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# ARTICLES

## CLASS ACTION ACCOUNTABILITY: RECONCILING EXIT, VOICE, AND LOYALTY IN REPRESENTATIVE LITIGATION

*John C. Coffee, Jr.\**

*In two recent and highly technical decisions—Amchem Products v. Windsor and Ortiz v. Fibreboard Corp.—the Supreme Court has recognized that a serious potential for collusion exists in class actions and has outlined a concept of “class cohesion” as the rationale that legitimizes representative litigation. Although agreeing that a legitimacy principle is needed, Professor Coffee doubts that “class cohesion” can bear that weight, either as a normative theory of representation or as an economic solution for the agency cost and collective action problems that arise in representative litigation. He warns that an expansive interpretation of “class cohesion” could produce a “Balkanization” of the class action that would impair its utility. The guiding normative principle in class action reform, he suggests, should be the protection and enhancement of client autonomy, not “class cohesion,” because the class action for money damages is ultimately more an aggregation of individuals than a distinct entity.*

*Viewing class action accountability as at bottom a governance issue, Professor Coffee considers the relevance of corporate control mechanisms and market-based remedies that have worked in other contexts to limit agent opportunism. In particular, he concludes that a strategy of enhancing “exit” should outperform alternative efforts aimed at improving either client “voice” or agent “loyalty,” and suggests that “exit” could in some circumstances be a superior functional substitute for class cohesion.*

### INTRODUCTION

A transitory, but overdue, moment has arisen in which to rethink the role and scope of the class action. This brief moment arises primarily because of recent Supreme Court decisions whose scope has yet to be resolved, but it is overdue in large part because the academic literature on class actions (and complex litigation generally) has neglected to ask some basic questions. Chief among these is: How can we hold class counsel accountable to the class members that the attorney has elected to represent—without imposing constraints on the class action that threaten its viability? The premise to this Article is that a feasible answer to this question requires that we look outside the boundaries of the Federal Rules of

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Civil Procedure (or the existing academic literature on civil procedure) and view the class action as an organizational form that has become dysfunctional because the principals cannot effectively monitor their agent. Effective monitoring requires in turn that we rethink the governance structure of this organizational form. In particular, meaningful reform requires that we consider market-based remedies and checking mechanisms that have worked in related contexts to align the interests of the principal and the agent.

That this question is timely is shown by the dramatic shift in attitudes—both popular and academic—toward the class action. Where once it was seen as the plaintiff's sword, it is now increasingly recognized that it can be the defendant's shield.<sup>1</sup> Where once it was viewed as empowering class members, increasingly it is seen as entrapping them.<sup>2</sup> Correspondingly, where the plaintiffs' attorney was once seen as a public-regarding private attorney general, increasingly the more standard depiction is as a profit-seeking entrepreneur, capable of opportunistic actions

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1. I have no doubt contributed to this depiction and continue to view it as a serious problem. See John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 *Colum. L. Rev.* 1343 (1995); see also Susan P. Koniak & George M. Cohen, *Under Cloak of Settlement*, 82 *Va. L. Rev.* 1051 (1996) (noting prevalence of collusive settlements); John Leubsdorf, *Co-opting the Class Action*, 80 *Cornell L. Rev.* 1222 (1995) (analyzing how defendants can manipulate class actions). The empirical literature on class action practices is relatively modest, but tends to corroborate the critique that I have advanced. In 1999, the RAND Institute for Civil Justice conducted an extensive case study of recent class actions and summarized the accountability problem in terms that should surprise no one familiar with the prior academic literature:

Such "clientless litigation" holds within itself the seeds for questionable practices. The powerful financial incentives that drive plaintiff attorneys to assume the risk of litigation intersect with powerful interests on the defense side in settling litigation as early and as cheaply as possible, with the least publicity. These incentives can produce settlements that are arrived at without adequate investigation of facts and law and that create little value for class members of society. For class counsel, the rewards are fees disproportionate to the effort they actually invested in the case. For defendants, the rewards are a less-expensive settlement than they may have anticipated given the merits of the case. . . . For society, however, there are substantial costs: lost opportunities for deterrence . . . , wasted resources . . . , and—over the long run—increasing amounts of frivolous litigation . . . .

Deborah R. Hensler et al., *RAND Inst. for Civ. Just., Executive Summary, Class Action Dilemmas: Pursuing Public Goals for Private Gain* 1, 10 (1999) [hereinafter, *RAND Study*].

2. This entrapment results in part because the class member has no ability to opt out from certain "mandatory" class actions, which may in fact be sponsored by the defendants. See, e.g., Samuel Issacharoff, *Class Action Conflicts*, 30 *U.C. Davis L. Rev.* 805 (1997); Richard L. Marcus, *They Can't Do That, Can They?: Tort Reform Via Rule 23*, 80 *Cornell L. Rev.* 858 (1995); Henry Paul Monaghan, *Antisuit Injunctions and Preclusion Against Absent Nonresident Class Members*, 98 *Colum. L. Rev.* 1148 (1998). For a further discussion of the mandatory class action, see *infra* note 10. Even apart from the mandatory class action, entrapment can result because "future claimants" in some class actions have little incentive to object or protest until, after a long latency period, they learn for a fact that they have been injured.

and often willing to subordinate the interests of class members to the attorney's own economic self-interest.<sup>3</sup> Nowhere has the vulnerability of absent class members to such opportunism been more apparent than in the context of mass tort litigation, where the majority of the class usually consists of persons who have been exposed to a hazardous product or substance and will not suffer any compensable injury until some distant time in the future (if at all).<sup>4</sup> The mass tort class action thus stands as the paradigmatic context in which the agency costs of holding the plaintiffs' attorney accountable to the class are likely to be the highest.

Nonetheless, distinctive as the mass tort class action may be, the differences between it and other class actions are more a matter of degree than of kind. Across all class action contexts, the same principal/agent problems recur and need to be addressed in a consistent fashion. With its recent decisions in *Amchem Products, Inc. v. Windsor*<sup>5</sup> and *Ortiz v. Fibreboard Corp.*,<sup>6</sup> the Supreme Court has now recognized the potential for collusion in class action settlements. In response, viewing judicial tolerance of novel or expansive class action procedures that departed from the historical model as inviting a "greater . . . likelihood of abuse,"<sup>7</sup> the majority in *Ortiz* has essentially frozen the development of the class action. Indeed, the clearest message in *Ortiz* is that any innovation in class action procedures that departs from "the traditional norm" is hereafter likely to be disfavored.<sup>8</sup>

Still, even though the Court has chilled the use of the more manipulative devices by which defendants and class counsel could structure a settlement that maximized their interests at the expense of the class members—most notably, the "settlement class action"<sup>9</sup> and the "limited

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3. For probably the most vehement critique of plaintiffs' attorneys as advancing their own interests to the detriment of class members, see Susan P. Koniak, Feasting While the Widow Weeps: *Georgine v. Amchem Products, Inc.*, 80 Cornell L. Rev. 1045 (1995). The general description of the plaintiffs' attorney as a risk-taking legal entrepreneur dates from the mid-1980s and was intended more as a positivist analytic construct than a normative evaluation. See John C. Coffee, Jr., The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action, 54 U. Chi. L. Rev. 877 (1987); John C. Coffee, Jr., Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions, 86 Colum. L. Rev. 669 (1986) [hereinafter Coffee, Understanding the Plaintiff's Attorney]; Jonathan R. Macey & Geoffrey P. Miller, The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations For Reform, 58 U. Chi. L. Rev. 1 (1991).

4. For exhaustive treatment of this theme, see Symposium, Mass Torts: Serving Up Just Desserts, 80 Cornell L. Rev. 811 (1995).

5. 521 U.S. 591 (1997).

6. 119 S. Ct. 2295 (1999).

7. *Ortiz*, 119 S. Ct. at 2313 (1999) ("[T]he greater the leniency in departing from the historical limited fund model, the greater the likelihood of abuse . . .").

8. *Id.* at 2312 ("At the least, the burden of justification rests on the proponent of any departure from the traditional norm.").

9. The term "settlement class" refers to a class action that has been certified only for purposes of settlement and not for litigation. Thus, if the case does not settle, the

fund,” non-opt-out class action<sup>10</sup>—it has banned neither. Rather, both *Amchem* and *Ortiz* rely more on rule formalism than due process to reach their results. Fact-sensitive and rule-dependent decisions that shrink from announcing any broad constitutional norms, they effectively whisper “Rule 23 does not authorize that,” rather than proclaim “Due process forbids that.” At most, the Court has warned that it holds in reserve an embryonic theory of “adequacy of representation,” which it may develop as a due process limitation upon the ability of class counsel to resolve the legal rights of absent or non-consenting class members.

Ironically, this cautious, provisional approach to both “settlement classes” and the “limited fund” class action risks two inconsistent dangers:

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defendants have not conceded that the action can go to trial as a class action. Prior to *Amchem*, the federal circuit courts were divided as to whether the requirements for class certification were relaxed in the case of a settlement class action. Specifically, because Rule 23(b)(3) of the Federal Rules of Civil Procedure requires that common issues of law and fact “predominate” before a class action that is primarily for money damages can be certified, the view of some courts that the fairness and adequacy of any proposed settlement constituted a “predominant” issue implied that settlement classes could be certified so long as the reviewing court considered the settlement to be fair. See, e.g., *In re Asbestos Litig. (Ahearn I)*, 90 F.3d 963, 975–76 (5th Cir. 1996). The first decision to reject this logic and insist that the settlement’s adequacy did not resolve the issues relating to the process by which it was reached was *In re Gen. Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 799–800 (3d Cir. 1995).

10. Rule 23 of the Federal Rules of Civil Procedure directs that the class members must be given a right to opt out only in the case of a Rule 23(b)(3) class action (which is the section of Rule 23 that broadly authorizes class actions for money damages). See Fed. R. Civ. P. 23(c)(2). Thus, actions brought under Rule 23(b)(1) or Rule 23(b)(2) need not permit the class member to opt out (unless a court determines that due process so requires). In particular, Rule 23(b)(1)(B) authorizes a mandatory class if:

the prosecution of separate actions by or against individual members of the class would create a risk of . . . adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests.

Fed. R. Civ. P. 23(b)(1)(B). The classic illustration would be a dispute over the assets in a specific fund or trust because a victory by one claimant against the fund would preclude or substantially limit recovery by other claimants. See *Ortiz*, 119 S. Ct. at 2308–09. However, during the 1990s, some federal courts began to view a corporation which lacked sufficient assets to satisfy all claimants as itself a “limited fund” that could invoke Rule 23(b)(1)(B) to achieve certification of a non-opt-out class action whose settlement would bind all claimants. Such a device, which essentially made the class action a more attractive alternative to bankruptcy reorganization, was particularly attractive to corporations facing massive mass tort claims that would predictably be brought by “futures” claimants. See *Ahearn I*, 90 F.3d at 1001–02 & n.17 (Smith, J., dissenting). For criticisms of the legitimacy of proposed extensions of Rule 23, see Paul D. Carrington & Derek P. Apanovitch, *The Constitutional Limits of Judicial Rulemaking: The Illegitimacy of Mass-Tort Settlements Negotiated Under Federal Rule 23*, 39 *Ariz. L. Rev.* 461, 491 (1997); Monaghan, *supra* note 2, at 1164–65. *Ortiz*, of course, restricted this use of Rule 23(b)(1)(B) by finding it to be beyond the scope of the Rule as intended by the Advisory Committee. See 119 S. Ct. at 2311–14. Until Rule 23 is amended to provide otherwise, *Ortiz* establishes that limited funds created by and not pre-existing the litigation do not qualify for certification under Rule 23(b)(1)(B). See *id.* at 2313–14.

(1) it may do too little, and (2) it may do too much. The first danger arises because fairly modest revisions to Rule 23 of the Federal Rules of Civil Procedure (which authorizes the class action) could seemingly restore both the "settlement class" and the "limited fund" class action to their former vitality.<sup>11</sup> A powerful coalition of interests—defendants seeking to economize on tort liability costs, trial judges intent on minimizing individual trials, and plaintiffs' attorneys eager to receive lucrative class action fee awards—seems intent on recapturing the ability to use "settlement classes" and "limited fund" class actions.<sup>12</sup> In short, to the extent that *Amchem* and *Ortiz* are non-constitutional decisions, they may provide only a temporary respite and could be outflanked by revisions to Rule 23. Only if the concept of "adequacy of representation" can be given a firmer constitutional grounding than either *Amchem* or *Ortiz* has yet provided will class members gain durable due process protections which cannot be distinguished away in the next case or trivialized through rule revisions.

The second danger arises because an expansive reading of *Amchem* and *Ortiz* threatens the viability of the class action across a broad range of litigation contexts. An aggressive reading of *Amchem*'s standards for class certification might permit a class action to be certified only when the class representative possesses virtually identical characteristics with the class members who are to be represented in the action. This new strictness flows from *Amchem*'s core assertion that "class cohesion" legitimizes the representative action and cannot be replaced simply by an ex post judicial review of the settlement's fairness.<sup>13</sup> But the more that "cohesion" is required, the more the class must be fragmented into subclasses with their own separate counsel. Ultimately, if any material difference in the legal status, compensable injury, or negotiating leverage possessed by class members were to require subclassing in order to maintain sufficient "cohesion" among class members, the upshot would be what this Article will term the "Balkanization" of the class action: namely, its fragmentation into a loose-knit coalition of potentially feuding enclaves that could

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11. This possibility is underlined by the concurring opinion of Justice Rehnquist (joined in by Justices Scalia and Kennedy), which expresses the view that were they "devising a system for handling these claims on a clean slate, [they] would agree entirely with [the] dissent." *Ortiz*, 119 S. Ct. at 2323–24. When coupled with the dissent, five justices thus appear to be hinting that the only real obstacle to "limited fund" class actions is amendment of Rule 23.

12. The desire to restore "settlement classes" and mandatory, non-opt-out classes to a status close to their former position comes through loud and clear in the Report of the Advisory Committee on Civil Rules and the Working Group on Mass Torts to the Chief Justice of the United States and to the Judicial Conference of the United States. See Federal Judicial Center, Report on Mass Tort Litigation 57 (1999). A number of proposals for liberalized settlement and mandatory classes are discussed in this Report, but no clear consensus appears to have crystallized as to which option is most feasible.

13. *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 623 (1997) ("But it is not the mission of Rule 23(e) to assure the class cohesion that legitimizes representative action in the first place.").

seldom litigate effectively as an organization. After *Ortiz*, the prospects for such Balkanization are real and require a clearer definition of when intra-class differences should be viewed as undermining representational adequacy.

More generally, in its emphasis on class cohesion, *Amchem* seems to have accepted an implicit theory of representation: A representative is entitled to bind only those persons whose interests and legal positions match those of the representative. Philosophers have a name for this idea that a representative must mirror the characteristics of the representative's constituency: "descriptive representation."<sup>14</sup> As well-recognized as this theory of representation is, it is remarkably inadequate when applied to the context of litigation. The initial problem is that there are many decisions in life over which most individuals would not wish to cede authority to an unchosen agent to act on their behalf—at least not simply because that person bore surface similarities with them and had no discernible conflict of interest. The deeper problem lies, however, in the fact that even an entirely unconflicted representative whose characteristics correspond in every way with their own might still be an ineffective agent. For example, such a "mirror image" agent could still be undermotivated, indifferent, or uninformed—or could have very different risk preferences than the parties that the agent is seeking to represent. Descriptive representation may then be a necessary condition, but it should not be a sufficient condition, for representational adequacy.

In fairness to the *Amchem* majority, the problem of defining representational adequacy is obviously complex. Furthermore it has not been seriously addressed in the existing academic literature on litigation and civil procedure. Put bluntly, that literature is underconceptualized, viewing the class action narrowly in terms of either the intent of the drafters of Rule 23 of the Federal Rules of Civil Procedure or the administrative needs of judges. But, as *Amchem* appropriately realized, a broader theory of representation is ultimately necessary before the class action can rest on any normatively satisfactory foundation.

On what foundation then should such a theory of representational adequacy be based? Of course, there are multiple answers, and different theories may apply more aptly in different contexts. Nonetheless, this Article starts from the premise that the class action is essentially an organizational form that at bottom involves a principal/agent relationship.

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14. See Hanna Fenichel Pitkin, *The Concept of Representation* 60–91 (1967); see also *infra* notes 10–39 and accompanying text. Students of civil procedure will, of course, understand that the "typicality" requirement of Rule 23(a)(3) also requires a correspondence between the class representative's injury and legal position and that of the class members. See *infra* text accompanying notes 89–90. But, in focusing on "class cohesion," *Amchem* went well beyond the typicality requirement and appears to have insisted on a broader principle of legitimacy to justify representative litigation. This Article agrees that a principle of legitimacy is necessary, but doubts that any concept of class cohesion can alone bear that weight.

From this starting point, it follows that the class members, as the principals, should be deemed to have consented to the representation only if the agency costs associated with the relationship have been minimized.<sup>15</sup> Then, and only then, is the fiduciary likely to be faithful. In other contexts where agents who have not been expressly appointed by their clients represent the interests of a large group of persons (for example, the corporate context where officers and directors represent the interests of shareholders), well-developed markets and voting mechanisms exist to minimize these agency costs.<sup>16</sup> Ultimately, what is most distinctive about the class action is the absence of any similar mechanism.

Across a variety of contexts, the reduction of agency costs is a standard goal in organizational design, which typically is pursued by modifying the governance structure of the organization. To use a standard typology borrowed from the vocabulary of corporate governance, one can focus on “exit,” “voice,” or “loyalty” as alternative mechanisms by which to modify behavior within the organization.<sup>17</sup> For example, in the corporate context, the agency costs of holding management accountable to its shareholders can be reduced by granting shareholders either greater “voice” (e.g., greater ability to nominate, elect or remove corporate directors or to communicate with other shareholders) or greater “exit” rights (e.g., the ability to sell into the market or seek a judicial appraisal of the fair value of their shares). Market-based remedies—such as the tender

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15. For the standard definition of “agency costs,” see Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 *J. Fin. Econ.* 305 (1976) (defining agency costs as the sum of the preventive costs taken by firms to limit misappropriation by their agents, the bonding cost undertaken by agents themselves, and the irreducible minimum of losses from agent misconduct that it is not efficient to prevent). For the application of this concept to class actions, see Macey & Miller, *supra* note 15, at 12–19.

16. Jensen and Meckling identify two principal means for reducing agency costs: monitoring by the principal and bonding by the agent. See Jensen & Meckling, *supra* note 15, at 308. Neither works well in the class action context. Class members may have too small an individual stake in the action to engage in costly monitoring, and the primary bonding mechanism in the market for legal services involves the attorney’s investment in his or her professional reputation. But investment in reputation is an imperfect form of bonding, particularly where the attorney may “cash in” this reputation in order to receive a potentially astronomical fee award, where there are time lag and final period problems, and where the client does not truly select the attorney (which the class does not do, at least on a majoritarian basis, in class actions). See Macey & Miller, *supra* note 15, at 16–17 & n.41.

17. The obvious reference here is to Professor Hirschman’s seminal work. See Albert O. Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (1970). I use Professor Hirschman’s vocabulary because it provides an easily understood nomenclature but do not intend to adopt any specific conclusions from Professor Hirschman’s work. My use of this terminology grows out of a series of discussions that I have had over the last year with Professor Samuel Issacharoff, who also uses this vocabulary in a provocative new article. See Samuel Issacharoff, *Governance and Legitimacy in the Law of Class Actions*, 1999 *Sup. Ct. Rev.* \_\_\_\_ (forthcoming). While we take somewhat different positions, the idea of extending this familiar terminology from corporate governance to class actions is a joint one.



offer and proxy fight—combine elements of exit and voice in order to constrain managerial behavior. Correspondingly, within the class action, one could enhance the exit option by increasing the “opt-out” rights of class members; alternatively, one could rely more on voice by giving class members greater authority to hire or fire the class’s attorney (or to approve the settlement). Finally, enhancing the standards for representational adequacy amounts to a loyalty-based approach, which seeks to impose increased fiduciary or ethical duties on the class representatives. Necessarily, there are trade-offs between these approaches, and each should be evaluated in relation to the others.

Concededly, the academic literature on complex litigation has not analyzed class actions in these agency cost terms, but this may be a symptom of that literature’s tunnel vision, which tends to focus only on rules and cases.<sup>18</sup> Still, even if reformers have not used this terminology or been conscious of this perspective, many of their reform proposals can be characterized as intended to enhance either exit, voice, or loyalty.<sup>19</sup> To compare and evaluate these proposals, common criteria and a common perspective are needed. Thus, this Article’s initial claim is that a sophisticated approach to the protection of class members must consider and balance elements under each of these headings. Sometimes, the optimal answer may be an enhanced right to “exit” the class and pursue an individual action; other times, greater voice in the form of an expanded opportunity to participate in class decisionmaking or to select class counsel

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18. Following Macey & Miller, *supra* note 15, a few commentators have begun to focus on the similarities between controlling agency costs in the corporate setting and in the class action context. See Charles Silver & Lynn Baker, *I Cut, You Choose: The Role of Plaintiffs’ Counsel in Allocating Settlement Proceeds*, 84 Va. L. Rev. 1465, 1466 (1998) (noting analogy to corporate law); see also Issacharoff, *supra* note 17. This Article, however, will attempt to move from the analogy of corporate governance to the more specific legal engineering problems in class action governance.

19. For example, Professor Woolley’s proposals to permit class members a greater right to intervene and participate in class action decisionmaking would be characterized as a “voice” reform. See Patrick Woolley, *Rethinking the Adequacy of Adequate Representation*, 75 Tex. L. Rev. 571, 604 (1997). Correspondingly, Professor Weber’s proposal for a greatly enhanced right to opt out is an example of an “exit” remedy. See Mark C. Weber, *A Consent-Based Approach to Class Action Settlement: Improving Amchem Products, Inc. v. Windsor*, 59 Ohio St. L.J. 1155, 1193 (1998). Finally, Professor Koniak recommends greater use of a guardian ad litem to monitor the performance of plaintiffs’ attorneys in class actions. See Koniak, *supra* note 15, at 1092. Such a proposed reform seeks in essence to enhance the “loyalty” of the agent to the principal. All these proposals are serious and intelligent, but the trade-offs among them are more easily compared and debated if some common criteria can be established by which to generate points of reference.

Not all recent reform proposals fit within this nomenclature. In particular, the proposal of Professors Macey and Miller to auction the legal cause of action to the highest bidder falls clearly outside. See Macey & Miller, *supra* note 15, at 105. This is essentially because their proposal seeks to abolish the principal/agent relationship between attorney and client and convert the attorney into a principal. This is one way to solve agency cost problems, but probably a normatively unacceptable way.

may be the superior remedy; across all contexts, some heightened duty of loyalty on the part of the agent to its principal is probably also needed. But the balance among these elements logically should depend on the costs of reform. Those costs will be a second and major focus of this Article.

