee until a settlement is judicially approved. Approval depends, among other things, upon the judge’s views and the reaction of the class. Class counsel therefore has an interest in selecting allocations that satisfy these constituencies. Class settlements also frequently contain ‘walk away’ provisions that condition settlement on an agreed level of claimant participation. When allocating common funds, class counsel may keep the required level of participation in mind.

As explained, only class members with large claims are likely to object or opt out. This is why ‘walk away’ provisions usually target large-claim plaintiffs. A rational strategy for class counsel may therefore be to over-compensate large-claim plaintiffs and to shortchange everyone else. This approach enables class counsel to mollify large-claim plaintiffs without risking a revolt by small-claim plaintiffs, who rarely complain.

The desire to avoid objections can also lead to class counsel to overcompensate class members who belong to organizations. For example, an asbestos class action may include workers who are union members and workers who are not. Because a union can be an effective advocate of its members’ interests, it may contest a settlement that treats them poorly. Class counsel may therefore be inclined to involve the union in the design and administration of the settlement and to overcompensate its members.

A separate dynamic can cause class members with large claims to be underpaid. The typical class contains a small number of persons with sizeable claims and a far larger number whose claims are comparatively small or weak. The latter claims may add little value to the group lawsuit, but they increase greatly the number of mouths to be fed. Unfortunately for class members with large claims, judges are reluctant to deny any subgroup of absent plaintiffs a share of settlement benefits, especially a subgroup that is large. The price of feeding everyone is that plaintiffs with large claims receive less than they should.

The weak may also beggar the strong in litigation groups simply because the weak have less at stake. In bargaining situations, the player who stands to lose the most from the failure to reach an agreement can be expected to give up the most to salvage a deal. Plaintiffs with large claims have more at stake than plaintiffs with small claims, often far more. Small-claim plaintiffs can therefore take advantage of them. Risk aversion will predictably cause plaintiffs with large claims to sacrifice even more because the risks attached to large claims are harder to diversify and because large claims constitute a more sizeable portion of plaintiffs’ wealth.

Defendants also may have interests in skewing allocation formulas. For example, they may want to direct as much money as possible to claimants who are current customers, suppliers, employees, or shareholders and as little as possible to others (Coffee, 1998). A plaintiffs’ attorney who is indifferent to the manner of allocation will have no reason to resist a defendant’s efforts to direct funds to its favorites.

26. Possible Allocation Standards

The possibility of arbitrary allocation plans makes plain the need for concrete normative guidelines. Many scholars seem to embrace a Paretian standard of equity according to which class members should receive at least the expected value of their claims in conventional litigation. This probably includes most scholars who criticize allocations that ignore factors bearing on the size and strength of claims or that take account of irrelevant factors (Coffee, 1995a; Cramton, 1995; Koniak, 1995; Menkel-Meadow, 1995). They seem to assume that size and strength have the greatest impact on claim values in conventional litigation, and they therefore conclude that when size and strength are ignored, claimants are shortchanged.

The merit of the Paretian standard is that it respects the intuition that rational persons would not join litigation groups hoping to make themselves worse off than they are on their own. They would do so expecting collective action to enhance the value of their claims.

There are many difficulties with the Paretian standard, however. One is that the value of claims in conventional litigation is not self-evident. It must be assigned, and the data needed to make the assessment may be unavailable. A second is that the proper baseline to begin with may not be the expected value of claims in conventional litigation. Instead, one could start with a claim's highest expected value in any possible coalition of claimants. Needless to say, this value is not self-evident either. A third is that a commitment to Paretianism may not lead to the conclusion that allocations should reflect only the size and strength of claims. Other factors could also affect the value claims have in conventional litigation, including factors that may have nothing to do with the merits such as sex, age, race, or jury appeal. It is an empirical question which factors matter in particular cases. A fourth difficulty is that a Paretian standard does not tell one how to divide any surplus that exists above the chosen baseline. This shortcoming is especially problematic when class actions include some or solely claims that are too small to litigate individually, as most do.

A fifth problem is that claimants who participate in consensual group lawsuits rarely take steps in advance to identify or protect anything that might serve as a baseline for Pareto comparisons. Most such plaintiffs do nothing to provide for the division of settlement funds. They trust their fates to the discretion of their attorneys, reserving only the right to veto settlements as a means of protecting themselves. The veto right is often more illusory than real, however, because plaintiffs rarely have independent counsel to advise them how to use it.

