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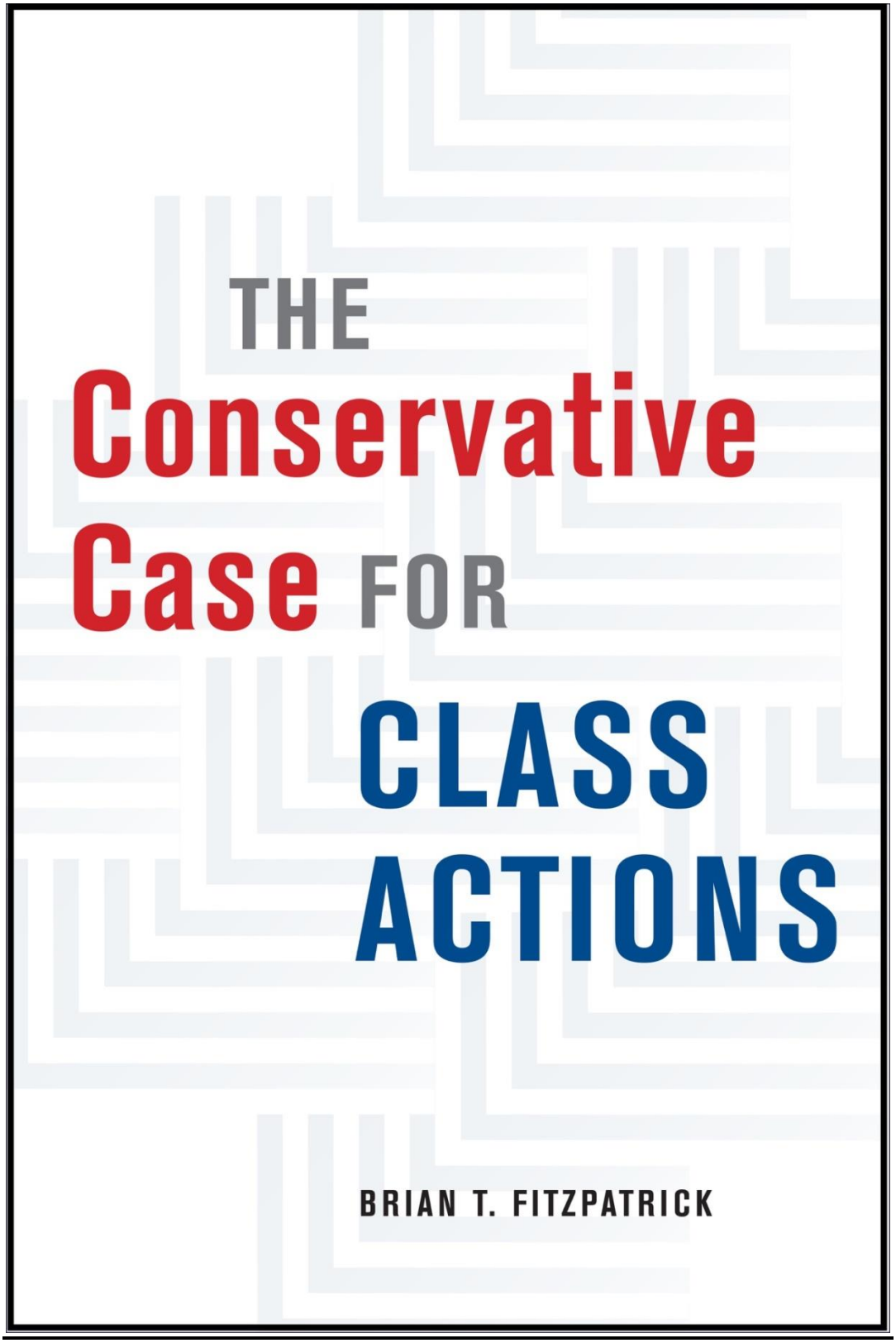

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Introduction

This book is about conservative principles. This is a matter I know something about; I have been a conservative my entire life. As an adolescent, I subscribed to *National Review* and read books by Dinesh D'Souza. Ever since my first semester of law school, I have been a member of the Federalist Society. After law school, I worked for two of the most conservative judges—Diarmuid O'Scannlain on the Ninth Circuit and Nino Scalia on the Supreme Court—as well as for one of the most conservative members of the U.S. Senate—John Cornyn of Texas. I have never voted for a Democrat for president in my entire life.

One thing I have learned over the years is that what is good for conservative principles is not always what is good for big corporations. It often is, but not always. Consider what perhaps the most famous conservative academic of them all--the economist Milton Friedman—says on this question:

> Over and over again you have the big businessman who talks very effectively about the great virtues of free enterprise and, at the same time, he is off on a plane to Washington to push for special legislation or some special measures for his own benefit. I don't blame him from the point of view of his business, but . . . I do blame the rest of us for not recognizing that [the free enterprise] system is not going to be saved by [the] National Association of Manufacturers, the Chamber of Commerce—you name them—the big organizations and big business—they are almost always on the wrong side.[i]

In other words, "being pro-free enterprise may sometimes require that we be anti-existing business."

