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## Corruption of the Class Action: The New Technology of Collusion

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## SUMMARY

### THE CORRUPTION OF THE CLASS ACTION: THE NEW TECHNOLOGY OF COLLUSION

*John C. Coffee, Jr.†*

Professor Coffee's article, an oral version of which was given at the Cornell Mass Torts conference, is appearing in the *Columbia Law Review*. However, because commentators in this volume have responded to it, he has authorized the following summary of his views.

Professor Coffee argues that recent developments in the mass tort class action reveal an impending and historic shift in the function of the class action: Once a sword for plaintiffs, it is becoming a shield for defendants. Until recently, the class action primarily served as a vehicle by which plaintiffs could aggregate claims of low to moderate value, which could not be asserted in an economically feasible manner on an individual basis, into a larger collective action, thereby gaining leverage over defendants. Today, however, it is increasingly the corporate defendant that wishes to be sued in a class action and—with the help of a friendly plaintiffs' attorney—that often actively arranges for such a suit to be brought by a nominal plaintiff. The procedures by which such a collusive action can be implemented are relatively new and represent for defendants a major development in legal technology that may allow them in the future to escape or minimize their liability for most mass torts.

The new pattern is most evident in the mass tort area for several basic reasons: (1) many mass tort victims are able to bring economically viable individual actions (and many are sufficiently high stakes plaintiffs that they would opt out of any class action—provided that the law permitted them to do so); (2) increasingly during the 1980s, mass tort claims threatened public corporations with bankruptcy (and actually bankrupted A.H. Robins, Johns Manville, National Gypsum, and others, who but for their tort liabilities would have escaped bankruptcy); and (3) particularly in the case of asbestos, mass tort claims began to cast a longer and longer shadow on the federal docket. Fearing that mass tort claims could bankrupt their corporations and

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† John C. Coffee, Jr. is the Adolph Berle Professor of Law at Columbia University Law School. Professor Coffee testified as an expert witness for objectors in *Georgine v. Amchem Products, Inc.*, 157 F.R.D. 246 (E.D. Pa. 1994), but did so on a pro bono basis.

swamp their dockets, both defendants and federal judges began to look for a mechanism by which to reduce the impact of such litigation.

Rather than resist class action certification, defendants changed their tactics and began to seek provisional certification (for "settlement purposes only") because they discovered this technique could assure low cost settlements. Historically, collusive settlements in class actions were effected by plaintiffs' attorneys exchanging a low recovery for a high attorneys' fee from the defendants.<sup>1</sup> However, this technique was at least potentially susceptible to judicial control—because even when the court approved the settlement, it could still reduce the fee award. The new technique that has developed in mass tort cases, however, largely outflanks the (limited) effectiveness of judicial oversight through control over the fee award. Defendants can offer plaintiffs' attorneys a global settlement by which they agree to settle the plaintiffs' attorneys' entire inventory of existing cases at the prevailing market rate for such claims if the same attorneys will agree to bring and settle a class action on behalf of other (largely future) claimants on a less favorable basis. Uniquely, such an inventory settlement is possible in the mass tort field where the plaintiffs' attorney is likely to be a specialized practitioner handling a large volume of a specific category of personal injury claims (asbestos cases, for example), usually on a referral basis.<sup>2</sup>

Professor Coffee examines several recent examples where such an inventory settlement of existing cases has accompanied (and sometimes been clearly linked to) a class action settlement on behalf of future claimants. He predicts that the defense bar is now broadly adopting and generalizing this approach, which will be widely followed in the future to the detriment of injured tort victims unless reforms are introduced.

In his critique of current practices, Professor Coffee focuses on three specific targets:

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<sup>1</sup> For reviews of the limited success of courts in dealing with this problem, see John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669 (1986); 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).

<sup>2</sup> In contrast, plaintiffs' attorneys in the securities or corporate field lack any such clientele of individual cases and so cannot be offered an inventory settlement.

### 1. *The "Settlement Class Action"*

Until recently, courts did not permit a settlement of a class action until after the court "certified" the class and selected lead counsel.<sup>3</sup> Often, there was a considerable struggle within the plaintiffs' camp surrounding the selection of lead counsel. At least potentially, this contest both maximized the court's discretionary control over the case and reduced (marginally) the possibility of a quiet collusive settlement. Yet in a "settlement class action," plaintiffs' lawyers and defendants typically negotiate a settlement prior to filing the class action, and the class action is certified for purposes of settlement only. Not only do the plaintiffs' attorneys abandon the right to litigation at the outset (which assures defendants that there is little downside risk from the use of this approach), but there is little opportunity for judicial oversight or intervention by other plaintiffs' attorneys.

