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Compensation's Role in Deterrence

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ARTICLES

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ABSTRACT

There are plenty of noneconomic reasons to care whether victims are compensated in class actions. The traditional law-and-economics view, however, is that when individual claim values are small, there is no reason to care whether victims are compensated. Rather than compensation deterring wrongdoing is tort law's primary economic objective. And on this score, law-and-economics scholars contend that only the aggregate amount of money that a defendant expects to pay affects deterrence. They say that it does not matter for deterrence purposes how that money is split between victims, lawyers, and charities. This Article challenges that claim about achieving tort law's primary objective and argues that there is an economic reason to care whether victims are compensated in class actions. It offers reason to think that compensating victims deters more wrongdoing than the same amount of relief in other forms, at least in damages class actions.

Put a different way, this Article contends that the primary objectives of class actions—compensation and deterrence—are intertwined in ways that scholars have not previously recognized. Compensation affects the amount of reputational harm that class actions inflict on defendants, and anticipating that reputational harm provides a source of deterrence. Because the public cares whether victims are compensated in civil litigation, if class actions were fre-

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quently to slight compensation that would undermine public perception of the class device; class actions would come to seem more like plaintiffs' lawyers' extortion mechanisms than legitimate means of redressing harm. Diminished procedural legitimacy makes the class action a less powerful signal about the validity of the underlying claims, which undermines reputational deterrence.

INTRODUCTION

In 2014 Pepsi settled a labeling class action regarding Naked Juice for $9 million.[1] Of that $9 million settlement fund, $5.5 million was allocated to compensate customers.[2] A few years ago Facebook settled a privacy class action for $9.5 million;[3] in contrast to the Naked Juice settlement, none of the money went to victims.[4] It went instead to charity and class counsel as attorneys' fees.[5]

There are, of course, noneconomic reasons to care whether victims are compensated in class actions: class counsel's professional responsibility or agency obligations to the class,[6] philosophical commitments to compensating victims,[7] or the Rules Enabling Act.[8] From an economic perspective, however, scholars have argued that for purposes of tort law's primary objective—deterring wrongdoing[9]—it does not matter whether victims are compensated in class actions.[10] Rather, they argue, only the aggregate amount and likeli-

1 Civil Minutes at 4, Pappas v. Naked Juice Co. of Glendora, Inc., No. CV11-08276 JAK (PLAx) (C.D. Cal. Jan. 2, 2014).

2 *See id.*

3 Lane v. Facebook, Inc., 696 F.3d 811, 817 (9th Cir. 2012).

4 *Id.*

5 *Id.*

6 *See, e.g.*, 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, 680 (1986) ("[I]n economic terms, there are high 'agency costs' associated with class and derivative actions."); Samuel Issacharoff, *Governance and Legitimacy in the Law of Class Actions*, 1999 SUP. CT. REV. 337, 354 (identifying "the incentives for faithful representation by class counsel" as "the real source of legitimacy in class actions").

7 *See, e.g.*, JULES L. COLEMAN, RISKS AND WRONGS 326 (1992) (articulating a corrective-justice account of tort law that requires wrongdoers who cause harms to others to bear the cost of the loss imposed).

8 *See* Martin H. Redish, *Class Actions and the Democratic Difficulty: Rethinking the Intersection of Private Litigation and Public Goals*, 2003 U. CHI. LEGAL F. 71, 75–82 (arguing that bounty hunter class actions violate the Rules Enabling Act by transforming the compensatory norm of the substantive law).

9 David Rosenberg, *Decoupling Deterrence and Compensation Functions in Mass Tort Class Actions for Future Loss*, 88 VA. L. REV. 1871, 1874, 1890–91 (2002) (identifying deterrence as tort law's primary objective).

10 *See id.* at 1893 ("[A]ll that matters for optimal deterrence is that the judgment or settlement accounts for the total aggregate tortious harm, *not how or whether it distributes damages among claimants.*" (emphasis added)); *see also* Brian T. Fitzpatrick, *Do Class Action Lawyers Make Too Little?*, 158 U. PA. L. REV. 2043, 2060 (2010) ("[A] purely deterrence-based theory of civil litigation might be indifferent between defendants paying those they have injured and defendants paying completely unrelated third parties."). Descriptively, John Coffee has recognized that courts are more willing to impose high penalties when

hood of payment matter when considering the settlement's deterrent effect.[11] Whether class actions typically follow the Naked Juice approach of giving much of the judgment to victims or the Facebook approach of giving nothing to victims—the thinking goes—does not affect deterrence.[12] This Article challenges that notion.

Instead, it offers reason to think that compensation affects deterrence in ways that scholars have not recognized. A class action judgment will likely do more harm to a defendant's reputation if class action damages[13] are typically paid primarily to victims than if they are typically paid primarily to attorneys or charities.[14] Although class action judgments in practice typically compensate victims, some cases have recently pushed the boundaries of using *cy pres* awards for charity or attorneys' fees instead of compensating victims,[15] and the Supreme Court seems poised to consider the proper role for such compensation-less class settlements.[16] Although the primary goal of this Article is to refine the scholarly understanding of deterrence in damages class actions and recognize that compensation plays a role in deterrence, developing the theoretical underpinnings for how compensation-less settlements affect tort law's primary economic objective is particularly important in light of likely Supreme Court review.

Avoiding reputational harm constitutes a largely unrecognized form of deterrence. Most scholars have focused on damages as though it were the sole source of deterrence in litigation.[17] A few scholars, however, have recognized that nonlegal harms—including harms that litigation inflicts on

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victims are compensated. John C. Coffee, Jr., *"No Soul to Damn: No Body to Kick": An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 MICH. L. REV. 386, 434–35 & n.133 (1981).

11 *See* Rosenberg, *supra* note 9, at 1893.

12 *See id.*

13 This Article addresses damages class actions under Rule 23(b)(3) and not traditional civil rights cases or individual tort litigation. The same dynamics may play out in at least some individual tort litigation, but that claim is beyond the scope of this Article.

14 Victim compensation here is contrasted with attorneys' fees and *cy pres* awards to charity that do not compensate victims directly. Damages that escheat to the state or other regulatory fines may be closer to compensation than to *cy pres* awards for reputational purposes, but those types of relief are not addressed here.

15 *See, e.g.*, *In re* Dry Max Pampers Litig., 724 F.3d 713, 715 (6th Cir. 2013) (reversing approval of settlement that awarded $2.73 million to class counsel and "nothing but nearly worthless injunctive relief" to absent class members); Lane v. Facebook Inc., 696 F.3d 811, 817 (9th Cir. 2012), *cert. denied*, 134 S. Ct. 8 (2013) (affirming approval of settlement that awarded nothing to absent class members but $6.5 million to a new charity, one of whose directors is a Facebook executive).

16 Marek v. Lane, 134 S. Ct. 8, 9 (2013) (Roberts, C.J., respecting the denial of certiorari) (explaining that the Court should soon take up "more fundamental concerns" with *cy pres* awards in class actions).

17 *See, e.g.*, STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 473 (2004); David Rosenberg, Response, *Mandatory-Litigation Class Action: The Only Option for Mass Tort Cases*, 115 HARV. L. REV. 831, 853 (2002).

defendants' reputations—deter wrongdoing.[18] The literature on reputational deterrence in class actions has been particularly thin. Only one scholar has noted, in passing, this idea that reputational harm may deter wrongdoing.[19]

Class actions provide reputational deterrence so long as the filing or settlement of a class action is seen to signal wrongdoing. Because class action settlement agreements explicitly deny wrongdoing, reputational harm and the extent to which potential defendants can anticipate such harm depend in part on whether the class device is viewed as a meaningful signal of wrongdoing despite that denial. Drawing on corporate crime and derivative suit literature, this Article contends that whether a class action is seen to signal to the casual observer that the underlying claims have merit turns on the procedural legitimacy of the class device.[20] That's where compensation comes in.

Whether victims are typically compensated in class actions affects the procedural legitimacy of the class device because the American public values compensation and expects civil litigation to compensate victims, including class actions.[21] Scholars agree as a descriptive matter that the public desires victim compensation in civil litigation.[22] This compensationalist sentiment that ties compensation to procedural legitimacy can be seen from several different perspectives. First, it can be seen through elected officials. Congress relied on compensationalist rhetoric to advance several pieces of legislation affecting class actions: the Class Action Fairness Act of 2005 (CAFA),[23] the Private Securities Litigation Reform Act of 1995 (PSLRA),[24] the FAIR Funds Act,[25] and the FTC Improvement Act.[26] Using compensationalist rhetoric suggests that members of Congress thought the compensationalist message would resonate with their voters. Moreover, for those wary of concluding that congressional rhetoric means anything, there is evidence from the judi-

18 *See, e.g.*, Robert Cooter & Ariel Porat, *Should Courts Deduct Nonlegal Sanctions from Damages?*, 30 J. LEGAL STUD. 401, 401 (2001); Paul H. Rubin et al., BMW v Gore*: Mitigating the Punitive Economics of Punitive Damages*, 5 SUP. CT. ECON. REV. 179, 186 (1997).

19 *See* Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2222 (2010) (mentioning reputational harm as a potential source of deterrence in the securities context); *cf.* Jaime Dodge, *Disaggregative Mechanisms: Mass Claims Resolution Without Class Actions*, 63 EMORY L.J. 1253, 1272, 1280 (2014) (recognizing reputational concerns in class actions, though not as a source of deterrence).

20 *See, e.g.*, Samuel W. Buell, *The Blaming Function of Entity Criminal Liability*, 81 IND. L.J. 473, 511 (2006); Lawton W. Hawkins, *Exchange-Enhanced Special Litigation Committees: Enforcing Fiduciary Duties amid a Crisis of Trust*, 2003 UTAH L. REV. 587, 602; *infra* Part IV.

21 *See infra* Part III.

22 *See id.*

23 Pub. L. No. 109-2, 119 Stat. 4 (2005) (codified in scattered sections of 28 U.S.C.).

24 Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified in scattered sections of 15 U.S.C.).

25 Sarbanes-Oxley Act of 2002, Pub L. No. 107-204, § 308, 116 Stat. 745, 784 (codified at 15 U.S.C. § 7246 (2012)).

26 Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, Pub. L. No. 93-637, § 206(a)(b), 88 Stat. 2183, 2201–02 (1975) (codified as amended at 15 U.S.C. § 57b(b)); *see infra* Section III.A.

cial branch about compensationalist public sentiment and its relationship to the legitimacy of the class device. Two prominent judges relied on the need to preserve public legitimacy in aggregate litigation as reason to modify private attorneys' fee arrangements.[27] Similarly, a Judicial Conference Report expressed concern that affording too little compensation for victims risked jeopardizing the legitimacy of the class device.[28] Lastly, polling data confirms this compensationalist sentiment.[29]

If class actions are typically seen as shakedowns by plaintiffs' lawyers trying to make a buck, class action filing or settlement will send a different message than if class actions are seen as compensatory. If victims are typically compensated, class actions will tend to be seen as fulfilling the public's expectation of civil litigation—providing a means to redress widespread harm to actual victims.[30] The perception that some have been wronged necessarily carries with it the perception of wrongdoing and a wrongdoer—likely the defendant.

The intertwinement of compensation and deterrence means that compensation is not merely a "[f]alse [i]dol"[31] or relevant only to those who approach tort law and complex litigation from a noneconomic perspective. Rather, compensation matters for economic reasons, including in small-claim class actions. In small-claim cases, several scholars have recently advocated focusing only on the aggregate judgment without considering how much of the money goes to victims because—they contend—how much money goes to victims does not matter for deterrence.[32] Brian Fitzpatrick argues that compensation impedes deterrence, and he thus advocates eliminating compensation entirely and awarding class counsel all of the recovery in small-claim cases—what he calls a 100% attorneys' fee.[33]

But recognizing the complex relationship between compensation and deterrence means that it is not clear whether increasing fees as a portion of the class's recovery, and thus reducing compensation across class actions,

27 *See* Transcript of Status Conference at 54–56, *In re* World Trade Ctr. Disaster Site Litig., No. 1:21-mc-00100-AKH (S.D.N.Y. Apr. 2, 2010), ECF No. 2037; *In re* Zyprexa Prods. Liab. Litig., 424 F. Supp. 2d 488, 493–94 (E.D.N.Y. 2006); *infra* Section III.B.

28 REPORT OF THE JUDICIAL CONFERENCE COMMITTEE ON RULES OF PRACTICE AND PROCEDURE TO THE CHIEF JUSTICE OF THE UNITED STATES AND MEMBERS OF THE JUDICIAL CONFERENCE OF THE UNITED STATES 19 (2002), http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/Reports/ST9-2002.pdf [hereinafter JUDICIAL CONFERENCE REPORT].

29 *See infra* Section III.B.

30 *See* Deposit Guar. Nat'l Bank v. Roper, 445 U.S. 326, 339 (1980) (recognizing that where individual damages are small the class action may be necessary to make compensating victims feasible); Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 161 (1974) (same).

31 Myriam Gilles & Gary B. Friedman, *Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers*, 155 U. PA. L. REV. 103, 131 (2006).

32 *See id.* at 105–06 (arguing that courts and policymakers should ignore victim compensation when individual claim values are small); *see also* Fitzpatrick, *supra* note 10, at 2044.

33 *See* Fitzpatrick, *supra* note 10, at 2069–70.

would actually increase deterrence.[34] Increasing fees would generate more litigation and thus presumably more damages deterrence. Yet decreasing victim compensation would tend to reduce reputational deterrence. Whether these two effects would sum to increase or decrease deterrence is unclear, but that ambiguity means that compensating victims is economically important in ways that scholars have not yet recognized, even when claim values are small.[35] And it means that broad-brush efforts to achieve optimal deterrence trans-substantively across all class actions are unlikely to succeed.[36] This uncertainty compounds the challenges that scholars have already recognized as inherent in optimizing deterrence through private enforcement.[37]

Trying to optimize deterrence with a scalpel in individual cases offers more promise than adjusting fees across all class actions.[38] Embracing a broader role for public enforcement would allow the government to more carefully manipulate the expected costs to defendants in each case. Although public enforcement faces significant resource constraints, a gatekeeping scheme much like the qui tam procedure could allow the government to cut off liability to prevent overdeterrence or add its imprimatur to increase reputational harm on a case-by-case basis without bearing the full costs of public enforcement.[39] Another possibility would be to rely on judges to set damages in individual cases such that each defendant's total cost from a class action (in reputation and damages) equals the amount of the harm it imposed on others.[40] The latter approach requires judges not only to estimate the amount of anticipated reputational harm but also to account for the degree of victim compensation in class actions in so doing.

Although optimizing deterrence might seem best achieved by reducing difficult-to-calibrate reputational deterrence and focusing on damages deterrence, reputational harm from class actions can be socially desirable.[41] Reputational harm may be more efficient than damages sanctions reached through settlement negotiations with significant information asymmetries and may better reflect harms to non-parties.

Aside from optimal deterrence, reputational harm from settlement helps preserve class actions' informational function.[42] Reducing reputational harm would make quick settlement cheaper for defendants than it is now; the reputational costs of settlement would decrease while the potential

34 *See infra* Section V.A.

35 *See* Fitzpatrick, *supra* note 10, at 2044; Gilles & Friedman, *supra* note 31, at 105–06.

36 *See infra* Section V.A.

37 *See, e.g.*, Steven Shavell, *The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System*, 26 J. LEGAL STUD. 575, 577 (1997).

38 *See infra* Section V.A.

39 *See generally* David Freeman Engstrom, *Agencies as Litigation Gatekeepers*, 123 YALE L. J. 616 (2013) (creating a taxonomy of various ways in which the government can act as "gatekeeper" to gain benefits of enforcement discretion without bearing all of the costs of purely public enforcement); *infra* subsection V.A.1.

40 *See infra* subsection V.A.2.

41 *See infra* Section V.B.