We see examples of the difference between conservative principles and the interests of big business all the time. Consider states' rights. Conservatives like to decentralize power by divesting it to the states; yet big corporations often lobby the federal government to start regulating things in order to override state laws the corporations don't like. Or consider price controls. Conservatives *hate* government-imposed price controls on goods and services because we believe the market knows better than any government bureaucrat what the right prices are; yet, in recent years, big corporations lobbied Congress for a price control on what lawyers could

charge their clients in many personal injury cases, asking to cap lawyers' fees at 20 percent of recoveries.

I believe we should add one more item to the list of things that may be good for conservative principles even though they may be bad for big corporations: class action lawsuits.

Although class action lawsuits can be filed against anyone—including the government—my focus in this book is on class action lawsuits that are filed against corporations because these are the class actions that have become controversial in recent years. It should come as no surprise that corporations don't like class action lawsuits. They cost them billions of dollars every year. For this reason, big corporations have been trying to get rid of class action lawsuits ever since we put them on the books in 1966.

I like corporations. I happily represented corporations every day during my years as a practicing lawyer, and I still thank them frequently for all of the prosperity they bring our country. But they are wrong about class actions. As I explain in my book, class action lawsuits are not only the most effective way to hold corporations accountable, they are also the most *conservative* way to hold them accountable. In fact, there are only two alternatives, and neither of them should be the least bit appealing to conservatives.

The first alternative is to rely entirely on market feedback loops. If a company does something bad, won't it lose customers? If so, then shouldn't the fear of losing customers be enough to keep companies in line? Conservatives do like market feedback loops, but almost no conservatives think market feedback loops are sufficient to keep companies in line. Although conservatives are often caricatured as against all regulation of the market, this caricature is not true. Almost all conservatives know that markets need at least *some* rules. At the very least, we support rules requiring companies to honor their contracts, rules preventing companies from committing fraud, and rules prohibiting companies from forming cartels to fix prices. No one really thinks companies ought to be able to do whatever they can get away with.

But someone has to enforce these rules. Who will do it if there are no class action lawsuits? Relying on each person a company steals from to enforce the rules is unrealistic: people sometimes don't know about the theft, and, even when they do, the theft might not be worth enough to hire a lawyer. Class actions overcome these problems by letting one person sue for everyone else; this transforms an unprofitable lawsuit for a small amount of money into a profitable lawsuit for a lot of money.

This brings me to the second alternative to the class action: the government. The government could file lawsuits against companies to disgorge all their ill-gotten gains. But when is the last time conservatives thought the government was the best solution to a problem? Conservatives believe that the private sector is better at doing most everything than the government is. We favor private schools, private highways and railroads, private prisons, private parks, private retirement accounts, private venture capitalists, and private insurers—just to name a few—rather than public ones. But that's exactly why we should like class action lawsuits: they are *privatized* enforcement of the law. That's why we often refer to class action lawyers as *private attorneys general*. As with just about everything else, we should favor the *private* attorney general over the public one.

The funny thing is, for most of American history, what I have said thus far was not particularly controversial. It was liberals who thought the government should police the marketplace and conservatives and libertarians who thought it should be private lawyers representing private citizens. Hence, in 1940, perhaps the most liberal president in American history, Franklin Delano Roosevelt, vetoed a bill because he thought that it tilted enforcement of the law too far in favor of private lawyers over government agencies. As late as 1978, perhaps the second most liberal president in American history, Jimmy Carter, proposed abolishing most private class action lawsuits and replacing them with government lawsuits instead. During all this time, it was conservative Republicans in Congress and elsewhere who argued that, if laws were to be created, they should be enforced by the private bar not the government.

Something changed in recent years. Today, most conservatives seem to want to get rid of class action lawsuits just like Jimmy Carter did in 1978. When a major class action case called *AT&T Mobility v. Concepcion* came before the U.S. Supreme Court a few years ago, many conservatives wrote to the Court and urged it allow companies to insulate themselves from class action lawsuits entirely by adding fine print to their contracts. The five conservatives on the Supreme Court readily agreed and have now put the class action lawsuit on the road to its demise. The same anti-class action sentiments reign supreme among Republicans in Congress, where proposals to abolish or seriously curtail class action lawsuits against corporations are frequently introduced and sometimes enacted.

Why the change of heart? Why are today's conservatives taking advice from Jimmy Carter? Part of the answer is the cozy relationship between today's Republican Party and big

corporations. But some of the opposition is more principled. Some conservatives complain that the underlying rules we have adopted in the market go too far, and, if the underlying rules go too far, then those who are trying to enforce them must be going too far as well. I completely understand this. We regulate companies way too much—well beyond the simple rules I mentioned above against breach of contract, fraud and price fixing. But the solution to this problem is not to kill *all* class action lawsuits; it is to get rid of the rules we don't like—or, if that is not possible, to kill *only* the class actions that seek to enforce rules that we don't like. We should not throw the class action out with the bathwater, but that's precisely what the Supreme Court's *Concepcion* decision threatens to do.