This was the pattern in *Georgine v. Amchem Products, Inc.*,<sup>4</sup> where, after many months of private negotiation and prior to the filing of the class action, a consortium of twenty major asbestos producers reached a global settlement covering all future asbestos personal injury claims with just two plaintiffs' law firms. The complaint, the answer, and the settlement were all filed on the same day. Although the two plaintiffs' law firms had earlier served on a nationwide steering committee of plaintiffs' attorneys, the majority of this committee had rejected a settlement with the same defendants.

Professor Coffee argues that the critical problem with settlement class actions is that they permit the defendants to choose the plaintiffs' attorneys. Even when no discernible side payment is offered to the plaintiffs' attorneys, defendants can effectively conduct a reverse auction among plaintiffs' attorneys, seeking the lowest bidder from the large population of plaintiffs' attorneys. Because each attorney knows that there are other attorneys to whom the defendant can make the same offer, and because ultimately the most cooperative plaintiffs' attorney (that is, the lowest bidder) will win, plaintiffs' attorneys are pressured to accept settlements on terms favorable to the defendants. In effect, defendants confer a valuable property right on the "friendliest" plaintiffs' attorney: the right to represent a very large class of plaintiffs (mostly future claimants) that the attorney does not currently represent. This valuable right *plus* the linked ability to settle on a superior basis all the cases in the attorney's existing inventory

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<sup>3</sup> The original *Manual for Complex Litigation* strongly discouraged settlement negotiations prior to certification. See *MANUAL FOR COMPLEX LITIGATION* § 1.46, at 60-61 (1977). For early, but equivocal, judicial evaluations, see *Girsh v. Jepson*, 521 F.2d 153, 155 n.3 (3d Cir. 1975); *Greenfield v. Yillager Indus.*, 483 F.2d 824, 826 (3d Cir. 1973).

<sup>4</sup> 157 F.R.D. 246 (E.D. Pa. 1994).

(which cases might not otherwise be resolved for years) represents the inducement for reaching a weak settlement.

Although courts historically viewed "settlement class actions" skeptically (and indeed mass tort class actions were themselves rarely certified at all until recently), judicial attitudes changed sharply in the late 1980s, as the federal judiciary searched for some means by which to protect itself from an inundation of individual mass tort cases. Although class actions provisionally certified "for purposes of settlement only" have now become common (in the asbestos field, breast implants, and defective product cases), the critical fact about these cases is that the dominant interpretation of Federal Rule of Civil Procedure 23 would probably prevent the same class action from being certified for purposes of trial.<sup>5</sup> The doctrinal problem is the "commonality" requirement of Federal Rule of Civil Procedure 23(a), which some circuits believe cannot be satisfied in mass tort class actions for personal injuries.<sup>6</sup> The consequence, however, is a profound imbalance that denies even well-meaning plaintiffs' attorneys any leverage in settlement negotiations. Put simply, plaintiffs' attorneys in such a setting have only a limited franchise: they can settle, but not fight. Given these constraints, they are effectively negotiating with at least one arm tied behind their backs. Indeed, when the class action cannot be brought to trial, the most logical reason for defendants to settle is that they believe that "a settlement class action" is cheaper than a continuing stream of individual actions. Under these circumstances, the class action becomes the defendants' weapon.

## 2. "Future Claims"

A unique characteristic of recent mass tort class actions has been their deliberately narrow definition of the class so as to include only those persons who had not yet filed a lawsuit on the date the class action was filed. This practice of sharply separating present from future claims both reflects the desire of counsel (on both sides) to purge from the class any present claimants (who have both the incentive and ability in "high stakes" cases to monitor their attorneys) and

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<sup>5</sup> In *Georgine v. Amchem Products Inc.*, the defendants asserted that the class could not be certified for litigation purposes, but only for settlement purposes. The doctrinal rationale for this position is that the plaintiffs have a "common interest" in the settlement, even if the factual circumstances surrounding their injuries (or the causation thereof) do not present sufficiently common questions of law or fact to satisfy Federal Rule of Civil Procedure 23. The district court accepted this position, finding that the class members "all share an interest in receiving prompt and fair compensation" and that the settlement's adequacy "is a predominant issue for the purpose of Rule 23(b)(3)." *Georgine*, 157 F.R.D. at 316; see also *Bowling v. Pfizer, Inc.*, 143 F.R.D. 141, 160 (S.D. Ohio 1992).