Even in defining the constitutional minimum required by the Due Process Clause, the trade-offs among these elements can be critical.<sup>20</sup> Their relative importance depends greatly on the context. In traditional small claimant class actions, where the individual lawsuits would be uneconomical to litigate, the right to exit will mean little, but this same right becomes critical in mass tort and other large claimant class actions, where at least some claimants hold high-value claims. Thus, a properly nuanced theory should recognize that sometimes one element can serve as a functional substitute for another.

To date, the Supreme Court has focused principally on the loyalty component and ignored the possibility that "exit" and "voice" may sometimes be partial substitutes for ideal representational adequacy. This omission is perhaps surprising because *Ortiz* was at bottom a dispute about the right to exit—whether class members could be locked into a mandatory class and denied any opt-out rights. In all likelihood, the Court probably believed it prudent to approach the mandatory class action warily and at least initially on a non-constitutional level. Yet, the more that heightened standards for representational adequacy are recognized as involving costs as well as benefits for class members, the more that strategies based on "exit" and "voice" need to be balanced and compared. Because some low-level, less visible conflicts will necessarily escape judicial detection, the loyalty of the agent to the principal can never be absolute. To say this is not to express cynicism about plaintiffs' attorneys, but rather to state a truth about all principal/agent relationships: The agent's self-interest is seldom fully aligned with that of the principal.<sup>21</sup> As a result, a single-minded focus on loyalty (i.e., the right to adequate representation) may do less to protect class members than a more multifaceted and balanced theory that enhances rights to exit and voice.

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20. For example, this Article will argue that a higher standard of representational adequacy should be required in the case of a mandatory or non-opt-out class action (where the class member lacks "exit") than in the case of an opt-out class action under Rule 23(b)(3). A few cases have begun to adopt a similar standard, requiring a higher level of class cohesion in a non-opt-out class action than in an opt-out class action. See *Jefferson v. Ingersoll Int'l Inc.*, 195 F.3d 894, 896–97 (7th Cir. 1999); see also *infra* notes 161–164. Essentially, this development implicitly recognizes that exit can be a partial substitute for loyalty.

21. A common theme in the theoretical literature on agency costs is that the disparity in interests between the principal and the agent can be reduced, but never eliminated. See Kenneth J. Arrow, *The Economics of Agency*, in *Principals and Agents: The Structure of Business* 37, 37 (John W. Pratt & Richard J. Zeckhauser eds., 1985); Geoffrey P. Miller, *Some Agency Problems in Settlement*, 16 *J. Legal Stud.* 189, 190 (1987); Steven Shavell, *Risk Sharing and Incentives in the Principal and Agent Relationship*, 10 *Bell J. Econ.* 55, 55–57 (1979).

The roadmap for this Article follows from these premises. Based on the premise that the agency costs in representative litigation can be reduced,<sup>22</sup> this Article will assess in successive sections the possibilities for enhancing class members' rights to exit, loyalty, and voice—and the trade-offs among them. The search will not necessarily be for the constitutional minimum, but rather for policy levers that could be used to enhance each of those components.

Before undertaking this tour, however, a prior question must be faced. Everything said up to this point assumes that underlying the class action is a principal/agent relationship between the attorney and the individual class members.<sup>23</sup> From this perspective, the class is no more or less than the aggregation of its individual members. Yet this view is not universally shared. Some academics have suggested that the class should be viewed not as an aggregation, but as an entity—much as corporations or other business organizations are viewed as entities distinct from their owners.<sup>24</sup> An obvious implication of this approach is that once the attorney becomes counsel to an “entity,” the attorney can ignore the preferences of individual class members—much as counsel to a corporation is free to disregard the preferences or instructions of individual shareholders. Indeed, class counsel can more easily resist the attempts of individual class members to opt out of the class and may be able to define the goals of the litigation differently than they otherwise would. As a result, this entity theory provides a justification for the attorney making judgments in the “best interests” of the class and allocations among class members in precisely the manner that *Amchem* seemed to forbid.

Hence, a normative issue must be addressed before appraising the more instrumental policy options: Who is the client—an entity or an aggregation of individuals? As already indicated, this Article will view at least the class action for money damages as an aggregation of individuals

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22. In the corporate context, the neo-classical economic assumption has been that agency costs have already been minimized because of the entrepreneur's desire to maximize share value. See Jensen & Meckling, *supra* note 15, at 310 (arguing that entrepreneurs reduce agency costs in order to maximize the value they receive for their shares in a firm when they market those shares to investors). Whatever the accuracy of this assumption, it is clear that an efficient market does not exist in the market for legal services and attorneys cannot today sell shares in the action's potential recovery. In this light, one focus of this Article involves how to introduce more competitive conditions into this market in order to induce plaintiffs' attorneys to bond themselves to their clients.

23. That the attorney is the agent of the client, who must normally accept the client's preferences and decisions, is expressly dictated by legal ethics. See Model Rules of Professional Conduct Rule 1.2(a) (1998) (“A lawyer shall abide by a client's decisions concerning the objectives of the representation, subject to . . . [certain limited exceptions].”).

24. See Edward H. Cooper, Rule 23: Challenges to the Rulemaking Process, 71 N.Y.U. L. Rev. 13, 26–32 (1996) (discussing benefits of entity status); David L. Shapiro, Class Actions: The Class As Party and Client, 73 Notre Dame L. Rev. 913, 917–18 (1998) (arguing that “the class as entity should prevail over more individually oriented notions of aggregate litigation”).

and argue that the alternative entity theory amounts to a transparent legal fiction.<sup>25</sup> From this premise, this Article will advance its own normative position: The ethical obligation of the attorney to such a class should not be to pursue the “best interests” of the class (however determined), but rather to facilitate client autonomy.

Part I of this Article will begin by examining the organizational reality of class actions and mapping the conflicts that can arise within them. It will then examine the impact of *Amchem* and *Ortiz* on the future of class action practice. Part II will then seek to evaluate and compare potential means by which to enhance representational adequacy (or “loyalty”), voice, and exit in class actions. Part III will then turn to the costs of reform—namely, the danger that heightened loyalty standards could lead to the Balkanization of the class action or to opportunistic holding out by class members seeking special preferences, in either case with a consequent loss of the class action’s efficiency as a mechanism for aggregating claims. These dangers will lead to this Article’s conclusion that enhancing voice and exit may be more sensible reforms than attempting to insist upon a rigorous definition of class cohesion. Still, this Article does offer an easily operationalized standard for when subclassing should be required, one that distinguishes the traditional small claimant class action from the “high variance” class actions posed by the facts of *Amchem* and *Ortiz*.

## I. THE INSTITUTIONAL BACKDROP

### A. *Entity or Aggregation: What Is A Class?*

Legal fictions gain acceptance more because they are useful than because they are plausible. In this light, the key attraction of the “entity model” of the class action is that under it “the *entity* is the litigant and the client.”<sup>26</sup> From this, it follows that “the individual who is a member of the class . . . is and must remain a member of that class, and as a result must tie his fortunes to those of the group with respect to the litigation, its progress, and its outcome.”<sup>27</sup> The obvious attraction of such a model for many is that it greatly facilitates the ability of the class action to serve as a vehicle for the resolution of complex and burdensome mass torts. But neither legitimizing solutions that enable defendants to economize on their tort liabilities nor making life easier for trial judges is by itself an adequate justification for the subordination of the individual to the group. Still, proponents of the entity model argue that the law has recog-

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25. Class actions for equitable and injunctive relief can present different issues and may require a different theory of representation. See *infra* notes 161–162 and accompanying text. This is less because such a class is more “cohesive” or more resembles a political community than because the remedy must bind all class members. To this extent, the class members’ fates are linked, even if they lack “cohesion.”

26. Shapiro, *supra* note 24, at 919.

27. *Id.*

nized a variety of public and private associations as legal entities that can sue or be sued in their own right—for example, corporations, partnerships, trade unions, and even municipalities.<sup>28</sup> Yet, each of these examples involves factors not present in the case of most class actions and particularly absent in the case of the mass tort class action.

In overview, the factors that normatively bear on whether an individual possessing legally recognized claims should be compelled to accept the determination of an entity (i.e., the class and its counsel) as to whether to settle or litigate these claims fall under four principal headings.

1. *Consent.* — The individual may, of course, accept the class action as a cheaper or more efficient means of resolving the individual's legal claim. In such cases where the individual has consented, there is no dispute that the individual should not be able to have it both ways by later attempting to escape the class if the class action is lost (or results in a disappointing outcome). Although no one doubts that actual consent should bind the individual class member, considerable room for debate exists as to when consent should be inferred. Today, actual notice does not have to reach class members in order to bind them (if they fail to opt out from the class); rather, all that is required is that they be sent the "best notice practicable under the circumstances."<sup>29</sup> Inevitably, some members of a large class will never receive notice and cannot therefore be assumed to have consented even though they will be bound by the judgment or settlement.

Implicit consent, of course, can be inferred in some circumstances. One such example involves instances where the institutional structure created a specific enforcement mechanism known to the individual and implicitly accepted by the individual. For example, the trustee represents the trust vis-a-vis third parties. Implicit consent may be found here in the donor's or grantor's knowing adoption of the trust format.<sup>30</sup>

In these cases, it is fair to say that consent may be implied because the individual knew the "rules of the game" at the time that he or she voluntarily associated with the group. For example, suppose that a share-

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28. See *id.* at 921.

29. Fed. R. Civ. P. 23(c)(2) (requiring "the best notice practicable under the circumstances"). Under prevailing precedents, actual notice need not be provided to class members, so long as the "best practicable" notice was given to absent class members. See *Silber v. Mabon*, 18 F.3d 1449, 1454 (9th Cir. 1994) (stating the "best notice practicable" standard); *In re "Agent Orange" Prod. Liab. Litig.*, 818 F.2d 145, 167-68 (2d Cir. 1987) (same).

30. Alternatively, consent may be expressed by the beneficiaries themselves by their acceptance of the terms of the contract that governs their rights. For example, bond indentures often explicitly provide that under most circumstances only the trustee or a specified percentage of bondholders (usually 25%) may bring suit against the issuer. See, e.g., *Metropolitan Life Ins. Co. v. RJR Nabisco, Inc.*, 906 F.2d 884, 888 (2d Cir. 1990). Bondholders who buy with actual or constructive notice of the indenture's terms will and should be bound by these contractual terms.

holder in a corporation learns that the corporation's president has embezzled \$10,000,000 from the firm and that the shareholder's loss (based on a five percent ownership) is therefore \$500,000. Under the traditional rules of corporate law, the shareholder may not sue in his individual capacity (or as the representative of a class);<sup>31</sup> rather, only the corporation can bring suit—either directly or by means of a derivative action. Although technically the derivative action is not a class action, it is another form of representative litigation, and under its rules the individual is subordinated to the entity. However, this result occurs as a matter of substantive corporate law; the individual never actually held the legal rights or claims against the corporate officials that others are seeking to assert or settle on the individual's behalf. Even more importantly, the individual can be said to have voluntarily assented to this arrangement at the time that he or she acquired shares in the firm.

2. *Majoritarian Control.* — An individual's legal rights may also be entrusted to an entity by contract or by statutory law under a legal regime that permits the majority to bind the minority. The typical bondholder indenture is an example of such a contractual mechanism, and federal labor law provides a similar statutory example. Under the National Labor Relations Act, a majority of the employees in a designated bargaining unit may select a bargaining representative (i.e., a union), who will represent all employees in the unit.<sup>32</sup> In such cases, the individual is indeed submersed within the entity, but based on a legislatively imposed norm of majority rule.

No such majoritarian mechanism operates in the class action. Although steering committees are often used, they are composed of lawyers, not the clients. Conceivably, client elections of a class representative (or a steering committee) might be possible in some limited types of class actions, where the individual stakes are large enough to overcome the clients' rational apathy. But in other contexts, such as small-claimant class actions where the individual damages are small, few claimants would participate. Even in cases where the individual damages may be large (such as the mass tort class action), the client's voice may be muted by the fact that most victims do not yet know that they have been injured. Given the long latency period in many mass tort class actions, the class members will ordinarily not be identifiable, and hence any democratic election will normally be infeasible.

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31. Under standard corporate law principles, "a wrongful act that depletes corporate assets and thereby injures shareholders only indirectly" cannot be challenged by the shareholder in a direct action, but only in a derivative action and only then in the unusual circumstances when demand on the board can be excused. American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* 7.01 cmt. c (1994). (The author served as Reporter to The American Law Institute for this topic of the derivative action).

32. See 29 U.S.C. §§ 158(a)(5), 159 (1994).

3. *Prior Association or Community of Interests.* — Another possible justification for permitting an entity to represent and determine the best interests of the class members is that the class logically shares a community of interests that pre-exists or is otherwise extrinsic to the litigation. For example, residents of a neighborhood, members of a private association, adherents of a religious congregation, or advocates of a political cause may well share strong common interests—at least if the litigation truly relates to those interests and pits the group or association against some outside group. Indeed, this is where the class action historically began. For example, in a famous case, the mayor of one English city sued citizens of other nearby towns on behalf of the residents of his city in a dispute over fishing rights in a local river.<sup>33</sup> Recognizing the role of an elected representative to serve as the centralized litigation authority for that official's constituency seems a fairly simple judicial step, but the development continued. Later cases permitted fraternal orders and other unincorporated associations to sue on behalf of their members.<sup>34</sup> On such a basis, members of a village, a parish, or a guild could be represented and bound by their organization or an appropriate officer thereof.

Two facts stand out about these cases. First, the entity pre-existed the litigation. Second, in the medieval and pre-industrial eras, an individual's identity was to a greater extent defined by the individual's residence or membership in a village, parish, or guild.<sup>35</sup> Today, a member of a group (for example, a labor union) does not necessarily share that group's views about the environment, politics, abortion, or any other social issue. Nor would a union member necessarily see her interests aligned with those of her union with regard to her claims against an employer for exposure to a dangerous product or substance in the workplace. Even if the union were eager to represent its members and to organize litigation on their behalf, this interest might still be traded off against other interests (for example, higher wages) that other, non-injured workers shared. In any event, no logical reason is apparent why individual union members would necessarily want to settle their high-value claims according to a formula that the union thought appropriate. Given the high stakes involved, some might prefer instead to opt out and accept the risk of suing individually. In short, the union is not a natural "vicarious representative" for its members.

Although the extent to which these historical examples provide relevant models for today can reasonably be debated, it seems doubtful that

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33. See *Mayor of York v. Pilkington*, 25 Eng. Rep. 946 (Ch. 1737).

34. See, e.g., *Lloyd v. Loaring*, 31 Eng. Rep. 1302 (Ch. 1802). For a U.S. decision similarly permitting a fraternal order to represent its members, see *Supreme Tribe of Ben-Hur v. Cauble*, 255 U.S. 356, 367 (1921).

35. This point has, of course, been made by many others. See Stephen C. Yeazell, *From Medieval Group Litigation to the Modern Class Action* 52-68 (1987); Robert G. Bone, *Personal and Impersonal Litigative Forms: Reconceiving the History of Adjudicative Representation*, 70 B.U. L. Rev. 213, 220 (1990).

individuals who are simply seeking money damages in a class action because of a common injury (which may have been sustained at widely separated times and places) share any meaningful prior associations or community. To be sure, they may be made worse off if individual actions deplete the defendant's limited assets. This, though, is not an argument that the class is an entity, but rather that individuals would rationally elect to be restrained for their mutual benefit.

4. *Homogenous Preferences.* — Probably the weakest normative basis for deeming individuals to belong to a collective entity that can determine their rights is that they share the same preferences and hence can be efficiently collectivized. Questionable as this basis may be as a normative matter, it probably works adequately for some class actions. For example, in securities class actions, it can be safely assumed that the class shares a common preference for more money rather than less. More importantly, because the damages will be calculated on a per-share basis, an automatic allocation formula exists, thereby usually reducing intra-class tensions.<sup>36</sup> Also, because shareholders hold diversified portfolios of securities, it is likely that most class members have suffered damages that are small in proportion to their overall portfolios. The import of this fact is that class members should tend to be risk-neutral and hence should share a common attitude toward the evaluation of any settlement offer (at least if they share a common estimate of the litigation risks). As discussed below, this assumption of risk-neutrality does not work in the mass tort class action, where class members have typically suffered injuries ranging from the trivial to the fatal. Here, widely varying attitudes toward risk are predictable.

5. *Theories of Representation and the Class Action.* — Many of the foregoing objections boil down to this basic problem: By what right is the class representative entitled to make highly discretionary decisions on behalf of the class? Philosophers and political scientists have recognized that a common principle of legitimacy within political bodies is that the representatives should mirror their constituents.<sup>37</sup> But legislative bodies are different from the class action in a variety of ways, the most notable of which is that the representative is held accountable through regular elections. Also, the representative is the true decisionmaker. In contrast, in the class action, the class representative is usually a token figure, with the class counsel being the real party in interest. Because the class counsel, not the class representative, is the party who invests in the action and expects the real economic payoff from its success, it may matter little

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36. Allocation issues can still arise even in this context, as individual class members may have purchased their securities either before or after a particular alleged misstatement or omission. If the legal strength of their claims differ materially, there may again be a need for subclassing. See *infra* notes 64–64 and accompanying text.

37. See Pitkin, *supra* note 14, at 61–62, 84–89. This theme regularly surfaces in the debate over proportional representation and litigation over “at large” voting districts.



whether the class representative mirrors the characteristics of the class members.

Where does this simple truth lead? Theorists have distinguished between “formal representation” and “descriptive representation.”<sup>38</sup> The former is based on contractual agreements that delegate authority to the class representative to act for the class, while the latter is based on a correspondence between the relevant characteristics of the agent and the principal. While “descriptive representation” may not be meaningless in the litigation context, it is still an inadequate and incomplete theory upon which to vest broad discretionary authority in the agent. Thus, some alternative mechanism of representation seems necessary. In overview, two alternatives seem possible: (1) greater reliance could be placed on formal contracting, or (2) in some contexts, direct democracy could be a partial substitute for representation and might operate through the use of referenda.

To sum up, the “entity theory” posits the existence of factors that unite the class and that make it more than an aggregation of individuals holding similar claims against common defendants. To date, however, its proponents have failed to identify these factors in the case of the class action for money damages. In such a class action, there is no community of similarly situated persons who can rely on “descriptive representation,” but only a motley assortment of individuals who at most may find it efficient to economize on transaction costs by sharing an attorney or who may enjoy increased leverage by aggregating their claims. Internal unity within the class sufficient to justify reliance on “descriptive representation” probably arises only in the rarest of cases, which typically involve claims for structural relief, not monetary damages.<sup>39</sup> To be sure, efficiency arguments do exist for collectivizing class members (e.g., their claims may not be economically viable on an individual basis or the defendant’s assets might be exhausted before the plaintiff’s individual case could be heard). But these are efficiency arguments for the class action, not for presuming the class to be a natural entity.

### B. *The Pervasiveness of Conflicts*

Even if extrinsic factors that unite the class do exist, other factors will still typically divide class members into contending subgroups. In over-

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38. *Id.* at 112–43. Pitkin also uses a third category, which she calls “symbolic representation,” which has even less relevance to this context.

39. Even in the classic illustration of a school desegregation case, there may be significant divergences within the class in terms of the remedy desired. For a strong statement of this view, see Derrick A. Bell, Jr., *Serving Two Masters: Integration Ideals and Client Interests in School Desegregation Litigation*, 85 *Yale L.J.* 470, 505–12 (1976). For example, some minority group parents may prefer an integrationist remedy, while others might prefer a remedy based on increased funding. The fact that the class representative is a minority group parent does little to assure that this conflict is resolved in a legitimate way, even if this fact does satisfy the standards of “descriptive representation.”

view, structural conflicts in the mass tort class action can be grouped under four basic headings: (1) internal conflicts that exist within the class—typically, because subcategories of class members are competing over the allocation of the settlement; (2) external conflicts that arise because class members (or their attorneys) have some extraneous reason for favoring a settlement that does not truly benefit the interests of all class members; (3) risk conflicts that arise because class members or class counsel have very different attitudes about the level of risk they are willing to bear; and (4) conflicts over control of the litigation.

1. *Internal Conflicts.* — Whenever the injuries suffered by class members are relatively heterogenous, internal conflicts necessarily arise. Fortunately, this circumstance does not prevail in the case of most commercial class actions because typically in these cases, some objective measure permits the damages to be automatically allocated without any discretionary decision by class counsel. Thus, whether the individual shareholder in the typical securities class action has large or small losses, the shareholder's losses can be easily determined by reference to the stock market decline in the share price of the security. Problems only surface when the class period is extended, so that some investor plaintiffs have claims of lesser legal strength than those plaintiffs who relied on the principal alleged misstatements or omissions. Similarly, in an antitrust class action, all class members will typically have suffered a known increase in a commodity price because of collusion, and they will differ primarily in terms of the amount of their purchases (and hence their injuries). Thus, even if the losses vary among individual class members, these losses can be objectively calculated in a manner that does not create conflicts within the class.

In contrast, in mass tort class actions, exposure to a particular substance, chemical, or drug may produce widely varying injuries, ranging from the trivial to the fatal. To illustrate, assume that exposure to a toxic product or substance creates two significantly different types of injuries: (1) a moderately disabling condition (such as asbestosis) which impairs the individual's ability to function or hold employment (but is generally not fatal), and (2) a usually fatal disease (such as mesothelioma). In such cases, there predictably will be disputes both as to the relative value of these claims and as to their priority for payment. Some argue that the "worst should go first"<sup>40</sup>—with the result that the fatally or more seriously injured should recover more or less in full before the less disabled recover anything. Conversely, the moderately disabled can argue that they also have families and dependents to support, and to the extent that they will survive longer in a disabled and unemployable condition, they need even greater compensation. Similarly, it can be reasonably debated what the ratio between the value of their injuries should be: 2:1, 3:1, or 10:1.

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40. See, e.g., Peter H. Schuck, *The Worst Should Go First: Deferral Registries in Asbestos Litigation*, 75 *Judicature* 318 (1992) (advocating as a rationing device that lesser injuries be deferred without cash recovery until (and if) they became more severe).