Other conservatives oppose class actions because they don't like that the lawyers who file these cases are motivated by making money. I find this remarkable. Conservatives normally love the profit motive! Indeed, it is one of the reasons why we want to privatize everything in the first place. Profit-motivated private citizens do a better job than salaried, tenured government bureaucrats do, and relying on private citizens to do things reduces the size of government and the taxes we have to pay to support it. So why have we turned our backs on the profit motive here? Some conservatives say that the profit motive has led the lawyers to abuse the system. Some of these claims are based on myths about class actions that I debunk in the book. But it is certainly true that an unbridled profit motive can lead to destructive consequences. But this is true of any profit motive, including the profit motives of corporations. We aren't afraid of corporate profit motives, and we shouldn't be afraid of lawyers' profit motives either. The challenge is to put rules into place to harness the good of the profit motive without the bad. We do this for corporations by regulating them. We can do the same for class action lawyers.

What would the rules for class action lawyers look like? Many of them are already in place: judges already have the power to dismiss meritless class action lawsuits as soon as they are filed, and they already must scrutinize the lawsuits before they go to trial, approve any settlements, and award the fees the lawyers earn. Most judges exercise these powers wisely, but I offer few suggestions in my book to make our system even better. But I agree with our corporate friends that we may need some new rules altogether. Right now, you can bring a class action lawsuit for almost any violation of the law. But, as I noted, we don't like a lot of the laws that we make companies comply with. Perhaps we should reserve the class action only for the good laws like breach of contract, fraud, and horizontal price fixing? Right now, class actions are too

expensive and risky for companies to defend—one jury can resolve hundreds, thousands or even millions of claims all at once—and class action lawyers know it; this leads them to demand settlements from companies that may be more than the companies should have to pay. Perhaps we should make it even easier to dismiss meritless cases, break up class action trials into smaller pieces to reduce the risks, and require class action lawyers to share more of litigation expenses than they do now?

I focused this book on conservatives because, if the class action is to survive, it is conservatives who need to be persuaded. We are the ones who are killing it. But if I can be persuaded, I think others can be as well. We can mend the class action; we don’t have to end it.

Chapter Eight: Do Class Actions Deter Wrongdoing?

I love my fellow conservatives. But we are schizophrenic when it comes to deterrence and class actions. As I explained in a previous chapter, one of the principal conservative complaints about class actions is that they deter too much: the profit motive overheats enforcement and corporations are thereby discouraged from many socially useful activities for fear of lawsuits. As I have also explained, to the extent this is true—and I think to some extent it is—we can tweak our system to deal with it; we don't need to throw the class action out with the bathwater. I address these tweaks in the next chapter.

But some conservatives complain about class actions for the exact opposite reason: not that class actions deter too much, but that they don't deter at all. This argument is a curious one because it flies in the face of decades of economic theory that was pioneered by *conservative* academics. Nonetheless, it is the latest conservative attack on class actions, and in this chapter I try to explain why it does not hold up.

Specific versus general deterrence

Let me begin by making an important distinction that is sometimes overlooked in the discussion about class actions and deterrence. There are two types of deterrence, and it is impossible to deny that class actions *do* achieve one of them.

One type of deterrence is known in the academic world as *specific deterrence*. Specific deterrence refers to how an *actual* wrongdoer responds to an *actual* lawsuit against it: does that wrongdoer stop the misbehavior after it gets caught? The other type is known as *general deterrence*; it refers to how *potential* wrongdoers respond to a *potential* lawsuit: do potential wrongdoers decide not to commit misconduct to begin with because they are afraid of lawsuits against them?

There is no doubt that class action lawsuits generate specific deterrence. How do we know this? We know this because when class action lawsuits are resolved they often include a court order obligating the defendant to change its behavior. This is sometimes called *injunctive relief*, as I noted in previous chapters. When I examined every single class action settlement in federal court over a two-year period for the empirical study I have relied upon throughout this book, I found that almost one quarter of the time, the settlement included a provision requiring the defendant to change its behavior in some way. In some types of class action lawsuits, I found

behavior-modification provisions as often as 75% of the time. That's a lot of specific deterrence! But even these numbers *understate* how much specific deterrence is caused by class actions because many times corporations drop offending practices as soon as they get sued for them; they don't wait for a settlement.

Some conservatives complain that the behavior-modification provisions in class action settlements are cosmetic and do not impose real restrictions on corporations. For example, the well-known class action critic who works at the conservative Competitive Enterprise Institute, Ted Frank, says that he has "yet to see one single case with valuable injunctive relief for the class." Remember that there are roughly 350 class action settlements every year in federal court alone, and I found that roughly 80 of these include behavior-modification provisions. Although our data on state courts are not as good, I suspect there are at least as many settlements with behavior-modification provisions in state courts as well. Are these provisions as toothless as Mr. Frank suggests?