42 *See id.*

harm from bad documents emerging in discovery or at trial would remain unchanged. Encouraging quick settlement can be socially harmful, however, because "[l]itigation is when the facts come out."[43] The firestorm over General Motors' ignition switches was triggered by an investigation into a wrongful death claim.[44] Merrill Lynch's CEO acknowledged in a deposition that black brokers may have had a harder time at the company than white brokers.[45] A Wal-Mart employee signed a declaration alleging that she attended a business meeting at a Hooters restaurant, and another declared that she felt compelled to visit an adult dance club on a business trip.[46] These widely reported facts surfaced only through litigation, and reputational harm from settlement increases defendants' incentive to litigate despite informational risk.

Thus, there is reason to think that compensation creates more reputational deterrence than other forms of relief, at least in damages class actions. Even in small-claim class actions where compensation is not a relevant economic end in itself, compensation remains important as a means to the deterrence end. And more broadly, the primary objectives of tort law and class actions—deterrence and compensation—are intertwined in ways that scholars have not recognized.

This Article proceeds in five Parts. Part I explains traditional notions of deterrence and compensation in litigation. Part II considers the nature of reputational harm in class actions and its role in optimizing deterrence. Part III discusses compensationalist public sentiment. Part IV explains why compensationalist sentiment means that compensation affects deterrence in class actions. Lastly, Part V explores some of the implications of compensation's reputational effect on deterrence.

I. Deterrence and Compensation

Economic tort theorists identify optimal deterrence as the primary aim of tort law.[47] Some scholars such as David Rosenberg identify optimal insurance as the secondary aim.[48] Let us consider those in turn, focusing on deterrence.

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43 Lynn M. LoPucki, *Court-System Transparency*, 94 Iowa L. Rev. 481, 510 (2009).

44 Joanna C. Schwartz, *Introspection Through Litigation*, 90 Notre Dame L. Rev. 1055, 1067–68 (2015); Bill Vlasic, *An Engineer's Eureka Moment with a G.M. Flaw*, N.Y. Times (Mar. 28, 2014), http://www.nytimes.com/2014/03/29/business/a-florida-engineer-unlocked-the-mystery-of-gms-ignition-flaw.html?_r=0.

45 Patrick McGeehan, *Merrill Lynch in Big Payout for Bias Case*, N.Y. Times: DealB%k (Aug. 27, 2013, 9:02 PM), http://dealbook.nytimes.com/2013/08/27/merrill-lynch-in-big-payout-for-bias-case.

46 Ellen Hawkes, *What Wal-Mart Women Want*, Ms. Mag. (Sept. 2003), http://www.msmagazine.com/sept03/walmart.asp.

47 Rosenberg, *supra* note 17, at 843.

48 *Id.*; *id.* at 846 (explaining superiority of optimal deterrence to optimal insurance).

Litigation seeks to generate optimal deterrence by forcing firms to bear the full social costs of their decisions.[49] Under conditions of optimal deterrence, firms will choose their level of output and safety precautions based on the net social costs of those choices rather than solely their net private costs.[50] Optimal deterrence is achieved when firms' expected private costs (including damages paid in litigation) equal the net social costs of their contemplated behavior—"no more, no less."[51]

Assuming enforcement of every violation for the sake of explanation, optimal deterrence would require setting damages equal to the harm imposed on others.[52] Suspending that full-enforcement assumption, optimal damages must account for the chance that defendants will not be forced to pay anything in litigation.[53] Mathematically, optimal deterrence then requires setting the sanction equal to the harm imposed on others multiplied by the inverse of the probability that it will be imposed.[54] To take an example, "if the harm is 100 and the probability of sanctions is 50 percent, the sanction should be multiplied by $1/.5 = 2$, so the sanction should equal 200 (and thus the expected sanction would equal 100)."[55]

Optimal deterrence is not maximal deterrence.[56] Optimal deterrence does not seek to induce firms to take all possible precautions to reduce the

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49 *Id.* at 843. This Article seeks to refine deterrence theory in class actions and thus does not enter the empirical debate regarding effectiveness of optimally deterrent damages. *See generally* Linda Sandstrom Simard, *A View from Within the Fortune 500: An Empirical Study of Negative Value Class Actions and Deterrence*, 47 IND. L. REV. 739, 744–45 (2014) (concluding that deterrence in corporations is not as powerful as theory suggests); *see also* Elizabeth Chamblee Burch, *Securities Class Actions as Pragmatic* Ex Post *Regulation*, 43 GA. L. REV. 63, 92 (2008) ("Empirical analysis cannot, for example, *quantify* the amount of fraudulent conduct deterred by litigation, nor can it measure litigation's benefits.") .

50 *See* Margaret H. Lemos, *Special Incentives to Sue*, 95 MINN. L. REV. 782, 843 (2011); A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 HARV. L. REV. 869, 881–82 (1998); Rosenberg, *supra* note 17, at 843.

51 Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301, 1322 (2008); *accord* Rosenberg, *supra* note 17, at 843 ("Optimal tort deterrence threatens firms with liability for the total costs of their tortious conduct.").

52 SHAVELL, *supra* note 17, at 482–83.

53 Rose, *supra* note 51, at 1322 & n.98 (quoting SHAVELL, *supra* note 17, at 483); *see also* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 784 (2011); Coffee, *supra* note 10, at 389.

54 Polinsky & Shavell, *supra* note 50, at 874; *see also* Steven Shavell, *Liability for Harm Versus Regulation of Safety*, 13 J. LEGAL STUD. 357, 363 (1984) [hereinafter Shavell, *Liability for Harm*] ("[T]he chance that parties would not face the threat of suit for harm done . . . results in a dilution of the incentives to reduce risk created by liability . . . ." (emphasis omitted)).

55 SHAVELL, *supra* note 17, at 483.

56 William T. Allen, *Commentary on the Limits of Compensation and Deterrence in Legal Remedies*, 60 L. & CONTEMP. PROBS., Autumn 1997, at 69–70; Rose, *supra* note 51, at 1331; *see also* William M. Landes & Richard A. Posner, *The Private Enforcement of Law*, 4 J. LEGAL STUD. 1, 15 (1975) (describing the "overenforcement theorem" and explaining that overenforcement emerges when sanctions are set above the social costs of the illegal activity because that sanction then triggers greater private enforcement); Polinsky & Shavell, *supra*

risk of harm to others or cease activity that will or might cause some harm.[57] Although it might seem that more deterrence of illegal conduct is always better, overdeterrence "may result in wasteful precautions and the withdrawal of socially valuable products and services from the marketplace."[58] Taking these one at a time, deterrence theory does not seek to induce "socially excessive precautions"—those "that cost[ ] more than the reduction of harm produced by [them]."[59] In addition to socially excessive precautions, overdeterrence may cause a firm "to withdraw its product from the marketplace even though consumers place a higher value on the product than its full cost of production, which includes the average harm caused by the product."[60] In fact, optimal enforcement includes some underdeterrence to offset enforcement costs.[61]

A word about terminology is necessary here. Scholars often use "compensation" to discuss the non-instrumental virtue of civil litigation redressing victims' harm.[62] "Compensation" is not typically thought to be an economic concern in and of itself.[63] Rather, Rosenberg and others posit that compensation is relevant only as a means to provide "insurance."[64] This Article uses "compensation" to refer to paying victims to redress harm, regardless of the underlying normative theory that justifies the payment, whether economic or moral.

Scholars have recognized a connection between deterrence and compensation.[65] When defendants pay money judgments to their victims, that

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note 50, at 890 ("It is important to stress that the level of damages given by the formula is optimal not only because this level remedies problems of underdeterrence, but also because it avoids problems of overdeterrence.").

57 *See* Polinsky & Shavell, *supra* note 50, at 900.

58 *Id.*; *see also* POSNER, *supra* note 53, at 244 ("It is just as important, however, from an economic perspective, to avoid overcompensation as undercompensation. Overcompensation can increase the number of accidents by making potential victims careless, and can make medical care more expensive . . . ."); Allen, *supra* note 56, at 85 ("[P]olitically or socially, we tend to be concerned about deterrence, not over-deterrence. But our welfare as a people requires us to be concerned about opportunity losses that enforcement of legal rules can impose.").

59 Polinsky & Shavell, *supra* note 50, at 879; *see also* Rosenberg, *supra* note 17, at 831–32 (explaining that excessive precaution would harm overall social welfare by exceeding the point at which the sum of accident costs is minimized).

60 Polinsky & Shavell, *supra* note 50, at 882.

61 A. Mitchell Polinsky & Steven Shavell, *The Economic Theory of Public Enforcement of Law*, 38 J. ECON. LITERATURE 45, 54 n.29, 70 (2000).

62 Fitzpatrick, *supra* note 10, at 2060; John C.P. Goldberg, *Twentieth-Century Tort Theory*, 91 GEO. L.J. 513, 521–37 (2003).

63 Fitzpatrick, *supra* note 10, at 2060.

64 Rosenberg, *supra* note 9, at 1881–82; *see also* Fitzpatrick, *supra* note 10, at 2060–61. Typically, maximizing social welfare under Rosenberg's model requires not only optimal deterrence but also optimal insurance. Rosenberg, *supra* note 17, at 843, 845. Some risk of harm will remain even if deterrence were optimized, and that residual risk might induce individuals to behave inefficiently if they could not count on litigation (or some other form of insurance) to cover their losses. *See id.* at 845.

65 Rosenberg, *supra* note 9, at 1892.

they pay money deters wrongdoing. But Rosenberg argues that whether the money goes to victims is irrelevant to deterrence.[66] Rather, compensating victims matters only for insurance purposes.[67]

In small-claim class actions, Fitzpatrick persuasively argues that there is no need for insurance because individual claim values are small and individuals are not risk-averse regarding small losses.[68] Because of the lack of risk aversion, individuals will not alter their behavior ex ante to account for the risk of loss.[69] Thus, he argues, there is no benefit to compensating victims.

Fitzpatrick's focus on deterrence in small-claim class actions puts him in good company.[70] Two other scholars have recently argued that courts and scholars should pay no mind to compensation when claim values are small.[71] They argue that several prominent scholars' concerns about agency costs and misalignment of class counsel and the class's interests are largely wrongheaded[72] because those concerns rely on the premise that it matters whether class members are compensated.[73] From a purely economic perspective, Fitzpatrick and others are right that deterrence is indeed the sole virtue of class

66 *Id.* at 1893 ("[A]ll that matters for optimal deterrence is that the judgment or settlement accounts for the total aggregate tortious harm, *not how or whether it distributes damages among claimants.*" (emphasis added)).

67 *Id.*

68 Fitzpatrick, *supra* note 10, at 2066–67.

69 *Id.*; *see also* Gilles & Friedman, *supra* note 31, at 135–36 (arguing that victims would not alter their ex ante conduct based on the availability of compensation through small-claim class actions and that compensation is therefore not economically necessary).

70 *See, e.g.*, POSNER, *supra* note 53, at 785 ("[W]hat is most important from an economic standpoint is that the violator be confronted with the costs of his violation—this preserves the deterrent effect of litigation—not that he pay them to his victims."); Gilles & Friedman, *supra* note 31, at 105 ("All that matters [in small-claim class actions] is whether the practice causes the defendant-wrongdoer to internalize the social costs of its actions."); *id.* at 106 ("[C]lass member compensation is irrelevant."); William B. Rubenstein, *Why Enable Litigation?: A Positive Externalities Theory of the Small Claims Class Action*, 74 UMKC L. REV. 709, 720–25 (2006) (arguing that small-claim class actions are socially justified because of the positive externalities they generate, including deterrence); David L. Shapiro, *Class Actions: The Class as Party and Client*, 73 NOTRE DAME L. REV. 913, 924 (1998) (contending that deterrence is the most important goal of small-claim class actions and is "perhaps [the] entire[ ]" purpose of such cases); *see also* Elizabeth Chamblee Burch, *CAFA's Impact on Litigation as a Public Good*, 29 CARDOZO L. REV. 2517, 2519 (2008) ("Optimally deterring wrongdoing through litigation is one example of a public good.").

71 Gilles & Friedman, *supra* note 31, at 131–39. Although Gilles and Friedman address the noneconomic concept of compensation, their sole focus on deterrence necessarily implies that the economic concept of insurance—like compensation—is irrelevant.

72 Coffee, *supra* note 6, at 680 ("[I]n economic terms, there are high 'agency costs' associated with class and derivative actions."); Issacharoff, *supra* note 6, at 366 ("The key issue is the guarantee that the agent be the faithful guardian of the interests of the class."); Jonathan R. Macey & Geoffrey P. Miller, *Judicial Review of Class Action Settlements*, 1 J. LEGAL ANALYSIS 167, 197 (2009) ("The request for an award of fees and expenses places class counsel in a direct conflict with the interests of the class.").

73 Gilles & Friedman, *supra* note 31, at 115–21; *see also id.* at 104 (labeling agency cost problem "a mirage").

actions when all claim values are low.[74] But this Article contends that compensation is nonetheless economically relevant because it bears on deterrence.

In sum, optimal deterrence requires setting defendants' expected private costs (including litigation judgments) equal to their social costs. Moreover, Rosenberg and Fitzpatrick contend that compensating victims is no different for deterrence purposes than requiring the defendant to pay the same aggregate amount to anyone else except insofar as paying victims instead of attorneys reduces the incentive to litigate.

II. Reputational Harm and Optimal Deterrence

Although the general construct of optimal tort deterrence requires setting potential defendants' total expected costs equal to the net social harm from their conduct,[75] most tort theorists treat the expected unfavorable court judgment as though it were the only way in which litigation increases defendants' expected costs. For instance, Steven Shavell, in *Foundations of Economic Analysis of Law*, begins his discussion of sanctions and optimal deterrence by focusing only on deterrence from "monetary sanctions by the state."[76] He addresses non-monetary sanctions only to the extent that they are deliberately imposed.[77] Similarly, A. Mitchell Polinsky's and Shavell's classic analysis of punitive damages contends that "damages"—rather than total costs to the defendant of litigation—should be "equal to the harm the defendant has caused."[78] Rosenberg too seems to focus solely on monetary damages as a source of deterrence.[79]

Some scholars, however, have recognized that litigation can and frequently does inflict nonlegal harms on defendants such as harm to their reputations.[80] In the securities context, Amanda Rose explains that private

74 This is not to suggest that the class-client's particular interests and the agency cost problem are irrelevant, but rather that they are not *economically* important and thus fall outside the frame of this Article.

75 Rose, *supra* note 51, at 1322; Rosenberg, *supra* note 17, at 843; *supra* Part I.

76 Shavell, *supra* note 17, at 473.

77 *Id.* at 492–514.

78 Polinsky & Shavell, *supra* note 50, at 878.

79 Rosenberg, *supra* note 17, at 853 ("Optimal deterrence is achieved by threatening the defendant with *damages* equal to the aggregate tortious loss." (emphasis added)).

80 *See, e.g.*, Cooter & Porat, *supra* note 18, at 401 ("[T]he total sanction suffered by the wrongdoer equals the nonlegal sanction plus damages."); Rubin et al., *supra* note 18, at 186 ("We will not re-examine that theory here except to note that for nonintentional torts, *market forces (including reputational losses)*, regulation and compensation for financial losses through the tort system provide sufficient deterrence (and possibly over-deterrence in many situations)." (emphasis added)); *see also* David A. Skeel, Jr., *Shaming in Corporate Law*, 149 U. Pa. L. Rev. 1811, 1815, 1824 (2001) (explaining that the most prominent instances of corporate shaming come about through court decisions, and the fear of shaming affects whether a company will risk wrongdoing in the first instance).