<sup>6</sup> For recent cases reversing attempts to certify a "hostile" mass tort class action for personal injuries, see *In re Rhone-Poulenc Rorer, Inc.*, 51 F.3d 1293 (7th Cir. 1995); *In re Joint E. & S. Dist. Asbestos Litig.*, 982 F.2d 721 (2d Cir. 1992).

the defendants' primary desire, given the long latency period (possibly extending for decades) in mass tort cases, to obtain litigation closure so that plaintiffs' recoveries will not continue to spiral upward.

If the defendant corporation waits until these injuries actually develop, the asbestos experience has taught them that an aggressive plaintiffs' bar will continue to obtain very costly individual verdicts, possibly including punitive damages. However, because only a small percentage of those exposed to the dangerous product or toxin will develop injury, defendants can anticipate that these prospective victims will take little action to protect their claims from an unfairly cheap compromise before they develop the first signs or symptoms of injury. As a result, when a mass torts class action is defined primarily to encompass future claimants, defendants can expect "rational apathy" on the part of most class members, who have little incentive to protect themselves (and no reason to opt out with regard to injuries they have not yet experienced). This, in turn, sets the stage for a collusive settlement.

Current experience suggests that the beneficiaries of the "future claims" class action are: (1) defendants, who cap and limit their liability; (2) courts, which escape the prospect of a high volume of individual claims crowding their dockets; and (3) the plaintiffs' attorneys selected by defendants as class counsel, who are generously paid for their willingness to settle the claims of persons who have never sought to be represented by them.

### 3. "Opt-Outs"

In some recent class actions, individual plaintiffs have been denied the right to "opt out." When such a right exists, individual plaintiffs often exercise it in large numbers (as happened in the silicone breast implants settlement).<sup>7</sup> Some courts are now denying plaintiffs any right to opt out, making a class action lawsuit mandatory in order to avoid depletion of a "limited fund."<sup>8</sup> Procedurally, this "limited

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<sup>7</sup> In the breast implants litigation, about 250,000 persons opted out of the class, giving rise to assertions that the settlement might founder because the defendants might exercise their right of withdrawal. See *Georgine*, 157 F.R.D. at 325 (Reed, J., rejecting this contention).

<sup>8</sup> See *Ahearn v. Fibreboard Corp.*, Order Provisionally Certifying Class for Settlement Purposes, No. 93-526 (E.D. Tex. Sept. 9, 1993) (certifying non-opt-out limited fund class). Under Federal Rule of Civil Procedure 23(b)(1)(B), the court may find that "adjudications with respect to individual members of the class . . . would as a practical matter be dispositive of the other members . . . or substantially impair or impede their ability to protect their interests." Where overhanging tort liabilities threaten a corporation with insolvency (or where the corporation's insurance policy is its principal asset and may prove inadequate to cover all liabilities), some courts have certified a "limited fund" class action under Federal Rule of Civil Procedure 23(b)(1)(B) on the rationale that later creditors would not be paid unless all claims are pooled and a prorated recovery paid to all. In the past, such attempts

fund" rationale for denying opt-outs has been implemented by treating the corporation's insurance policy as the limited fund. The problem with this rationale is that it permits opportunistic behavior by the corporate debtor, which can scale down its tort liabilities and avert bankruptcy. In contrast, in bankruptcy, the absolute priority rule would require that shareholders not retain any interest in the company unless creditors were first paid in full. Thus, the "limited fund" class action may serve chiefly to effect wealth transfers from a corporation's tort creditors to its shareholders.<sup>9</sup>

#### 4. Possible Reforms

Professor Coffee examines a variety of possible reforms, including (1) interpreting Rule 23(a)(4) to prevent a plaintiffs' attorney from resolving future claims on a less favorable basis than the attorney has recently settled any significant number of present claims, thereby precluding the defendants' use of inventory settlements to induce the attorney to represent the future claims class;<sup>10</sup> (2) modifying the right to opt-out for the special case of the future claimant so that it commences as of the claimant's discovery of his injury;<sup>11</sup> and (3) representative plaintiff steering committees or an auction procedure for the choice of lead counsel to improve the accountability of the counsel selection process. Certain of these reforms may be constitutionally required by the Due Process Clause.<sup>12</sup> More broadly, Professor Coffee

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have been rejected by appellate courts. See *In re School Asbestos Litig.*, 789 F.2d 996 (3d Cir. 1986); *In re Northern Dist. of Cal. Dalkon Shield IUD Prods. Liab. Litig.*, 693 F.2d 847 (9th Cir. 1982). Bankruptcy, of course, supplies an alternative means by which to prorate creditor claims and offers more procedural protections.