This charge is admittedly difficult to evaluate; it would require someone with knowledge about each lawsuit to make an educated judgment about how well the modification prevents future misconduct. Someone has indeed done this—the federal judge who approved each of the settlements—but critics are skeptical that judges do a good job of it because class action settlements often have no opposition and it is more difficult for judges to find flaws when no one is pointing them out. There is something to this skepticism. So what can we do to assess how good these behavior-modification provisions are?

As I argued in chapter six when I addressed the charge that class actions are meritless, we can at least ask critics to tell us what they think a bad behavior-modification provision looks like—and, if they have trouble coming up with many good examples, we might be skeptical of their skepticism. How many provisions have critics identified?

Not many. The most comprehensive list comes from an article co-authored by Mr. Frank; this is what he and his co-author came up with:

- In lawsuits filed by shareholders objecting to mergers between their companies, the lawsuits often settle with the companies agreeing to disclose more information to shareholders about the merger; these disclosures have been found to be wholly irrelevant to shareholders, as measured by how they vote on the mergers. Mr. Frank rightly criticizes these provisions as toothless, and courts have begun to

reject them. Although there indeed have been a large number of these settlements in the years after my empirical study, I am not sure how many will escape judicial scrutiny in the future. In any event, merger litigation is obviously a *very* specialized area of the law; it does not tell us much about the rest of our class action system.

- In a lawsuit against Gillette for making misrepresentations about a battery, the settlement included a provision forbidding Gillette from making the same misrepresentations in the future. Frank says the provision did not forbid the misrepresentations if Gillette changed the name of the battery. I do not know if Mr. Frank is right or wrong about this, but, even if he is right, this would simply be bad lawyering. Most fraud lawyers know that you not only bar your adversary from repeating the same misrepresentations, but any misrepresentations that are functionally equivalent. Countless class action settlements follow the latter approach.
- In a lawsuit against Facebook for violating the privacy of rights of customers by tracking the links they sent in their private messages, the settlement included a provision requiring Facebook to disclose this practice to its customers on its website. Mr. Frank says the disclosure was ineffective, and, again, I do not know if he is right or wrong—Facebook says a lot of people have visited the website, and the courts haven't weighed in on the matter yet—but I will give him the benefit of the doubt.
- In three consumer fraud lawsuits against companies that made or sold vitamins and other health products, the settlements included provisions requiring the companies to disclose more information to consumers about their products. Mr. Frank says the disclosures were hollow (or even counterproductive), and, again, his claims are hard for me to evaluate, but, in two of the settlements, the courts agreed with him, and, in the other one, the parties renegotiated the settlement. As such, I will side with him in these cases as well.
- In a lawsuit against a drug company by its shareholders, the settlement ordered the company to make corporate governance changes similar to changes that a committee convened by the company had already recommended. Mr. Frank said

the settlement therefore added nothing, but, as the court that rejected Mr. Frank's argument noted, the corporate governance changes recommended by the committee had been suggested *because of the class action lawsuit*. I think Mr. Frank is wrong on this one.

- In a lawsuit against a company by some of its employees for racial discrimination, the settlement included a provision requiring the company to come up with unspecified reforms to its hiring and promotion practices. The settlement required the company to meet periodically with an expert and class counsel to assess the efficacy of the reforms, but, if the expert or class counsel were unimpressed, the company was not obligated to do anything more. Although the trial court thought this was good enough, the court of appeals disagreed, and I think Mr. Frank is right to criticize this behavior-modification provision, too, as weak.

Although Mr. Frank seems right to criticize many of these settlements, outside the specialized world of merger litigation, that's only six "bad" examples. Six—out of hundreds upon hundreds of settlements with behavior-modification provisions over this same time period. That's not many. Outside of merger litigation, I see no reason to doubt the efficacy of specific deterrence in class actions.

In a previous chapter, I noted that I have served as an expert witness in many class action cases over the last few years. In that chapter, I offered a list of some of the cases I worked on to show you examples of what I think are the many meritorious class actions that are filed every year. Many of these cases ended in settlements that included provisions requiring the defendants to change their behavior, and, in my view, none of these provisions were illusory. I do not want to take the time like I did in the earlier chapter to describe each of these provisions in detail, but, if you are interested, I describe some of them briefly in the endnote.

The reason I do not want to take the time to engage further on specific deterrence is because, in my mind, the more interesting debate in class action circles is about general deterrence: some conservatives today cast doubt on the theory of general deterrence when it comes to class actions. This is interesting because *conservative academics invented the entire theory of general deterrence*! I take up this surprising turn of events now.

The theory of general deterrence

In the first semester of the first year in every law school in America, the students are taught that the threat of a lawsuit deters misbehavior. Law students have been taught this for almost 50 years. Students are taught it because the conservative Chicago School of law and economics told us that it is true. That this has become such an article of faith in the academic world is one of the most resounding successes of conservative intellectualism in the law.