There are other non-damages sources of deterrence such as defendants anticipating having to pay their attorneys' fees to defend a case and the notion that firms faced with

securities enforcement may deter corporate officer wrongdoing in part by threatening to inflict reputational damage.[81] Robert Cooter and Ariel Porat analyze the role of nonlegal sanctions such as reputational harm in optimizing deterrence, though they do not discuss the class action or settlement contexts.[82] Recognizing reputational harm in class actions is important to optimal deterrence because these harms will be non-negligible in many instances[83] and are particularly acute in the class action context where the nature of the alleged harm is necessarily widespread.[84]

Scholars who ignore the import of reputational harm for optimizing deterrence may assume that reputational harm creates a deadweight loss for defendants that defendants will already internalize.[85] Under that premise, reputational harm would indeed be irrelevant to optimizing deterrence. But

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suits will have their employees tied up dealing with lawyers instead of advancing the business. *See* Cynthia A. Williams, *Corporate Compliance with the Law in the Era of Efficiency*, 76 N.C. L. REV. 1265, 1369 (1998); *see also* Deborah A. Sudbury et al., *Keeping the Monster in the Closet: Avoiding Employment Class Actions*, 26 EMP. REL. L.J., Autumn 2000, at 5, 20–21. This Article focuses on *reputational* harm rather than these other sources of non-damages deterrence.

81 Rose, *supra* note 19, at 2222. Although Richard Bierschbach and Alex Stein focus largely on criminal enforcement, they recognize the existence of what they term "market spillover[s]," meaning reputational or other harms to the defendant caused by something other than the legal sanction itself such as consumers or shareholders modifying their behavior to avoid involvement with a settling defendant. Richard A. Bierschbach & Alex Stein, *Overenforcement*, 93 GEO. L.J. 1743, 1748 (2005); *see also* STEVEN SHAVELL, ECONOMIC ANALYSIS OF ACCIDENT LAW 269–70 (1987) (assuming away for purposes of an example the existence of reputational concerns); Buell, *supra* note 20, at 508 ("[T]he argument that law does not matter to reputational effects [on entity criminal defendants] should be approached skeptically."); Polinsky & Shavell, *supra* note 61, at 73 ("[O]thers may impose on the violator external, extra-legal social sanctions (gossip, ostracism) . . . .").

82 Cooter & Porat, *supra* note 18. Rose writes about designing an ideal securities enforcement regime to achieve optimal deterrence but mentions deterrence from reputational harm only in passing. Rose, *supra* note 19, at 2222.

83 *See* Cooter & Porat, *supra* note 18, at 420 (noting that accounting for reputational harm would "significantly reduce damages" in many cases).

84 *See* FED. R. CIV. P. 23(a)(1) (requiring that a class be sufficiently numerous that joinder of members individually is impracticable); *see also* Allen, *supra* note 56, at 67 ("Regularly, if not daily, print and broadcast journalists report violations of legal norms by business corporations that affect thousands of persons.").

85 *See* Kyle D. Logue, *Coordinating Sanctions in Tort*, 31 CARDOZO L. REV. 2313, 2351–52 (2010) (noting that law-and-economics scholarship on optimal deterrence typically assumes implicitly that reputational harms effectuate a deadweight loss). *But cf.* Cindy R. Alexander, *On the Nature of the Reputational Penalty for Corporate Crime: Evidence*, 42 J.L. & ECON. 489, 489 (1999) ("To obtain a total sanction equal to the optimal sanction, following theory developed by Gary S. Becker and others, requires coordination of [formal civil or criminal sanctions with reputational penalties] to avoid over- or underdeterrence of crime." (citing Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968))); Jonathan M. Karpoff et al., *The Cost to Firms of Cooking the Books*, 43 J. FIN. & QUANTITATIVE ANALYSIS 581, 584 (2008) ("[I]t is a mistake to consider only prospective legal penalties in . . . setting public policy because most of the financial penalty for cooking the books comes from lost reputation.").

reputational harm is typically not a deadweight loss.[86] Rather, reputational harm to defendants creates positive value for others by deterring wrongdoers and informing potential victims so that they can avoid a loss.[87] Accordingly, calculating ideal damages to achieve optimal deterrence in tort class actions requires courts accounting for these benefits from reputational harm.[88]

Section A considers the nature of reputational harm in class actions, while Section B expands on the discussion in the previous paragraph about why reputational harm cannot simply be ignored when optimizing deterrence.

A. Nature of Reputational Harm in Class Actions

Criminal law literature illuminates the nature of reputational harm to corporate defendants and their employees. Although criminal charging and conviction is not perfectly analogous to class actions that are typically resolved via settlement,[89] reputational harm occurs at various stages of a class action, albeit frequently to a lesser extent than in criminal law.[90] That the discrimination suits against Denny's and Texaco were civil rather than criminal seems unlikely to have done much to lessen their devastating reputational effect.[91] Texaco's market capitalization "plunged" by a billion dollars as allegations of its misconduct surfaced even though the case was a class action resolved by settlement.[92] Similarly, legal liabilities from the Firestone tire cases "pale in comparison to the costs of the relentless—and relentlessly

86 Cooter & Porat, *supra* note 18, at 405–10; *see also infra* Section II.B.

87 Cooter & Porat, *supra* note 18, at 405–06; *see also infra* Section II.B.

88 Cooter & Porat, *supra* note 18, at 402–03, 415–17; *see also infra* Section II.B.

89 Samuel Issacharoff, *The Governance Problem in Aggregate Litigation*, 81 FORDHAM L. REV. 3165, 3173 (2013) (describing settlement as "the overwhelming form of resolution of any case in which a class is certified"). Regarding the broader potential concern that the civil and criminal systems are simply too different to warrant meaningful comparison, see David A. Sklansky & Stephen C. Yeazell, *Comparative Law Without Leaving Home: What Civil Procedure Can Teach Criminal Procedure, and Vice Versa*, 94 GEO. L.J. 683 (2005) (calling for more comparative work between civil and criminal procedure while explaining their core similarities) and Russell M. Gold, *"Clientless" Lawyers*, 92 WASH. L. REV. (forthcoming 2017) (manuscript at 6-23) (on file with author) (explaining reasons for comparing plaintiffs' counsel in damages class actions to criminal prosecutors).

90 *See* Buell, *supra* note 20, at 507 (arguing that criminal blame creates the strongest form of institutional blame); *see also* Samuel W. Buell, *Potentially Perverse Effects of Corporate Civil Liability*, *in* PROSECUTORS IN THE BOARDROOM: USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT 87, 88 (Anthony S. Barkow & Rachel E. Barkow eds., 2011) (explaining that a civil sanction that is less serious than a criminal sanction is the appropriate structure for creating ideal incentives). Buell explains that SEC enforcement actions "[u]ndeniably" "have some stigmatic impact" and that the lack of admission required by defendants is similar in SEC enforcement actions as in private lawsuit settlements. *Id.* at 93. The level of stigma may be influenced by the SEC's presence in the case. *See id.*

91 Skeel, *supra* note 80, at 1831 & n.75; *see also* Steven A. Ramirez, *Diversity and the Boardroom*, 6 STAN. J.L. BUS. & FIN. 85, 108–09 (2000) (describing Texaco as a "casualty" and as suffering "devastating losses" as a result of a race discrimination class action).

92 Ramirez, *supra* note 91, at 108.

scathing—media coverage" of the litigation.[93] "Class actions can become a public relations nightmare, especially when a large, well-known corporation is the defendant."[94]

Consider first the nature of reputational harms to corporations and their employees from legal proceedings. In the corporate investigation context, "[t]hese sanctions include loss of morale, damage to reputation and corporate image, damage to relationships with customers, suppliers, and the government, bars to future business, and (as a consequence of all of this) significant drops in share price and market share."[95] Similar concerns arise in the class action context, and corporate employees are deterred from wrongdoing by seeking to avoid these potential reputational harms.[96] This claim about deterrence tracks corporate crime scholarship explaining that officers and employees would recognize a decline in "reputational capital" from a violation and would "have incentive to encourage and monitor colleagues' compliance with the law" to avoid the "sting of such reputational effects"[97] and securities enforcement scholarship noting that reputational harm from private enforcement can deter wrongdoing.[98] That employees anticipate and seek to avoid reputational harms that flow either to themselves or to the institution with which they affiliate deters wrongdoing.[99]

One type of reputational harm is internal (i.e., harm to the company's image with an internal audience). The model of internal reputational harm explored here builds on social psychology literature. It begins with the idea that "people's views of themselves are linked to their views about the status of the groups to which they belong."[100] Tom Tyler and Steven Blader explain that "people develop [favorable supportive] attitudes and values" toward

93 Skeel, *supra* note 80, at 1851 (collecting sources).

94 Sudbury et al., *supra* note 80, at 21.

95 Bierschbach & Stein, *supra* note 81, at 1771–72 (footnotes omitted); *see also id.* at 1771 ("Investigations and convictions of corporations, like those of individuals, often trigger significant extralegal sanctions for the defendants and their employees."). Cass Sunstein offers a similar explanation of the effect of violating social norms and ties that notion to the law as a source of social norms. Cass R. Sunstein, *On the Expressive Function of Law*, 144 U. PA. L. REV. 2021, 2029–30 (1996).

96 *See* Rose, *supra* note 19, at 2222.

97 Buell, *supra* note 20, at 501.

98 Rose, *supra* note 19, at 2222.

99 Buell, *supra* note 20, at 500 ("[R]eputational effects are likely to flow through to institutional members in ways that deter wrongdoing and encourage compliance efforts."); Coffee, *supra* note 10, at 448 ("Deterrence is an indirect organizational strategy: we raise the costs of an activity in anticipation that the organization will restrain its agents."); Rose, *supra* note 19, at 2222; Sunstein, *supra* note 95 (explaining that the most important impact of social norms is their ex ante effect generating an expectation of shame that tends to induce compliance).

100 TOM R. TYLER & STEVEN L. BLADER, COOPERATION IN GROUPS: PROCEDURAL JUSTICE, SOCIAL IDENTITY, AND BEHAVIORAL ENGAGEMENT 144 (2000); *accord id.* at 143 ("[W]e argue that an important function of groups is to provide people with a framework within which they can construct a social identity."); *see* Buell, *supra* note 20, at 501–02 (explaining that people's lives are dominated and perhaps defined by their institutional affiliations).

their organizations "and engage in [cooperative] behaviors as a way to support their positive sense of themselves."[101] Tyler and Blader distinguish between two forms of status: "pride" refers to the perceived status of the group as a whole and "respect" to the way an individual perceives her own status within the group.[102] Both pride and respect play important roles in whether employees will cooperate with and advance the organization's goals,[103] which is important to effective and efficient functioning.[104]

Having their employer labeled a wrongdoer by an authoritative source like a court, however, can reduce pride.[105] Reducing pride in turn jeopardizes whether employees will seek to advance the organization's goals[106] and can also increase employee turnover.[107] This relationship to employee turnover also relies on social identity scholarship. Because social identity plays an important role in self-image,[108] people prefer affiliating with organizations they view as having high status.[109] Thus, if their institution's social identity is diminished, people will be tempted to change groups to preserve their self-image.[110]

Reputational deterrence occurs because employees want to protect their organization's pride as a form of protecting self-identity.[111] They thus avoid actions that would tend to lead to their company becoming embroiled in

101 TYLER & BLADER, *supra* note 100, at 143; *accord id.* at 145 ("[P]eople will act in ways that are designed to enhance the status of the groups to which they belong.").

102 *Id.* at 194.

103 *Id.* at 148 ("[S]tatus judgments are central to shaping cooperative behavior within the group."); Tom R. Tyler & Steven L. Blader, *Identity and Cooperative Behavior in Groups*, 4 GROUP PROCESSES & INTERGROUP REL. 207, 212 (2001) ("[P]eople who feel greater pride and respect are more likely to engage in cooperative behavior on behalf of their groups."); *see also* TYLER & BLADER, *supra* note 100, at 151 ("Membership in a high-status group leads to a more favorable social identity and to higher feelings of self-esteem and self-worth. It also leads to greater cooperative behavior."). This is not to suggest that instrumental reasons for voluntary cooperation such as financial incentives are irrelevant but only, as Tyler and others have shown, that social identity plays a greater role. *See id.* at 65.

104 TYLER & BLADER, *supra* note 100, at 23; Tyler & Blader, *supra* note 103, at 208.

105 *See* Buell, *supra* note 20, at 501–02; *see also* Charles S. Mishkind et al., *The EEO Class Action in the New Millennium*, *in* LITIGATING EMPLOYMENT DISCRIMINATION CASES 1998, at 133, 210–11 (PLI Litig. & Admin. Practice, Course Handbook Series No. H0-001C, 1998) ("In the employment context, [class actions] raise heightened concerns where the employer is large and well known because, inevitably, there will be a battle for the hearts and minds of both the public and the defendants' employees which will, in turn, affect the employer's relations with its workers . . . .").

106 TYLER & BLADER, *supra* note 100, at 150 (explaining that negative status evaluation can lead individuals to not engage in cooperative behavior).

107 *Id.* at 161–63; Tyler & Blader, *supra* note 103, at 218.

108 TYLER & BLADER, *supra* note 100, at 143.

109 *Id.* at 180; *see also id.* at 151 ("Membership in a high-status group leads to a more favorable social identity and to higher feelings of self-esteem and self-worth.").

110 Tyler & Blader, *supra* note 103, at 209; *see also* TYLER & BLADER, *supra* note 100, at 150.

111 TYLER & BLADER, *supra* note 100, at 180.

legal proceedings that can tarnish organizational pride and prefer instead to act in ways that will enhance their group's status.[112]

This conception of reputational deterrence applies across the employer's workforce, though it is likely to be most pronounced with high-ranking executives. High-ranking executives of large, publicly held corporations, are a "close-knit" and "status-conscious" bunch,[113] which means that these executives would be "tremendously" "embarrass[ed]," "feel 'tainted'" amongst family and community members, and "anxious about their chances for advancement and future prestigious assignments" if their company received publicity for legal trouble even if the officers themselves were uninvolved.[114] Employees who were involved in or are identified with wrongdoing face difficulty advancing either within their firm or at another firm.[115] Based on case studies of major publicity scandals in the 1960's and 1970's, two social scientists concluded that these internal harms were more significant than monetary harm to companies embroiled in scandal.[116]

Internal reputational harm is not limited to cases that draw media coverage. Rather, many employees—and particularly high-ranking ones—are likely to be aware of ongoing litigation because it affects their work in some respect, they have received a litigation hold, because they have read or helped prepare their company's SEC disclosures, because these issues came up while talking around the water cooler, or simply because they pay attention to discussion of their company on social media or the internet.

Another type of reputational harm is external to the corporation, such as changes in consumer behavior or stock price. These external harms—at least as to stock price—have been more easily measured empirically. Most of this work has been done in the corporate crime context. One scholar confirmed "the presence of a reputational penalty and underscores termination and/or suspension of business relationships with customers as a significant form of real-world [external] reputational sanction" for corporate crime.[117] Two others concluded based on their empirical work spanning 1978 to 1987 that initial press reports of alleged corporate fraud against private victims corresponded to an average stock value decrease of more than one percent.[118] They found that 93.5% of companies' stock price declines after news coverage of a criminal investigation or conviction were attributable to

112 *Id.* at 145.

113 Jayne W. Barnard, *Reintegrative Shaming in Corporate Sentencing*, 72 S. CAL. L. REV. 959, 966 (1999); Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1013 (1997).

114 Barnard, *supra* note 113, at 966–67.

115 Coffee, *supra* note 10, at 412.

116 BRENT FISSE & JOHN BRAITHWAITE, THE IMPACT OF PUBLICITY ON CORPORATE OFFENDERS 243 (1983) ("It was non-financial impacts that executives in all of the companies reported as the factors which truly hurt and which made them want to avoid a recurrence even if it cost a great deal of money to try to guarantee this.").

117 Alexander, *supra* note 85, at 504.

118 Jonathan M. Karpoff & John R. Lott, Jr., *The Reputational Penalty Firms Bear from Committing Criminal Fraud*, 36 J.L. & ECON. 757, 758–59 (1993). The magnitude of a stock

reputational loss;[119] only 6.5% was attributable to formal legal penalties.[120] A qualitative study of seventeen cases of corporate wrongdoing found that adverse publicity reduced earnings in four cases, reduced stock value in seven cases, and damaged image in fifteen cases.[121]

Although criminal conviction signifies the strongest form of institutional blame,[122] reputational harm exists in class actions as well.[123] Civil litigation more generally can inflict reputational harm similar to what scholars have described in corporate crime.[124] Similarly, empirical work on civil litigation and civil enforcement proceedings has found significant reputational harm to defendants' stock price due to the proceedings.[125]

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price decline based on allegations of defrauding a government agency was much larger (five percent). *Id.*

119 *Id.* at 784.