As the Supreme Court essentially recognized in *Amchem*, no single class representative can act for both these subgroups because they are inherently warring over the allocation of the settlement.<sup>41</sup>

Differences in the severity of injuries represents only one form of internal conflict. Even starker is the tension between present claimants and future claimants. The former will logically want high individual damages, coupled with an immediate payout and hopefully punitive damages that can be quickly distributed to them.<sup>42</sup> The latter will equally logically want the settlement fund to retain funds to protect its solvency until their claims mature. Hence, they will want to restrict large individual payouts until it can be reliably established that future claimants will also be paid. Logically, future claimants would also resist punitive damage awards in order to retain funds for the most disabled of them in the future. Finally, present claimants may be content with a lump-sum settlement (which defendants will predictably prefer), while future claimants will presumably prefer an open-ended settlement that does not cap the defendant's total liability. Because the number of future claimants will usually be very speculative, a lump-sum settlement shifts the residual risk of the mass tort from the defendants to the future claimants (but does not significantly prejudice present claimants).

While the foregoing conflicts were recognized in *Amchem*, *Ortiz* added a new dimension to the problem by finding that differences in the legal or economic strength of class members' claims may also necessitate subclassing.<sup>43</sup> Once this is recognized, the potential fault lines that run through many class actions multiply quickly. Some class members may reside in jurisdiction X (where the local substantive law is very favorable to them), while others may reside in jurisdiction Y (where the substantive law is essentially adverse). Given this disparity, should class counsel seek to obtain higher recoveries for the residents of jurisdiction X? Or, should counsel seek to impose a federal or other uniform rule of liability for this multistate class action with the result that the damage awards will be averaged? Or, does such an attempt amount to a forbidden allocation which

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41. According to the *Amchem* decision, "the interests of those within the single class are not aligned" because "named parties with diverse medical conditions sought to act on behalf of a single giant class rather than on behalf of discrete subclasses." *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 626 (1997). This language of interest alignment is important because it is the standard "law and economics" vocabulary for dealing with principal/agent problems.

42. Again, *Amchem* states this explicitly: "Most saliently, for the currently injured, the critical goal is generous immediate payments. That goal tugs against the interest of exposure-only plaintiffs in ensuring an ample, inflation-protected fund for the future." *Id.*

43. In *Ortiz*, the majority decision stressed the difference in position between those class members who had been exposed to Fibreboard's products before 1959 and those exposed only afterwards. See *Ortiz v. Fibreboard Corp.*, 119 S. Ct. 2295, 2320 (1999). Because Fibreboard's principal insurance policy with Continental expired in 1959, the Court stated that: "Pre-1959 claimants accordingly had more valuable claims than post-1959 claimants", which in turn produced "disparate interests within the certified class." *Id.* For a fuller discussion of this point, see *infra* note 66.

an individual lawyer cannot make under *Amchem* and so requires subclassing? Of course, if the entity model is accepted, such damage averaging is more easily defended; but, if the aggregation model is chosen, the rights of individual class members must be respected.

2. *External Conflicts*. — If *Amchem* illustrated the problem of internal conflicts within the class, *Ortiz* exemplified and emphasized external conflicts. In *Ortiz*, plaintiffs' counsel were offered a favorable settlement for their large inventories of individual clients, but on the condition that these same attorneys agree to serve as class counsel in an action seeking to resolve the rights of future claimants.<sup>44</sup> After *Ortiz*, such "side settlements" now seem to represent a per se "impermissible conflict of interest."<sup>45</sup> But if so, any other pending litigation brought by class counsel against the same defendant creates a potential conflict to the extent that the terms of one settlement might be traded off against the other. Typically, experienced class counsel in a mass tort class action may have a large inventory of individual actions pending against the same defendants. Thus, although disqualifying class counsel on this basis after *Ortiz* may be justified, the impact of such disqualifications on the plaintiffs' bar with experience in these actions may be fairly sweeping.

Although class action conflicts usually involve the interests of class counsel, the class representative can also have its own conflicts with the other class members. A fascinating, but little-noticed example arose in *Ahearn v. Fibreboard Corp.*, which involved an accompanying defendants' class action.<sup>46</sup> Defendant class actions are as rare as unicorns, generally because defendants do not wish to risk having their rights resolved by a representative. Nonetheless, Fibreboard's problem was that not only had innumerable plaintiffs sued it for asbestos-related claims, but most fellow asbestos defendants had the right to seek either contribution or indemnification from it. For example, distributors of Fibreboard's asbestos products had regularly sued Fibreboard for payments they had made to asbestos victims on account of Fibreboard products. Similarly, other asbestos manufacturers possessed claims against Fibreboard for contribution to the extent that these manufacturers had paid claims levied against them

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44. See *Ortiz*, 119 S. Ct. at 2318.

45. *Id.* (citing Roger C. Cramton, Individualized Justice, Mass Torts, and "Settlement Class Actions": An Introduction, 80 Cornell L. Rev. 811, 832 (1995) for the proposition that "side settlements suggest that class counsel has been laboring under an impermissible conflict of interest . . .").

46. See *Ahearn v. Fibreboard Corp.*, No. 6:93cv526, 1995 U.S. Dist. LEXIS 11531 (E.D. Tex. July 27, 1995). The existence of this separate settlement with Fibreboard's co-defendants is noted in *Ortiz*. See 119 S. Ct. at 2304 n.4 & 2306 n.8. I must disclose that I was retained as an expert witness by members of this defendant class (i.e., large defendants who did not want their claims for contribution or indemnification to be released by a conflicted representative) who sought to attack the settlement collaterally on grounds of the inadequacy of the class representative. See *Fibreboard Corp. v. Plant Insulation Co.*, No. 757932-5 (Alameda Super. Ct. filed Oct. 5, 1995). That action has, of course, been mooted by the outcome in *Ortiz*.

under a “market share” theory of liability. Finally, a miscellaneous assortment of landlords, building owners, architects, engineers, and other persons that had owned, designed, constructed, sold, leased, or occupied premises containing Fibreboard’s products also possessed potential causes of action against Fibreboard.

To resolve all these claims, Fibreboard approached another large asbestos manufacturer and distributor, Owens-Illinois, Inc., to represent all defendants holding asbestos claims against Fibreboard. Under the proposed settlement, all members in the class would essentially waive their rights against Fibreboard in a mandatory, non-opt-out class action in return for the creation of a settlement fund to be established by Fibreboard’s insurers. Owens-Illinois was, however, uniquely conflicted. First, because it was a fellow asbestos manufacturer, both it and Fibreboard necessarily held reciprocal claims for contribution against each other. In contrast, the other defendants in the class—Fibreboard’s distributors and other third party defendants—held claims against Fibreboard, but were not in any realistic sense liable to Fibreboard. Second, and even more ominous, subsequent events revealed that Owens-Illinois, Inc. was itself considering a similar global limited-fund class action in order to terminate its own asbestos liabilities. In short, if the Fibreboard global settlement could be upheld, it would constitute a blueprint for Owens-Illinois, which might then follow suit.

In overview, it is hard to think of a less adequate representative than Owens-Illinois. In effect, a Fibreboard creditor that was also Fibreboard’s debtor was representing a class of other creditors against Fibreboard, and it was apparently hoping to establish a legal precedent that could reduce its own substantial asbestos liabilities. The entire proceeding seemed a dress rehearsal for Owens-Illinois’s own potential class action. Nonetheless, although some class members objected to Owens-Illinois’s acting in this conflicted role as their representative, the federal district court approved the settlement. The lesson here is that once a potential settlement of complex litigation is in view, federal trial courts tend to tolerate almost any conflict in order to achieve a settlement that brings litigation peace—but at a cost paid by the class members.

3. *Risk Conflicts.* — The foregoing conflicts have involved either special extrinsic relationships between a fiduciary for the class and the defendants or a high level of heterogeneity within the class. But even in the absence of such facts, a more basic conflict remains. Imagine two similarly situated victims of the same mass tort injury. Both have equivalent injuries, which will in time prove fatal. One, however, has multiple dependents who require financial support, while the other does not. The latter plaintiff wants to win the largest possible recovery to vindicate his rights and punish the defendant; the former cannot afford this luxury of moral vindication and desperately needs a settlement to support her children. Hence, the former wants a quick settlement, while the latter insists on gambling on a trial. In overview, the latter plaintiff can be called a risk

preferrer, while the former is risk averse. Neither has the same attitude toward the litigation, nor approaches the settlement/trial decision from the same perspective. Nevertheless, under all established precedents, either could serve as the class representative for a class action containing the other as a class member.<sup>47</sup>

Arguably, little harm may result from this variety of conflict—so long as either plaintiff can opt out, once it is clear what the other plaintiff's preferences are. But the practical ability to opt out and pursue one's own preferences requires that special circumstances exist, and often these conditions are lacking. For example, the class may be a mandatory, non-opt-out class or the period for opting out may have expired before the proposed settlement is first disclosed. Or, the individual claim, even though substantial, may be uneconomical once divorced from the aggregate body of claims.

Conflicts among class members over issues of risk tolerance are overshadowed in turn by an even more fundamental conflict over risk: An almost inevitable conflict arises between class members and class counsel. In the typical small-claimant class action that supplies the basic rationale for the modern class action, no individual class member will have an expected recovery sufficient to justify individual litigation. Given their small stakes, class members should logically be risk neutral in their approach to litigation decisions (and in particular to whether to accept a proposed settlement offer). Even where the recovery may be larger, such as in securities class actions, most investors will be diversified and so should again be relatively risk neutral.

But this same generalization does not hold for plaintiffs' attorneys. Effectively, class action plaintiffs' attorneys are joint venturers with their clients who strike a bargain with them under which they will advance the litigation's actual expenses and receive a median contingent fee that is typically between 27% and 30% of the class's recovery, plus their expenses from the class's recovery fund.<sup>48</sup> Class counsel are, however, far less diversified than securities investors, and by the point that settlement negotiations begin in earnest in the typical class action, they may have already invested several million dollars of their own funds in carrying the litigation. Even beyond these reimbursable litigation expenses, plaintiffs' counsel will also have invested their own time plus the time of their associates, paralegals, and staff. Given this financial outlay and the significant opportunity cost that the litigation represents to them, plaintiffs' attor-

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47. Particularly to the extent that class certification precedes settlement, the court will never know the attitudes of the class representatives toward a proposed settlement that does not then exist.

48. For the finding that median fee awards in class actions are within this range, see Thomas Willging et al., *Empirical Study of Class Actions in Four Federal District Courts: Final Report to the Advisory Committee on Civil Rules 69* (1996). While median fee awards ranged only between 27% and 30% of the recovery fee, average awards ranged more broadly between 20% to 40% of the recovery. See *id.*

neys are unlikely to be as risk neutral in their approach to the litigation as the average class member can be. To illustrate, consider the difference between: (1) a class member facing a decision whether to accept a settlement that will pay him a certain \$1,000 or a risky \$1,500 if the action is litigated further, and (2) a plaintiffs' attorney facing the choice between a defendant-proposed settlement that will mean a likely fee award for the attorney of \$5,000,000 and further litigation that might yield a fee award of \$7,500,000. Although the same proportions are involved, the marginal utility of money makes a major difference here, and one strongly suspects that it will be far easier for the class member to walk away from this settlement offer than for the plaintiffs' attorney.

Next, add to this picture the additional likely facts that the attorney has advanced litigation expenses of \$500,000 to the class and that in reality, the fee award will typically tend to be a declining percentage of the recovery to the class. Now, two additional reasons for attorney risk aversion emerge. First, because the plaintiffs' attorney is inherently a creditor of the class action, but will not receive any truly risk-related return on the \$500,000 expenses that the attorney has advanced to the class, the attorney should logically be disinclined to accept risks that the class may consider acceptable. Creditors inherently tend to be more risk averse to the extent that their return is limited and they do not receive a risk-adjusted premium. Second, because the fee award does not increase proportionately with the recovery (at least not after some point),<sup>49</sup> the attorney's self-interest is poorly aligned with that of the class. It is simply unrealistic to expect the attorney to accept additional risk without the prospect of commensurate return.

All this adds up to a pessimistic assessment: Across a broad range of cases, plaintiffs' attorneys will be more risk averse than class members in considering settlement offers and will wish to accept many offers that the class will rationally wish to reject. To be sure, class members may also be irrationally optimistic about the litigation odds in many cases, either because they lack "real world" experience with litigation or because they have a strong emotional desire for vindication that exists apart from their financial incentives. Nonetheless, the bottom line is that this conflict over risk is basic and recurring.

In turn, this suggests that the leading cause of "cheap settlements" may not be collusion between class counsel and defendants (as some have argued<sup>50</sup>), but rather a basic differential in the level of risk aversion. What can be done about this? A partial answer no doubt lies in the use of more sophisticated fee formulas that compensate class counsel for ac-

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49. For a summary of the evidence that fee awards decline as a percentage of the recovery as the recovery increases, see *In re Nasdaq Market-Makers Antitrust Litig.*, 187 F.R.D. 465, 486 (S.D.N.Y. 1998).

50. See Koniak & Cohen, *supra* note 1, at 1051-89.

cepting risk,<sup>51</sup> but this topic is beyond the scope of this Article. The optimal answer cannot lie in disqualifying class counsel for risk aversion, because most class counsel will, to greater or lesser degrees, be subject to this problem.

4. *Conflicts over Control.* — A final factor that can increase the readiness of the plaintiffs' attorneys to accept an inadequate settlement involves the risk of a competing class action being brought by a rival team of plaintiffs' attorneys. Such competitions between rival proposed nationwide class actions have become increasingly common.<sup>52</sup> If we assume that both rival teams of plaintiffs' attorneys are roughly equally competent, class members might be rationally indifferent to which team won. But the rival legal teams cannot be indifferent, because only the winning team will be entitled to a court-awarded attorney's fee. Hence, both teams have an incentive to strike an early deal with the defendants, and the defendants can in turn exploit this leverage and force an auction between these rival teams to see which will make (or accept) the lowest settlement offer.<sup>53</sup> Even when no rival class action is filed, plaintiffs' attorneys understand that one might be filed, and hence they may be anxious to negotiate an early settlement before a rival bidder appears. Finally, class counsel is aware that if they press defendants "too hard," defendants may actually solicit a rival team of plaintiffs' attorneys to file an action elsewhere and then may enter an immediate settlement with these new entrants. So long as this rival action is filed in a different state court, the court hearing the original class action—whether a state court or a federal court—will be essentially powerless to stop this potential reverse auction.<sup>54</sup>

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51. I have argued elsewhere that the plaintiffs' attorney's fee award should increase (rather than decrease, as it does today) as a percentage of the recovery as the recovery increases above the standard recovery in order to induce the attorney to accept greater risk and pursue an above average recovery. However, to avoid over-compensation, the fee award should begin at a lower percentage than it does today. See Coffee, *Understanding the Plaintiff's Attorney*, supra note 15, at 725–26.

52. A major impetus has been the Supreme Court's decision in *Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367, 378–79 (1996), which held that state courts have jurisdiction to enter binding orders and approve settlements in class actions even with regard to claims that they lacked subject matter jurisdiction to try. Thus, a state court settlement releasing federal antitrust or securities law claims will carry "full faith and credit," even though federal law gives exclusive subject matter jurisdiction to federal courts over these claims. As a result, competitions between rival class actions covering federal securities or federal antitrust claims are now possible between federal and state court actions.

53. I have elsewhere described this process in more detail and called it the "reverse auction" phenomenon. Coffee, supra note 1, at 1370–72.

54. Professor Geoffrey Miller has examined the judicial tools that are available to a federal court in this context, especially the All Writs Act, 28 U.S.C. § 1651(a) (1994). See Geoffrey P. Miller, *Overlapping Class Actions*, 71 N.Y.U. L. Rev. 514, 538–39 (1996). Subsequent decisions convince me, however, that this Act, as currently interpreted, provides little significant protection for class members. See *In re General Motors Corp. Pick-Up Truck Fuel Tank Prod. Liab. Litig.*, 134 F.3d 133, 137–38 (3d Cir. 1998) (refusing



The bottom line then is that rational class members and rational class counsel are likely to evaluate a proposed settlement very differently. Although rational class members should only settle based on the litigation odds and will compare the proposed settlement with their discounted estimate of the probable outcome at trial, rational plaintiffs' attorneys will need to consider also the prospect that a competitor may emerge, thereby inclining them to accept a cheaper settlement. This may not be the same phenomenon as actual collusion, but the results can look very similar. Hence, the inescapable point here is that, under current law, one cannot realistically expect the plaintiffs' attorney to be as loyal to the class members' interests as the classic fiduciary can be to its beneficiary. The guardian or trustee neither has the same personal stake in the matter nor faces the same risks. Hence, other approaches—in particular, enhancing “exit” and “voice”—must be considered in addition to “loyalty.”

### C. *The Impact of Amchem and Ortiz*

Against this backdrop of pervasive conflicts, what new constraints do *Amchem* and *Ortiz* impose? Both cases involved remarkably similar fact patterns: sprawling mass tort class actions involving every conceivable position on a spectrum of injury running from mere exposure to fatal diseases caused only by asbestos.<sup>55</sup> *Amchem* focused principally on the differences among class members and the fact that the terms of the settlement unevenly allocated the recovery among these various categories of plaintiffs, rewarding some and denying any compensation to others. In the *Amchem* Court's view, this allocation was impermissible because the class representatives had not acted on behalf of discrete subclasses, but rather had sought to represent the class as a whole.<sup>56</sup> Given the diversity of interests and injuries affected by the settlement, *Amchem* understandably insisted that there be some “structural assurance of fair and adequate representation for the diverse groups and individuals affected.”<sup>57</sup> This assurance could be most easily provided, it said, by a negotiating structure under which each representative served “for a separate constituency,” and not “as representative for the whole.”<sup>58</sup> In short, the strong implication of *Amchem* was that allocations have to be bargained out among sub-

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to enjoin Louisiana state court nationwide class action that was a rival to an earlier filed federal nationwide class action).

55. It is generally recognized that mesothelioma, an invariably fatal cancer of the lung lining tissue, is principally caused by asbestos exposure. See, e.g., *Becht v. Owens Corning Fiberglas Corp.*, 196 F.3d 650, 652 (6th Cir. 1999); *Greenleaf v. Garlock, Inc.*, 174 F.3d 352, 356 (3d Cir. 1999); *Brown & Root, Inc. v. Sain*, 162 F.3d 813, 815 (4th Cir. 1998).

56. See *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 627 (1997).

57. *Id.*

58. *Id.* The Court did, however, indicate that an appropriate “assurance” might also be found in “the terms of the settlement,” as opposed to “the structure of the negotiations.” *Id.* It is not entirely clear what this distinction involves, but it does open the door to the possibility that the availability of exit—such as in the form of a continuing and

classes, each presumably with its own counsel, and not resolved by class counsel acting as a neutral philosopher king. Although this message has revolutionary implications for existing class action practices (where such allocations by a single counsel have been a common event), *Amchem* still left vague just how serious the differences among class members had to be before such subclassing was required.

In *Ortiz*, the settling parties believed that they had discovered a simple expedient by which to sidestep and outflank the *Amchem* allocation problem. By avoiding any specific allocation or damage award schedule and instead consigning each class member to a post-approval arbitration procedure, the settling parties could argue that no allocation had been made and hence there was no need for subclassing. Although a divided Fifth Circuit panel accepted this distinction,<sup>59</sup> the Supreme Court dismissed it as superficial, finding that the failure to differentiate “the claims of the immediately injured” from “the more speculative claims of those projected to have future injuries” was itself a preference for one group over another.<sup>60</sup> In essence, the Court found that to treat “unlike” cases alike was as much an “allocation decision” forbidden by *Amchem* as any actual disparity in the amounts awarded.<sup>61</sup> Indeed, *Ortiz* is far clearer than *Amchem* that subclassing must be accompanied by separate representation, with a “division into homogeneous subclasses . . . with separate representation to eliminate conflicting interests of counsel.”<sup>62</sup> Whereas *Amchem* had largely focused only on the class representatives, *Ortiz* recognized that representatives in fact rely on class counsel and hence different counsel for each subclass would be necessary.<sup>63</sup>

Even more importantly, *Ortiz* tightened the concept of cohesion within the class, applying it not simply to gross differences in the nature of the plaintiffs’ injuries but also to differences in the legal and negotiating positions of the class members. After *Amchem*, it was at least arguable that only the distinction between present and future claimants truly required subclassing. But *Ortiz* laid this modest reading of *Amchem* to rest. Because the *Ortiz* class “included those exposed to Fibreboard’s asbestos products both before and after 1959,”<sup>64</sup> the date on which Fibreboard’s principal insurance policy expired, the Court found that the pre-1959 claimants held “more valuable claims than post-1959 claimants” and so belonged in a separate subclass.<sup>65</sup> Arguably, if this difference required

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unlimited right to opt out—could have relevance and save an allocation that would otherwise flunk *Amchem*’s bargaining requirements.

59. See *In re Asbestos Litig.*, 134 F.3d 668, 669–70 (5th Cir. 1998), rev’d, *Ortiz v. Fibreboard Corp.*, 119 S. Ct. 2295 (1999).

60. *Ortiz*, 119 S. Ct. at 2320.

61. *Id.* (“The very decision to treat them all the same is itself an allocation decision . . .”).

62. *Id.* at 2319.

63. See *id.* at 2319 n.31.

64. *Id.* at 2320.

65. *Id.*

subclassing (and separate counsel), then a host of other differences might also. Viewed simply in terms of intra-class differences, the expiration of an insurance policy means only that the claims of some class members are more valuable than those of others, and other common legal variables—such as the possible expiration of a statute of limitations or legal differences among jurisdictions in the elements of a particular cause of action—similarly imply that some class members have more valuable claims than others. Yet, alternatively, the failure to create subclasses for the pre- and post-1959 claimants can be viewed as, itself, strong evidence of collusion on the special facts of *Ortiz*.<sup>66</sup>

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66. The key premise to Justice Breyer's dissent in *Ortiz* and the core justification advanced by the proponents of the *Ortiz* settlement was the alleged urgent need of all the participants to reach and implement a global deal before the California appellate court decided the coverage action brought by Fibreboard against its two liability insurers. According to Justice Breyer, "[w]ithin weeks after the parties' settlement agreement, the insurance policies might well have disappeared, leaving most potential plaintiffs with little more than empty claims. The ship was about to sink, the trust fund to evaporate; time was important." *Id.* at 2329 (Breyer, J., dissenting). But this analysis badly misunderstands the facts. Time was not necessarily important to Fibreboard. Whatever happened in the coverage case, it was still destined to become bankrupt in a relatively short period of time. This was because the two insurance policies covering it only applied to asbestos exposure claims arising before 1959. The policy issued by Pacific Indemnity Company covered claimants whose claims arose in 1956 and 1957. Fibreboard simply had no liability insurance with respect to workers who were first exposed to asbestos after 1959. Alone, these claims were sufficient to bankrupt Fibreboard. The district court that approved the *Ortiz* settlement estimated Fibreboard's value (free of asbestos liabilities) at \$235 million. See *Ahearn v. Fibreboard Corp.*, 162 F.R.D. 505, 529 (E.D. Tex. 1995). Although this estimate may have been low, the total number of pending asbestos claims against Fibreboard was estimated in the claims notice mailed to class members at 200,000 (and additional future claims were certain to arise). See *Coffee*, *supra* note 1, at 1400 & n.217. If one were to value the typical claim at \$20,000, this would imply an aggregate liability of at least \$4 billion (exclusive of future claims). In short, the post-1959 uninsured claims dwarfed Fibreboard's assets, and the district court expressly found that Fibreboard could not have avoided bankruptcy even if it had won the insurance coverage litigation. See *Ahearn*, 162 F.R.D. at 529.