It is easy to see why the theory is so powerful. All we have to do is assume people are rational. A rational person does not want to get sued. Lawsuits cost money. You have to pay lawyers, and, if you lose, you have to pay the plaintiff. This means that lawsuits are a great way to stop people from misbehaving when we don't want them to: all you have to do is set the damages awarded in a lawsuit equal to an amount related to the harm the misbehavior inflicts on the injured party. If the misbehavior benefits the corporation less than the harm it inflicts on others, then the corporation will rationally choose not to engage in the misconduct. Indeed, the only time the corporation will rationally choose to engage in the misconduct is when the benefits outweigh the harm, but that's ok: we want people to do things that generate more benefits than costs if we can make the injured party whole in the process. This is what we in the academy call *internalization of costs*. The rational-actor model of cost internalization is part of what is known as *classical law and economics*. Classical law and economics was pioneered by conservative Chicago School giants. Class action litigation has always been a hallmark of the conservative deterrence-through-litigation school of thought.

It is important to note that lawsuits are not the only way we can deter misbehavior. Another way to do so is simply to rely on word of mouth in the marketplace: if a company mistreats its customers, employees, or shareholders, then the customers, employees, and shareholders can tell others to go elsewhere. We conservatives love market feedback loops like this, but as I explained in chapter two, most conservatives do not think that consumer, employee, and shareholder boycotts are sufficient to stop corporations from misbehaving; we think we also need market rules and someone to enforce the rules. Indeed, enforcing market rules through lawsuits enhances the market feedback loops we love so much: lawsuits publicize wrongdoing to consumers, employees, and shareholders in a way that word of mouth does not on its own.

Many liberals do not like classical law and economics. Some don't like it because they do not like the utilitarianism that underlies it—who cares if the benefits outweigh the costs if what is

going on is unfair? But some don't like it because they think the underlying model of human behavior is inaccurate: people, it turns out, are not very rational. There are now countless studies and even popular books showing how all of us make the same types of mistakes over and over again when we try to process information; we do not simply add up the costs and compare them to the benefits before we act. Thus, a new branch of law and economics has formed called *behavioral law and economics*; behavioralists seek to update the classical rational-actor model with findings from these studies.

The behavioral findings are admittedly powerful, but none of them suggest that the teams of people who run corporations are systematically irrational in the same way the rest of us are. Indeed, we often refer to corporate executives as "bean counters" for a reason: if anyone is counting up the costs and benefits of things, it's them. Moreover, the behavioral findings are not why some conservatives think that class actions do not facilitate general deterrence; conservative critics of class actions accept that corporations behave in a rational way in response to incentives just like conservative classical economists do.

So why do some conservatives think that the conservative theory of general-deterrence-through-lawsuits is wrong when the lawsuits are class action lawsuits? There are two reasons.

The first reason is what we in the academy call *principal-agent costs*. This is the price a principal pays when his agent is unfaithful to him. For example, the people who run a corporation are agents of the corporation (or, better yet, agents of the owners of the corporation, the shareholders).Yet, sometimes what is rational for the corporate executives to do is not what is best for the corporation.

Consider an example: let's say a corporate executive has to decide whether to put a falsehood on the package of a product—something like "Can cure cancer in two weeks!"Let's say the corporate executive thinks that this new packaging will sell $10 million of additional product, leading to additional profits of $2 million. But let's say the executive thinks that there is a 50/50 chance the corporation will get sued in a class action over the new packaging and lose the lawsuit, and, if it loses, it will have to pay $10 million. The corporation's owners would not want to use the new packaging: the expected initial gain is $2 million, but then come the expected losses of $5 million (50% chance of a $10 million loss). But let's say the executive is planning to stay only one more year at the company, and, by the time any lawsuit is resolved, he will be long gone. He won't be there when the corporation loses the $5 million; he will only be

there when the corporation makes the $2 million. If his salary did not vary based on the corporation's profits, maybe the executive would be indifferent about the new packaging; but if, as is common, the executive receives a bonus every year based on the corporation's profits, it would be rational for him to approve the new packaging even though the corporation's owners would not want him to.

This is a classic *agency cost*—in this example, the executive's unfaithfulness is going to cost the corporation $3 million. Because of agency costs like this, some conservatives say that class actions do not deter corporate misconduct.

But this is only true if corporations do not try very hard to align the interests of corporate officers and the corporation. All it requires is a little imagination. Take, for example, our corporate executive here. How might the corporation solve the problem that the executive might make bad decisions because his time horizon is much shorter than the time horizon of the corporation's owners? Write into his contract that his bonus will be paid to him based not on *this* year's profits but on *future* profits; that is, he will have to wait and see how much his bonus will be, and, if he makes bad decisions today that cost the company money tomorrow, his bonus will be smaller. Easy, right? So easy that many corporations figured this out long ago. Many agency problems can be solved with well-designed contracts.