120 *Id.*

121 *See* FISSE & BRAITHWAITE, *supra* note 116, at 231–32.

122 Buell, *supra* note 20, at 507; Coffee, *supra* note 10, at 424–25; *see also* Allen, *supra* note 56, at 77 ("Criminal remedies provide the strongest set of deterrence signals."); Geoffrey P. Miller, *The Compliance Function: An Overview* 16–17 (NYU Law & Econ. Research Paper Series, Working Paper No. 14-36, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2527621 ("Organizational defendants don't want to admit to criminal behavior, both because doing so will damage their reputations and also because the plea may be used against them in subsequent civil litigation.").

123 Ann C. Hodges, *Can Compulsory Arbitration Be Reconciled with Section 7 Rights?*, 38 WAKE FOREST L. REV. 173, 207 (2003); Rose, *supra* note 19, at 2222; Sylvia R. Lazos, Note, *Abuse in Plaintiff Class Action Settlements: The Need for a Guardian During Pretrial Settlement Negotiations*, 84 MICH. L. REV. 308, 313 (1985). Even Coffee—who argues that the harm from criminal conviction is greater—acknowledges that "[l]ittle doubt exists that corporations dislike adverse publicity and that unfavorable publicity emanating from an administrative or judicial source has considerable credibility." Coffee, *supra* note 10, at 425. *But see* Gregory M. Gilchrist, *The Expressive Cost of Corporate Immunity*, 64 HASTINGS L.J. 1, 35 (2012) (contending that civil liability for corporations does not result in reputational loss).

124 Vijay Sekhon, *Enforcement of Material Non-Disclosure Under the Federal Securities Laws*, 16 STAN. J.L. BUS. & FIN. 273, 279 (2011) ("[T]he announcement of civil charges against corporations has substantial extralegal [reputational] effects including loss of employee morale, strained relationships with customers and suppliers, damage to reputation and corporate image, and a consequent decrease in market value beyond the expected liability from the charges." (footnotes omitted)); Skeel, *supra* note 80, at 1831 & n.75 ("For example, when Denny's, and later Texaco, were sued for alleged discrimination, the fact that the lawsuits were civil rather than criminal in nature seems unlikely to have diminished the damage to the firms' reputations."); *see also* Cooter & Porat, *supra* note 18, at 405 (recognizing that civil litigation creates reputational harm).

125 Sanjai Bhagat et al., *The Shareholder Wealth Implications of Corporate Lawsuits*, 27 FIN. MGMT., Winter 1998, at 5, 6 ("We find that no matter who brings a lawsuit against a firm . . . defendants experience economically meaningful and statistically significant wealth losses upon the filing of the suit."); Karpoff et al., *supra* note 85, at 600 (calculating reputational loss following financial fraud enforcement actions, many of which also resulted in class actions, to be 92.09% of the total loss the firm incurs); Sam Peltzman, *The Effects of FTC Advertising Regulation*, 24 J.L. & ECON. 403, 418 (1981) (finding that FTC false advertising complaints result in stock price dip of 3.25%). *But cf.* Jonathan M. Karpoff et al., *The Reputational Penalties for Environmental Violations: Empirical Evidence*, 48 J.L. & ECON. 653, 655

There is also evidence of reputational harm in class actions. Two studies found significant reputational harm to defendants' stock prices because of class actions.[126] Two other studies concluded that public attitudes toward defendants are indeed impaired by class actions.[127]

Litigation is not necessary for companies to face bad publicity, but legal process draws attention to and is seen to substantiate allegations.[128] "In a noisy world,"[129] many members of the public rely on proxies such as the existence of or outcome of litigation to overcome substantial information costs[130] of learning details of every allegation and to confer some imprimatur of legitimacy on those allegations.[131] In the product liability context where consumers would seem to have the greatest incentive to learn about risks,[132] producers face market pressure to exploit heuristics and perception biases to cause consumers to underestimate risks.[133] Litigation increases salience by drawing attention to the allegations,[134] which can help combat these efforts

(2005) (finding that market losses due to environmental violations are similar in degree and correlated to legal penalties).

126 *See* Amar Gande & Craig M. Lewis, *Shareholder-Initiated Class Action Lawsuits: Shareholder Wealth Effects and Industry Spillovers*, 44 J. FIN. & QUANTITATIVE ANALYSIS 823, 829 (2009) (finding a 4.66% drop in stock price attributable to filing of securities class actions); Joni Hersch, *Equal Employment Opportunity Law and Firm Profitability*, 26 J. HUM. RES. 139, 150 (1991) (finding that EEO "class action suits are associated with a significantly negative average prediction error of 15.6 percent over the period" spanning from thirty days before the announcement to thirty days after the announcement). Michael Selmi found to the contrary—that stock prices do not decline due to an employment discrimination class action filing or settlement—though he recognizes that his finding runs contrary to the rest of the literature. Michael Selmi, *The Price of Discrimination: The Nature of Class Action Employment Discrimination Litigation and Its Effects*, 81 TEX. L. REV. 1249, 1253, 1260–65, 1267 (2003).

127 Doris Van Doren et al., *The Effect of a Class Action Suit on Consumer Attitudes*, 11 J. PUB. POL'Y & MARKETING, Spring 1992, at 45, 49; Mark Peyrot & Doris Van Doren, *Effect of a Class Action Suit on Consumer Repurchase Intentions*, 28 J. CONSUMER AFF. 361, 378 (1994).

128 *See* A. Mitchell Polinsky & Steven Shavell, *The Uneasy Case for Product Liability*, 123 HARV. L. REV. 1437, 1445 (2010) (explaining that reputational penalties can only be brought to bear if consumers are informed of allegations).

129 Buell, *supra* note 20, at 511.

130 *See, e.g.*, Mark A. Geistfeld, *Products Liability*, *in* TORT LAW AND ECONOMICS § 11.6, at 293 (Michael Faure ed., 2d ed. 2009) (explaining information costs in product liability context).

131 Buell, *supra* note 20, at 511 (arguing that criminal blame creates the strongest form of institutional blame). Although violating the law does not perfectly equate to wrongdoing that generates reputational harm, the two largely coincide because the law affects social norms such that violations of law tend to also violate social norms. *See* Sunstein, *supra* note 95, at 2031–32.

132 *See generally* Polinsky & Shavell, *supra* note 128.

133 Geistfeld, *supra* note 130, § 11.5, at 292.

134 *See* John D. Graham, *Product Liability and Motor Vehicle Safety*, *in* THE LIABILITY MAZE 120, 184 (Peter W. Huber & Robert E. Litan eds., 1991) ("The case studies reveal that the liability system in particular often stimulates media coverage of safety concerns."); *see also* Bowling v. Pfizer, Inc., 143 F.R.D. 141, 147–48 (S.D. Ohio 1992) (recognizing that ending

(albeit perhaps overly so).[135] That product safety suits typically reduce stock price supports the notion that the market had previously under-perceived risk.[136]

The idea that legal process increases reputational harm appears in tort[137] and corporate crime literature.[138] In the product liability context, one study found that "the indirect effect of liability on consumer demand—operating through adverse publicity about a product's safety and a manufacturer's reputation—is often the most significant contribution of liability to safety. The direct financial costs of liability are usually a relatively minor factor . . . ."[139] A similar finding appears across several government investigation contexts.[140]

Although most of the tort literature focuses on added publicity from litigation rather than substantiation, one empirical study supports the notion that substantiation is not limited to criminal proceedings. It found that news stories about product safety *litigation* had stronger negative effect on firms' stock prices than articles that discussed product safety risks but did not discuss litigation.[141] The extent to which legal proceedings are seen to substantiate allegations depends on the perceived legitimacy of the process, which is what ties this discussion to the economic import of compensation.

Reputational harms can occur at all stages of a class action. Because most class actions are resolved by settlement and many by settlement classes

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damaging media coverage over artificial heart valves that could fracture was one reason that defendant wanted to settle).

135 *See* Graham, *supra* note 134, at 184; Christine Jolls, *On Law Enforcement with Boundedly Rational Actors*, *in* THE LAW AND ECONOMICS OF IRRATIONAL BEHAVIOR 268, 271, 277 (Francesco Parisi & Vernon L. Smith eds., 2005) (explaining that the perceived probability of certain events are skewed based on the ease with which an instance comes to the decisionmaker's mind).

136 Geistfeld, *supra* note 130, § 11.11, at 303 (collecting sources regarding typical drop in stock price and explaining that drop indicates that market had previously under-perceived product risk).

137 Graham, *supra* note 134, at 180–82; Polinsky & Shavell, *supra* note 128, at 1457 ("[A]dverse publicity accompanying litigation can spur market forces." (citing Graham, *supra* note 134, at 180–82)).

138 Buell, *supra* note 20, at 511.

139 Graham, *supra* note 134, at 181–82.

140 FISSE & BRAITHWAITE, *supra* note 116, at 243.

141 W. Kip Viscusi & Joni Hersch, *The Market Response to Product Safety Litigation*, 2 J. REG. ECON. 215, 219 (1990). There are some companies that are impervious to dips in their external reputation and for whom anticipating such harm thus has no deterrent effect. Companies that do not have investors and either do not have customers or whose customers are unlikely to care about their reputations fit into this category. Consider debt buyers and debt collectors. Debt buyers do not have customers in any traditional sense; so long as their investors do not care about being affiliated with wrongdoing, there is no reason to anticipate external reputational harm. As to debt collectors, there is no reason to think their customers care whether their practices are unsavory or illegal unless those practices seem somehow likely to reflect back on the debt holder. Nonetheless, internal reputational harm should still be a factor even in these contexts.

rather than settlement following plenary class certification,[142] the most prominent points for reputational harm to occur are the filing of the complaint and the announcement of a settlement.[143] If a case does not settle quickly, however, reputational harm can come from any potentially newsworthy step in the case including motion filings or from any detrimental information that emerges in discovery or at trial. It is not necessarily the motions themselves that cause harm; more frequently, they provide a trigger for coverage of the substantive allegations.

Reputational harm can occur first with the mere filing of a class action.[144] Because of the systemic nature of the harms alleged by a class,[145] class actions tend to draw more media scrutiny than individual cases[146] and can be less easily spun by defendants as one-off incidents.[147] In one extreme example, shortly after a wave of lawsuits against HMOs, the defendants' stock prices dropped by more than $12 billion.[148] Indeed, the few empirical studies on point find that filing of the complaint causes the greatest reputational harm in class actions.[149]

142 Settlement classes are those certified for purposes of settlement only and not for litigation. *See* Howard M. Erichson, *The Problem of Settlement Class Actions*, 82 GEO. WASH. L. REV. 951 (2014) (arguing for elimination of settlement class actions); Thomas Willging & Emery Lee III, *Class Certification and Class Settlement: Findings from Federal Question Cases, 2003–2007*, 80 U. CIN. L. REV. 315, 341 (2012) (finding that more than half of class settlements in the past decade were certified as settlement class actions).

143 Filing the complaint and proposing settlement may occur simultaneously. *See, e.g.*, Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 602 (1997).

144 Gande & Lewis, *supra* note 126, at 829; Hersch, *supra* note 126, at 150; *see also* Buell, *supra* note 20, at 510–11 ("[L]egal process, and especially criminal legal process, will tend to generate publicity that will increase both the depth of observers' knowledge about an instance of wrongdoing and the number of observers with knowledge of the wrongdoing."); Sudbury et al., *supra* note 80, at 21 ("At the first mention of a potential class action, even before a complaint is filed in court, the media attention can begin.").

145 *See* FED. R. CIV. P. 23(a)(1) (requiring that claims be sufficiently numerous to render individual joinder impractical); *id.* at (a)(2) (requiring that claims raise common issues of law or fact); *id.* at (b)(3) (requiring that common questions predominate over individualized questions); Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541, 2551 (2011) ("[C]laims must depend upon a common contention . . . of such a nature that it is capable of classwide resolution—which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke.").

146 *See* Hodges, *supra* note 123, at 207; *see also* Sherry E. Clegg, Comment, *Employment Discrimination Class Actions: Why Plaintiffs Must Cover All Their Bases After the Supreme Court's Interpretation of Federal Rule of Civil Procedure 23(a)(2) in* Wal-Mart v. Dukes, 44 TEX. TECH L. REV. 1087, 1111–12 (2012).

147 *See* Suzette M. Malveaux, *Clearing Civil Procedural Hurdles in the Quest for Justice*, 37 OHIO N.U. L. REV. 621, 631 (2011) ("[A]n employer can more easily mask discrimination when challenged on an individual basis than on a class-wide basis.").

148 Bryce A. Jensen, Note, *From Tobacco to Health Care and Beyond—A Critique of Lawsuits Targeting Unpopular Industries*, 86 CORNELL L. REV. 1334, 1358 (2001); David Segal, *Tag-Team Lawyers Make Businesses Blink*, WASH. POST (Nov. 12, 1999), http://www.washingtonpost.com/wp-srv/WPcap/1999-11/12/091r-111299-idx.html.

149 Gande & Lewis, *supra* note 126, at 829; *see* Hersch, *supra* note 126, at 150.

Second, news of class settlements can generate reputational harm.[150] News of a settlement is likely to trigger media coverage of the underlying allegations. Moreover, because settling entails refusing to formally defend the allegations, it may appear to admit some degree of wrongdoing even when the settlement agreement explicitly provides to the contrary, as settlement agreements typically do.[151] The fact of settlement will communicate with less force than a conviction or a judicial finding of liability because it provides less procedural assurance of merit. But some observers—both defendants' employees and external observers—will view a company's decision not to contest allegations against it and a judge approving the settlement[152] to provide some substantiation.[153] That some defendants bargain for provisions in settlement agreements preventing class counsel from publicizing the settlement bolsters this claim that defendants fear reputational harm from class action settlements finding their way into the press.[154] Consider a few examples of recent settlements where it is difficult to imagine all employees and customers accepting the decision to pay these amounts rather than defend the charges as totally innocent. That the NFL agreed to pay $765 million to resolve the concussion settlement (and later agreed to lift even that large cap) must look to some—including this author—as less than

150 *See* Samuel Issacharoff, *Assembling Class Actions*, 90 WASH. U. L. REV. 699, 709–10 (2013) (mentioning "reputation effects" for companies resulting from trial or settlement).

151 *See* Deborah R. Hensler, *Money Talks: Searching for Justice Through Compensation for Personal Injury and Death*, 53 DEPAUL L. REV. 417, 451 (2003) ("Voluntary monetary transfers can demonstrate individuals' acceptance of responsibility for the consequences of wrongdoing . . . ."); Tom R. Tyler & Hulda Thorisdottir, *A Psychological Perspective on Compensation for Harm: Examining the September 11th Victim Compensation Fund*, 53 DEPAUL L. REV. 355, 359 (2003) (arguing that agreeing to pay compensation is seen as acknowledging some degree of wrongdoing or responsibility for harm because "[w]e normally think that innocence from wrongdoing is a defense in court"); Paul C. Quinn, Comment, *The EPA Guidance on Landowner Liability and the Innocent Landowner Defense: The All Appropriate Inquiry Standard: Fact or Fiction?*, 2 VILL. ENVTL. L.J. 143, 179 (1991) ("Corporate entities are very cognizant of the public's perception of them and a majority of the public looks upon a settlement as being tantamount to an admission of guilt."); *see also* Richard Frankel, *The Disappearing Opt-Out Right in Punitive-Damages Class Actions*, 2011 WIS. L. REV. 563, 608 n.166 ("[D]efendants routinely disclaim wrongdoing in class action settlement agreements."); *cf.* Carolyn J. Paschke, *The* Qui Tam *Provision of the Federal False Claims Act: The Statute in Current Form, Its History and Its Unique Position to Influence the Health Care Industry*, 9 J.L. & HEALTH 163, 174–75 (1995) (noting that "virtually all" qui tam settlements include secrecy clauses because of sensitivity to public opinion and resulting business harm).