Thus, to avoid bankruptcy, Fibreboard's goal had to be to use the insurance coverage litigation to force a global settlement that also extinguished post-1959 claims. In part, this goal required the use of the available insurance to settle the post-1959 claims. Presumably, if the pre-1959 claimants were represented by loyal representatives (whom they had personally retained), these counsel would have objected to any such dissipation of the insurance assets that were uniquely intended to benefit pre-1959 claimants. But class counsel knew that Fibreboard would only agree to a class action settlement (and thereby make possible a class action fee award) if the settlement averted bankruptcy by resolving the post-1959 claims. Hence, both to achieve this settlement and to obtain the inventory settlements applicable to their individual clients (whose claims were linked to the class action's settlement), class counsel had to acquiesce in this seeming misappropriation of the insurance policies that by contract protected only pre-1959 claimants.

In this light, the seeming indifference of class counsel to the critical distinction between pre-1959 and post-1959 claims is not simply an example of class counsel making an arguably impermissible allocation between two subgroups within the class, but rather evidences collusion by a conflicted class counsel. Under this proposed narrower interpretation, *Ortiz* should be read not as mandating subclassing whenever there is a

The implications of this distinction only come into clear focus when we consider how many different subclasses might be required under the broader reading of *Ortiz* even in the case of a garden variety, small claimant class action. Consider, for example, a hypothetical tort class action involving only three characteristic types of injury (small, medium, and large), but also involving the common law of multiple states (whose laws subdivide in turn into three categories: strict liability, negligence, and intentional misconduct), and extending over time periods that raise issues under each jurisdiction's statute of limitations. On this basis of three types of injury, three applicable legal rules, and two statute of limitations categories, there would logically need to be eighteen distinct subclasses, each apparently with its own counsel under *Ortiz*. That is, each additional factor must be multiplied by, and not simply added to, the other factors. Nor is this example far-fetched.<sup>67</sup> Many other legal or economic issues can be imagined that would push this number far higher (e.g., the relative solvency of different defendants, the existence of insurance policies applicable to the claims of some but not all class members, special statutory causes of action or affirmative defenses applicable to some, but not all, class members, etc.).

At this point, *Ortiz* and *Amchem* could call into question the viability of the class action as an efficient organizational form. But will other courts truly read these decisions to require multiple subclasses? In *Ortiz*, the dissenting judge on the Fifth Circuit panel read *Amchem* to mean "that *any* real conflict, even if minor when compared to interests held in common, will render the representation inadequate."<sup>68</sup> Although this was the dissenting opinion, the Supreme Court's subsequent reversal of

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material difference in claim strength between two groups of class members, but rather as requiring subclassing when defendants are inducing class counsel to subordinate one group to another (here, by using one group's funds to buy another group's release). Under this interpretation, use of a neutral or objective formula by class counsel to allocate the settlement fund would not raise the same issues nor necessarily require separate counsel for each subgroup.

67. For example, in one post-*Amchem* decision, *In re Teletronics Pacing Systems, Inc.*, 172 F.R.D. 271 (S.D. Ohio 1997), the district court certified a nationwide class that included nine separate subclasses in order to address variations in state law. The defendant's product was a heart pacemaker that was allegedly prone to fracture with the result that a sharp wire within the pacemaker could then protrude and cause injury to the heart. Some 25,000 pacemakers were installed in U.S. residents between December 1988 and February 1993, with a fracture rate that appears to have been between 12% and 20%. See 172 F.R.D. at 277. The district court certified two medical monitoring subclasses, which subdivided all U.S. states into three categories depending on whether the individual jurisdiction accepted, accepted in modified form, or rejected Section 402A of the Restatement (2d) of Torts. *Id.* at 293. The district court rejected still another proposed subclass for punitive damages and also declined to further divide the class based on potentially differing interpretations of proximate cause. See *id.* at 293. Hence, even more subclasses were possible. Yet, this was ultimately a case involving only a single product and a single prospective type of injury.

68. *In re Asbestos Litig.*, 134 F.3d 668, 677 (5th Cir. 1998) (Smith, J. dissenting), *rev'd*, *Ortiz v. Fibreboard Corp.*, 119 S. Ct. 2295 (1999).

the Fifth Circuit in *Ortiz* may make this view an accurate prophecy. Indeed, the criterion most stressed by the Court in *Ortiz* as necessitating a subclass, the expiration date of an insurance policy, would have probably struck most trial court judges prior to *Ortiz* as not requiring subclassing. To be sure, *Ortiz* does sense the danger in excessive subclassing, and the majority decision notes that "at some point there must be an end to reclassification with separate counsel."<sup>69</sup> But it provides no clear answer as to where that "point" is located.

Because *Ortiz* implies that each subclass must have its own counsel, its logic could make the large class action not simply unmanageable, but uneconomical for counsel to bring on a traditional contingent fee basis. Assume that a plaintiffs' law firm investigates and decides to bring a class action that no other law firm has yet prosecuted. Its motivation is the likelihood of a fee award equal to 25% to 33 1/3% of the recovery (discounted, of course, by the non-trivial possibility that there will be no recovery). But, at the outset, assume that it also understands that *Amchem* and *Ortiz* require that the class must be fragmented into six different subclasses (reflecting different injuries, applicable legal rules, and other relevant variables). If we assume that each subclass requires separate counsel, the economic consequence is that our hypothetical plaintiffs' firm must invite five other firms into the cases to share this expected fee award with it. The incentive to bring the action, or to search generally for meritorious actions, is thereby weakened.<sup>70</sup>

Not only is multiple counsel costly, its imposition still does not assure adequate representation. Today, overlapping class actions are often filed, and, if filed at the federal court level, such actions are generally consolidated for pre-trial discovery purposes before a single court by the Judicial Panel on Multidistrict Litigation.<sup>71</sup> In these instances, the counsel in these actions may simply decide to organize and subdivide the class action among themselves. The alternative is open warfare over which counsel is to be chosen lead counsel, and, over the years, plaintiffs' counsel have learned that a negotiated resolution is more in their collective self-interest than the trading of charges and counter-charges as rival coalitions compete for the court's favor. Pursuant to such negotiated resolution, counsel may agree to share the fee award by contract pursuant to some negotiated formula.<sup>72</sup> But now, the danger of collusion surfaces: The various counsel may be sufficiently comfortable with this arrange-

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69. *Ortiz*, 119 S. Ct. at 2320.

70. To be sure, a system of reciprocal case sharing could soon develop ("I'll invite you into my case, if you invite me into yours"), but this only exacerbates the underlying danger of collusion that both *Amchem* and *Ortiz* sensed and responded to by tightening the rules of class certification.

71. See Miller, *supra* note 54, at 519-20; see also 28 U.S.C. § 1407(a) (1994).

72. Such fee sharing agreements among cooperating plaintiffs' counsel in a class action that specify how they will divide the court-awarded fee are common, but can still sometimes produce disputes that result in litigation. See, e.g., *French v. Selden*, 59 F. Supp. 2d 1152 (D. Kan. 1999).

ment that they are not truly bargaining at arm's length on behalf of their subclasses for purposes of *Amchem* and *Ortiz*.

Indeed, imagine a case where six plaintiffs' firms decide to file essentially the same overlapping class action and, upon its eventual consolidation before a district judge, quickly decide to divide up the necessary subclasses among themselves. Both to reduce risk and to minimize friction among themselves, they also decide to pool any fees awarded to them by the court and allocate the fee pool among themselves by contract. Indeed, such pooling is fairly standard.<sup>73</sup> But at this point, is it realistic to expect these separate law firms to bargain on behalf of their separate subclasses over the settlement's allocation when their own fees are pooled? At the least, it is clear that they have no economic incentive to do so. Worse, because disputes over allocation can easily imperil the overall settlement with defendants, each plaintiffs' counsel has a strong incentive to achieve consensus and not disrupt the settlement by demanding a larger share of the settlement for their subclass. Ultimately, their incentive to bargain aggressively for their subclass requires that their own economic recovery be tied to their clients' recovery—and in this example, fee pooling severs that tie.

Hence, *Amchem* and *Ortiz* force the courts to find some balance between two opposing dangers. First, if subclassing is required for each material legal or economic difference that distinguishes class members, the Balkanization of the class action is threatened. Such a fragmented class might be unmanageable, certainly would reduce the economic incentives for legal entrepreneurs to act as private attorneys general, and could be extremely difficult to settle if each subclass (and its attorney) had an incentive to hold out for more. Second, the converse danger is that subclassing as a remedy for class action collusion may accomplish little if plaintiffs' attorneys for different subclasses could by pooling their fees effectively cancel the incentives that the law means to create for them to zealously represent their clients.<sup>74</sup>

Each of these problems must be satisfactorily addressed before *Amchem* and *Ortiz* can be said to have sensibly resolved the class action problems that they have recognized. At present, *Amchem* and *Ortiz* represent an incomplete revolution in class action practices: one that unfortunately has the potential to complicate and perhaps foreclose the availabil-

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73. This does not mean, however, that courts will necessarily defer to such agreements. A number of cases have refused to honor or enforce fee-sharing agreements where they have concluded that these agreements gave rise to perverse incentives or rewarded attorneys not actually participating in the litigation. See, e.g., *In re FPI/Agretech Sec. Litig.*, 105 F.3d 469, 473–74 (9th Cir. 1997); *Class Plaintiffs v. Jaffe & Schlesinger*, 19 F.3d 1306, 1308 (9th Cir. 1994); *In re "Agent Orange" Prod. Liab. Litig.*, 818 F.2d 216, 222 (2d Cir. 1987).

74. I do not mean to suggest that fee allocation agreements are generally suspect, but only that they create perverse incentives when counsel for different subclasses are parties to them. In those instances, it becomes possible for the attorney to do well while the subclass does poorly.

ity of the class action in circumstances where no other legal remedy is available, but not one that offers a clear vision of how absent class members are to be protected. Moreover, given the inevitable divisions in the federal and state judiciary, it is likely that the two decisions will be given highly variant interpretations by lower courts. Conservative courts will resist class certification in reliance on their language, while other courts seek to accommodate settlements, except in the clearest instances of intra-class conflict. A roadmap for the implementation of *Amchem* and *Ortiz* is therefore essential.

## II. BALANCING EXIT, VOICE, AND LOYALTY IN CLASS ACTIONS

### A. *Loyalty: What Defines Adequate Representation?*

*Amchem* contains two distinct, incomplete and potentially inconsistent theories of adequate representation. Most evident is its idea that “cohesion” within the class or subclass legitimizes representation that can bind absent class members.<sup>75</sup> In short, only “likes” can bind “likes”—and only when the “like” representatives “understand that their role is to represent solely the members of their respective subgroups.”<sup>76</sup> As already noted, this is a theory of representation that philosophers refer to “descriptive representation.”<sup>77</sup> *Amchem*’s variation on this theory is that only a representative who shares the narrow, parochial interests of the subclass can be trusted to negotiate for their interests exclusively, rather than for the general good or best interests of the entire class.

The second theory of adequacy, which is only implicitly stated in *Amchem*, is that the class representative must possess leverage. The essential problem with the settlement class action, *Amchem* notes, is that if class counsel could only settle and not litigate, “both class counsel and court would be disarmed.”<sup>78</sup> Thus, similar standards for class certification should apply in both the settlement and litigation contexts, it said, because class counsel needed “the threat of litigation to press for a better offer.”<sup>79</sup> Although never explicitly stated, the next step in this syllogism would seem to be that a class counsel who lacks leverage and is therefore disarmed cannot be an adequate representative. Unfortunately, the majority opinion can be read to undercut this clear position because it also recognizes that the standards for a settlement class can sometimes be less

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75. 521 U.S. 591, 623 (1997) (“[C]lass cohesion . . . legitimizes representative action . . .”).

76. *Id.* at 627 (quoting *In re Joint E. and Southern Dist. Asbestos Litig.*, 982 F.2d 721, 742–43 (2d Cir. 1992)), modified on reh’g sub nom., *In re Findley*, 993 F.2d 7 (2d Cir. 1993).

77. See *supra* notes 10–38 and accompanying text (discussing nomenclature proposed by Hanna Pitkin).

78. 521 U.S. at 621.

79. *Id.*

demanding than for a litigation class.<sup>80</sup> However, as later discussed, it is not necessary to read *Amchem* to make any concession that the representative can be “disarmed,” and hence the leverage thesis remains valid.

In overview, the first theory (the cohesion thesis) is structural, while the second (the leverage thesis) is functional. Individually, each is incomplete for reasons next discussed.

1. *The Cohesion Thesis*. — The key problem with subclass cohesion as the test of adequacy is that a representative who is entirely characteristic of other subgroup members may still be conflicted or simply passive, apathetic, and unmotivated to fight for the class’s common interests. Even holding the problem of conflicts aside, consider the case of a class member whose entire claim is for ten dollars in a class action where two subgroups have claims of differing legal strength. Those in subgroup A (including our hypothetical representative) have claims that, based on their intrinsic legal merit, deserve a settlement payment of ten dollars, while those in subgroup B hold claims entitling them on the same basis to a settlement payment of only eight dollars. For reasons of rational apathy, class counsel is inclined to avoid any allocation (because it would require subclassing and procedural complexity) and simply average the damages so as to award everyone nine dollars. Will our hypothetical class member in subgroup A object to this averaging and insist on ten dollars? Not if this representative is sane! Life is short, and the time and costly effort that would be expended in objecting will profit each member little and may delay (or even derail) the settlement.

A second problem with the cohesion thesis is that its historical foundations are shaky. The *Amchem* opinion finds a principal source of the cohesion requirement to lie in the “predominance” test of Rule 23(b)(3).<sup>81</sup> But Rule 23(b)(3)’s requirements seem much more closely linked to considerations of judicial efficiency than to concerns about absent class members. As next discussed, the more closely one examines the context in which the “predominance” test was framed as part of the 1966 revisions of Rule 23, the more likely it seems that the draftsmen’s primary intent was to confine Rule 23(b)(3) within judicially manageable limits.

*Amchem*’s claim that the “predominance” requirement in Rule 23(b)(3) “tests whether proposed classes are sufficiently cohesive to warrant adjudication by representation”<sup>82</sup> can be traced back to earlier com-

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80. Essentially, the Court said that a settlement class need not meet the “manageability” standards that apply to a litigation class. See *id.* at 620. The significance of this point is discussed *infra* notes 92–95 and accompanying text.

81. See 521 U.S. at 623. Rule 23(b)(3) requires that common issues “predominate over any questions affecting only individual members.” Fed. R. Civ. P. 23(b)(3).

82. 521 U.S. at 623.



mentators,<sup>83</sup> but nevertheless this interpretation reads history backwards in light of contemporary concerns. In fact, the “predominance” test was designed to accompany an innovative and experimental extension of the reach of the class action in 1966. Prior to that time, class actions based solely on common questions were known as “spurious” class actions and were permitted by Rule 23(a)(3), but these actions only bound the named parties and others who joined in.<sup>84</sup> Thus, they were based on “opt-in” consent, rather than the failure to opt out (as current Rule 23(b)(3) operates). This shift in 1966 from an opt-in to an opt-out rule of inclusion was obviously significant, and the Advisory Committee that drafted Rule 23(b)(3) knew it was making a major change in the law. Indeed, Professor Benjamin Kaplan, the Reporter to the Advisory Committee, called Rule 23(b)(3) the “most adventuresome” feature in the 1966 amendments to Rule 23.<sup>85</sup> The Advisory Committee understood that the new Rule 23(b)(3) was broadly designed for circumstances in which “class-action treatment is not as clearly called for,” but in which a class suit “may nevertheless be convenient and desirable.”<sup>86</sup> Therefore, it understandably added two constraints to its new creation in order to ensure that the revised rule did not permit all (or even most) individual actions for money damages to be aggregated into a class action against the same defendant.<sup>87</sup>

First, the court certifying a Rule 23(b)(3) class action was required by the term of this new provision to find that common questions of law or fact “predominate over any questions affecting only individual members.” Second, the court had to further find that class resolution was “superior to other available methods for the fair and efficient adjudication of the controversy.” Under the prior rule, the court had to find only that the class sought common relief.<sup>88</sup> By adding these more restrictive “predominance” and “superiority” tests, the draftsmen were seeking to assure that certification would only be permissible in cases “in which a class action would achieve economies of time, effort, and expense, . . . without sacrificing procedural fairness or bringing about other undesirable results.”<sup>89</sup> In short, “predominance” and “superiority” were parallel constraints designed to assure that their new experiment did not open the floodgates

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83. Indeed, *Amchem* cites 7A Charles Alan Wright et al., *Federal Practice and Procedure* § 1777, at 518–19 (2d ed. 1986) for this proposition. See *Amchem*, 521 U.S. at 623.

84. 7A Wright et al., *supra* note 83, § 1777, at 517.

85. Benjamin Kaplan, A Prefatory Note, 10 B.C. Indus. & Com. L. Rev. 497, 497 (1969).

86. Adv. Comm. Notes, 28 U.S.C. app., 697 (1994). This language is quoted in *Amchem*, 521 U.S. at 615.

87. See *id.* at 615–16.

88. 7A Wright et al., *supra* note 83, § 1777, at 518.

89. Adv. Comm. Notes, 28 U.S.C. app., 697; see also Benjamin Kaplan, Continuing Work of the Civil Committee: 1966 Amendments to the Federal Rules of Civil Procedure (I), 81 Harv. L. Rev. 356, 390 (1967).

to an unanticipated volume of litigation in class form. So understood, the “predominance” test seems less intended to provide due process protections for absent class members than to protect trial judges and conserve judicial resources.

The structure of Rule 23 reinforces this conclusion. If one were concerned about the vulnerability of absent class members to collusive settlements, one would not logically locate any intended protection in Rule 23(b)(3), because then it would not apply to Rule 23(b)(1) and (b)(2) actions (which *Ortiz* has shown are equally vulnerable to abuse). Instead, one would place the protection in Rule 23(a), which applies to all class actions. In fact, this is just how Rule 23 is structured, because both the “typicality” requirement of Rule 23(a)(3) and the “adequacy” requirement of Rule 23(a)(4) are clearly intended to protect absent class members from such abuse. The logic of the “typicality” requirement, which requires that the class representative assert claims “typical” of the class, is that such a “typical” representative will have interests aligned with those of other class members.

“Typicality” thus closely overlaps with the idea of “cohesion” within the class, which suggests that it would be redundant to read the predominance test in Rule 23(b)(3) as having the same goal in mind. More importantly, typicality has been long read by courts to be a far less demanding test than *Amchem*’s concept of cohesion.<sup>90</sup> While *Amchem* can be read to require identity within the group (or subgroup) in terms of the injury sustained and the members’ legal position, typicality has traditionally required only an approximate alignment of interests between the representative and the class. As later discussed, the cost of reading cohesion to mean identity may be prohibitive.

These objections do not mean that *Amchem* was wrong in insisting on class cohesion. Rather, they imply that class cohesion may be more a necessary than a sufficient requirement. Moreover, in some contexts, it may be a requirement for which other functional substitutes could suffice.

2. *The Leverage Thesis.* — The alternative suggestion in *Amchem* that some degree of leverage must be possessed before a class representative can be adequate has a number of advantages, but nonetheless is arguably contradicted by other language in the opinion. Requiring that the representative not be “disarmed,”<sup>91</sup> and have the ability to negotiate effectively, directly addresses the problem of collusive settlements. Such a test also instructs the court to focus equally on class counsel as well as on the class representative.

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90. See, e.g., *Forbush v. J.C. Penney Co.*, 994 F.2d 1101, 1106 (5th Cir. 1993) (test for typicality is not demanding and does not require identity); see also *In re American Med. Sys. Inc.*, 75 F.3d 1069, 1083 (6th Cir. 1996) (holding that claims are typical if they arise from the same course of conduct).

91. *Amchem*, 521 U.S. at 621 (“[I]f a fairness inquiry under Rule 23(e) controlled certification, eclipsing Rule 23(a) and (b), and permitting class designation despite the impossibility of litigation, both class counsel and the court would be disarmed.”).

Despite the advantages of this test, the *Amchem* opinion seems to take a fundamentally inconsistent position as to whether class counsel can be “disarmed.” Although *Amchem* says that class counsel needs the “threat of litigation” to negotiate effectively,<sup>92</sup> the majority also agrees with the proponents of the settlement that: “Confronted with a request for settlement-only class certification, a district court need not inquire whether the case, if tried, would present intractable management problems.”<sup>93</sup> Arguably, this statement tolerates a “disarmed” class counsel because it seems to imply that a class counsel who has brought a class action that would be too “unmanageable” for certification for litigation purposes can still settle it as a settlement class action. Yet, if this “unmanageable” case cannot get to trial, counsel is seemingly disarmed by definition.

Nonetheless, this seeming contradiction may be more apparent than real. Although these two statements in *Amchem* exhibit some unresolved tension, no necessary contradiction exists between them. Under some circumstances, a class counsel who cannot proceed to trial because of an insurmountable barrier to certification still may not be “disarmed.” Consider, for example, a plaintiffs’ attorney who has a large inventory of individual mass tort clients (hypothetically, 25,000 cases). These cases could be tried individually, settled on an “inventory” basis,<sup>94</sup> or resolved pursuant to a settlement class action. The possession of an inventory gives the attorney considerable negotiating leverage, because the claims are inherently aggregated through the existence of a common agent. If the attorney decided to resolve the claims of these clients pursuant to a settlement class action, the attorney would not be “disarmed” by an inability to go to trial in the class action, because the attorney would still have the threat of individual litigation to enforce the attorney’s negotiating position.

To be sure, these are not the facts of *Amchem* or *Ortiz*, where very conflicted plaintiffs’ attorneys settled their individual cases on an inventory basis and then settled the class action on less favorable terms on behalf of future claimants. But such a hypothetical fact pattern does show that an attorney who cannot proceed to trial in the class action might still possess considerable negotiating leverage. In short, the possession of leverage is not incompatible with a concession that a litigation class cannot be certified. As a result, *Amchem*’s focus on negotiating leverage does not have to be seen as contradicted by other portions of the opinion that permit a class too “unmanageable” for trial to be certified for settlement purposes.

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92. *Id.*

93. *Id.* at 620.