In short, this criticism of the theory of deterrence is pretty weak. Indeed, one sign that the criticism is weak is what its implications are beyond class action lawsuits. The exact same principal-agent problems that some conservative critics say make corporate executives unresponsive to class action lawsuits would make them unresponsive to every other type of lawsuit as well; are conservative critics saying the *entire* theory of general deterrence is wrong? That would be quite ironic given that we created it. Indeed, not only does this criticism suggest that the theory of deterrence is wrong, it also suggests that the theory of market feedback loops that we love so much is wrong as well. If we cannot make corporate executives respond to the threat of lawsuits, then why would we think we can make them respond to the threat of consumer, employee, or shareholder boycotts? I don't have an answer to that question. And neither do the conservative critics of class actions. The truth is this: if class action lawsuits can't deter corporate misconduct because of agency costs then nothing else that costs the corporation money can either. If we contend that the class action lawsuits are failures, then we have to admit

that other lawsuits and the market feedback loops are, too. But no conservative I know wants to admit all that.

This brings me to the second reason some conservatives say class actions don't generate deterrence: corporations cannot avoid the misconduct that leads to class actions because corporations cannot predict which of their activities will lead to class actions. Class actions, they say, target behavior at random; no corporate executive can guess why he will be sued. If you can't predict beforehand why you will be sued, then you can't change your behavior to avoid the lawsuit. On this view, running a corporation is something like playing Russian roulette: you just go to work day in and day out never knowing which day a class action might be fired at you.

There is no doubt that there is uncertainty in our system of justice. Lawyers and judges may or may not come up with new legal doctrines. Witnesses may or may not break down on the stand. Juries may or may not see things your way. You may recall from a previous chapter that some of this uncertainty is a good thing: we don't want rigid rules in place that box companies in and prevent them from innovating; we'd rather let companies do what they want to do and make them pay the costs later if they harm people. Uncertainty means flexibility.

But it also means that it is sometimes hard to predict what will happen when a company does something new. But hard to predict does not mean impossible. If there is a 50/50 chance a company might lose a lawsuit, then the corporate executives do not just throw up their hands and say "we don't know what will happen so let's not worry about it." They do what any other rational person would do: they discount the amount of money they would pay out if they lose the lawsuit by the 50% chance they might not lose the lawsuit. Thus, harking back to the example I gave above, if putting a falsehood on a product's package will lead to a 50% chance the company will lose a $10 million lawsuit, the company knows this business decision is expected to cost it $5 million.

But this assumes the company knows it might be sued for the falsehood to begin with. What if it is impossible for the company to know which of its business decisions might get it into trouble? Is it supposed to assume every decision might lead to a 50% chance it will lose a lawsuit? How does the company figure out what the damages would be in the lawsuit if it can't even figure out what it might be sued for to begin with?

These are all hard questions, but corporations long ago found a solution to them: they hire lawyers! Yes, they hire dozens or even hundreds of them, pay them big salaries, and ask them to

do something called *risk assessment*. That's right: they sit around all day and assess the risk that the corporation might be sued for something it does, and how much it might pay out if it is sued. I am most familiar with risk assessment departments in the automotive industry because one of my colleagues, Kip Viscusi, has chronicled them in great detail, but every other industry does the same sort of thing in one way or another with their in-house legal departments.

Admittedly, sometimes it is too difficult even for in-house legal departments to figure all this lawsuit stuff out, but the corporations have devised a solution in these circumstances, too: they hire more lawyers! Not in-house lawyers, but outside lawyers, who work at law firms, and who sometimes charge $1000 per hour or more. They ask them to write "opinion letters" assessing whether what the corporation wants to do is legal or not, the chance the corporation might be sued, and what might happen if the corporation is sued. In other words, all the information the corporation needs to know in order to be discouraged from misconduct by the threat of a lawsuit. I know all of this because for several years I was one of the lawyers who wrote these letters. Indeed, sometimes my firm did not even wait for the corporations to ask for help; sometimes we sent unsolicited letters—for free!—on how to avoid potential lawsuits, letters just like this one: "Mitigating Consumer Fraud Class Action Litigation Risk: Top Ten Methods for 2015."

I will admit that sometimes even all these lawyers are completely hopeless at seeing what the future might hold. In some physical injury cases where the harm caused by a company's products does not manifest itself for decades after the company sold the product, I admit that it may be impossible for a company to anticipate that it might be sued. Who knows what law—let alone science—will look like 20 years from now? But the good news is that there are almost no class action cases of this sort; it is almost impossible to bring a class action for physical injuries. More to the point: for the types of market rules that we conservatives support—breach of contract, fraud, and horizontal price-fixing—we rarely if ever have to wait 20 years to find out that we've been wronged.

Which is why corporations are spending the gobs and gobs of money I mentioned assessing their risks of facing class actions and other lawsuits. Only fools would spend gobs and gobs of money for nothing. Corporate executives may be many things, but they are not fools. They spend this money because it works: it helps them to predict when they will be sued and what will happen if they are.