152 *See* FED. R. CIV. P. 23(e)(2) (requiring judicial finding that settlement is "fair, reasonable, and adequate" to bind absent class members).

153 *See* Quinn, *supra* note 151, at 179.

154 *See, e.g.*, Stipulation of Settlement ¶ 115, Pappas v. Naked Juice Co. of Glendora, No. 2:11-cv-08276-JAK-PLA (C.D. Cal. July 2, 2013), ECF No. 118; Settlement Agreement and General Release ¶ 37, Pearson v. Target Corp., No. 1:11-cv-07972 (N.D. Ill. May 7, 2013), ECF No. 73-1.

completely innocent.[155] Citigroup's $590 million and $730 million settlements on claims involving subprime mortgages look similar.[156]

Third, class actions pose further risk of reputational harm as they proceed through various steps in the litigation process.[157] Judges Posner's and Easterbrook's versions of the blackmail settlement narrative—that class counsel may "wring settlements from defendants whose legal positions are justified but unpopular"[158]—suggest that reducing reputational harm is so important to defendants that it is worth settling very winnable cases.

Every step of the litigation process including briefing or rulings on motions or trial provides potential triggers for media coverage. A lawyer for Google recently admitted in open court that trial in an antitrust class action would likely harm the company's reputation.[159] And news articles about class certification motions rarely focus on Rule 23 disputes. Rather, they tend to focus on racier underlying allegations. Consider, for instance, a recent privacy class action against Facebook that settled for pennies on the available statutory damages.[160] Forbes covered the settlement by highlighting a Facebook user who claimed to have unwittingly become a pitchman for a fifty-five-gallon drum of personal lubricant instead of covering the legal issue of whether misappropriation of a name or likeness under California law is an inherently individualized injury that rendered certification of a contested litigation class unlikely.[161] Pending lawsuits expose the defendant and its employees to reputational harm, which often prompts relatively quick settle-

155 *In re* Nat'l Football League Players Concussion Injury Litig., 821 F.3d 410, 422-23 (3d Cir. 2016) (affirming approval of class action settlement creating an "uncapped Monetary Award Fund that provides compensation for retired players who submit proof of certain diagnoses" and recounting the district court's earlier refusal to approve a settlement because this amount was capped).

156 *See In re* Citigroup Inc. Sec. Litig., 965 F. Supp. 2d 369 (S.D.N.Y. 2013); *In re* Citigroup Inc. Bond Litig., 296 F.R.D. 147 (S.D.N.Y. 2013).

157 *See* Marissa L. Bracke, Note, *Where Improper Purposes Lead, Inadequate Protections Follow: Integrating the Rule 11 Improper Purpose Inquiry with the Rule 23 Protections for Absent Class Members*, 41 VAL. U. L. REV. 353, 366 (2006) ("Class actions often provide the potential for large fee payouts for the class's attorney, as well as negative media attention and economically harmful litigation for the defendant." (citing Robert W. Gordon, *The Ethical Worlds of Large-Firm Litigators: Preliminary Observations*, 67 FORDHAM L. REV. 709, 736 (1998))).

158 Blair v. Equifax Check Servs., Inc., 181 F.3d 832, 834 (7th Cir. 1999); *see also In re* Rhone-Poulenc Rorer Inc., 51 F.3d 1293, 1299 (7th Cir. 1995) (noting the likelihood that plaintiffs' claims "lack legal merit" "despite their human appeal"). *But see* Charles Silver, *"We're Scared to Death": Class Certification and Blackmail*, 78 N.Y.U. L. REV. 1357 (2003) (arguing that none of the various iterations of the blackmail settlement narrative are persuasive).

159 Transcript of Proceedings at 42, *In re* High-Tech Employee Antitrust Litig., No. C-11-02509 LHK (N.D. Cal. June 19, 2014) (court: "It's not just financial risks [for the defendants from going to trial]. It's other damage that your companies would get in trying to recruit other employees and what that would do to your image, to your goodwill."); *id.* (response from counsel for Google: "I'm not denying that one bit.").

160 Fraley v. Facebook, Inc., 966 F. Supp. 2d 939, 940, 943 (N.D. Cal. 2013).

161 Kashmir Hill, *Facebook User Unwittingly Becomes Sex Lube Pitchman Thanks to Sponsored Stories*, FORBES.COM (Feb. 28, 2012, 10:13 AM), http://www.forbes.com/sites/kashmirhill/

ment. For instance, Denny's, Inc.'s quick settlements of race discrimination class actions are attributed at least in part to the CEO's fear that publicity from those pending cases would jeopardize another business endeavor of his—namely, buying an NFL franchise.[162]

Lastly, defendants can be harmed by bad facts that emerge in discovery, through investigation of claims, or at trial.[163] With these sources of reputational harms, procedural legitimacy is not important because the process is not providing a proxy for merit.[164] Rather, discovery can provide proof of the underlying wrong, and trial may reveal that proof publicly.[165] The smoking gun renders the defendant's protestations of innocence hollow and proxies unnecessary. Consider the product liability context. "Whether or not they will be held liable, firms do not want their products to harm their customers because, if this occurs, firms will tend to lose business and/or have to lower their prices as a consequence."[166] Yet the extent to which these concerns actually lead firms to produce safe products depends on the assumption that consumers will learn of the risk.[167] And defendants of course typically seek to keep documents confidential that might otherwise provide such information.[168]

2012/02/28/facebook-user-unwittingly-becomes-sex-lube-pitchman-thanks-to-sponsored-stories/. The headline alone is telling.

162 *See, e.g.*, Stephen Labaton, *The Nation; Denny's Gets a Bill for the Side Orders of Bigotry*, N.Y. TIMES (May 29, 1994), http://www.nytimes.com/1994/05/29/weekinreview/the-nation-denny-s-gets-a-bill-for-the-side-orders-of-bigotry.html?pagewanted=all (implying that settling the cases and reaching an agreement with the NAACP were efforts to enable Denny's CEO to buy the Carolina Panthers); Faye Rice, *Denny's Changes Its Spots*, FORTUNE, May 13, 1996, at 133, 134 (explaining that "negative press" from the suit "could have blown the deal" to buy the Panthers).

163 *See* Lazos, *supra* note 123, at 313. As a practical matter, discovery plays a more important role than trial in this context. Although trial might more effectively capture public attention, trials are too infrequent in damages class actions to play a meaningful role in publicizing bad facts. *See* Brian T. Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. EMPIRICAL LEGAL STUD. 811, 812 (2010) ("[V]irtually all cases certified as class actions and not dismissed before trial end in settlement.").

164 *See* Cooter & Porat, *supra* note 18, at 416–17 (explaining that a nonlegal sanction may be triggered by committing an underlying wrong).

165 At a settlement fairness hearing, Judge Koh explicitly raised this point. *See* Transcript of Proceedings, *supra* note 159, at 41 (Court: "[H]ow much did you all want to gamble with all of that information coming out? How much did you all want to go to trial on this?"); Order Denying Plaintiffs' Motion for Preliminary Approval of Settlement at 12, *In re* High-Tech Employee Antitrust Litig. (N.D. Cal. June 19, 2014) (recounting evidence of an internal Apple email instructing recruiters, which stated, "Please add Google to your 'hands-off' list. We recently agreed not to recruit from one another . . . .").

166 Shavell, *supra* note 37, at 590.

167 *Id.* at 590–91; *see also* Polinsky & Shavell, *supra* note 128, at 1445–46 & n.22 (recognizing the same and acknowledging that "consumers are not perfectly informed in fact").

168 As a practical matter, in my experience, when counsel for both sides consent to filing documents under seal, courts tend to approve this arrangement. In one interesting recent case, however, the Ninth Circuit reversed a ruling denying an intervenor's motion

Consider a few prominent examples of discovery harm. Merrill Lynch's former CEO testified at a deposition in a race-discrimination class action that black brokers might have had a harder time at the company than white brokers because the firm's prospective clients are mostly white and might be less trusting of a broker of a different race.[169] In *Wal-Mart*, class-member declarations about a business meeting held at a Hooters restaurant and a visit to an adult dance club on a business trip were less than ideal for public relations[170] even though they proved detrimental to the plaintiffs on class certification.[171] These class-member declarations in *Wal-Mart* were publicly filed documents discussed in and filed concurrently with the most important and highest-profile filing in the case: the motion for class certification. So too were they discussed in the Supreme Court briefing.

Negative press coverage from class actions at any of these phases may sprawl rather than focusing on the particular class action or settlement at issue, which exacerbates the concern over anticipated reputational harm.[172] In an article reporting on a sex-discrimination class action against Goldman Sachs, the author reminded readers about the firm's recent "public relations beating" including a $550 million SEC settlement.[173] An article two years later about a securities class action regarding subprime mortgages mentioned the same SEC settlement.[174] More recently, in a case against Apple for denying warranties due to false positive readings on a liquid damage indicator on the iPhone, one news story led with the agreement to settle for $53 million but followed by criticizing Apple's warranty practices regarding its iPod Nano, the quality of iPod batteries, and the iPhone replacement and repair process in China.[175] In an era of online news with open comment

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to unseal in a product liability case for using an insufficiently stringent standard in denying the motion. *See* Ctr. for Auto Safety v. Chrysler Grp., LLC, 809 F.3d 1092 (9th Cir. 2016).

169 McGeehan, *supra* note 45.

170 *Female Wal-Mart Workers: Meetings Held at Strip Clubs*, USA TODAY (Apr. 29, 2003, 8:30 AM), http://usatoday30.usatoday.com/money/workplace/2003-04-29-walmart-discrimination-suit_x.htm (contending that female managers testified that business meetings have been held in strip clubs and Hooters restaurants); *see also* Hawkes, *supra* note 46.

171 Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541, 2556 (2011). Even though class action discovery is often separated into class-stage and merits-stage phases, discovery related to the merits may nonetheless be available at the class stage in many instances because courts cannot ignore factual disputes when ruling on Rule 23 issues just because those disputes overlap with the merits. *Id.* at 2551–52.

172 *See* FISSE & BRAITHWAITE, *supra* note 116, at 228 (explaining that their case studies "illustrated in varying degrees how adverse publicity concerning one alleged wrongdoing can snowball into unfavorable coverage over other, unrelated, issues").

173 Peter Lattman, *3 Women Claim Bias at Goldman*, N.Y. TIMES (Sept. 15, 2010), http://www.nytimes.com/2010/09/16/business/16bias.html.

174 REUTERS, *Class Action Against Goldman Can Proceed, Judge Rules*, N.Y. TIMES (Feb. 3, 2012), http://www.nytimes.com/2012/02/04/business/class-action-against-goldman-can-proceed-judge-rules.html.

175 Ian Sherr, *Apple Settles iPhone Water Damage Lawsuit for $53 Million*, WALL ST. J. (May 28, 2013), http://www.wsj.com/articles/SB10001424127887323855804578511720535072276.

threads for consumers and pervasive social media, a news story like the Apple settlement spurs public griping that can multiply quickly.[176]

In sum, as with criminal cases, class actions can generate reputational harm to defendants. The mere facts of declining to contest the allegations and paying money to alleged victims may imply wrongdoing even though the settlement agreement expressly provides to the contrary. The procedural legitimacy of the class device determines the extent to which class actions serve as a proxy for the public that allegations are meritorious. Reputational harm typically results from the filing of a class complaint and the fact of settlement and may be further triggered throughout the litigation including by the emergence of bad facts in discovery or at trial.

Although estimating the magnitude of the likely reputational harm from a particular lawsuit may be fraught, defendants can anticipate bearing some reputational harm if suit is filed—anticipating that harm contributes to class action deterrence.[177] The notion that anticipating reputational harm from suit deters wrongdoing is familiar in the medical malpractice context.[178] There, scholars are typically concerned that reputational deterrence is too powerful because it results in inefficient, defensive medicine.[179] Similarly, class actions can create reputational deterrence that risks overdeterrence, especially if the optimization problem focuses only on damages and ignores reputational deterrence.

B. Why Reputational Harm Matters for Optimizing Deterrence

Given the evidence that the threat of reputational harm deters wrongdoing, how should social policymakers account for reputational deterrence when seeking to optimize deterrence in class litigation? In short, it should be

176 David Kravets, *Apple Agrees to Pay $53M to Settle iPhone Warranty Lawsuit*, WIRED (Apr. 11, 2013), http://www.wired.com/gadgetlab/2013/04/iphone-warranty-flap; *see also* Cooter & Porat, *supra* note 18, at 420 (explaining—at a time when Facebook membership was still limited to those with college affiliations and Twitter did not exist—that nonlegal sanctions are most effective in cyberspace).

177 *See* Polinsky & Shavell, *supra* note 128, at 1443 ("Market forces can provide firms with an incentive to improve product safety, for if consumers believe that the risk of a product is high, they will either avoid buying the product or will not pay as much for it as they otherwise would.").

178 *See, e.g.*, James Gibson, *Doctrinal Feedback and (Un)reasonable Care*, 94 VA. L. REV. 1641, 1668–69 (2008) (explaining "the prevalence of defensive medicine" based on "the deterrent effect" of costs including "the significant reputational effects" of a medical malpractice claim being filed); Robert Quinn, *Medical Malpractice Insurance: The Reputation Effect and Defensive Medicine*, 65 J. RISK & INS. 467, 468 (1998) ("The desire to avoid these implicit costs [including loss of reputation] will give an incentive to the physician to behave in a safer, less risky manner.").

179 *See, e.g.*, Gibson, *supra* note 178, at 1668–69; Michelle M. Mello & Troyen A. Brennan, *Deterrence of Medical Errors: Theory and Evidence for Malpractice Reform*, 80 TEX. L. REV. 1595, 1606 (2002) ("[A] defensive-medicine response to perceived malpractice risk is really a measure of overdeterrence or excessive precaution-taking, rather than true deterrence of substandard care.").

deducted from the magnitude of victim harm to achieve ideal net damages because it is not a deadweight loss.[180]

If reputational harm were a deadweight loss to defendants, it would rightly be excluded when calculating damages because defendants would already internalize it.[181] If reputational harm to the defendant generates benefit for others, however, reputational harm plays an important role in calibrating optimal deterrence.[182]

Cooter and Porat rightly explain that reputational harm is typically not a deadweight loss.[183] Rather, reputational harm often generates three benefits: conveying information about the wrongdoer to potential victims to help them avoid future harm, benefiting competitors of the wrongdoer, and deterring the particular wrongdoer and others because they anticipate this extralegal harm.[184] Consider what it would mean to embrace a contrary, deadweight-loss view[185]: accepting that publicity from a lawsuit would not make a single person aware of potential future harm, deter a single firm (including the specific defendant), or benefit competitors by harming the competition. That is highly implausible and contrary to literature explaining that litigation makes consumers more aware of potential risks.[186]

To account for the transfer value of reputational harms, courts would ideally achieve optimal deterrence by deducting the value of the benefits from the amount of harm the victim has suffered to calculate the amount of net damages necessary in an individual case.[187] Otherwise, the defendant's expected sanction would exceed the expected social harm.[188] Because these benefits are difficult to calculate practically, however, Cooter and Porat recommend that courts deduct the extent of the reputational *harm* as a proxy

180 Cooter & Porat, *supra* note 18, at 405–10. Such deductions could lead to perverse results if viewed from the perspective of trying to redress victims' harm rather than optimize deterrence for potential defendants. But that difference goes to the lexically prior questions of what that law should be trying to achieve and a battle of economic versus corrective justice objectives that is assumed away by this Article's frame.

181 For a more detailed explanation, see *id.* at 403–10.

182 *Id.* at 405–10.

183 *Id.* at 405–08.

184 *Id.* at 401, 405–08.