94. Mass torts plaintiffs’ attorneys often settle cases on an “inventory” basis—meaning that an attorney resolves all pending individual cases that it had with the defendants according to some overall formula. Both *Amchem* and *Ortiz* involved such inventory settlements. See *Ortiz v. Fibreboard Corp.*, 119 S. Ct. 2295, 2301 (1999); *Amchem*, 521 U.S. at 600. The inventory settlement involving the principal class counsel in *Ortiz* involved some 53,000 claimants. See *Ortiz*, 119 S. Ct. at 2319. The ethical issues in such inventory settlements are analyzed in Silver & Baker, *supra* note 18.

Negotiating leverage, however, should not alone make counsel an adequate representative. As *Ortiz* bluntly recognized,<sup>95</sup> the expectation of a large fee award can leave class counsel unwilling to use the leverage that it in fact possesses. As a result, a complete definition of "adequacy" should contain three elements: (1) an absence of any serious conflict of interest; (2) negotiating leverage (as shown by the ability to credibly threaten to go to trial in some forum); and (3) the incentive to use that leverage.

The economic incentive to use negotiating leverage exists principally when class counsel will maximize its own recovery by maximizing the recovery for the class. As next discussed, class counsel may often be economically indifferent as to whether his clients' economic position is maximized by a proposed settlement.

3. *The Relevance of Fee Formulas.* — Two examples involving fee award formulas illustrate their potentially perverse impact on the attorney's incentives to benefit the class. First, suppose, based on *Amchem's* criteria, that a class action is divided into four subclasses, each with its own counsel. The four law firms are each compensated by the court under the "lodestar" formula, which essentially multiplies each attorney's time invested in the action by the attorney's normal hourly rate (and potentially adds a risk premium to reflect the contingent nature of the fee).<sup>96</sup> The result of this fee formula is that each participating attorney is now economically indifferent as to the allocation of the settlement among the four subclasses, because each will be paid based on their own time, not on their success for their client. To be sure, every attorney may fulfill their fiduciary duty to their respective subclass and bargain zealously over the allocation of the settlement, but they have little incentive to do so. Moreover, because most of the time expended will likely be incurred in connection with litigating against the common foe (i.e., the defendants), it is entirely possible for the attorney to do well, while the subclass does poorly. In short, the interests of the attorney and the subclass are not aligned under this fee arrangement.

Second, consider a more common variation: Class counsel is compensated based on a percentage of the recovery obtained for the class, but the court does not allocate the fee award among the counsel. Instead, the court either permits lead counsel for the class to allocate the

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95. See *Ortiz*, 119 S. Ct. at 2317 n.30 ("In a strictly rational world, plaintiff's counsel would always press for the limit of what the defense would pay. But with an already enormous fee within counsel's grasp, zeal for the client may relax sooner than it would in a case brought on behalf of one claimant.")

96. The lodestar formula has been mandated by the Court in fee shifting cases. See *City of Burlington v. Dague*, 505 U.S. 557, 562 (1992). However, in "common fund" cases where the fee award comes from the settlement fund created by the litigation, the vast majority of federal courts use the percentage of the recovery approach. See *Swedish Hosp. Corp. v. Shalala*, 1 F.3d 1261, 1267 (D.C. Cir. 1993). A Federal Judicial Center empirical study has found that most trial courts appear in fact to be using the percentage formula in preference to the lodestar formula. See Willging et al., *supra* note 48, at 69-70.

fee award or defers to any fee allocation agreement that was agreed to by counsel. Again, the result is to leave class counsel rationally indifferent as to the allocation of the settlement among the subclasses.

Although fee agreements among cooperating counsel in a class action have many justifications,<sup>97</sup> the indifference that they engender towards the subclass's success seems inconsistent with the concept of "adequate representation." If lead counsel for the class is authorized to allocate the fee award, lead counsel can use this power as a practical matter to bring subclass counsel into line and constrain their ability to negotiate in an adversarial manner for their subclasses. Indeed, lead counsel (or any similar authority, such as a committee of counsel appointed pursuant to a private agreement among class counsel) has every incentive to use discretionary power in this fashion to ensure that intra-class bickering does not delay or derail the settlement.

What then is the appropriate answer? Ideally, the attorney for the subclass should be compensated based on the recovery to the subclass—not based on the recovery to the class as a whole. Such a rule enforces *Amchem's* statement that the representative must understand that its role is to negotiate for the subclass and not the class as a whole; correspondingly, each subclass, as the true client, should compensate its own attorney. Because such a rule aligns the attorney's self-interest with the interests of the attorney's clients, the attorney will logically seek to maximize the allocation of the recovery to the attorney's subclasses. Under such a rule, however, fee-pooling agreements entered into at the outset of the litigation among counsel for different subclasses would have to be prohibited.

Although no court has yet connected the issue of adequacy to fee award formulas, this failure may be because subclassing was a fairly unusual procedure prior to *Amchem*. In any event, the connection simply must be made. Once we realize that subclasses are in active competition after *Amchem*, the need to establish a strong linkage between duty to the subclass and payment from the subclass becomes logically unavoidable. To illustrate, suppose a plaintiffs' attorney in a class action were to be compensated in an amount to be determined at the discretion of the defendants. Even the most ardent defender of the status quo would probably acknowledge that such control by the defendants over the plaintiffs' attorney would compromise the latter's adequacy. Yet, if defendant control over the fee impairs representational adequacy, precisely the same conflict arises when one subclass (or the attorneys therefor) has the ability to determine the compensation for any other subclass's attorneys. After *Amchem*, subclasses have to be regarded as adversaries which must bargain at arm's length.

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97. For example, in a large class action involving numerous plaintiffs' attorneys (but no subclasses), there is a strong argument that lead counsel will know far better than the trial court which attorneys have labored productively for the class—and which have not.

This conclusion that representational adequacy cannot be meaningfully analyzed apart from an analysis of economic incentives and fee formulas leads, however, to a cautionary observation. If *Amchem* were read to require subclassing in most class actions, based on any material difference among class members, and if subclass counsel must be compensated based on their individual recoveries, then the settlement process may be significantly slowed. Moreover, the prospect of the Balkanization of the class action—namely, its division into warring fiefdoms—would be greatly enhanced. This evaluation does not mean that subclasses are not sometimes necessary or that economic incentives can be ignored in discussing representational adequacy; rather, it strongly suggests that a cautious approach has to be taken in determining when subclassing is required. This topic will be returned to shortly.

### B. *Voice: How Much Is Desired?*

It is easy enough to advance proposals to give class members greater “voice.” For example, class votes could be taken on important questions (such as on any proposed settlement); class steering committees could be formed; and class member participation could be maximized at every stage. But such reforms are costly.

Moreover, the real issue is whether the majority of class members (and not simply the occasional dissident) truly want such a voice. On the policy level, the choice is between the uninformed democracy of class members versus the often self-interested professionalism of plaintiffs’ attorneys. To understand this trade-off, it is useful to begin with a focus on how undemocratic current class action procedures actually are.

1. *The “Voiceless” Representative.* — One of the ironies of *Amchem* is the stress it placed on the need for an unconflicted and “adequate” class representative without any recognition of the basically trivial role currently accorded to the class representative. Commentators have generally agreed that the representative in a class action is more a figurehead than an actual decisionmaker.<sup>98</sup> For the contending plaintiffs’ counsel, a client is a ticket of admission into the negotiations that determine lead counsel and the composition of the plaintiffs’ steering committee. Typically, counsel finds the client in order to launch its projected class action, not the reverse.

More importantly, existing law gives the class representative very little, if any, real authority. A dramatic example of the relative powerlessness of the class representative is revealed by a recent Third Circuit deci-

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98. For the fullest discussion of this theme, see Macey & Miller, *supra* note 15, at 19–27; see also Edward H. Cooper, *The (Cloudy) Future of Class Actions*, 40 *Ariz. L. Rev.* 923, 927 (1998) (“class representatives often are recruited by class counsel, play no client role whatsoever, and—when deposed . . . —commonly show no understanding of their litigation.”). One exception to this generalization is, however, increasingly important: the role of institutional investors in securities class actions as “lead plaintiffs.” See *infra* notes 120–120 and accompanying text.

sion, which involved the rare fact pattern in which the class representatives were sophisticated and substantial participants in the proceeding. In *Lazy Oil Co. v. Witco Corp.*,<sup>99</sup> a dispute arose between class counsel and three of the four class representatives who had brought a class action, based on the Sherman Antitrust Act, against three substantial oil companies. Each of the class representatives was a corporation or partnership that specialized in the oil industry, and the principal representative—Lazy Oil Co.—was described by the Third Circuit as the party who “conceived the suit but later became disaffected with its management and direction and ultimately with its fruits—the settlement.”<sup>100</sup> Only one of four named class representatives sided with class counsel in favoring the settlement, and it had not participated in the original filing of the action.<sup>101</sup>

Not only did three of the four named class representatives object to the adequacy of the settlement, but an additional 384 class members agreed with them and filed similar objections.<sup>102</sup> In common, the objectors considered the proposed settlement to be inadequate and argued that a separate subclass should be created to reflect their different economic position as full-time oil producing entrepreneurs because the rest of the class consisted mainly of passive investors.<sup>103</sup> Given their disappointment with class counsel (whom they had originally retained), they also moved to disqualify class counsel from representing the class because class counsel was “now representing a party (i.e., the plaintiffs) adverse to one they previously represented (i.e., the objectors), [thus] creating an impermissible conflict of interest.”<sup>104</sup> Under the traditional ABA standard, such representation would justify disqualification—at least in a case involving only individual litigants.<sup>105</sup>

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99. 166 F.3d 581 (3d Cir. 1999).

100. *Id.* at 583. The district court also recognized Lazy Oil Company’s decisive role by awarding it a \$20,000 incentive fee for its services as class representative. Two other class representatives received a \$5,000 incentive fee each, thus suggesting that Lazy Oil had truly been the driving force in this class action. See *Lazy Oil Co. v. Witco Corp.*, No. 94-110, 1997 U.S. Dist. LEXIS 21397, at \*105–\*109 (W.D. Pa. Dec. 31, 1997).

101. Wynnewood Drilling Associates was the only class representative to side with class counsel. This is stated most clearly in the district court’s opinion. See *id.* at \*10. As a result, all the representatives who originally filed the suit opposed the settlement.

102. See *id.* at \*15. Other objectors raised still other grounds but did not appeal the district court’s decision.

103. See *Lazy Oil*, 166 F.3d at 583. As discussed later, this demand raises the possibility of a holdout problem: Namely, the objectors may have wanted a larger allocation of the settlement, which they could better bargain for if they were placed in a separate subclass. This possibility underlines another problem with subclassing: It may be used by organized subgroups whose legal position is not truly different from that of other class members in order to extort a larger share of the settlement by threatening to delay or veto the settlement. See *infra* notes 161–163 and accompanying text.

104. *Id.* at 588.

105. Under the ABA’s Model Rules of Professional Conduct, Rule 1.9(a) provides that a “lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person’s

The district court disagreed with the objectors in all respects, finding the settlement fair, the proposed subclass unnecessary, and the asserted conflict of interest insufficient to justify disqualification in the class action context. The Third Circuit affirmed, after first deciding that the appropriate standard for review was the very deferential standard of "clear abuse of discretion."<sup>106</sup> In addition, the Third Circuit panel endorsed the district court's position that a conflict of interest that would lead to disqualification of counsel in the context of individual litigation might not be sufficient in the case of class action litigation.<sup>107</sup>

In overview, it is possible to find the Third Circuit's analysis persuasive on many of its factual conclusions and yet still feel that the broader question has been largely missed (or politely suppressed). That question is: What control should sophisticated class representatives have over a class action? Can class counsel simply ignore their preferences, even when a clear majority of the representatives wants the settlement rejected? Effectively, class counsel did that in *Lazy Oil* by resigning as counsel to seventy-five percent of the class representatives (who opposed the proposed settlement), but remaining as counsel to the fourth representative and to the class generally.

Little about this conflict between the class representatives and their counsel, or its outcome, should be surprising. Similar conflicts have happened before and with the same ultimate outcome.<sup>108</sup> When disputes arise between class counsel and the class representatives over a proposed settlement, it is likely to be the case that counsel will want to settle, while the representatives favor rejection of the offer. Such a disagreement is simply a specific example of the earlier noted predictable conflict over risk between class members and their counsel.<sup>109</sup> In *Lazy Oil*, class counsel's motives for settlement were both understandable and self-interested. First, the litigation odds in a price-fixing class action were formidably stacked against it because discovery had not uncovered any hard evidence of actual collusion. Second, the proposed fee award was liberal (thirty

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interests are materially adverse to the interests of the former client unless the former client consents after consultation." Model Rules of Professional Conduct, Rule 1.9(a) (1998).

106. *Lazy Oil*, 166 F.3d at 587 (citing *In re Prudential Ins. Co. of Am. Sales Practices Litig.*, 148 F.3d 283, 299 (3d Cir. 1998)).

107. See *Lazy Oil*, at 589-91.

108. Class action settlements have been approved despite even higher levels of objections from class members and class representatives. See, e.g., *County of Suffolk v. Long Island Lighting Co.*, 907 F.2d 1295, 1325 (2d Cir. 1990) (noting that even if the majority of class members oppose a settlement, that fact cannot bar the approval of a settlement that a district judge determines to be reasonable); *Maywalt v. Parker & Parsley Petroleum Co.*, 864 F. Supp. 1422, 1430-33 (S.D.N.Y. 1994), *aff'd*, 67 F.3d 1072 (2d Cir. 1995) (approving settlement despite objections of class representatives and 2,700 class members).

109. See *supra* notes 47-51 and accompanying text. One discrepancy between *Lazy Oil* and the typical such conflict should be acknowledged: The class representatives in *Lazy Oil*, being "professional" oil producers, were not fully diversified and hence were unlikely to be risk neutral.



percent of the settlement plus expenses, which brought the total payment to counsel for fees and expenses up to a very generous forty percent of the recovery). Finally, the objectors' theory for why greater damages were obtainable seemed tenuous, and their request for a special subclass made little sense.<sup>110</sup>

All these factors made the proposed settlement seem reasonable. Still, the key issue remains: Whose lawsuit was it? If a substantial group of individuals sued together in a consolidated proceeding, their ability to change counsel would seem beyond question and could not be denied simply because their attorney was more realistic than they were about the action's merit. Yet, the practical impact of the Third Circuit's holding in *Lazy Oil* was clearly to imply that class counsel had effective control of the class action (indeed, possibly even if all the class representatives were to oppose the settlement). Such a result can be rationalized on the ground that the attorney represents all class members, and not simply the representatives, but the implicit assumption here that the rest of the class would side with the attorney (and not the class representatives) simply because they did not opt out or because the court approved the settlement as fair and adequate assumes precisely what is to be proven.<sup>111</sup> Such an approach makes judicial approval of the settlement's fairness the exclusive test, and this is precisely the approach that *Amchem* rejected, because it would "eclipse" the other protections of Rule 23.<sup>112</sup>

What is missing in the Third Circuit's analysis is any recognition that some level of client disapproval may signal that the proposed settlement is more in the attorneys' interest than that of their clients. Instead, the Third Circuit panel reasoned that if class counsel were required to recuse itself because it was now litigating against a former client in a closely related matter, then "not only would the objectors enjoy great 'leverage,' but many fair and reasonable settlements would be undermined by the need to find substitute counsel after months or even years of fruitful settlement negotiations."<sup>113</sup> This point about the excessive "leverage" that an objector would gain if it could disqualify class counsel whenever they disagreed over the settlement (or any other litigation issue) has some merit, but the strength of this point is greatly reduced when a majority of the class representatives dissent and object to the settlement. Although individual objectors are frequent, dissent by a majority of the class repre-

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110. Subclasses for professional versus passive investors seem unnecessary because under the Sherman Act their price-fixing claims were legally equivalent.

111. As discussed later, class members did not have the opportunity to opt out in *Lazy Oil* after the settlement was reached because the opt-out period had expired earlier. The class action had been certified on June 30, 1995 and the district court had provided for a forty-seven day opt-out period, which began on October 18, 1995, within which class members could request exclusion from the class. See *Lazy Oil Co. v. Witco Corp.*, No. 94-110, 1997 U.S. Dist. LEXIS 21397, at \*6-\*7 (W.D. Pa. Dec. 31, 1997). The final settlement was not reached until 1997. *Id.* at \*9-\*10.

112. *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 621 (1997).

113. *Lazy Oil Co. v. Witco Corp.*, 166 F.3d 581, 589 (3d Cir. 1999).

sentatives is rare and probably telling. By analogy, such a case resembles a decision by a majority of a corporation's shareholders to reject a transaction brought to them for ratification by their corporation's board of directors. At a minimum, the Third Circuit panel needed to explain better why the majority should not presumptively rule. Instead, *Lazy Oil's* focus on the threatened loss of a "fruitful settlement negotiation" begs a prior question: "fruitful" for whom? Perhaps, the settlement negotiations had proven more "fruitful" for counsel than for the class.

For the future, the greater significance of *Lazy Oil* is that it shows that contractual arrangements cannot be relied upon to assure the loyalty of class counsel to the class representatives. To illustrate, assume that a group of sophisticated corporate buyers in an antitrust class action determine to bring a price-fixing class action against one or more defendants (much as happened in *Lazy Oil*). Now, however, they enter into a retainer agreement with a plaintiff law firm or firms under which the law firms will prosecute the case on a contingent fee basis, but with the additional proviso that class counsel will not enter into even a preliminary settlement agreement with the defendants without the prior consent of a majority of these class representatives. The class action is filed, and the court names the retained law firm as counsel to the class. After conducting negotiations with the defendants, class counsel decides that the best settlement from its perspective is one that its clients will never approve (either because of their clients' unrealistic expectations or because of a basic conflict over risk).<sup>114</sup> Accordingly, while the law firm resigns as counsel to the class representatives, it remains counsel to the class—and promptly enters into a settlement with the defendants. Because the court has designated the law firm as class counsel, the law firm can apparently act in exactly this way, justifying its actions with the claim that it owes a duty to the class as a whole. The trial court will, of course, be required to approve the settlement's fairness (and also the adequacy of the class representative and class counsel). If need be, the court can also appoint a new successor class representative.<sup>115</sup> If experience is any guide, the trial court will be extremely pleased that a settlement has been reached, and will side in this dispute with the class counsel, who will present itself as protecting the interests of the class as a whole against the "unrealistic"

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114. One will never know which of these possibilities is decisive, and a legal rule that privileged class counsel to settle based on their clients' unrealistic expectations, but not because of risk conflicts, would be empty of content.

115. If the unanimous opposition of the class representative were thought to make a difference (in contrast to the 75% opposition in *Lazy Oil*), class counsel would predictably learn very quickly to include at least one nominal representative in the complaint who was loyal to it. Indeed, it can always amend the complaint to do so. Interestingly, this may have happened in *Lazy Oil*, because the one class representative who supported class counsel in *Lazy Oil* joined the action subsequent to the filing of the initial complaint. See *supra* note 101 and accompanying text. Additional class representatives have been added in other controversial cases. See *County of Suffolk v. Long Island Lighting Co.*, 907 F.2d 1295, 1322 (2d Cir. 1990).

demands of the original class representatives. Hence, the court will overrule the original class representatives, just as it normally overrules objectors. The bottom line then is that in class action practice the lawyers decide and the clients are relatively powerless.

There is an additional nuance that further reduces the class representative's power. Suppose a class representative objects to the settlement and retains one of the prior class counsel to represent it (perhaps, a long-standing client relationship will lead the law firm to follow its client and represent it as an objector). Even prior to *Lazy Oil*, the case law strongly suggests that the remaining attorneys for the class can disqualify this law firm from serving as counsel for its client, the objector, because of its prior representation of the class. This was the outcome in *In re Corn Derivatives Antitrust Litigation*.<sup>116</sup> As a result, there is a one-way ratchet effect here: Class counsel can remain in the action if it falls out with its client, but if class counsel switches with its client to represent objectors, it stands an excellent chance of disqualification, based on the same prior representation.

2. *The Difficulty of Compromise.* — What degree of control should the class representatives have over class counsel—if any? Few would argue that a class representative should have absolute control over class counsel, who after all owes an overriding duty to the entire class. Even an unconflicted class representative may have an idiosyncratic or overly optimistic view of the merits of the case, whereas class counsel, having far more experience, understands the inevitable risks and uncertainties in litigation. In addition, when class counsel is in effect financing the action by advancing litigation expenses and accepting a contingent fee, its economic stake in the litigation may dwarf that of the class representatives. Realistically, one cannot expect an unsecured creditor to be as docile as an agent paid on an hourly basis.

Still, the more that one despairs of a model of “descriptive representation,” the more it becomes appropriate to consider whether greater accountability could result from a “formal representation” model.<sup>117</sup> Under such a model, contractual agreements between the counsel and the class representatives might attempt to structure a reasonable compromise. For example, a contract between class counsel and the class representatives might provide that in the event of a dispute over the adequacy of a proposed settlement, the class representatives should have the right to replace the class counsel (with a successor counsel satisfactory to the court), and that the original class counsel should then be entitled to im-

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116. 748 F.2d 157, 160–62 (3d Cir. 1984). But see *Bash v. Firstmark Standard Life Ins. Co.*, 861 F.2d 159, 161 (7th Cir. 1988) (refusing to disqualify objector's counsel on somewhat different facts).

117. As noted earlier, Professor Pitkin distinguishes between “formal,” “descriptive,” and “symbolic” representation. Pitkin, *supra* note 14, at 112–43. The real issue in her terminology is how to move from any of these categories to “substantive representation” in which the agent truly “acts for” the constituency.

mediate repayment of the litigation expenses that it had advanced and to eventual payment of a reasonable contingent fee based on the originally proposed settlement (if an equivalent or greater recovery were ever obtained). Hypothetically, if the proposed settlement were for \$10,000,000 and successor counsel eventually won a settlement of \$16,000,000, the original counsel might be entitled to a fee equal to 25% of the \$10,000,000 settlement it earned plus interest from the time of the initial settlement (while successor counsel might be entitled to an even larger percentage of the difference between \$10,000,000 and \$16,000,000, given the greater risk that it assumed).