Scholars who embrace Paretian standards must also consider how shortfalls should be dealt with. Settlements yield actual values, and actual values may be smaller than expected values even when class actions are run efficiently. When a group-wide settlement is too small to pay everyone the amount required by the Paretian baseline, some or all claimants must be shortchanged. The difficulty is in deciding which claimants and how much. Again, the number of possible allocations is exceedingly great.

27. Reform Proposals

There is broad agreement that judges should change certain aspects of the way they manage class actions. For example, whether an auction, a contingent percentage or even the lodestar method is used to set fees, most scholars encourage judges to set the terms of compensation up front. Today, judges often delay this matter until class actions settle. This practice requires class counsel to devote significant economic resources to a risky venture with no formal understanding as to the expected return. It also complicates settlement negotiations by leaving an additional and sizeable matter for the negotiators to resolve. The practice also burdens class counsel with a conflict of interests by creating the possibility that an impasse over fees may block an attractive settlement on the merits.

Investors in risky undertakings rarely tolerate this degree of uncertainty or conflict. They provide in advance for the division of returns, even when there may be no returns to divide. By doing so, they encourage their agents to work hard for their benefit. Judges presiding over class actions should mimic the market in this regard (Federal Judicial Center, 1995).

The practice of setting fees at the end also skews fee awards downward. In hindsight, the risk of loss will naturally seem smaller than it was. It is also more difficult to award large fees when the precise amount of the fee is known. This problem disappears when fees are set before any money is offered in settlement.

Another way to improve the class action to use percentage compensation instead of the lodestar method whenever possible and to increase percentages at the margin as the amount recovered rises. By offsetting risk aversion and the declining marginal value of money, this will encourage class counsel to strive for larger recoveries instead of being satisfied with smaller ones.

Other reform proposals include giving class members the right to opt out of all settlements (Rutherglen, 1996), forced fee sharing between class counsel and lawyers representing clients who opt out (Coffee, 1987b), improved notice (Woolley, 1997), allowing absent plaintiffs to sue class counsel for malpractice and collusion (Koniak and Cohen, 1996), encouraging judges to decide merits issues before motions for class certification (Berry, 1980; Priest, 1997), increased use of injunctions to prevent parallel class litigation (Miller, 1996), restricting opt-out rights (Perino, 1997), and alternative fee arrangements that link counsel's compensation to fees paid in individual representations (Hay, 1997b).

G. Conclusions

28. The Potential for Good

The class action is a procedural device with extraordinary potential for good. It can force product manufacturers and service providers to take account of externalities that they would otherwise ignore, encouraging them to perform more efficiently and compensating victims who would otherwise lack remedies. It can make the procedural system operate more efficiently by enabling judges to process related claims en masse at less cost per claim. It can save claimants' and defendants' money by enabling both to take maximum advantage of economies of scale. It can align the stakes of defendants and claimants so that litigation investments are more nearly equal and settlement bargains better reflect the merits of claims.

29. The Potential for Bad

The class action also entails important risks and dangers. Conflicts among claimants inhere in all class actions and must be resolved as cases are prepared for trial and settled. Lack of market oversight and improper judicial regulation create opportunities for class counsel and defendants to collude. This can frustrate the cost-internalization function of the class action by enabling wrongdoers to escape the social costs of their conduct. It can frustrate the compensatory function as well by shortchanging claimants. The latter can occur independently of the former as a result of improper allocation plans.

30. The Need for Dispassionate Analysis

At the microeconomic level, class actions are fascinating and truly intricate. Agency problems abound, and strategies for dealing with them are often subject to counter-strategies that are difficult to plan for in advance. Compounding the problem is the fact that judges do not always understand or even care about the impact their decisions have on the microstructure of the class action. Many decisions, such as those that require individual notice in small-claim class actions and those that announce the homogeneity of injunctive class actions, are patently flawed. Politics also takes a toll, especially when it comes to lawyers' fees, a subject of great partisan debate in the United States. If the atmosphere surrounding the class action ever cools, it may be possible to reform the device and avoid many excesses.

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