185 Law-and-economics scholarship on optimal deterrence—excluding that of Cooter and Porat—seems to assume implicitly that reputational harm effectuates a deadweight loss. *See* Logue, *supra* note 85, at 2351.

186 *See* Shavell, *supra* note 37, at 605 (explaining that litigation can bring damaging facts to light and that "if the public learns about the defect, perhaps people can take precautions to reduce harm and, further, the firm will suffer adverse consequences, leading to improved deterrence"); *see also* LoPucki, *supra* note 43, at 510 ("Litigation is when the facts come out."); Elizabeth G. Thornburg, *Going Private: Technology, Due Process, and Internet Dispute Resolution*, 34 U.C. DAVIS L. REV. 151, 210 (2000) ("Privatized processes . . . allow the parties to keep the matter secret. This may result in the public, or even the government, lacking information about important issues of public health or safety or product reliability.").

187 Cooter & Porat, *supra* note 18, at 409.

188 *Id.*

for third-party *benefit* from that harm.[189] Accordingly, optimal deterrence requires that potential defendants anticipate an award of damages equal to victim harm minus third-party benefits of the defendant's reputational harm (or, as a proxy, victim harm minus reputational harm).

Whichever method is used to calculate the deduction, the magnitude of reputational harm and the benefits that it creates can be significant.[190] An empirical study of stock market impacts from employment discrimination class actions found that the average drop on the day a case is announced "is triple that of the average direct costs to the firm of settling the case."[191] Securities enforcement proceedings generate reputational losses exceeding legal penalties by more than 7.5 times.[192] In the criminal context, one study concluded that the reputational cost of corporate fraud encompassed 93.5% of the relevant stock market declines.[193]

Moreover, for deterrence purposes, it is not important whether reputational harm will actually be significant in a particular case but rather whether firms fear significant reputational harm from litigation when they choose levels of activity and safety precautions.[194] And expected reputational harm can be significant. "[F]irm managers believe that serious legal proceedings . . . can have potentially devastating effects on business."[195] Or as another study put it, "corporations fear the sting of adverse publicity attacks on their reputations more than they fear the law itself."[196]

In sum, class actions generate significant reputational harm, particularly when filed, settled, or when they unearth evidence of wrongdoing. And reputational harms cannot be ignored for purpose of optimizing deterrence because they do not create a deadweight private loss.

III. COMPENSATIONALISM

> When the award was finally settled, [the securities enforcer] kept the money [instead of giving it to the victims]. I likened it to the call to the sheriff's office when you report your car stolen, the sheriff calls you back two days later and says, "Good news, we found the car; bad news is, I am keeping it."[197]

189 *Id.* at 415–16.

190 *Id.* at 401, 420 (explaining that their approach "would significantly reduce damages [from existing levels] in torts and contracts," "especially in close-knit communities and cyberspace where nonlegal sanctions work").

191 Hersch, *supra* note 126, at 152.

192 Karpoff et al., *supra* note 85, at 582.

193 Karpoff & Lott, *supra* note 118, at 784.

194 Rose, *supra* note 51, at 1322; Rosenberg, *supra* note 17, at 843.

195 Buell, *supra* note 90, at 103.

196 FISSE & BRAITHWAITE, *supra* note 116, at 249; *see also id.* at 356 n.16 (recognizing that the reputational harm that companies fear is related to enforcement of law).

197 *It's Only Fair: Returning Money to Defrauded Investors: Hearing Before the Subcomm. on Capital Markets, Ins., and Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 108th Cong. 1–2 (2003) (statement of Rep. Richard H. Baker, Chairman, H. Subcomm.) [hereinafter *It's Only Fair*].

This Part contends that as a descriptive matter, the public values compensation in class actions, as seen largely through Congress's actions and its rhetoric surrounding those actions.[198] Indeed, scholars have widely recognized that the public views compensating victims as an important aim—if not the sole aim—of civil litigation. As one prominent scholar puts it, "[i]t could hardly be controverted that many private citizens find . . . lawsuits [in which claimants are not meaningfully compensated] to be politically unwise, economically reckless, and morally offensive."[199] Another prominent scholar explains, "The 'aroma of gross profiteering' that many perceive rising from damage class actions troubles even those who support continuance of damage class actions and fuels the controversy over them."[200]

That the public values compensation is important because it means that compensation plays an important role in the magnitude of class actions' reputational deterrence, as explained below.[201]

A. Congressional Compensationalism

The most significant legislative changes to modern class action practice—CAFA and the PSLRA—claimed to protect victim compensation. Nowhere is this congressional sentiment clearer than in CAFA. Congress passed CAFA with resounding bipartisan support,[202] largely behind rhetoric criticizing settlements where victims were left with nothing more than a coupon for a discount on their next purchase from the defendant.[203]

In different contexts, both the FAIR Funds Act and the FTC Improvement Act allow federal agencies to displace (or at least supplement) the tradi-

198 The Supreme Court too has said that victim compensation plays an important role in class actions. *See* Deposit Guar. Nat'l Bank v. Roper, 445 U.S. 326, 339 (1980) ("Where it is not economically feasible to obtain relief within the traditional framework of a multiplicity of small individual suits for damages, aggrieved persons may be without any effective redress unless they may employ the class-action device."); Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 161 (1974) (recognizing that petitioner could not recover anything on his seventy-dollar claim without a class action). Similarly, many lower courts have adopted the private law conception of class actions that focuses on compensation. *See* Myriam Gilles, *Class Dismissed: Contemporary Judicial Hostility to Small-Claims Consumer Class Actions*, 59 DEPAUL L. REV. 305, 308–10 (2010). The executive branch too has sought to preserve a role for compensation. *See* Gilles & Friedman, *supra* note 31, at 125–28.

199 MARTIN H. REDISH, WHOLESALE JUSTICE 160 (2009).

200 Deborah R. Hensler, *Revisiting the Monster: New Myths and Realities of Class Action and Other Large Scale Litigation*, 11 DUKE J. COMP. & INT'L L. 179, 199 (2001) (footnote omitted) (quoting John P. Frank, Whither Rule 23: Memorandum to the Honorable Patrick Higginbotham (Apr. 28, 1995) (on file with author)).

201 *See infra* Part IV.

202 David Marcus, *Attorneys' Fees and the Social Legitimacy of Class Actions*, 159 U. PA. L. REV. PENNUMBRA 157, 165 & n.49 (2010) (recounting the Senate vote of 72-26 and the House vote of 279-149).

203 Class Action Fairness Act of 2005, Pub. L. No. 109-2, § 2(a)(3), 119 Stat. 4 (2005) ("Class members often receive little or no benefit from class actions . . . such as where—(A) counsel are awarded large fees, while leaving class members with coupons or other awards of little or no value . . . .").

tional role of private class actions and pursue victim compensation. The legislative history of both statutes similarly reveals Congress creating compensatory tools for government enforcement while claiming dissatisfaction with victim compensation in class actions.[204]

Whether Congress actually sought to protect the public's preferences for compensation in civil litigation or whether that contention was merely rhetorical,[205] that Congress couched its efforts in compensatory terms signals a belief amongst Members that the public values compensation in civil litigation.

1. Class Action Fairness Act of 2005

CAFA—the most significant legislative change to class actions—provides a stark example of Congress's narrative about protecting compensation and its claim that lack of compensation undermined the social legitimacy of the class device.[206] CAFA followed years of "significant criticism due to the great imbalance between the often worthless coupons that class members received and the sizeable fees their attorneys reaped."[207] The congressional debate was marked from start to finish by "invok[ing] the large fees that accompanied worthless coupons as evidence of a 'broken' system that produced 'outrageous decisions.'"[208] Or as the text of the final bill explained, the lack of compensation for victims had "undermined public respect for our judicial system."[209] That CAFA passed with strong, bipartisan support suggests that the narrative of insufficient compensation becoming a problem for class actions' legitimacy and reining in runaway attorneys' fees gained traction or at least proved popular enough to provide cover for other objectives.[210]

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204 *See infra* subsections III.A.3–4.

205 *Cf.* Daniel A. Farber & Philip P. Frickey, *Legislative Intent and Public Choice*, 74 VA. L. REV. 423, 425–28 (1988) (collecting sources questioning the notion that a legislature can have a coherent purpose).

206 Marcus, *supra* note 202, at 164; *see also* Class Action Fairness Act § 2(a)(3)(A); 151 CONG. REC. 1826 (2005) (statement of Sen. Hatch) ("[M]any of today's class actions are nothing more than business opportunities for some lawyers to strike it rich and too often they have little, if anything, to do with fairly compensating the injured class members."); MANUAL FOR COMPLEX LITIGATION, FOURTH § 21.61 (2004) (describing "granting class members illusory nonmonetary benefits, such as discount coupons" as "recurring potential abuse[ ] in class action litigation").

207 Marcus, *supra* note 202, at 164.

208 *Id.* at 165 (footnotes omitted) (quoting 151 CONG. REC. 2647 (2005) (statement of Rep. Jackson-Lee); 151 CONG. REC. 2072 (2005) (statement of Sen. Vitter); *see also* Jay Tidmarsh, *Living in CAFA's World*, 32 REV. LITIG. 691, 700 (2013) ("In enacting CAFA, Congress fashioned a comprehensive narrative about the nature of American class actions: Class actions were being abused, particularly in certain state courts. . . . [P]laintiffs rarely benefitted from these settlements." (footnote omitted)).

209 Class Action Fairness Act of 2005, Pub. L. No. 109-2, § 2(a)(2)(C), 119 Stat. 4; *see also id.* § 2(a)(3)(A) (finding that class counsel often receive large fees while harming the class members who receive little or no value).

210 Marcus, *supra* note 202, at 165; *see also* Tidmarsh, *supra* note 208, at 704 ("[W]e are living in CAFA's world: a world of wary and grudging acceptance of class actions in which

To address this compensation problem, Congress required courts awarding contingency-based attorneys' fees in coupon settlement cases to determine the award based on the value of coupons actually redeemed rather than the theoretical value of coupons issued.[211] Moreover, Congress required courts to issue a written finding after a hearing that proposed coupon settlements are "fair, reasonable, and adequate for class members" before such settlements could be approved.[212] CAFA's coupon settlement provisions help to protect some role for class action compensation.

2. Private Securities Litigation Reform Act of 1995

The PSLRA too was pitched as a means to provide more meaningful compensation to class members.[213] The conference report describes "testimony that counsel in securities class actions often receive a disproportionate share of settlement awards"[214] and testimony about "rampant" "manipulation by class action lawyers of the clients whom they purportedly represent,"[215] sounding much like the charges critics would levy against all class actions ten years later in support of CAFA. Although the findings in the PSLRA regarding compensation are not as explicit on the face of the legislation as in CAFA, the PSLRA too found Members of Congress claiming to protect victim compensation.

Congress left its mandate vague but linked class compensation to attorney compensation. It provided that "[t]otal attorneys' fees and expenses awarded by the court to counsel for the plaintiff class shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class."[216] In so doing, like CAFA's coupon settlement provision, the PSLRA linked attorneys' fees to actual victim compensation. Linking fees to compensation protects compensation by tying it to the agent's (class counsel's) incentives.[217] If victims were not compensated,

truly deserving class members can be rescued from the avarice of counsel only through the vigorous exercise of federal oversight.").

211 28 U.S.C. § 1712(a) (2012).

212 *Id.* § 1712(e).

213 *See* Gilles & Friedman, *supra* note 31, at 123 ("Legislative reforms, such as the 1995 Private Securities Litigation Reform Act (PSLRA) and the 2005 Class Action Fairness Act (CAFA), have been explicit in their intent to provide more meaningful investor and class member compensation." (footnotes omitted)); Richard H. Walker et al., *The New Securities Class Action: Federal Obstacles, State Detours*, 39 ARIZ. L. REV. 641, 641–42 (1997) ("A central theme of the legislative history [of the PSLRA] is that plaintiffs' lawyers, rather than faithfully representing investors, were acting for their own benefit.").

214 H.R. REP. No. 104-369, at 36 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 735.

215 *Id.* at 31.

216 15 U.S.C. § 77z-1(a)(6) (2012); *see also id.* § 78u-4(a)(6).

217 *See* Issacharoff, *supra* note 6, at 366 ("The key issue is the guarantee that the agent be the faithful guardian of the interests of the class.").

neither would attorneys be. Much like CAFA, the PSLRA garnered broad support in Congress.[218]

3. FAIR Funds Act

The FAIR[219] Funds Act[220] too was headlined by rhetoric evincing discontent with securities class actions' inefficacy at victim compensation.[221] The most powerful evidence comes from Congressman Baker, the Member who proposed FAIR Funds as an alternative to the traditional compensatory mechanism for securities violations: the private class action.[222] The quote in the epigraph above, analogizing compensation-less cases to the sheriff finding and keeping a stolen car, is his.[223]

The statute authorizes the SEC to obtain and distribute compensation to victims.[224] As Adam Zimmerman has explained, government distribution of compensation without class actions' procedural protections raises fairness concerns,[225] which makes it all the more striking that Congress gave the SEC this authority.[226]

4. FTC Improvement Act

Much like the FAIR Funds Act for the SEC that came decades later, in 1975, Congress authorized the FTC to pursue compensatory remedies on behalf of consumers.[227] And the legislative history of the FTC Improvement

218 Chauncey M. Lane, Comment, *To Plead or Not to Plead: The Plaintiff's Growing Burden in Securities Class Action Litigation*, 41 TEX. TECH L. REV. 615, 629 n.95 (2009) (recounting veto-override votes of 319-100 in the House 68-30 in the Senate for the PSLRA).

219 FAIR stands for Federal Account for Investor Restitution. Verity Winship, *Fair Funds and the SEC's Compensation of Injured Investors*, 60 FLA. L. REV. 1103, 1105 (2008).

220 Sarbanes-Oxley Act of 2002, Pub L. No. 107-204, § 308, 116 Stat. 745, 784.

221 148 CONG. REC. 13351 (2002) (statement of Rep. Baker) (proposing that the SEC be required to distribute ninety percent or more of ill-gotten gains to defrauded investors, which he explained was far better than "tak[ing] corporate wealth and giv[ing] it to trial lawyer[s]"); *see also* Jonathan Peterson, *Corporate Fraud Fund on Track, Officials Say; $2.6 Billion Collected for Investors*, CHI. TRIB. (Sept. 28, 2004), http://articles.chicagotribune.com/2004-09-28/business/0409280221_1_sec-enforcement-effort-fair-funds-nevis-capital-management ("When corporate executives make out like bandits, the money ought to go back to the investors, not to trial lawyers." (quoting Rep. Michael Oxley)); *see also* Rep. Richard Baker, *The Election and Your 401(k)*, NAT'L REV. ONLINE (Nov. 2, 2006), http://www.nationalreview.com/node/219131/print (contrasting the SEC's collections under the Fair Funds provision with "[r]unaway litigation").

222 *See* Adam S. Zimmerman, *Distributing Justice*, 86 N.Y.U. L. REV. 500, 529–33 (2011).

223 *It's Only Fair*, *supra* note 197, at 1–2.

224 Winship, *supra* note 219, at 1103 ("The Fair Fund provision of Sarbanes-Oxley allows the SEC to distribute money penalties to injured investors, heralding a new compensatory role for the agency.").

225 Zimmerman, *supra* note 222, at 504–07.

226 *See* Tyler & Thorisdottir, *supra* note 151, at 369–72 (explaining that distributive fairness is important to the public perception of legitimacy).

227 Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, Pub. L. No. 93-637, § 206(a), 88 Stat. 2183, 2201–02 (1975).

Act too contains rhetoric criticizing the class action for lack of compensation. A House report explained that "the promise of actual consumer redress that they can offer" was "illusory and misleading."[228]

Accordingly, Congress afforded the FTC the ability to file its own civil action.[229] The conference report recognized that the existence of a government redress action would afford at least a partial defense to defendants in private civil actions.[230] In so stating, the conference committee acknowledged that government enforcement would somewhat displace private—and often class—litigation.