At first glance, this arrangement may seem to balance fairly the interests of both counsel and the class representative, because it does not require the initial class counsel to finance a long-shot action that class counsel believed was too risky for its taste and it permits the class representative to replace the attorney. Still, this compromise is unlikely to please class counsel because it requires it to expose its expected fee award under the proposed settlement to the risk that successor counsel will lose the case. In effect, class counsel is asked to trade a "bird in the hand" for a more risky "bird in the bush" that will at least be delayed and may never be caught. Second, it may be impossible to compensate the successor counsel adequately out of the balance of the settlement fund—at least without depleting it unreasonably.<sup>118</sup>

Thus, even if the foregoing retainer arrangement between the class representatives and class counsel were enforceable, it would be a solution to a problem that would rarely arise. As a practical matter, the class representatives will rarely be willing to finance the action themselves (or to reimburse the expenses of a counsel they wish to replace). Client financing of the action is highly unlikely because of the inherent collective action problem in class actions; that is, a class representative who expects to receive one percent (or less) of the recovery will not logically finance one hundred percent of the action's costs. Even a larger team of class representatives would still face a substantial shortfall between its expected payoff and the risky investment that it would have to make if the price of control over the action is financing its progress.

Both because of these collective action problems and because the original counsel will not wish to risk its fee award under the proposed settlement, class counsel will predictably argue to the trial court that its proposed settlement is in the "best interests" of the entire class, and char-

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118. For example, suppose the initial proposed settlement is for \$10,000,000 and the class representatives reject it and obtain successor counsel who after two years' work obtains a recovery of \$12,000,000 from a jury. Successor counsel would be unlikely to accept this role without some assurance of substantial compensation if successful. If the original counsel receives 25% of the \$10,000,000 initial recovery and the successor counsel negotiates a similar fee, then roughly half the recovery goes to the attorneys. This is not unthinkable, but it suggests the high cost of seeking to contract for a right to replace counsel.

acterize the dissident class representatives (much like the traditional objector) as either unrealistic or as reflecting personal interests. Given the strong preference of most trial courts for settlement, it is a safe bet that class counsel will win most of these disputes. Indeed, the evidence shows that *Lazy Oil* is far from unique, and class action settlements have been approved in the face of high levels of opposition from class members and even the united opposition of the class representatives.<sup>119</sup>

The bottom line then is that class counsel is and will remain the sovereign of the class action with the class representative being largely a titular figurehead. In turn, this means that only modest hopes can be placed on proposals to enhance voice as a means of protecting class members. Thus, although some commentators have proposed expanded rights for all class members to intervene and participate in class action decisions,<sup>120</sup> the result of such reforms is likely to be modest at best. Amidst the cacophony of multiple voices, the trial court will as usual favor those arguing for approval of the proposed settlement.

3. *When Will Voice Work?* — If class counsel cannot be effectively restricted by contract and if the trial court will predictably favor the proponents of settlement over class members who would prefer to hold out, does this imply that class members lack any means of effective control over their nominal agent, the class counsel? Although the implications that flow from these tendencies are certainly pessimistic, it does not truly follow that a greater role for voice cannot be implemented in representative litigation. The one factor that gives class members some degree of control is that they are sometimes repeat players who will be recurrently involved in such actions. To the extent that they will repetitively retain class counsel, counsel will be constrained from pursuing their own self-interest by the desire to secure future employment. The clearest example of this phenomenon arises in securities litigation, where the Private Securities Litigation Reform Act of 1995 (“PSLRA”) creates a presumption that the class representative (or “lead plaintiff” in its terminology) should presumptively be the class member or members who have the largest stake in the action.<sup>121</sup> The PSLRA further provides that this lead plaintiff shall “select” the class counsel (subject to judicial approval). If such a lead plaintiff system applied to antitrust litigation, it would have meant that *Lazy Oil*, as the largest shareholder, would have been presumptively entitled to select counsel for the class in *Lazy Oil Co. v. Witco Corp.*

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119. See cases discussed supra note 108.

120. See Woolley, supra note 19. I do not mean to indicate opposition to Professor Woolley’s proposals, but only skepticism as to their likely impact.

121. The PSLRA directs the court to “appoint as lead plaintiff the member or members of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members.” 15 U.S.C. § 78u-4(a)(3)(B)(i) (Supp. IV 1998). The PSLRA then creates a “[r]ebutable presumption . . . that the most adequate plaintiff . . . is the person or group of persons that . . . in the determination of the court, has the largest financial interest in the relief sought by the class.” *Id.* § 78u-4(a)(3)(B)(iii)(I).

Still, one must be realistic about the actual impact of such a provision. In *Lazy Oil*, the class member with seemingly the largest stake in the action did select class counsel—but class counsel later rebelled and negotiated its own settlement which it probably knew would elicit the opposition of the client that retained it. Could this happen in the context of securities class actions as well? The PSLRA is silent as to whether the lead plaintiff has any ability to dismiss the counsel it retains, and once the court names this counsel as counsel for the class, it is arguable that the lead plaintiff lacks the power thereafter to replace that counsel with another counsel satisfactory to the court.

Still, the institutional investor has another and more important source of influence. Because institutional investors hold enormous portfolios of securities, they are well positioned to act as lead plaintiff in most securities class actions. They are thus repeat players who will have the opportunity again and again to select class counsel. This source of power may maintain the loyalty of any class counsel who wants to be selected by that institution in other actions in the future. Reinforcing this tendency is the fact that only a relatively small population of institutional investors—chiefly the largest public pension funds—have been willing to serve as lead plaintiffs.<sup>122</sup> Hence, the practical ability to select class counsel in securities class actions belongs to a relatively small and close-knit population of interacting public pension funds.

Nonetheless, the early experience under the PSLRA has revealed that even this legislatively-granted power to institutional investors to serve as lead plaintiffs has often elicited a hostile judicial reaction. Put simply, some trial judges have gone to considerable lengths to nullify this power to select class counsel. Initially, the traditional plaintiffs' bar sought to resist institutional investor control by aggregating the claims of individual investors and presenting this loose-knit grouping of individuals to the court as a rival candidate for the position of lead plaintiff.<sup>123</sup> For example, a hundred individual investors each owning small amounts might collectively own more stock in the defendant than any single institution. If they were designated lead plaintiff, they could then select the law firm that organized them into this group as class counsel. Some courts and the SEC have resisted this attempt to aggregate the claims of unaffiliated

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122. For early reviews of the performance of institutional investors as lead plaintiffs, see Jill E. Fisch, *Class Action Reform: Lessons from Securities Litigation*, 39 *Ariz. L. Rev.* 533 (1997); Keith L. Johnson, *Deterrence of Corporate Fraud Through Securities Litigation: The Role of Institutional Investors*, 60 *Law & Contemp. Probs.* 155 (1997); Elliott J. Weiss, *Comment: The Impact To Date of the Lead Plaintiff Provisions of the Private Securities Litigation Reform Act*, 39 *Ariz. L. Rev.* 561 (1997).

123. The first of these now recurring disputes arose in *Gluck v. Cellstar Corp.*, 976 F. Supp. 542 (N.D. Tex. 1997). There, the State of Wisconsin Investment Board ("SWIB") was appointed lead plaintiff, where its ownership clearly exceeded that of the individual plaintiffs, who had been brought together by a traditional plaintiffs' law firm (Milberg, Weiss). After much jockeying for position, the court ultimately appointed SWIB as lead plaintiff.

individual investors, arguing that the PSLRA intended to substitute client control over securities class actions for the prior patterns of attorney-driven class actions.<sup>124</sup> At present, courts remain divided about the propriety of such aggregation of unaffiliated individuals.

In any event, another and superior tactic for neutralizing the lead plaintiff concept has been perfected: The court can appoint multiple lead plaintiffs, each of whom then predictably appoints its own counsel, and the collection of class counsel thus assembled thereafter operates by majority vote.<sup>125</sup> For example, suppose a large institutional investor owns 2% of the outstanding securities in the class and the next two largest investor groups (each a collection of individual investors assembled by different traditional plaintiffs' law firms) owns 0.05% each. If the court appoints all three as lead plaintiffs and each selects its usual law firm, the result is that investors holding 0.1% effectively outvote the institutional investor who owns 2% (or twenty times their stake in the action).<sup>126</sup>

Why would a trial court manipulate the PSLRA in this fashion to nullify the seeming intent of the lead plaintiff concept? Although different courts may have different motives, the most likely explanation is that trial courts understand and welcome the fact that the traditional plaintiffs' firms tend to settle early and avoid protracted litigation.<sup>127</sup> Such a

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124. See, e.g., *In re Donnkenny Inc. Sec. Litig.*, 171 F.R.D. 156, 157–58 (S.D.N.Y. 1997) (finding that unrelated individuals cannot constitute a lead plaintiff and have their shares aggregated for purposes of the PSLRA's lead plaintiff proxism). Other courts have refused to permit multiple lead plaintiffs on the ground that they will be unable to control class counsel. See *In re Advanced Tissue Sciences Sec. Litig.*, 184 F.R.D. 346, 352 (S.D. Cal. 1998); *In re Milestone Scientific Sec. Litig.*, 183 F.R.D. 404, 417 (D.N.J. 1998). At least one court and the SEC have taken the position that "ordinarily . . . no more than three to five persons" should be aggregated as a group, because in its view a larger group would not "be capable of effectively managing the litigation and the lawyers." *In re the Baan Co. Sec. Litig.*, 186 F.R.D. 214, 216–17 (D.D.C. 1999). The SEC's standard amicus brief on this issue is attached as an appendix to the Baan decision. See *id.* app. at 218–35.

125. This is the fact pattern in *In re Oxford Health Plans, Inc., Sec. Litig.*, 182 F.R.D. 42 (S.D.N.Y. 1998). There, ColPERA, The Colorado Public Employee's Retirement Association, was found by the court "to have suffered the largest financial loss, followed by the Vogel plaintiffs and the PBHG Funds." *Id.* at 44. ColPERA suffered losses of over \$19 million. See *id.* The Vogel group consisted of individuals who collectively suffered losses of just over \$10 million, while the PBHG Funds alleged losses of \$2.756 million. See *id.* at 44–45. Thus, the losses to Vogel and the PBHG Funds, when added together, were well below the losses to ColPERA. Nonetheless, the court appointed all three as lead plaintiffs and permitted each to select their counsel as class counsel. See *id.* at 49–50. The net effect was to make ColPERA the equivalent of a minority shareholder, who could be outvoted by the other two.

126. In reality, this example is only a more extreme version of the actual outcome in the *Oxford Health* litigation. See *id.*

127. Indeed, in *Oxford Health*, the trial court noted that "[a]n overwhelming percentage of securities class actions are settled" and cited data indicating that 87.6% of securities class actions filed from April 1988 through September 1996 "ended in settlement." 182 F.R.D. at 47 n.5. Although securities class actions may be distinctive in some respects, they typically involve higher attorney fee awards than other class actions. This means that the asymmetry in the stakes between the plaintiffs' attorney and the

tendency makes economic sense. If we model the class action as a negotiating game between the plaintiffs' attorney and the defendants, then it follows that there is a basic asymmetry in the stakes. That is, the traditional plaintiffs' attorney expects a contingent fee that is likely to equal approximately one third of the recovery while in contrast the defendants are motivated by the threatened loss of the entire recovery or settlement (which by definition is three times greater). This imbalance in the stakes gives the defendants, who fear a loss that is a multiple of the plaintiffs' attorneys' gain, greater incentive to invest resources in the action.<sup>128</sup> In turn, this imbalance implies that the plaintiffs' attorney will under-invest (on a relative basis) and wish to settle earlier.

The irony is that the more loyal the class attorney is to the interests of the class, the more the attorney is likely to impose a greater burden on the trial court by resisting an early settlement. Thus, to the extent that institutional investors serving as lead plaintiffs secure more "loyal" counsel, the asymmetry in the stakes is reduced, but as a result the court faces a greater burden from such an action that is less likely to settle early. The bottom line is that the trial court therefore has a rational incentive to oppose the appointment of the more "loyal" class counsel selected by institutional investors.

To be sure, other explanations for resisting the appointment of institutional investors as lead plaintiffs can be given. Perhaps, some district courts have doubted the competence or skill of the plaintiffs' attorneys retained by institutional investors, whose attorneys have generally not been members of the traditional securities plaintiffs' bar. Thus, the court may prefer to appoint multiple law firms as lead counsel to assure adequate experience. Understandable as this concern may be, the early experience with public pension funds as lead plaintiffs actually indicates that the settlements obtained by institutional lead plaintiffs have been above average.<sup>129</sup> In any event, whether the dominant motivation has been judicial caution or a desire for early settlements, federal trial courts have initially resisted the lead plaintiff concept.<sup>130</sup> This suggests that other efforts to shift control of class action litigation, even marginally, from attorneys to their clients may encounter similar resistance.

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defendants' is even more pronounced than in other class actions and even more likely to elicit early settlements. See *infra* notes 128–120 and accompanying text.

128. See Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 15, at 686–90 (1986).

129. See Jay W. Eisenhofer & Abbott W. Leban, *The Lead Plaintiff Provision: Does It Work?*, *Corp. Governance Advisor*, May–June 1999, at 9, 14 (citing data in only the first two lead plaintiff cases to result in settlement).

130. More recently, however, federal courts have begun to resist the use of large aggregations of individual class members as lead plaintiffs. For the most recent indication of this trend, see *Mitchell v. Complete Management, Inc.*, No. 99 Civ. 1454, 1999 U.S. Dist. LEXIS 14460 (S.D.N.Y. Sept. 17, 1999); see also cases cited *supra* notes 123–123. Hence, there are counter-trends.



To be sure, other mechanisms for enhancing voice can also be envisioned that may be less susceptible to judicial nullification, but they also encounter severe problems. Voting is probably the most obvious means of according voice to class members. In principle, one could require class member ratification of the proposed settlement (much as is done with a proposed plan of reorganization in bankruptcy). But not only would such a change require legislative action, its feasibility also seems doubtful. Critical differences exist between the bankruptcy and class action contexts. First, in bankruptcy, the creditors are generally known, and their claims have been liquidated; as a result, it is feasible to solicit them. The reverse is true in the class action setting, where by definition the claims have not been reduced to judgment.

Second, the traditional class action aggregates small claims that are individually uneconomical to litigate. Small claimants have little incentive to vote. Thus, not only will these small claimants be hard to identify or contact, but they have little reason to respond to any solicitation. In turn, this implies a low turnout and referenda that might be decided by only a small percentage (say two to three percent) of the potential electorate. This means that active electioneering and public relations campaigns by the settling parties are likely to be more determinative of the outcome than in a high turnout election. A related problem is agenda manipulation. Much depends on who will frame the question on which class members will vote. The obvious candidates are the settling parties or the court, but both share a preference for settlement over litigation. Next, campaign finance is a critical factor in all elections, and objectors lack both the organization or incentives to match the expenditures that the settling parties will predictably incur to achieve a favorable vote.

Ultimately, the concept of class member referenda most clearly fails because of a collective action problem: A one percent class member will not incur the same expenditures to reject a proposed settlement that shortchanges this class member as the defendants will bear in order to economize on their settlement costs. In short, to make voting work, someone has to have sufficient incentives to organize the opposition. As will be suggested later, only a rival team of plaintiffs' attorneys seem likely to have the incentives to undertake this task.

### C. *Exit: Toward Client Autonomy*

Client autonomy—the idea that the attorney should abide by the client's preferences and litigation goals—is the baseline norm of legal ethics.<sup>131</sup> But, as already indicated, in representative litigation it is a rule honored more in the breach than in the observance. Moreover, it is also a norm that can only be incompletely realized at best in representative

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131. See Model Rules of Professional Conduct Rule 1.2(a) (1998) ("A lawyer shall abide by a client's decisions concerning the objectives of representation . . . [subject to specified exceptions]."). See *infra* note 138 for a fuller discussion of this rule.

litigation where the attorney is not simply an agent of the client. Rather, the attorney is also the creditor and joint venturer who is effectively financing their common undertaking and has much more at stake than any individual class member. This section will explore the degree to which client autonomy can and cannot be realized under these circumstances.

1. *A Hypothetical Bargaining Approach.* — If class counsel and disinterested class representatives are unlikely in fact to agree on terms that permit the class to fire and replace its counsel in the manner that an ordinary client can replace its attorney, this does not mean that other kinds of bargains could not be struck if it were possible for the attorney and the class to negotiate on a fully informed basis. Although such bargaining is hypothetical,<sup>132</sup> rather than real, public policy might be sensibly guided by examining the kind of “hypothetical bargain” that such parties would reach, given their divergent interests.

In this hypothetical world, the class counsel would understand the following facts: (1) the class likely would be considerably more risk neutral than its counsel; (2) at least some class members would have unrealistic expectations; and (3) some class members would desire a degree of emotional and public vindication for their grievances that was either unrealistic or simply counterproductive to the attorney’s desire to maximize the financial recovery. Thus, the attorney would rationally fear that the class might want to free ride on the attorney’s efforts and gamble on a long-shot recovery based on the effectively free financing for the action that the attorney was providing.

Conversely, rational class members would fear that class counsel would behave in a risk-averse fashion and settle the action at an amount well below the level that a more aggressive and risk neutral agent could negotiate. They would further understand that the more time the attorney invested in the action and the more funds the attorney advanced for expenses, the more the attorney logically would become risk averse. The class would also recognize that there were enormous possibilities for latent conflicts of interest to cloud their counsel’s judgment and distort counsel’s incentives.

In short, neither side can take much comfort from its assessment of the other’s inclinations and incentives. Thus, the basic message is that neither side can regard the other as a natural partner with fully compatible interests and expectations. What then can they agree upon? Basically, they could agree on protections so that neither side could be exploited by the other.

Motivated by a contingent fee, class counsel would particularly not want to risk being replaced by a successor counsel if class members

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132. For a discussion of hypothetical bargaining, see David Charny, *Hypothetical Bargains: The Normative Structure of Contract Interpretation*, 89 Mich. L. Rev. 1815 (1991).

elected to take a long-shot gamble on trial. Class counsel's rational fear would be that after it had funded the action for years, it might be replaced on the brink of trial and victory, because it rationally counseled caution.<sup>133</sup> Class members in turn would fear that plaintiffs' counsel, the defendants, and a trial court that was usually inclined to prefer settlement over trial might conspire to strike a deal that ignored the class's own preferences.

Given these rational fears, both sides should recognize that they needed a right to effect a divorce of their de facto partnership when their interests conflict (as they legitimately can conflict). The most sensible response to this recognition would be to permit a "no fault" divorce that did not require proof of culpability or fiduciary misconduct. How would they achieve this? One answer would be to negotiate reciprocal rights to exit the class action. Viewing their situation *ex ante*, rational class members would want to maximize their right to opt out if the settlement struck them as overly cheap. Correspondingly, class counsel would want the right to avoid conscription by a class intent on utilizing the counsel's funds and efforts in order to take a long-shot gamble at trial. Hence, both sides would agree that each could call the partnership off if their interests deviated. For class members, this means a right to opt out. For class counsel, this implies some right to recover even if the class representatives want to utilize a different strategy and a different attorney.

Against this backdrop, a central contention of this Article is that "exit" is more likely to be effective than "voice."<sup>134</sup> But the right to exit today is often compromised or eclipsed by a variety of stratagems that the settling parties use to minimize opt outs. Reform is thus needed. In addition, as next will be suggested, exit and voice can be combined in ways that make each more effective.

2. *Protecting Exit.* — Because collective action problems confound voice, the more feasible route to client autonomy may lie in enhancing the right to exit. To understand why, it is useful to return to the facts in *Lazy Oil*.<sup>135</sup> Arguably, the real problem in *Lazy Oil* was that the objecting class members were already locked into the class action and could not opt out when a settlement that they regarded as unsatisfactory was announced. As the District Court's opinion makes clear, the *Lazy Oil* class was certified as a Rule 23(b)(3) class action pursuant to an order entered on June 30, 1995, and a settlement notice, dated September 27, 1995, was

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133. If traditional legal ethics govern, the law of many states gives the client the right to fire the attorney at any time. See *Covington v. Rhodes*, 247 S.E.2d 305 (N.C. App. Ct. 1978); *Hiscott & Robinson v. King*, 626 A.2d 1235 (Pa. Super. Ct. 1993); see also Model Rules of Professional Conduct Rule 1.16 cmt. (1998) ("A client has a right to discharge a lawyer at anytime, with or without cause . . .").

134. This conclusion is limited to class actions primarily seeking money damages, where the class's interests are linked by their joint desire to reduce transaction costs and increase leverage. Where the action primarily seeks non-pecuniary goals, "voice" may well be the preferred checking mechanism by which to control attorney opportunism.

135. See *supra* notes 99–115 and accompanying text.

mailed to class members that gave class members forty-seven days to request exclusion from the class.<sup>136</sup> Yet, the settlement agreement that aroused the ire of objectors was not entered into by counsel until January, 1997, nearly fourteen months after the deadline to opt out from the class had expired.<sup>137</sup> Although no indication exists that counsel deliberately delayed the *Lazy Oil* settlement's disclosure until after the class members could not escape it, plaintiffs' counsel does have precisely such an incentive—because opt-outs reduce the size of the settlement (and thus their expected fee if it is calculated on the normal percentage of the recovery basis) and may even imperil the settlement if the number of objectors are significant.

In this light, the simplest means of assuring the right to exit would be to delay the opt-out deadline until after at least the approval of the proposed settlement. Otherwise, by placing the opt-out deadline first, counsel is in a position to impose a settlement upon the class that may be unsatisfactory to it. Defendants have every reason to join this conspiracy, and even the trial court has an incentive to acquiesce in any tactic that minimizes opt-outs because opt-outs pose a serious problem for the court and may even require it to try the same case on an individual basis that it had just seemingly settled on a class basis.

Operationally, a right to exit could be implemented either by delaying class certification to the time of settlement approval (which is in fact a common pattern today) or by granting an additional, delayed opt-out right that begins upon the approval of the settlement. Of these two choices, the second is clearly preferable because the plaintiffs' attorney has an obvious reason for seeking early class certification: It increases plaintiff's leverage over the defendant by removing one of the principal litigation uncertainties. The additional opt-out period would only arise if a settlement were reached, meaning that if the defendants were able to obtain a dismissal on the merits after the action was initially certified, then all class members would be bound. Although judicial rules could be used to implement this approach, another means of implementation could be legal ethics. Ultimately, the attorney should be regarded as having a fiduciary duty to the class members to take all feasible steps to permit them to decide for themselves whether to accept a proposed settlement or opt out in light of it.<sup>138</sup>

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136. See *Lazy Oil Co. v. Witco Corp.*, No. 94-1110, 1997 U.S. Dist. LEXIS 21397, \*6-\*7 (W.D. Pa. Dec. 31, 1997).

137. See *id.* at \*10.

138. Legal ethics is deeply imbued with the idea that the client should be enabled by the attorney to make an individual choice with respect to important litigation decisions, including the acceptance or rejection of a settlement. Thus, Rule 1.2(a) of the ABA Model Rules of Professional Conduct specifies: "A lawyer shall abide by a client's decisions concerning the objectives of representation," subject to certain carefully defined exceptions in paragraphs (c), (d) and (e) of the Rule. See Model Rules of Professional Conduct Rule 1.2(a) (1998).