<sup>9</sup> Interestingly, in the *Fibreboard* "limited fund" class action, see *supra* note 8, the stock price of Fibreboard has soared following the announcement of the class action settlement. See *Mass Tort Actions, A Growing Movement, Are Viewed with Mixed Emotion by Attorneys*, NAT'L L.J., Dec. 26, 1994, at C14.

<sup>10</sup> Federal Rule of Civil Procedure 23(a) requires the court to find that "the representative parties will fairly and adequately protect the interests of the class." This "adequacy of representation" standard should preclude an attorney who has entered into such an inventory settlement from representing the class.

<sup>11</sup> Mass toxic torts typically have long latency periods. Thus, the point at which a "future claims" class action is certified and the settlement approved may be decades before a class member discovers that he or she is ill. To make the right to opt out meaningful, it should accrue as of the moment of discovery, not as of the settlement's approval. Interestingly, there is some precedent for this approach. See *In re A.H. Robins Co.*, 880 F.2d 709, 745 (4th Cir. 1989) (stating that any class member who was dissatisfied with the settlement offer had, under the settlement, "the right to elect to have her claim settled in a trial with all the procedural rights normally attaching to a jury trial"). In effect, this election amounts to a delayed opt-out right. See also *Bowling v. Pfizer, Inc.*, 143 F.R.D. 141 (S.D. Ohio 1992).

<sup>12</sup> See, e.g., *Phillips Petroleum v. Shutts*, 472 U.S. 797, 811 (1985) (due process entitles class members to a right to opt out from the class); *Brown v. Ticor Title Ins. Co.*, 982 F.2d 386 (9th Cir. 1993), cert. dismissed, 114 S. Ct. 1359 (1994). But see *In re Agent Orange Prod. Liab. Litig.*, 996 F.2d 1425, 1437 (2d Cir. 1993) (right to opt out not required where it

questions whether the filing of a future claims class action based only on the fact of exposure to a toxic or dangerous product should satisfy the "case and controversy" requirement of Article III of the U.S. Constitution.<sup>13</sup> Standing, he suggests, should be limited to those circumstances in which (1) class members are likely to be aware of their injuries at the time of certification (such as in the defective heart valve or breast implant cases) and (2) the class includes present and future claimants so that at least some class members are in a position to monitor the adequacy of their attorneys' representation. Finally, Professor Coffee argues that "settlement class" actions should only be tolerated where the same class action could be certified for purposes of trial. This would require the court to make the same finding of "commonality" under Federal Rule of Civil Procedure 23(a) and, in an action certified under Federal Rule of Civil Procedure 23(b)(3), the same finding that such common issues "predominate over any questions affecting only individual members"—without relying on the fairness or adequacy of the settlement as the alleged common issue.<sup>14</sup> This requirement would arm plaintiffs' attorneys in settlement negotiations with the ability to go to trial.

Ultimately, the most distinctive fact about mass tort class actions, Professor Coffee argues, is not the opportunistic behavior of the settling parties, but the palpable self-interest of distinct judges seeking to avoid a flood of individual actions. Accordingly, the likelihood of real reform, he suggests, depends upon convincing federal courts that their ends do not justify the current means, and that the necessary case load reduction can be achieved through techniques that are less invasive of plaintiffs' rights and less costly to the appearance of justice. The most important reform, he argues, may therefore be to chill "opportunistic" opt-outs and to reallocate all opt-outs equitably among judicial districts and among the state and federal systems.

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would be meaningless to future claimants). Professor Coffee argues that because due process is a flexible concept, the best compromise is to extend the right to opt out until a reasonable period after discovery of the injury.

<sup>13</sup> See *Lujan v. Defenders of Wildlife*, 112 S. Ct. 2130, 2136 (1992); *Allen v. Wright*, 468 U.S. 737, 751 (1989) (requiring "concrete injury-in-fact" as standard for Article III standing).

<sup>14</sup> One recent and important decision has already imposed such a requirement. See *In re General Motors Pick-Up Truck Fuel Tank Prod. Liab. Litig.*, Nos. 94-1064, 94-1194, 94-1195, 94-1198, 94-1202, 94-1203, 94-1207, 94-1208, 94-1219, 1995 U.S. App. LEXIS 8815 (3d Cir. Apr. 17, 1995).