B. Popular Compensationalism

Congressional rhetoric regarding protecting compensation that Members used to reform or partially displace class actions evinces a broader public sentiment about civil litigation. These four statutes may have been genuine efforts to implement the public's concerns about protecting victim compensation.[231] But even if not, that Congress sought to couch its efforts in compensationalist rhetoric indicates that at least some Members view victim compensation as popular with their voters. If Congressman Baker's colorful analogy about the stolen car was merely a ruse, that he used the analogy at all speaks meaningfully about his view of his voters' sentiment surrounding compensation and perhaps of American voters more broadly. CAFA is often viewed largely as an attack on trial lawyers—at least plaintiffs' class action lawyers.[232] That CAFA passed with broad bipartisan support while attacking lawyers taking money from victims suggests that Members of Congress thought compensationalist sentiment would make the bill more politically popular.[233] Accordingly, the rhetoric behind these four pieces of legislation affecting class actions reveals, by proxy, public compensationalist sentiment.

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228 H.R. REP. NO. 93-1107, at 82 (1974), *reprinted in* 1974 U.S.C.C.A.N. 7702, 7748.

229 15 U.S.C. § 57b(a) (2012).

230 S. REP. NO. 93-1408, at 41 (1974) (Conf. Rep.), *reprinted in* 1974 U.S.C.C.A.N. 7755, 7773; *see also* 15 U.S.C. § 57b(e).

231 *See* Paul R. Verkuil, *A Judge of Character*, 52 ADMIN. L. REV. 11, 14–15 (2000) ("Members of Congress—even powerful ones—are in the business of serving constituents, not private interests."); James M. DeMarco, Note, *Lobbying the Legislature in the Republic: Why Lobby Reform Is Unimportant*, 8 NOTRE DAME J.L. ETHICS & PUB. POL'Y 599, 621 (1994) ("Representatives assure their reelection by pleasing constituents' locally oriented desires . . . .").

232 *See* Stephen B. Burbank, *The Class Action Fairness Act of 2005 in Historical Context: A Preliminary View*, 156 U. PA. L. REV. 1439, 1441 (2008) (describing CAFA as one of a "trio of 'tort reform' measures sought by the Bush Administration" coupled with "unrelenting attacks on lawyers in general and plaintiffs' lawyers in particular"); Nan S. Ellis, *The Class Action Fairness Act of 2005: The Story Behind the Statute*, 35 J. LEGIS. 76, 86–87 (2009) ("The lawyer is held forth as the chief 'culprit' responsible for the pathological tort system. He is both greedy and manipulative." (footnote omitted) (quoting MARC GALANTER, LOWERING THE BAR: LAWYER JOKES AND LEGAL CULTURE 9 (2006))).

233 *See* Class Action Fairness Act of 2005, Pub. L. No. 109-2, §§ 2(a)(2)(C), (3)(A), 119 Stat. 4.

Judge Weinstein, who has been deeply involved in American complex litigation, has expressed similar concern that paying attorneys too much and victims too little jeopardizes the legitimacy of aggregation devices. In the Zyprexa multidistrict litigation,[234] he set aside the plaintiffs' lawyers' contingency fee arrangements and instead set an overall compensation scheme across the litigation.[235] In so doing, he noted that the litigation shared many characteristics of a class action, characterizing it as a quasi–class action.[236] Giving too little money to plaintiffs and too much to lawyers would "be viewed as abusive by the public," he explained, and preserving the "[p]ublic understanding of the fairness of the judicial process" allows mass actions to continue to provide "an important tool for the protection of consumers in our modern corporate society."[237]

In the 9/11 first responders' litigation, Judge Hellerstein similarly reduced the contractual attorneys' fees, based (albeit less explicitly) on seemingly similar concerns about the legitimacy of the process.[238]

Much like Judges Weinstein and Hellerstein, the United States Judicial Conference as a whole expressed similar concern about undercompensating victims in class actions jeopardizing the legitimacy of civil litigation.[239]

Polling data too supports the claim that the American public values compensation as an important component of class actions. In a recent poll, only half of respondents said that most class action suits currently filed in the United States are justified.[240] Eighty-three percent said that settlements should require cash payments to claimants.[241] Another poll found that sev-

234 Multidistrict litigation is a non-class form of aggregation authorized by statute in which cases are consolidated before a single court for pretrial purposes and are typically resolved via settlement at that stage. *See* 28 U.S.C. § 1407 (2012); Elizabeth Chamblee Burch, *Judging Multidistrict Litigation*, 90 N.Y.U.L. REV. 71, 73 (2015) (citing statistics demonstrating that less than 3% of cases transferred through the MDL process are ever remanded to their original districts).

235 *In re* Zyprexa Prods. Liab. Litig., 424 F. Supp. 2d 488, 496 (E.D.N.Y. 2006).

236 *Id.* at 491.

237 *Id.* at 494; *see also* Troy A. McKenzie, *Bankruptcy and the Future of Aggregate Litigation: The Past as Prologue?*, 90 WASH. U. L. REV. 839, 890–91 (2013) (recognizing merit in Judge Weinstein's approach of controlling attorneys' fees to protect the legitimacy of aggregation devices).

238 *See* Transcript of Status Conference at 54, *In re* World Trade Ctr. Disaster Site Litig., No. 1:21-mc-00100-AKH (S.D.N.Y. Apr. 2, 2010), ECF No. 2037 ("This is different. This is 9/11. This is a special law of commons. This is a case that's dominated my docket . . . .").

239 JUDICIAL CONFERENCE REPORT, *supra* note 28, at 19 ("The award of large attorney fees in the absence of meaningful recoveries by class members in some class actions brings the civil justice system into disrepute.").

240 LANGER RESEARCH ASSOCIATES, DRI, THE ANNUAL DRI NATIONAL POLL ON THE CIVIL JUSTICE SYSTEM: CLASS ACTION, JUDICIAL FUNDING, AND POTENTIAL JUROR BIAS 3, 5 (2013).

241 *Id.* at 5.

enty-four percent of respondents indicated that class actions "drive[ ] up prices and should be restrained."[242]

Some readers may be understandably skeptical of drawing any conclusion about popular sentiment from polling data—especially polls conducted by defense-oriented groups. Nonetheless, even scholars who have argued that compensation has no normative value recognize descriptively that the American public seeks compensation from class actions.[243]

Accordingly, based on scholarly consensus, congressional rhetoric, the explicit view of two prominent complex litigation jurists, the Judicial Conference, and polling data, it is fair to say that the American public values compensating victims as an important objective of class actions.

IV. How Compensation Affects Deterrence

Compensationalist sentiment is important because there is reason to think that it links compensation to reputational deterrence in class actions. Because the public values compensation, the extent to which victims are typically compensated in class actions plays a role in class actions' procedural legitimacy. The procedural legitimacy of class actions in turn affects how strongly defendants' employees and the public perceive class action filing or settlement to signal wrongdoing. The signaling effect in turn plays an important role in how strongly defendants are deterred by anticipating reputational harm. In short, lack of compensation tends to signal frivolousness to casual observers because it thwarts public expectations of compensation and the public perception of distributional fairness, which in turn undermines reputational deterrence.

I do not mean to suggest that reputational deterrence depends entirely on the extent to which victims are compensated in class actions. It doesn't. Rather, the claim is that the level of compensation has some effect on reputational deterrence.[244] Compensation-less class actions would bolster defendants' ability to portray class action filings or settlements as mere nuisances generated by money-grubbing plaintiffs' lawyers. Lack of compensation also supports the narrative that there are no victims because there was no harm.[245]

The magnitude of reputational deterrence varies based on both the procedural legitimacy of class actions and the likely underlying facts of any case

242 Press Release, U.S. Chamber of Commerce, Chamber Poll Shows Americans Want Class Action Reform (Mar. 4, 2003), https://www.uschamber.com/press-release/chamber-poll-shows-americans-want-class-action-reform.

243 Gilles & Friedman, *supra* note 31, at 129–31; *see also* Fitzpatrick, *supra* note 10, at 2075 (acknowledging political difficulty if judges were to award 100% attorneys' fees in part because they would incur public ire).

244 The magnitude of compensation's effect on reputational deterrence in class actions generally or in particular subject areas would benefit from empirical study.

245 *See* Jonathan Baron & Ilana Ritov, *Intuitions About Penalties and Compensation in the Context of Tort Law*, 7 J. Risk & Uncertainty 17, 31 (1993) (explaining that the public typically views compensation as restoring a balance between injurer and victim).

in particular.[246] The perception of class actions writ large is where compensation plays its biggest role; as compensation decreases, so too does legitimacy of the class device. To the extent that the legitimacy of the procedural device is undermined, settlement sends a weaker signal about the allegations' merit to defendants' employees and the public.[247]

Lack of victim compensation and the resulting harm to procedural legitimacy animated much of the legislation and judicial action described in the previous section.[248] To quickly review the most prominent evidence, concern about the connection between compensation and procedural legitimacy underlies Judge Weinstein's decision to reduce contractual attorneys' fees in the Zyprexa litigation out of concern that too little compensation would "be viewed as abusive by the public" and would undermine the public perception "of the fairness of the judicial process."[249] A Judicial Conference report recommending an amendment to Rule 23 regarding attorneys' fees said that "[t]he award of large attorney fees in the absence of meaningful recoveries by class members in some class actions brings the civil justice system into disrepute."[250] Moreover, a well-known class action plaintiffs' lawyer admitted before Congress that the "public sees the lawyers on both sides . . . as the only winners in [class actions]. This . . . perception [by] a large portion of the public . . . erodes the image of the American justice system."[251]

This negative public reaction to poorly compensatory class settlements may be explained by the behavioral concept of strong reciprocity.[252] In short, individuals respond "kindly toward actions that are perceived to be kind and hostily toward actions that are perceived to be hostile" based on the

246 *See* James D. Cox, *The Social Meaning of Shareholder Suits*, 65 BROOK. L. REV. 3, 6, 8 (1999) (explaining that reputational effect of shareholder suits depends both on expressive value of shareholder suits generally and on the substance of the claim).

247 *See* Samuel W. Buell, *Liability and Admissions of Wrongdoing in Public Enforcement of Law*, 82 U. CIN. L. REV. 505, 514 (2013) (arguing that "legitimacy of the public enforcement" plays an important role in deterrent effect). Buell makes this point when discussing admissions of wrongdoing in settlements and argues that they enhance the legitimacy of the enforcement proceeding. *Id.* The same result would follow if class actions were to require defendants to admit wrongdoing, but that requirement would probably prove too burdensome for defendants to accept in most instances. *See* Buell, *supra* note 20, at 507 n.153 (explaining that SEC policy not requiring admissions to settle cases was designed to avoid preclusive effect from serving as a hurdle to settlements); Buell, *supra* note 90, at 99 ("[F]irms would mightily resist settlements with devastating potential in collateral civil litigation.").

248 *See supra* Part III.

249 *In re* Zyprexa Prods. Liab. Litig., 424 F. Supp. 2d 488, 494 (E.D.N.Y. 2006).

250 JUDICIAL CONFERENCE REPORT, *supra* note 28, at 19.

251 *Mass Torts and Class Action Lawsuits: Hearing Before the Subcomm. on Courts and Intellectual Prop. of the H. Comm. on the Judiciary*, 105th Cong. 117 (1998) (statement of Elizabeth J. Cabraser, Partner, Lieff, Cabraser, Heimann & Bernstein, LLP).

252 I am grateful to Mark Geistfeld for this suggestion.

fairness or unfairness of the intention underlying the action.[253] That perception of fairness depends on "the equitability of the payoff distribution."[254] How the public reacts to class settlements therefore depends on its perception of the equitability of distribution of the proceeds.[255] Its sense of equitable distribution favors money going to victims who have been harmed over others because compensation is seen as setting "the balance right between the injurer, if any, and the victim."[256]

Let us then consider the connection between procedural legitimacy and reputational harm. In short, "[n]o shame is attached to being the victim of an unfair proceeding."[257] Defendants' employees will not perceive a suit to strongly signal wrongdoing or tarnish their self-image by implication if they view the procedure as illegitimate.[258] One scholar argues that the deterrent effect of shareholder derivative suits has already been undermined by directors' and others' perception that these suits are frivolous.[259]

Procedural legitimacy likely affects external reputational harm similarly;[260] more importantly for deterrence, however, procedural legitimacy similarly affects firms' *expectations* of external reputational harm because the false consensus effect leads firms' employees to expect that others will react as they do.[261] Attempting to anticipate something as depersonalized as general public reaction may exacerbate this tendency.[262]

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253 Ernst Fehr & Urs Fischbacher, *The Economics of Strong Reciprocity*, *in* MORAL SENTIMENTS AND MATERIAL INTERESTS: THE FOUNDATIONS OF COOPERATION IN ECONOMIC LIFE 151, 153 (Herbert Gintis et al. eds., 2005).

254 *Id.*

255 *Id.*; *see also* Tyler & Thorisdottir, *supra* note 151, at 369–72 (explaining the importance of distributive fairness).

256 Baron & Ritov, *supra* note 245, at 17, 31 (finding that many respondents would award higher damages when given a prompt of money going directly to victims than when the money was to go elsewhere) *see also* Coffee, *supra* note 10, at 434-35 & n.183 (recognizing that courts are willing to impose high penalities when victims are compensated).

257 Hawkins, *supra* note 20, at 602; *see also* Buell, *supra* note 90, at 90 ("[T]he reputational sanction[ ] comes largely from the category of the proceeding itself.").

258 Hawkins, *supra* note 20, at 602.

259 *See* Jessica Erickson, *Corporate Misconduct and the Perfect Storm of Shareholder Litigation*, 84 NOTRE DAME L. REV. 75, 129 (2008) ("[T]he defendants in derivative suits are often viewed as unfortunate victims of a flawed litigation system, rather than as actual wrongdoers, a perception that limits the deterrent impact of this litigation." (citing Cox, *supra* note 246, at 8)).

260 Cox, *supra* note 246, at 6 (observing that "[c]harges of usurping corporate opportunities, self-dealing and insider trading will fail to convey the social condemnation for such misconduct" if shareholder suits are commonly understood to be frivolous).

261 *See, e.g.*, JENNIFER K. ROBBENNOLT & JEAN R. STERNLIGHT, PSYCHOLOGY FOR LAWYERS 23 (2012) (claiming that the "false consensus effect" leads people to "believe that their behavior, choices, and beliefs are typical" of others').

262 Gary Marks & Norman Miller, *Ten Years of Research on the False-Consensus Effect: An Empirical and Theoretical Review*, 102 PSYCHOL. BULL. 72, 75–76 (1987) (suggesting that when asked to estimate consensus among abstract groups, subjects think about specific individuals close to them).

It is, of course, possible for scholars to separate strands of legitimacy grounded in distributional fairness from whether the existence of a class action or class settlement signals wrongdoing. But reputational harm depends on the broader public's perception, not scholars'. And such a distinction seems too subtle for the lay observer who does not undertake the information costs necessary in "a noisy world" to independently verify most allegations and instead relies on legal process as a proxy to signal merit.[263] Reputational harm thus "comes largely from the category of the proceeding itself."[264] Strong reciprocity leads most observers to react with general hostility to a form of proceeding lacking distributional fairness;[265] such general hostility, is largely inconsistent with finely parsing different forms of legitimacy to separate distributional fairness and merit.

Moreover, in the securities context, a few scholars have noted in passing this connection between lack of compensation and perceived frivolousness.[266] The legislative history of the PSLRA also connects these concepts explicitly.[267] And there is no reason to think that lack of compensation undermines reputational harm to settling defendants only in securities cases. As with shareholder suits,[268] so too has the public questioned the efficacy of class actions generally based on lack of compensation.[269] Indeed, the concern may be even starker in class actions than in derivative suits, considering Congress's and the Judicial Conference's concerns about lack of compensation and procedural legitimacy.[270]

If class actions are seen as legitimate means of seeking redress for victims, pursuing that legitimate objective makes proceedings look better than

263 Buell, *supra* note 20, at 511.

264 Buell, *supra* note 90, at 90; *see also* Coffee, *supra* note 10, at 425 ("Little doubt exists that corporations dislike adverse publicity and that unfavorable publicity emanating from an administrative or judicial source has considerable credibility.").