But you do not have to take my word for it. We can ask the corporate executives themselves. A legal scholar at Suffolk Law School, Linda Simard, did just that. She sent a questionnaire to the top lawyer—the general counsel—at every company in the Fortune 500. She asked them about the class action lawsuits they had faced, and whether they had any ability to predict the lawsuits at the time their corporation made the business decisions giving rise to the class actions. Dozens of them wrote back to her. What did they say? They said that their ability to predict the class actions they had faced varied based on what kind of lawsuits they were. For some class actions, over 90% of the time they said they had "moderate" or "high" ability to predict that they would be sued. But even for the wiliest class actions of all—those resting on a completely novel legal theory—still 25% of the corporate lawyers said they had a "moderate" or "high" ability to predict they were coming. Our system is hardly random if even the new legal theories can be anticipated 25% of the time. Although surveys are not necessarily the most reliable way to study the question (I get to more reliable ways in the next section), it should be noted that Professor Simard is not the only person corporate lawyers have told such things to.

I should pause here to note something: even though these corporate lawyers knew they might be sued in a class action lawsuit, their companies did not always decide to refrain from the behavior; they sometimes went ahead and harmed people anyway. You might be asking yourself: how are class actions deterring anything if corporations are committing misconduct even when they know they might be sued? One answer is that even if the deterrence is imperfect—maybe damages are set too low by our laws?—it is better than nothing. But another answer goes back to the cost-benefit analysis I described earlier: we do not always want to stop corporations from harming people because sometimes the benefits to society outweigh the harms. What we do want, however, is for corporations to know they will pay for the harms before they decide to act so they only act when the benefits outweigh the harms. Class actions help corporations know that. (What we also want is for the people who are harmed to be made whole, and, as I explained in the previous chapter, class actions help with that, too.)

The good news in all of this is that we law professors have not been misleading our students for the past 50 years: the conservative theory of general deterrence is still sound. We still have every reason to think that lawsuits—including class action lawsuits—deter corporate misconduct.

The data on general deterrence

Everything I have said thus far about general deterrence is a theory. It is a strong theory, as even many class action critics admit—this is why every law school teaches it to every incoming class of students every single year—but it is still a theory. Naturally, the critics of class actions have picked up on this fact. Thus, the last argument some conservatives make about class actions and deterrence is this one: the theory may be good, but you have no evidence that it actually works in practice. Until we have some evidence, they suggest, we cannot assume class actions generate any deterrence. As Professor Linda Mullenix at the University of Texas puts it:

> [T]he deterrence theory suffers from a lack of empirical evidence and is based on conjectured hypotheses about corporate behavior . . .[S]ocial scientists have not been able to empirically measure . . . the deterrent effect of class litigation . . .Thus, judicial and scholarly arguments relating to the deterrent effect of class litigation are largely theoretical, conclusory pronouncements.

I do not like this argument very much. We have a strong theory that class action lawsuits generate deterrence. The critics do not have a strong theory that they do not. If anyone should have the burden of coming up with some evidence, it should be the people without a theory, not the people with a theory.

But the good news is that there is indeed evidence. It is not reams and reams of evidence, but there now are several studies, they span different time periods, involve different types of class actions, and, with one exception, they all say the same thing: class actions deter misconduct.

And these are just the class action studies. There *are* reams and reams of studies showing that other types of lawsuits deter misconduct. These other studies are not as uncontroverted as the class action studies, but there are many, many more studies finding that lawsuits generate deterrence than finding that they don't. These other studies are important because, as I noted above, some of the arguments critics raise about the theory of deterrence are not specific to class action lawsuits: if the evidence shows corporate executives respond to the threat of individual lawsuits, then there is reason to think they respond to the threat of class action lawsuits, too.

One note about these studies: many of them do not measure misconduct directly. That is because it is often impossible to measure misconduct directly. For example, it is impossible to

observe whether companies are secretly conspiring with one another to fix prices—they do it in secret! Thus, most of the studies below measure deterrence by looking at proxies for misconduct rather than misconduct itself—for example, for price fixing, the studies look at whether prices go up or down. It's not perfect, but it is the best science can do right now. But the best science can do suggests that lawsuits deter misconduct.

Let's start with the class action studies:

In 1981, several economists set out to examine whether increasing the threat of an antitrust enforcement action by the federal government deterred companies from price fixing. The economists examined the white bread industry. (This was back before nutrition was popular.) They looked at the markup (the price above the price of the ingredients) on a loaf of white bread in various places in the United States between 1965 and 1976; the markup was their proxy for potential price fixing. They compared these markups to the enforcement budget of the U.S. Department of Justice's Antitrust Division over time. They hypothesized that the more money the federal government devoted to enforcement, the greater the threat of an enforcement action against price fixers; thus, if federal enforcement deterred price fixing, the markups would be smaller when the federal government's enforcement budget was bigger.