Simple as this answer may sound, it will predictably not please any of the contending parties in a case like *Lazy Oil*. First, it will be resisted by the defendants because it could undercut the value of their settlement by forcing them to relitigate the same case with a substantial number of individual opt-outs. Defendants do, however, have a contractual remedy: They can provide that the settlement agreement is terminated if more than a specified number or percentage of class members opt out. Such provisions are common in settlement agreements, but rarely, if ever, are exercised.<sup>139</sup> Beyond this right to avoid being trapped in an empty or depleted class action settlement, it is difficult to see why defendants have any other valid objections to allowing class members to “vote with their feet” on the attractiveness of the settlement.

Class counsel will, of course, be unhappy with any proposed reform that increases the number of opt-outs because opt-outs potentially reduce their likely fee award. By the same token, however, this reform disciplines class counsel by threatening them with reduced fees if they propose a settlement that is unattractive to their clients. More surprising perhaps is the strong likelihood that the class representatives, such as those that objected in *Lazy Oil*, will also find this proposed reform unsatisfactory. In reality, what objectors often want is control over the class action (not merely the right to exit it) because control of the class gives them negotiating leverage with the defendants. That is, defendants who are reluctant to litigate a billion dollar class action (as in *Lazy Oil*) might be quite ready to litigate the same, but smaller, claims of large individual class members. That objectors want this leverage does not mean, however, that they are entitled to it. In any event, those who opt out could potentially bring an opt-out class action or sue on a consolidated basis, in either case giving themselves additional leverage.

Perhaps the greatest benefit of such a delayed opt-out rule is its ex ante impact on the original plaintiffs’ counsel. Knowing that class members can flee an inadequate or unattractive settlement, they have less incentive to enter one (at least to the extent that their expected fee award will decline); and defendants will also be less prepared to settle on such a basis. Today, as *Lazy Oil* illustrates, class counsel can sometimes force class members to buy the proverbial “pig in a poke” by resolving class

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As a specific illustration, Rule 1.2(a) adds: “A lawyer shall abide by a client’s decision whether to accept an offer of settlement of a matter.” *Id.*

The attorney is also expected to keep the client reasonably informed and explain matters “to the extent reasonably necessary to permit the client to make informed decisions concerning the representation.” *Id.* Rule 1.4(b). Of course, in a class action, the class member does not receive the opportunity to instruct the attorney, but the general obligation to inform the client in order that the client might decide its own best interests is most appropriately satisfied in this context by recognizing a specific obligation not to lock the client into an action by permitting the opt-out period to expire prior to settlement.

139. For the rare case in which such a termination provision based on an excessive number of opt-outs became applicable, but even then was waived by the defendants, see *Presidential Life Ins. Co. v. Milken*, 946 F. Supp. 267, 271 (S.D.N.Y. 1996).

certification before any settlement is reached. Once the class is locked in, the only remaining protection for class members is the possibility that objectors can convince the court not to approve the settlement. This seldom happens.

One skeptical response to this proposed reform is that, while it may be desirable, it will make little difference. Many class actions today are resolved through simultaneous class certification and settlement approval hearings, and yet few class members opt out. What explains low opt-out rates? The best explanation is probably rational apathy: Small claimants who have only modest claims and no real alternative because their claims are typically too small to litigate on an individual basis will simply not bother to opt out. More than is needed, before a right to exit is by itself an effective remedy. In particular, as next discussed, a practical means needs to be developed to aggregate the dissidents, because typically only an aggregation has leverage.

3. *Developing A Market For Exit.* — The potential for enhanced accountability in class actions can probably best be assessed by contrasting class action procedures with the comparable accountability mechanisms in corporate law. Strong analogies exist. In the corporate context, the principal/agent relationship between shareholders and managers can also become strained, as managers either shirk their responsibilities or pursue their own self-interests at the expense of their shareholders. Similarly, both exit and voice are potential remedies in corporate law (along with litigation against faithless agents). However, over the last three decades, one market-based remedy has come to overshadow all others: the hostile takeover. If corporate management underperforms and the price of its company's shares declines, the most likely consequence will not be litigation for breach of fiduciary duties (although that may happen also), but rather a takeover bid from another company that effectively invites the target's shareholders to exit the target company at a lucrative premium. Often, such a takeover bid is combined with a proxy contest to replace the target company's incumbent board—thereby combining voice and exit, but essentially seeking to effect a change in control of the underperforming corporation.

Although an exact analogy cannot be drawn between the class action and corporate governance contexts for a variety of reasons, the idea of a competitive bid has considerable relevance to the class action context. Today, the plaintiffs' counsel who wish to contend for control of the class can do so only at two junctures: (1) They can seek to become class counsel, which typically depends upon the support of the other plaintiffs' attorneys in the action or the favorable disposition of the trial court; or (2) They can object to any proposed settlement and seek to convince the court that the settlement is so inadequate that it should replace the original class counsel. This latter tactic may be often followed, but it rarely works. Understandably, the court will tend to prefer the known counsel to potential, but unknown, substitutes.

In overview, there are two basic problems with current accountability procedures: First, the competition is for the support of either other plaintiffs' attorneys or the court, but not that of the class members themselves. Second, the dissident objector is a poor champion of class action accountability. Primarily, this is because the objector's attorney can receive a fee award only when the objector's efforts "improve" the settlement, but not when the objector's efforts cause the court to reject the settlement or decline to certify the class. This creates an obvious incentive for the objector to "pull his punch" and prefer revision over objection; as a result, the settling parties know that objectors can often be bribed by offering cosmetic improvements to the settlement which they can attribute to the objector's efforts in order to justify a fee award to the objector's attorney. Even when the objector spurns these proposals and seeks to be appointed class counsel, this effort is unlikely to be successful, because the objector is simply seeking too much: namely, control of the entire class, including the vast majority of class members who have expressed no view on the action (and may be unaware of its existence). The more modest and practical alternative would be for counsel to solicit dissatisfied class members to opt into a parallel class action filed by it, but consisting only of those class members who wish to opt out of the original class action. Essentially, this proposal responds to the collective action problems that disable individual shareholders by employing entrepreneurially motivated attorneys to organize the opposition. But the goal of this solicitation is to increase client autonomy by placing the critical decision in the hands of class members; in turn, this forces the rival counsel to compete by signaling their loyalty to the class. Such signals could take a variety of forms: an offer to take a lower fee award or an offer to make their fee contingent on obtaining a superior settlement than that already obtained. At a minimum, class members are likely to find such a competition far more attractive than simply the prospect of opting out and bringing a possibly uneconomical individual action. In effect, such a solicitation is the equivalent of a hostile tender offer because it asks class members to "vote with their feet" and leave one class action to join another.<sup>140</sup>

Operationally, the optimal time for the counter-solicitation is after a tentative settlement has been reached. Then, at one multi-phase hearing, the court could evaluate the certifiability of the class, the adequacy of the proposed settlement, and the accuracy of the disclosures and assertions made in the objecting class counsel's rival solicitation. Thereafter, a reasonable period of time—say thirty to forty-five days from mailing—would elapse during which class members would consider whether to opt out and, if so, whether to join the rival class proposed (or already filed) by

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140. In truth, the more exact analogy is to a hostile equity exchange offer in which one bidder offers to exchange its shares with the shareholder for those of the target. This is because the class member is still very much subject to risk, while the shareholder who accepts a cash tender offer is no longer subject to the risks of the enterprise.

the insurgent class counsel. In effect, the contest would resemble rival proxy solicitations, except that there would be no attempt to vote out the incumbent team of class counsel, but only to encourage dissatisfied class members to opt out and join a rival class action. Such an approach maximizes individual choice, recognizing that inevitably some class members may be satisfied with a proposal settlement, while some may not. Moreover, this approach neither threatens the finality of settlements nor encourages collateral attacks on the class settlement.<sup>141</sup> Viewed in terms of the policy options, this approach provides a more feasible alternative to a broad right to attack class action settlements collaterally.<sup>142</sup>

The deeper premise here is that the best remedy for collusion is competition. If plaintiffs' counsel and defendants have struck a "sweet-heart deal" that shortchanges class members, the more feasible remedy is not to dismiss class counsel, but to invite class members to "vote with their feet" and join a rival class. The competitive solicitations would have to be monitored by the court (just as the SEC monitors rival proxy solicitations for full and fair disclosure). But once adequate disclosure was made, class members would be empowered to choose the action into which they would opt. The net result would be to induce competing counsel to find credible means by which to bond with their clients.

How is this proposal different from a shareholder vote over the selection of lead counsel (which was earlier dismissed as impractical)? Basically, this approach rejects the idea of the attorney's deciding the best interests of the class members as their fiduciary in favor of maximizing client choice so that different class members can select different options. Put simply, there may be no single best solution for all class members, given their different attitudes toward risk and different litigation objectives. Essentially, a competitive solicitation enables class members to self-segregate into those who are willing to accept greater risk and those who are not (with the former opting into the opt-in insurgent class and the remainder staying with the original class). Moreover, in contrast to a vote on the selection of lead counsel at the outset of the litigation, class members at this later stage would be better informed and better motivated

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141. This approach would not imperil the finality of settlements because the remedy for a false or misleading solicitation would be a fraud or malpractice action against the attorney, not a collateral attack on the settlement. See *Durkin v. Shea & Gould*, 92 F.3d 1510 (9th Cir. 1996) (holding that a court-approved settlement of shareholder derivative action does not preclude a subsequent action for attorney malpractice).

142. The ability of a dissatisfied class member to attack a class action settlement on grounds of inadequate representation is in serious question after the Ninth Circuit's final resolution of *Epstein v. MCA, Inc.*, 179 F.3d 641 (9th Cir.), cert. denied, 120 S.Ct. 497 (1999). Originally, the Ninth Circuit had invalidated a class action settlement reached in the Delaware Chancery Court on grounds of inadequate representation, see *Epstein v. MCA, Inc.*, 126 F.3d 1235 (9th Cir. 1997), but withdrew its decision following re-argument, ultimately holding that a challenge on that ground could be made only in the original court. It is beyond the scope of this article to consider whether, or how far, *Epstein* cuts back on *Hansberry v. Lee*, 311 U.S. 32 (1940), which permitted such an attack.



because they could examine the settlement's terms. Any earlier proxy solicitation would tend to resemble a beauty contest between rival counsel, at which the relative credentials of the competing counsel would be the principal focus. Such beauty contests are likely to leave most small claimants indifferent. Once a specific dollars-and-cents settlement offer is on the table, however, class members will predictably show greater attention to the settlement's terms and its impact on them.

Finally, a solicitation at this stage is more cost-efficient. Necessarily, there will be a mailing to class members with regard to the proposed settlement in order to satisfy the constitutional requirement of notice. Typically, this mailing will occur after preliminary judicial approval of the settlement, and the timing of this mailing could be structured to permit the inclusion of relatively short rival statements by objecting counsel who wished to pursue a rival class action (and a response by class counsel). To be sure, disputes would regularly arise about the accuracy of the statements made in these rival solicitations, but similar disputes occur in most corporate proxy contests and are resolved within even more compressed time schedules.

Although it seems likely that many small claimants will remain rationally apathetic, the most difficult problems in modern class actions have arisen not in small claimant class actions, but in class actions involving a high variance in claim values: i.e., classes having both high value and low value claims within the class. In such cases, the insurgent might propose to represent only a proposed subclass whose interests it believed were inadequately represented.

In truth, nothing similar to the foregoing proposal has ever been attempted.<sup>143</sup> Thus, even if this proposal would desirably enhance the value of exit and induce competing counsel to credibly signal their loyalty to their clients, it seems predictable that it, or anything similar that might complicate the settlement process, is certain to face resistance and to be dismissed by many as impractical. Three likely objections stand out and deserve special attention.

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143. On a number of occasions, class representatives in state court class actions have sought to opt out from federal court class actions settlements (which would bind them), both on their own behalf and for all fellow class members in the state proceeding. Although federal courts have permitted the class representative to opt out as an individual, they have uniformly rejected the attempt to extend this opt-out decision to their fellow class members. See *Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1024-25 (9th Cir. 1998) (stating that a class representative lacks the power to opt out an entire class without the permission of individual members); *Berry Petroleum Co. v. Adams & Peck*, 518 F.2d 402, 412 (2d Cir. 1975) (holding that attorneys for prospective class will be able to request exclusion only from people who authorize them to do so); *In re Lease Oil Antitrust Litig.* (No. II), 186 F.R.D. 403, 439 (S.D. Tex. 1999) (determining that class representative cannot opt out on behalf of entire class). Although these attempts might have permitted exit into a viable state court class action, they were properly rejected because the class representative has, and should have, no power to make the decision between competing classes on behalf of class members. As here contemplated, the choice to opt out would be on an individual basis.

a. *Are class members competent to decide?* — This question poses a predictable but extremely paternalistic objection. Admittedly, ordinary class members have little competence in evaluating the merits of a lawsuit, but the level of complexity is not necessarily any higher than that found in many SEC registration statements or proxy solicitations dealing with complex issues of valuation or accounting. Moreover, in the typical class action, the class members have relatively small amounts at stake, thus further reducing the case for judicial paternalism. Even when the stakes are high for the individual class member, that class member already has the right to opt out today. This proposal only formalizes an alternative vehicle into which this class member can opt, thereby enhancing choice, but not creating it.

b. *Will a swarm of contending solicitations produce Rube Goldberg-like complexity and confusion?* — If even a half-dozen rival counsel were to submit proxy solicitations proposing either rival classes or subclasses, the system would be unworkable, and the Balkanization of the class action would arrive by simply another route. But several factors are likely to discipline insurgent class counsel and make these rival solicitations the exception rather than the rule. First, insurgent counsel could be required to pay the reasonable costs of printing and mailing its proposal. This is precisely how the SEC handles hostile proxy solicitations: The company typically mails the insurgent's proxy statement but charges the insurgent its reasonable expenses.<sup>144</sup> Such an up-front cost should quickly screen out frivolous or underfunded class counsel. Second, rival counsel would have little incentive to represent a small opt-in class, as they would be compensated only out of their class's recovery. Hence, their solicitations would logically be contingent on obtaining a sufficiently substantial share of the class to make the litigation economically viable. This factor alone should preclude "Balkanized" classes or a host of satellite classes. Third, the court could refuse to certify the rival class if too few class members opted in or if it believed the proposed subclass otherwise failed the tests of Rule 23.<sup>145</sup> Finally, the court could simply and somewhat arbitrarily limit the solicitations it would include in the basic class action mailing to a feasible number (hypothetically, two or three at most), leaving others to contact class members on their own if they wished. After all, there would seem to be no First Amendment right implicated, as no public forum is involved.

c. *Won't judicial hostility doom this proposal?* — Judicial hostility is certainly to be expected, as this proposal would complicate and delay the

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144. Rule 14a-7 of the Securities and Exchange Commission Rules addresses the obligations of registrants regarding mail to security holders, and requires the issuer to specify to the insurgent "[t]he estimated cost of mailing a proxy statement." See 17 C.F.R. § 240.14a-7(a)(1)(iii) (1999).

145. Rule 23(a)(1) of the Federal Rules of Civil Procedure imposes a "numero[sity]" requirement that must be satisfied before a class action can be certified. Fed. R. Civ. P. 23(a)(1). Hence, if only fifty or so individuals elect to opt in to this rival proposed class, the court could refuse to certify it.

current settlement process. Even if the court to whom the original settlement was submitted would predictably be hostile to a class of opt-outs that have fled the proposed settlement, that court would typically not be the court that would preside over the trial or resolution of the insurgent opt-in class.<sup>146</sup>

Finally, the fundamental idea of a competitive solicitation, as here advanced, does not necessarily require the use of a rival class. For example, in the mass tort context, client choice might be best facilitated by enhancing the ability of class members to choose on a continuing basis between remaining in the class or electing to be represented on an individual or consolidated basis by traditional personal injury attorneys. This option would be particularly useful for the future claimant. If a mass tort settlement gave future claimants the ability to opt out of the settlement on a delayed basis at the point at which their medical condition deteriorated (for example, as of the time at which the asbestos-exposed class member is diagnosed as having lung cancer or mesothelioma), then traditional plaintiffs' attorneys could continue to solicit the class, hoping to cause individual class members to opt out at this point. Such a competitive remedy deters collusion (for example, it should here deter defendants from structuring inadequate settlements for future claimants that failed to adjust adequately for the impact of inflation).

Ultimately, this proposal for utilizing competition and market forces involves a basic policy choice: exit should be seen as a superior substitute to loyalty (or "class cohesion" in the Court's parlance), at least over a broad range of cases. Enhancing exit, as here proposed, is intended as a basis for reducing the need to insist upon high (and possibly unattainable) levels of class cohesion. As earlier noted, if *Amchem* and *Ortiz* are read literally, subclassing may be required whenever a material difference exists within the proposed class in terms of the injuries suffered or strength of the legal claims possessed by class members. Enforced strictly, such a requirement could eclipse the role of the class action in a variety of areas where it provides the only potential remedy for small claimants.

In this light, this Article is therefore proposing a refinement on *Amchem* and *Ortiz's* teachings: While "adequate representation" is a pre-

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146. An opt-out class would be vulnerable indeed if it had to go to trial before the same judge who approved the settlement that its members had earlier rejected. Yet, under *Lexecon Inc. v. Milberg, Weiss, Bershad, Hynes & Lerach*, 523 U.S. 26 (1998), the transferee court that receives the class action by order of the Judicial Panel on Multidistrict Litigation may not retain it for trial, but must refer the case back to the original jurisdiction from which the action was transferred. See 28 U.S.C. § 1407(a). Thus, in the typical case where multiple class actions are consolidated by the Judicial Panel for purposes of pre-trial discovery, the transferee court before whom the various actions are consolidated will evaluate the proposed settlement, but if an opt-in class is formed by those who have opted out of the original settlement, this action will eventually have to be transferred back to its original jurisdiction prior to trial. Effectively, this means that the insurgent class will not typically have to face the judge who approved the settlement as its trial judge.

requisite before a class action can be certified or absent class members may be bound by the judgment, “adequacy” is not self-defining. What constitutes adequate representation should depend in significant measure upon the effectiveness of the right to exit possessed by the class member. Much less should need to be shown to demonstrate adequate representation where there is an effective exit than where the class is a mandatory one from which exit is not permitted. More specifically, where the class member is given a fully-disclosed choice as to whether to participate in a potentially overbroad class or to opt into a narrower subclass, there is substantially less reason to find that differences in the legal strength of the claims held by class members deprived them of adequate representation when one counsel represents all members of the class.

The specifics of this proposal will be discussed further in the next section, but the immediately relevant point here is that if courts face a choice between permitting rival solicitations or requiring elaborate subclassing, they may find the former to be the more attractive option.

### III. THE COSTS OF REFORM: THE RISKS OF BALKANIZATION AND HOLDOUTS

As earlier noted, *Amchem* and *Ortiz* connect adequacy of representation to an ideal of class cohesion, using the predomina[nce] requirement of Rule 23(b)(3) as a partial justification for requiring that the class representative meet a higher standard than that imposed by the traditional “typical[ity]” requirement of Rule 23(a)(3).<sup>147</sup> The need for a higher standard in some contexts is easily understood and both *Amchem* and *Ortiz* seem obviously correct on their facts. But insisting on “class cohesion” may not be the reform best suited to the problems that *Amchem* and *Ortiz* accurately assess. Indeed, if the standard for subclassing were to become that class members must be placed into separate subclasses whenever material differences existed between their injuries or legal positions, the survival of the class action would be imperilled as a means of asserting claims that were infeasible to litigate on an individual basis.

In short, to the extent that *Amchem*’s concept of class cohesion is defined to require identity, the class action becomes threatened. On the other hand, unless subclassing with separate counsel is required in *Amchem*-type cases, class counsel will remain able to make highly discretionary allocations of the settlement among class members without their express consent. Applied across the board, subclassing could be a remedy worse than the disease. Ultimately, this dilemma frames a line drawing problem: When is subclassing truly needed?

To reach an acceptable compromise, this Article will suggest three basic rules by which to address the allocation issue that *Amchem* and *Ortiz* have obliquely raised but not clearly resolved. First, in the context of what this Article will call “negative value” class actions, differences in the

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147. Fed. R. Civ. P. 23(a)(3).

legal position or claim strength of class members need not be viewed as sufficiently material to require subclassing. Second, where the settlement does treat class members in a materially different fashion but class counsel has no external conflict, an effective right of exit plus the failure of the class member to opt out after notice should be viewed as implicit consent to this allocation. What constitutes an effective right of exit requires, however, careful definition, and it will be suggested that the right to exit may be effective in some contexts only if rival solicitations for an opt-in class are permitted. Third, in the case of the mandatory or non-opt-out class action, *Amchem* should be read strictly to require a very high level of cohesion bordering on identity.

#### A. *The Negative Value Class Action*

Both *Amchem* and *Ortiz* involved classes in which the variance in injury and economic damages among class members was extreme. Some class members were suffering from lung cancer and mesothelioma and had only a short time to live, while others had only relatively minor pleural scars caused by exposure to asbestos and were asymptomatic. In such a class that includes both high value claims and low value claims, an obvious problem surrounds class counsel allocating the settlement among class members. Because one counsel simply cannot fairly represent all the contending sides in the inevitable contest for a larger share of the settlement, the legitimacy of such a conflicted counsel (or a team of such counsel) agreeing on an allocation without bargaining between subclasses was properly rejected in both *Amchem* and *Ortiz*. Nor is the situation necessarily improved if all the class members receive the same amount so as to avoid any explicit allocation. *Ortiz* effectively disposed of this possibility by finding that the use of a post-settlement arbitration procedure to allocate the settlement fund also amounted to an allocation decision.<sup>148</sup> In effect, treating unequal cases equally amounts to a preference for the weak claims over the strong claims and thus demonstrates inadequate representation of the strong claims.<sup>149</sup>

Yet, if allocations are impermissible in high variance class actions, it does not logically follow that allocations cannot be made in other cases where the variance is lower. Take, for example, a hypothetical class action brought against an insurance company which has overcharged 100,000 customers somewhere between \$10 and \$20 each per year over a period of years. Presumably, if the amount of the overcharge can be calculated on an individual basis, it would not offend *Amchem* to pay each customer the actual amount of their overcharge. Nor should paying each customer fifty percent of the asserted overcharge be viewed as an impermissible allocation, as most settlements usually occur at some discount off

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148. See *Ortiz v. Fibreboard Corp.*, 119 S. Ct. 2295, 2320 (1999) ("The very decision to treat them all the same is itself an allocation decision . . .").