But that's not what they found. The federal government's enforcement budget had no effect on price markups until 1972; only then did a bigger budget lead to lower prices. Why? The economists concluded that only after 1972 did companies face the threat of private antitrust class action lawsuits (recall that only in 1966 was the modern money damages class action created) and *it was the private lawsuits that the companies were afraid of*. They found that "settlements in class actions for price fixing in the bread industry were almost 10 times greater than government-imposed fines", and that "the deterrent effect of DOJ's enforcement efforts came not from the threat of publicly imposed fines or imprisonment, but from the increased likelihood of an award of private treble damages". In other words: "class actions represent the effective penalty in price-fixing cases."

There have been several more recent studies, all of them concerning securities fraud class actions, and, with one exception, all of them likewise find that, the greater the threat of a lawsuit, the less corporate misconduct.

Two of these studies examined what happened when a U.S. Supreme Court decision in 2010 insulated some foreign companies from American securities fraud class action lawsuits.

The securities fraud laws make it illegal for companies to misrepresent or hide relevant information from shareholders. When the threat of class action lawsuits went away, did the companies disclose less information to their shareholders than they had before? Both studies found that the answer was a resounding yes: the threat of a class action lawsuit had induced the companies to be more forthcoming to their shareholders.

A third study examined disclosures to shareholders over a larger set of companies and over a longer time period, 1996 to 2010. The authors attempted to compare disclosure made by companies at a higher risk of facing securities fraud class actions to those at a lower risk; the authors identified which companies faced higher risks with a model that depended on the size of the company, the company's industry (e.g., whether a software company or a biotechnology company), and a host of other variables. What did they find? They found that companies at higher risk of being sued disclosed more information to shareholders, updated their disclosures more often, and rendered those disclosures in more readable language than companies at lower risk. To top it all off, they also examined whether this disclosure gap narrowed after 2005 when the Securities and Exchange Commission started requiring all companies—whether they were at high or low risk of being sued—to disclose all the same information on the forms they file every year with the federal government. The authors found that the gap did indeed narrow when the companies no longer had any choice but to make the disclosures. This means that, when the companies did have a choice, it was the threat of a securities fraud class action that made them do it.

A fourth study looked at what influenced corporate decisions to misrepresent their earnings to shareholders in the years 1997 through 2008. Did the fact that a company got sued in a securities fraud class action for earnings manipulation discourage *other companies* in that same industry or geographic region from manipulating their own earnings? Here again, after controlling for numerous other variables, the authors concluded that the answer was yes: class actions deter misbehavior.

Against these five class action studies, I found only one study that points in the opposite direction. Three scholars examined whether American corporations disclose more information to shareholders than Canadian corporations do. Because American securities fraud laws are more robust, that is what the deterrence theory would suggest. But they found precisely the opposite: more disclosure in Canada. As I noted in a previous chapter, it is hard to do cross-country

empirical studies because it is impossible to control for all the ways in which different countries differ from one another. And this study is directly contradicted by the several American-only studies, above, that show more liability leads to more disclosure. As a result, I do not put much stock in the Canadian study. And, as I said, it is the *only* contrary study I have found.

What about studies of other lawsuits? These studies are even *more numerous*. For decades and decades, scholars have studied the data on deterrence, and, for decades and decades, the studies have generally corroborated what the class action studies show: the threat of a lawsuit deters misconduct.

The studies outside the class action realm are too numerous to discuss comprehensively here. And not all of them deal with misconduct by corporations. But I will summarize them to give you a taste of what they say:

- *Tort liability and safety research*: scholars have found that the industries that face more tort liability spend more money researching safety measures for their products.
- *Workers' compensation and workplace injuries*: scholars have found that, when the benefits employers would have to pay out for workplace injuries increased, fewer workplace deaths followed.
- *Bartender liability and alcohol-related traffic deaths*: scholars have found that, when liability was imposed on bartenders for inebriated driving by their patrons, fewer alcohol-related traffic deaths followed.
- *Medical malpractice liability and negligence, deaths, and defensive medicine*: scholars have found that, when liability for medical malpractice decreases, doctors and hospitals spend less time and money on patients, and more medical negligence and deaths follow.
- *Tort reform and traffic accidents*: scholars have found that, when liability for traffic accidents decreases, more traffic accidents follow.

As I said, these studies are not uncontroverted, and I cite opposing studies in the above endnotes. But the important point is that the lion's share of studies *supports* the theory of general deterrence. Indeed, as two of the famous conservative Chicago School economists conclude: "[W]hat empirical evidence there is indicates that tort law deters".

Buy "The Conservative Case for Class Actions" on Amazon.

None of this should be surprising to conservatives. We invented the theory of deterrence. We've been teaching it to our students for 50 years. We should be happy to learn that we've been right all this time!

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See Brian deliver the keynote speech at the 4th Annual Class Action Money & Ethics Conference on May 4, 2020 in Midtown Manhattan.