149. *Id.* at 2319-20.

the maximum alleged damages. But now assume that this challenged practice has continued for a series of years, and there is uncertainty as to the applicable statute of limitations. Plaintiffs assert that a six-year statute applies, and defendants assert that a three-year statute cuts off the claims of class members. A further complication is that some class members were only insured by the defendant during this legally ambiguous three-to six-year period, while other class members have only been insured for the last three years, and still others for all six years. Assume finally that defendants are prepared to settle for \$10,000,000, based on paying \$6 a year for claims in the one- to three-year period, but only \$4 a year for claims in the four- to six-year period. Although all class members have suffered the same economic injury, the legal strength of their claims obviously varies. If subclassing were required, it would vastly compound the costs and difficulty of resolving this relatively small class action.

But how can subclassing be avoided? Even if the settling parties were to agree to pay all class members \$5 per year, this tactic would arguably still offend *Ortiz's* prohibition on treating unequals equally. Thus, the simplest and most candid answer is to allocate the settlement based on each claimant's relative legal strength, and defend this allocation on the basis that on these facts the difference is immaterial. One key difference between this hypothetical class action and the facts of *Amchem* and *Ortiz* is that these small claims could not be asserted on an individual basis. That is, these are "negative value" claims because the transaction costs in establishing and collecting them are greater than the potential recovery. As a result, "class cohesion" (in *Amchem's* phrase) exists, because all class members presumably share a common preference for some recovery over no recovery.

At first glance, this argument may sound like precisely the justification rejected in *Amchem* and *Ortiz* that the class's common interest in the fairness of the settlement alone satisfied the "predominance test" of Rule 23(b)(3).<sup>150</sup> But the issue here is representational adequacy, not predominance. Presumably, on the foregoing facts, predominance could be easily shown. Moreover, in *Amchem*, the differences between the amounts to be received by high value claims and low value claims were material, and in *Ortiz*, the failure to recognize the material difference in claim strength was the decision that the Court said amounted to an impermissible allocation. In short, neither *Amchem* nor *Ortiz* should be read as forbidding immaterial allocations.

But what then should the standard of materiality be in this context? After all, although the absolute difference between \$6 and \$4 in this hypothetical is small, the percentage difference is 50% (i.e., the strong claimants here receive 50% per year more than the weak claimants). Here, *Ortiz* considered a useful test, which it ultimately declined to resolve: Transaction cost savings may justify some relaxation of the rules

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150. Fed. R. Civ. P. 23(b)(3).

and some difference in treatment if strict compliance would clearly make everyone worse off.<sup>151</sup> In *Ortiz*, the settling parties claimed that the transaction cost savings from use of the mandatory class action procedure justified their conflicted settlement.<sup>152</sup> The District Court had estimated these savings at “hundreds of millions”<sup>153</sup> and noted that they exceeded Fibreboard’s net worth.<sup>154</sup> The Supreme Court acknowledged that this argument raised “at least a legitimate question, which we leave for another day,”<sup>155</sup> but still found the conflicts too numerous and too material to permit the settlement to stand.

This transaction cost justification makes greater sense in the context of deciding when an allocation by a counsel representing multiple clients should be permissible. Although the alleged transaction cost savings in *Ortiz* would have accrued to the defendants (who in theory could then have afforded to pay a portion of them to the class), the savings that would result in the foregoing hypothetical from avoiding the use of subclasses directly reduces the expenses of the class action (which are normally subtracted from the settlement fund). Essentially, the proposed exception to the prohibition on allocations can be operationalized as follows: Do the cost savings from avoiding subclassing exceed the differential between the amounts paid to the two groups? Typically, these cost savings will consist of the cost of additional counsel and possibly the cost of more elaborate notice.

Basic common sense underlies this proposed interpretation of *Amchem* and *Ortiz*. In high variance class actions (as those cases were), subclassing is a necessary response to the obvious conflicts of interest that often disable counsel. But in the classic small claimant class action where the option of individual litigation does not exist as a practical matter, subclassing is a remedy that may be worse than the disease. In the foregoing hypothetical involving small proposed individual recoveries of \$4 and \$6, no class member truly benefits from insisting upon separate counsel who will bargain over the \$2 difference (and possibly increase it to \$2.50 or decrease it to \$1.50). Whether the consequence of adding additional counsel to bargain over this margin is to increase or narrow it, everyone is worse off if the additional transaction costs exceed the gain to the side whose position is improved. Such an outcome is Pareto inferior, and no rational policy should impose it on the class.<sup>156</sup>

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151. See *Ortiz*, 119 S. Ct. at 2321–22 (“One great advantage of class action treatment of mass tort cases is the opportunity to save the enormous transaction costs of piecemeal litigation . . .”).

152. See *id.*

153. *Id.* (citing *Ahearn v. Fibreboard Corp.*, 162 F.R.D. 505, 529 (E.D. Tex. 1995)).

154. See *Ortiz*, 119 S. Ct. at 2322. It specifically found that Fibreboard’s estimated net worth “is considerably less than the likely savings in defense costs under the Global Settlement.” *Id.* (citing *Ahearn*, 162 F.R.D. at 529).

155. 119 S. Ct. at 2322.

156. *Ortiz* expressly recognizes that “at some point there must be an end to reclassification with separate counsel.” *Id.* at 2320. But it does not offer any guidance as to

Some limits on allocations are necessary, however, even in the context of “negative value” class actions. Suppose a conflicted or simply lazy counsel agreed to a settlement under which one subgroup would receive ten dollars and the other only one dollar or zero.<sup>157</sup> Now, the proposed transaction cost savings standard provides some actual protection. Assume that the \$9 difference in amounts paid to the two subgroups comes to \$9 million in the aggregate. This would clearly exceed the cost of using separate counsel, and thus makes the allocation impermissible. Equally important, such a standard is reasonably quantifiable and thus eliminates legal uncertainty over whether the settlement can be approved, thereby informing the settling parties in advance what the legal ground rules are.

*B. Implied Consent to Allocations: When Is Exit an Effective Substitute?*

At bottom, allocations that are “unbargained for” are impermissible under *Amchem* and *Ortiz* essentially because the clients have not consented to their conflicted attorney making the allocation. But, the law can sometimes infer consent. Thus, the relevant policy question becomes when it is appropriate to do so. At one extreme, plaintiffs’ counsel might argue that implied consent should be found in any opt-out class action where class members fail to opt out after notice. *Amchem* probably forecloses this overbroad argument, however, because its facts involved an opt-out class action in which it was feasible for at least those class members with present injuries to opt out.

1. *Future Claimants*. — It seems axiomatic that a current right to exit will never be an effective substitute for “class cohesion” in the case of future claimants because they do not yet know whether they have been injured—or how severely. Absent such knowledge, they cannot know into which cell in the typical settlement grid they will fall or whether that cell undercompensates them. In the typical case, the future claimants may have a low base expectancy rate of incurring future illness and must wait out a latency period that can stretch for decades. Thus, even rational future claimants will act as if they were indifferent.

But consider now an alternative settlement structure under which the class member has the right to opt out for some continuing period after the class member’s condition matures from mere exposure into any of a series of progressively more serious injuries. Thus, while the class member will receive, say, only \$5,000 for the mere fact of exposure, the class member becomes entitled to \$300,000 if the class member later develops lung cancer and also acquires the right to opt out from the class

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where this limit might lie. This transaction cost standard is intended to provide a feasible benchmark.

157. These are in a sense the facts of *Amchem* where some claims would have been waived without any compensation.



for six months after a diagnosis of lung cancer is made.<sup>158</sup> Under this proposal, a new right to opt out is triggered at exactly the same point as the class member develops a compelling interest in evaluating his or her legal position. Under these conditions, exit seemingly becomes an effective functional substitute for class cohesion—at least if the legal claim has a sufficiently high value that the exiting class member can reasonably expect to secure individual representation on a contingent fee basis. In contrast, opting out should not be seen as a viable option in the case of a “negative value” class action, where individual representation is not feasible.

Such a delayed opt-out might deter some settlements, largely because defendants could not be certain as to the number of future opt-outs and might fear that those who did opt out would predictably have high valued claims. Yet, the settlements so deterred would disproportionately be those that defendants had the greatest reason to expect to be inadequate for the class members. In general, defendants are far better positioned than individual class members or class counsel to make informed, actuarial predictions about the likely future rate of serious illness (which is the precondition for delayed opting out). They thus possess a form of asymmetric information, which they signal when they reject a settlement that contains a delayed opt-out feature. Moreover, defendants are also better positioned to deal with the problem of delayed opt-outs by purchasing liability insurance to cover their future obligations in respect of such opt-outs. Indeed, defendants’ inability to purchase such insurance is a signal that they have been unable to convince their insurers that the settlement is sufficiently fair to future claimants as to keep most within the class. If the insurer thinks the liability is sufficiently great as to make the insurance too expensive for the defendant, this implies that the insurer, as a relatively disinterested observer, believes that class members who incur future illness will be dissatisfied with the settlement’s terms and will reject the settlement’s certain recovery for the riskier course of individual litigation.

2. *Exit to a Rival Class: Competition as a Solution.* — Assume now that the proposed class consists only of present claimants, who disagree vociferously about the fairness of a proposed class action settlement. For example, assume a securities class action involving securities purchased at different time periods during which a series of allegedly false statements

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158. This hypothetical in many respects mirrors the recent \$4.75 billion settlement entered into by American Home Products with respect to “Fen-phen” claims. Some six million Americans have been exposed to “Fen-phen” (the popular name for two drugs containing Fenfluramine, which was prescribed to treat obesity but which apparently caused heart valve damage). Under the pending settlement, class members receive three separate opportunities to opt out: (1) immediately before the plan is approved; (2) after a test shows any heart valve damage; or (3) even after they qualify for a compensation payment. See Susan Borreson, *Fen-Phen Plan Doesn’t Thrill Texans; Most Plaintiff Lawyers to Opt Out of Settlement*, Tex. Lawyer, Oct. 18, 1999, available in LEXIS, Nexis Library, CURNWS File.

were made. Those who purchased during time period A will receive eighty percent of their losses, while those who purchased during time period B will receive only forty percent of their losses (on the theory that the market already knew much of the adverse information). Objections to the proposed settlement are received from class members who purchased during this second time period (but not from those who purchased during the first time period). Given that the difference in the amounts to be received is material, this two-to-one allocation of the settlement cannot be defended as immaterial (nor are these claims necessarily "negative value claims").

Here, however, exit may also sometimes be a fair substitute for subclassing. Assume that the court indicates that it would certify an opt-in class of investors who purchased in the second time period if sufficient investors choose to opt in. This message is included in the notice mailed to the class in connection with the original proposed settlement. In fact, only a handful of investors choose to opt out of this new class action (and they are too few to satisfy the numerosity requirement of Rule 23(a)(1)).<sup>159</sup> On this basis, the small number of opt-outs in the face of a clear alternative might appropriately be taken as an indication of implied consent by investors who purchased during the latter period. In short, implied consent can be fairly inferred when there is a real choice, but not when the only choice is Hobson's choice.

Even if the proposed class can be certified, one of the major attractions of this approach is that it does not produce a "dueling" class action or raise the prospect of a "reverse auction."<sup>160</sup> This is because the two class actions do not preempt each other. A release given by the plaintiffs' attorney on behalf of the class in the first action does not apply to the claims of those who have opted out; nor can any resolution of the second opt-in class action affect the first action. Thus, at a stroke, one obtains the advantages of competition and increases the choices available to the class members—without increasing the risks of collusion. Class counsel in the first action is disciplined (because opt-outs will predictably reduce their fee award), but they are not forced into a race to settle.

Effectively, this approach uses exit to promote loyalty, and recognizes that they are partial substitutes for each other. Accordingly, as next discussed, the level of representational adequacy that is required in an opt-out class action in which the right to exit is enhanced should be lower

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159. Rule 23(a)(1) specifies that before a class action may be certified the court must find that "the class is so numerous that joinder of all members is impracticable." Fed. R. Civ. P. 23(a)(1). While no fixed number is recognized for this purpose, classes of fewer than 50 members are relatively uncommon. One commentator has suggested that a presumption in favor of numerosity should commence at the level of 40 class members. See 1 Newberg on Class Actions § 3.05, at 3-25 (3d ed. 1992) (cited in *Mullen v. Treasure Chest Casino*, 186 F.3d 620, 624 (5th Cir. 1999)).

160. For a discussion of the "reverse auction" problem (and the coining of this term), see Coffee, *supra* note 1, at 1370-72.

than in a mandatory class action (such as *Ortiz*) where exit is forbidden. Reasonable persons can disagree about the specific tradeoffs, but this Article's central claim is that the legitimacy of such tradeoffs must be acknowledged.

### C. *The Mandatory Class Action*

Class cohesion is not a self-defining concept. How much cohesion is needed logically should depend on whether the class member has a right to exit. Hence, a more rigorous definition of class cohesion should apply in the case of the mandatory class action where the class member is essentially being coerced into participation.

But can one realistically expect courts to give class cohesion different meanings in different contexts? The simple answer is that some courts have already done so. In *Barnes v. American Tobacco Co.*,<sup>161</sup> the Third Circuit was faced with a Rule 23(b)(2) class action against the major tobacco companies based on a cause of action for medical monitoring, an equitable remedy. Although the class was clearly as broad and diverse as was the class in *Amchem*, plaintiffs' counsel argued that because Rule 23(b)(2) does not require any showing of predominance, *Amchem*'s requirement of cohesiveness—which seemingly rested on the predominance requirement—did not apply. Looking past the precise wording of *Amchem*, the Third Circuit properly said that cohesiveness is a requirement in all class actions.<sup>162</sup>

Then the court added that a mandatory class action, such as a Rule 23(b)(2) class, “may require more cohesiveness than [a] (b)(3) class. This is so because in [a] (b)(2) action, unnamed members are bound by the action without the opportunity to opt out.”<sup>163</sup> This logic not only makes good normative sense, but it supplies the necessary deterrent to prevent the misuse of Rule 23(b)(1) and (b)(2) class actions as a means of evading the greater procedural protections built into Rule 23(b)(3).<sup>164</sup>

### D. *Holdouts*

A final disadvantage of subclassing is that it encourages holdouts: namely, persons or subgroups who are opportunistically seeking to obtain a disproportionate share of the settlement because of their ability to delay or withhold consent. The facts of *Lazy Oil* underscore this problem, be-

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161. 161 F.3d 127 (3d Cir. 1998); see also *Jefferson v. Ingersoll Int'l, Inc.*, 195 F.3d 894, 897–900 (7th Cir. 1999) (holding that a right to opt out must be granted in any class action for more than incidental damages).

162. *Barnes*, 161 F.3d at 142 (“the cohesiveness requirement . . . extends beyond Rule 23(b)(3) class actions”).

163. *Id.* at 142–43 (citing *Wetzel v. Liberty Mutual Ins. Co.*, 508 F.2d 239, 248–49 (3d Cir. 1975) and *Santiago v. City of Philadelphia*, 72 F.R.D. 619, 628 (E.D. Pa. 1976)).

164. Not only does Rule 23(b)(3) require predominance and superiority (unlike Rule 23(b)(1) and (b)(2) class actions), but it also expressly requires notice and permits opt outs. See Fed. R. Civ. P. 23(c)(2).

cause there the dissident plaintiff class members were attempting to certify a subclass of oil-producing “professionals” who were distinguishable from the other class members in that they actively operated oil companies and were not simply passive investors.<sup>165</sup> Had such a subclass been certified, it seems likely that the “professionals” would have sought a larger proportion of the settlement—even though nothing entitled them to a larger share. That is, their distinctive status implied no special damages that they had uniquely experienced. In general, the more subclasses that are required, the greater the danger that one subclass will hold out—either because that subclass senses that it can exploit the situation (because others are more eager to settle than it is) or because it has made an unrealistic assessment of the relative strength of its legal claims.

In this light, the realistic policy choice is between two options: (1) the use of subclasses to achieve a bargained-for allocation of the settlement, or (2) offering a competing alternative (whether as an opt-in class or individual or consolidated litigation into which the dissidents could elect), thereby allowing the other class members to settle with the defendants. The key problem with subclassing is that it encourages holdouts and thereby invites tacit extortion. Most of the time, one simply cannot tell if an objector truly views the settlement as inadequate or is rather a potential holdout seeking to negotiate a larger share of the settlement for itself. In this light, the case for the opt-in class is essentially that it solves the holdout problem by forcing the holdout to elect—in the presence of a realistic choice—whether it truly wishes to take the high-risk step of rejecting the settlement. Concededly, the case against the opt-in class is that it may discourage defendants from settling at all if they cannot achieve a global settlement. Yet, by dividing the class and permitting those dissatisfied with the proposed settlement to migrate to a separate opt-in class, client autonomy is preserved, and some settlements may be achieved that would be blocked if a single subclass could veto them. Thus, the net effect on the settlement rate is simply indeterminate.

#### CONCLUSION

This Article’s specific proposals can reasonably be debated, but its more important claim is that a new framework is needed to assess class actions and the recurring accountability problems to which they give rise. Because the class counsel is more than simply a fiduciary, but rather is a joint venturer with the class, a fixation with fiduciary principles alone produces a myopic tunnel vision. Not only does a strictly fiduciary analysis misunderstand the position of class counsel, it also misconceives the interests of class members. In truth, there is seldom a single best solution for all class members, because their preferences and taste for risk necessarily differ. Viewed instead as an organization, the class action can and should be disciplined and monitored by a variety of market-based and

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165. See *supra* notes 99–103 and accompanying text.

legal mechanisms. The critical difference between the fiduciary-based approach and the market-based approach is that the former implicitly tends to assume that professionals should make litigation decisions for clients (who are, after all, their wards), while the latter views the client as a consumer, whose informed choice should both be expanded and respected.

From a normative standpoint, this Article has advanced the idea that client autonomy should be a central goal of class action reform. Expanding client choice—either by facilitating exit or by authorizing an overlapping, opt-in class action so that class members can choose their litigation goals—promotes this end. Client autonomy does not, of course, trump other values across all contexts. But in these other, more specialized contexts (such as institutional reform litigation), where inconsistent outcomes are unacceptable,<sup>166</sup> the alternative is to rely on voice, not exit. Nowhere should the governing principle be that of “professionals-know-best” (which is the de facto principle today across all class action contexts).

Clearly, however, any movement toward greater voice or exit (or any other principles of legitimacy) will predictably be resisted by those professionals (both counsel and trial judges) whose discretion it would reduce. From an agency cost perspective, this resistance should not be surprising; corporate managers did not rush to embrace the hostile takeover or proxy rule reform. Yet both reforms have come, and managerial accountability has been enhanced. Indeed, the goal of client autonomy—which includes protecting the absent individual from submergence in a larger entity that does not truly share that individual’s goals or preferences—seems the one thread that unites *Amchem* and *Ortiz* with earlier Supreme Court decisions, such as *Hansberry v. Lee*<sup>167</sup> and *Martin v. Wilks*.<sup>168</sup> Although both *Amchem* and *Ortiz* are written narrowly by majorities that sometimes seem obsessively focused on the language of Rule 23 and unwilling to look beyond it, they are consistent with the Court’s long-standing concern that absent class members (or others) not be bound by a disloyal representative.

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166. The simplest example is the traditional school desegregation suit involving a metropolitan-wide area. Defendants might propose a settlement that involves no mandatory busing across prior school lines, but instead adds millions of dollars to the school budgets in the de facto segregated area. Some parent groups might prefer the approach that improves educational opportunity to the more symbolic remedy of integration; others would not. The point is that client autonomy cannot be the answer in this context, because the two settlement proposals (busing versus money) are mutually exclusive. But even in this context, it does not follow that the plaintiffs’ attorneys should have the discretion to choose the preferred solution. See Bell, *supra* note 39. Instead, a more democratic approach to ascertaining the views of class members is needed; still, this topic of how to enhance voice is beyond this Article’s ambitions.

167. 311 U.S. 32, 42–43, 45 (1940) (holding that the Due Process Clause requires that the named plaintiff must always adequately represent the interests of absent class members).

168. 490 U.S. 755, 762 (1989) (holding that people are entitled to “[their] own day in court” to challenge actions taken under a consent decree to which they were not a party).

Reforms have costs as well as benefits. In particular, an exclusive focus on representational adequacy could result in the dismantling of the class action as the one feasible solution to the collective action problems that arise in litigating small claims individually. For this reason, this Article has urged that greater attention be given to alternative means to the same end: namely, greater reliance on "exit" and "voice." On the specific policy level, this Article has predicted that exit should outperform voice, at least when the litigation is intended to result in money damages. In part, this is because voice produces coercive, majoritarian solutions in a context in which individual solutions may be more just because the taste for risk is extremely subjective and personal. In contrast, exit facilitates individual choice and can be implemented through market-driven remedies.

Representational adequacy must, of course, be part of any solution, but this Article has argued that it can be carried too far. The Balkanization of the class action is a realistic prospect, and defendants have every incentive to hasten its arrival in order to preclude class certification. To the extent that subclassing is necessary (as it certainly is in the mass tort context), the test of the adequate representative should focus more on the representative's negotiating leverage and incentive to maximize the subclass's recovery than on any idealized concept of class cohesion. A cohesive subclass means little if the subclass counsel's incentives are to achieve an aggregate settlement, even at high cost to the subclass. Only a rule that compensates the counsel to the subclass exclusively out of the recovery to the subclass guards against this danger.

Although many reforms are possible and could succeed, only one is sure to fail: reliance on trial court scrutiny of the settlement.<sup>169</sup> Traditionally, this has been the Bar's response to demonstrated instances of class action abuse, but such a prescription of closer judicial involvement seems likely only to preserve the status quo. Appellate courts can improve the status quo by a variety of means: by requiring subclassing, by restricting limited fund and settlement classes, by encouraging greater negotiation between class counsel and economically substantial class representatives (such as the lead plaintiff in securities class actions), and by permitting easier exit. All make sense in moderation. But the limits on feasible reform also need to be understood: Too much medicine and the

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169. The principal policy recommendation made in the RAND Study is that "Judges Need to Scrutinize Settlements More Closely." RAND Study, *supra* note 1, at 32. Although this would be normatively desirable, it is vacuous as a policy proposal because it ignores the strong incentives for the court to approve a settlement, the limited information available to the court, and the even more fundamental problem that there may be no single best settlement for all class members. To believe that there is one best solution is to fall prey to the "one size fits all" fallacy. Although the RAND Study does make other proposals involving fee awards that are useful (and have been made before), the inadequacy of its prescriptions reminds us that empirical research alone cannot resolve the problem of class action accountability. Even first-rate empirical scholarship does not provide the theoretical basis for policy prescription. Sound policy must rest on a sound theory.

patient dies; too much reform, and the class action could become an endangered species.

Exit, voice, and loyalty have different costs and produce different benefits. Recognizing them as potential functional substitutes represents the rational first step toward reducing the agency costs of class action governance.