265 *See* Fehr & Fischbacher, *supra* note 253, at 153.

266 Cox, *supra* note 246, at 13; Erickson, *supra* note 259, at 129; Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 61 (1991); *see also* Cox, *supra* note 246, at 6 ("[T]he charges [against a manager] are weakened if the medium through which they are asserted itself lacks a credible reputation."); James J. Park, *Shareholder Compensation as Dividend*, 108 MICH. L. REV. 323, 353 (2009) ("A large shareholder-compensation payment may signal that a securities-fraud action had merit.").

267 *See* H.R. REP. NO. 104-369, at 32 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 731.

268 These contexts overlap because "shareholder suit" here refers to derivative suits and securities class actions. *See* Cox, *supra* note 246, at 5–6.

269 *Id.* at 13; Gilles & Friedman, *supra* note 31, at 129–31; *supra* Part III.

270 Class Action Fairness Act of 2005, Pub. L. No. 109-2, § 2(a), 119 Stat. 4 ("[T]here have been abuses of the class action device that have . . . undermined public respect for our judicial system [including when] counsel are awarded large fees, while leaving class members with coupons or other awards of little or no value . . . ."); JUDICIAL CONFERENCE REPORT, *supra* note 28, at 19 ("The award of large attorney fees in the absence of meaningful recoveries by class members in some class actions brings the civil justice system into disrepute.").

tabloid allegations.[271] Although news of class action filing or settlement is unlikely to generate the magnitude of reputational harm that criminal process does,[272] as long as it maintains some procedural legitimacy, it will continue to impose reputational harm that firms' employees can anticipate.[273] Even though most cases are resolved by settlement, class settlements require judicial approval for fairness,[274] and judicial imprimatur enhances procedural legitimacy.[275] Indeed, judicial approval often features in news stories about class settlement.[276] And it seems unlikely that casual observers would distinguish between a judge finding liability and a judge approving a deal as fair in which a corporation pays money to its victims and agrees not to fight allegations against it.[277] If defendants were not concerned that news of settlement signaled merit to at least some extent, none would bargain for agreements preventing class counsel from publicizing the settlement. But sometimes they do.[278] And even if these defendants' concern that the public would perceive a class settlement to indicate wrongdoing was misguided, that at least some defendants were concerned is what that matters for deterrence.

This discussion generates several questions that cannot be resolved in the abstract and require empirical study. One is the magnitude of the effect of slighting compensation on reputational deterrence. Another is whether there is some lower bound on how much compensation must go to victims to avoid undermining reputational deterrence.

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271 Hawkins, *supra* note 20, at 602. This is not to suggest that all class actions must pursue damages or be perceived as frivolous. To the contrary, the public probably does not perceive civil rights cases as frivolous just because they do not seek damages. Instead, the claim here focuses on damages suits such as consumer or securities cases.

272 *See* Buell, *supra* note 20, at 507; Coffee, *supra* note 10, at 424–25.

273 *See* Gande & Lewis, *supra* note 126, at 829–30 (finding significant reputational harm attributable to class action filing); Hersch, *supra* note 126, at 150 (same).

274 *See* FED. R. CIV. P. 23(e)(2) (requiring judicial finding that settlement is "fair, reasonable, and adequate" to bind absent class members).

275 *See* Coffee, *supra* note 10, at 425; *see also* Burch, *supra* note 49, at 109–10 (arguing that judicial approval of class action settlement published in written opinion after public fairness hearings in public courthouses open to television and newspapers is transparent and that this transparency is important to the legal system).

276 *See, e.g.*, *Judge Approves $3.4 Billion in Indian Royalties Settlement*, N.Y. TIMES (June 20, 2011), http://www.nytimes.com/2011/06/21/us/politics/21indian.html?_r=0.

277 *See* Hensler, *supra* note 151, at 451 (arguing that agreeing to pay money can demonstrate acceptance of responsibility); Tyler & Thorisdottir, *supra* note 151, at 359 (explaining that agreeing to pay compensation is seen as acknowledging some degree of wrongdoing or responsibility for harm); Quinn, *supra* note 151, at 179 (arguing that corporations are aware that the public views settlement as tantamount to admission of guilt). And indeed, likelihood of success on the merits factors into the fairness analysis. *See* 7B CHARLES ALAN WRIGHT ET. AL, FEDERAL PRACTICE AND PROCEDURE: CIVIL § 1797.1 (3d ed. 2005).

278 *See, e.g.*, Stipulation of Settlement ¶ 115, Pappas v. Naked Juice Co. of Glendora, No. 2:11-cv-08276-JAK-PLA (C.D. Cal. July 2, 2013), ECF No. 118 (containing such a provision); Settlement Agreement and General Release ¶ 37, Pearson v. Target Corp., No. 1:11-cv-07972 (N.D. Ill. May 7, 2013), ECF No. 73-1 (same).

Lastly, whether it is better for class actions' procedural legitimacy for victims to typically receive a very small check than no check at all warrants further study. Small checks may be seen as sham compensation or even taken as insulting. But my instinct is that seeing victims get some compensation is better for legitimacy than no compensation. Those who get paid typically had to overcome transaction costs and affirmatively file a claim, which means that they did not perceive the expected amount of the check as trivial. And it seems unlikely that many—other than law-and-economics class action scholars concerned about undermining enforcement incentives—would view class actions in a worse light if they distributed ten-dollar checks than if they did not compensate victims at all.

Reducing or even eliminating compensation would not, however, eliminate reputational harm because reputational harm also depends on the specifics of particular cases.[279] The more heinous the allegations the more likely employees and the public will be to condemn a company for refusing to dispute them even though the condemnation will be discounted if made through a device largely perceived as extortionist.[280]

Moreover, whether victims are compensated in particular cases matters because payments to class members suggest that the defendant has wronged identifiable individuals. Notwithstanding declines in the procedural legitimacy of class actions, defendants would have a harder time denying wrongdoing when paying people who seem like victims. This result too follows from compensationalist sentiment. Because the public expects civil litigation to compensate victims and sees damages as setting right the balance between victim and wrongdoer,[281] if companies pay people who are not lawyers to make suits go away, the likely perception is that the payment affords redress to the defendant's victims.[282]

A good public-relations campaign can use victim compensation to combat some of the reputational harm, however. A defendant may conclude that the public will attribute wrongdoing to it for its actions underlying a class suit (because class actions are procedurally legitimate, because the defendant appears to concede wrongdoing by compensating victims, because the mere existence of an allegation is good enough for some, or because there is independent reason to so conclude such as television footage day-after-day showing oil pouring into the Gulf). If the defendant has already reached that conclusion, compensating victims may help moderate the reputational harm

279 Cox, *supra* note 246, at 6.

280 *See* Tyler & Thorisdottir, *supra* note 151, at 359 (explaining that agreeing to pay compensation is seen as acknowledging some degree of wrongdoing or responsibility for harm because "[w]e normally think that innocence from wrongdoing is a defense in court").

281 *See* Baron & Ritov, *supra* note 245, at 31.

282 *See* Tyler & Thorisdottir, *supra* note 151, at 359 ("By stepping in and offering compensation, the government invited some seeking accountability for the events of September 11th to think that the government was acknowledging that it did not exercise enough care in preventing the tragedy.").

because the defendant can publicly claim to have "do[ne] the right thing."[283] Thus, even though compensating victims in class actions generally and in particular cases tends to increase reputational harm, compensation can also be used to moderate some of that harm through a public relations campaign.[284] Nonetheless, this reputational "benefit" from doing the right thing starts from a point at which reputational harm already exists. Despite the public-relations campaign, I seriously doubt that most people view BP as a good global citizen. Defendants thus seem unlikely to be able to reverse that reputational harm completely without a significant expenditure—if at all.

Accordingly, whether victims are compensated through class actions generally affects the legitimacy of the class device, which in turn affects the extent of class action reputational deterrence.[285] If the class action settlement were seen more as an extortion mechanism or a business opportunity for lawyers and less as a mechanism to redress harm done to victims, the public would be less inclined to assign culpability to settlement. Instead, class settlements would seem more like a mere cost of doing business in America.[286] Moreover, compensating class members in particular cases appears to concede some degree of wrongdoing.

V. IMPLICATIONS

Recognizing that compensation and reputational deterrence are intertwined means that optimizing deterrence is even more challenging than has been previously recognized and calls into question attempts to optimize deterrence trans-substantively across class action law.[287] Broadening public enforcement through gatekeeping procedures or allowing judges to try to get deterrence right in individual cases are more promising.

Moreover, diminishing the reputational harm that comes from class action filing and settlement, such as by reducing compensation, will make defendants somewhat more likely to settle quickly than they already are; that change in turn will impede the public informational function of litigation.[288]

A. Optimizing Deterrence

That compensation affects deterrence differently from other forms of class action relief makes social policymakers' task of optimizing deterrence through private class litigation even more difficult than scholars have previ-

283 Dodge, *supra* note 19, at 1272, 1280. Dodge points specifically to BP's reliance on its compensation fund "as the centerpiece" of its "public relations campaign." *Id.* at 1313.

284 *See id.* at 1272, 1280.

285 The degree to which compensation affects deterrence, and at what cost, is ultimately an empirical question that this Article does not attempt to answer. Rather, its aim is to lay the conceptual foundation for that empirical work.

286 *See* Cox, *supra* note 246, at 16 ("[P]rocedural rules existing prior to the [PSLRA] were seen as confirming the belief that being a defendant in a securities class action was nothing more than legalized bad luck.").

287 *See infra* Section V.A.

288 *See infra* Section V.B.

ously recognized. Optimal deterrence requires more than simply setting an aggregate damage award that matches the harm imposed on others.

Scholars have widely recognized that private enforcers' incentives and the public's interest in litigation are not inherently aligned.[289] These divergent incentives tend to lead to a socially inefficient volume of litigation.[290] Plaintiffs' private costs of litigation are lower than its social costs;[291] plaintiffs' private benefits are also lower than litigation's social benefits, including deterrence.[292] That there are both positive and negative externalities to plaintiffs' counsel's decision to litigate, however, makes it difficult to know whether our system will tend toward too much litigation, too little litigation, or both.[293]

When the government is not serving as enforcer, policymakers cannot directly set the enforcement level. Rather, policymakers can seek to achieve optimal deterrence in class actions only by structuring litigation incentives.[294] This is, of course, a difficult task even without considering reputational harm and compensation's role in it.[295]

One important tool is awarding attorneys' fees to prevailing plaintiffs. The traditional story with attorneys' fee awards in class actions is a tradeoff between deterrence and compensation.[296] Higher anticipated fees as a portion of the class's recovery mean greater likelihood of suit and thus more deterrence but at the cost of paying that money to victims, or so the story goes.[297] Recognizing that compensation affects deterrence through reputational harm changes this calculus, however.

Because of the interrelationship of compensation and deterrence, seemingly obvious ways to alter deterrence would not in fact yield predictable results. Even if it were clear that the status quo generated too little deterrence, it would nonetheless remain unclear what effect increasing attorneys' fees across all class actions would have on deterrence.

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289 Shavell, *supra* note 37, at 577; *see also generally, e.g.*, Steven Shavell, *The Social Versus the Private Incentive to Bring Suit in a Costly Legal System*, 11 J. LEGAL STUD. 333 (1982) [hereinafter Shavell, *Social Versus Private Incentive*]; Bierschbach & Stein, *supra* note 81.

290 SHAVELL, *supra* note 81, at 265; Shavell, *supra* note 37, at 577.

291 Shavell, *Social Versus Private Incentive*, *supra* note 289, at 333.

292 *Id.* at 333–34.

293 Shavell lists factors that tend to result in too much litigation and notes that the opposite will result in too little. *Id.* at 336.

294 *See* POSNER, *supra* note 53, at 842–43 (explaining that legislatures can alter the amount of the fine to change the incentives for private enforcement but that the probability of apprehension and conviction increases with the level of the fine, which makes setting the optimal level of enforcement difficult). Policymakers are also hampered by the quality of their information. *See* Shavell, *Social Versus Private Incentive*, *supra* note 289, at 333–34.

295 POSNER, *supra* note 53, at 842.

296 Fitzpatrick, *supra* note 10, at 2066–67; Rosenberg, *supra* note 9, at 1893.

297 *See* Macey & Miller, *supra* note 72, at 197 ("The request for an award of fees and expenses places class counsel in a direct conflict with the interests of the class.").

To explain that, let us return to Fitzpatrick's proposal to award all of the recovery to class counsel when individual claim values are small.[298] The seemingly obvious conclusion that deterrence would increase with a 100% attorneys' fee is not in fact obvious once we account for compensation's role. Increasing fees as a portion of the class's recovery means reducing compensation.[299] Reducing compensation, in turn, likely reduces but does not eliminate reputational deterrence. Increasing attorneys' fees would thus have two opposing effects. The greater fee would encourage more enforcement and thus create greater damages deterrence. But the reduction in compensation would also tend to reduce reputational deterrence. Whether these effects on deterrence would offset or whether increased fees would create more or less deterrence is unclear, which renders policymakers' task a taller order than previously recognized. Accordingly, increasing attorneys' fees to provide greater incentive for class counsel to file suits without accounting for reputational harm risks overdeterrence and underdeterrence.[300]

Two scholars have recently argued that allowing defendants to "buy their way out of court proceedings and public relations disasters ex post" through private corporate settlement mills could lead to too little deterrence.[301] Their argument suggests that defendants paying more to resolve cases with less reputational harm would result in less net deterrence.

Importantly for this analysis, eliminating compensation would not eliminate reputational deterrence. Some class actions would continue to generate reputational harm even in the absence of compensation because they would nonetheless tend to increase attention on the allegations, and some employees and members of the public would continue to perceive class actions to describe actual wrongdoing despite their diminished procedural legitimacy.[302] If eliminating compensation eliminated the difficult-to-measure reputational deterrence then it would actually make optimizing deterrence easier, but that result is quite unlikely.[303]

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298 Fitzpatrick, *supra* note 10, at 2069–70.

299 *See* Macey & Miller, *supra* note 72, at 197. Class action attorneys' fees may be awarded out of a common fund in which the defendants' payment is calculated and class counsel is paid some portion of that fund, or statutory fees may be calculated on top of the damages paid to the class. William B. Rubenstein, *On What a "Private Attorney General" Is—And Why It Matters*, 57 VAND. L. REV. 2129, 2139–40 (2004). But even under the statutory fees approach, greater fees likely means less compensation for class members. *See* William D. Henderson, *Clear Sailing Agreements: A Special Form of Collusion in Class Action Settlements*, 77 TUL. L. REV. 813, 815 (2003) ("Both courts and commentators have expressed apprehension that a plaintiff's counsel may be accepting a lower settlement for the class in exchange for a generous and nonadversarial treatment of fees.").

300 *See* Cooter & Porat, *supra* note 18, at 406 & n.5 (recognizing that deterrence generated by reputational harms is a social good but not if it results in overdeterrence).

301 Dana A. Remus & Adam S. Zimmerman, *The Corporate Settlement Mill*, 101 VA. L. REV. 129, 157 (2015).

302 In this scenario, the defendant's behavior rather than the litigation itself may be the source of most of the reputational harm, but litigation adds visibility.

303 Buell, *supra* note 20, at 512 (regarding measurement difficulty).

Because even eliminating compensation would not eliminate reputational deterrence, substantially increasing attorneys' fees carries great risk of overdeterrence. Higher fees will mean some weaker cases are filed that would not be filed currently.[304] Importantly, however, the mere filing of a class action reported in the media may cause reputational harm no matter how weak the claim and even if dismissed.[305] The mere allegation causes harm, and the seeming repudiation of that allegation through dismissal will likely mitigate but not eliminate that harm.[306] A news story about allegations of wrongdoing is more eye-catching than one about dismissal of a lawsuit.[307] Thus, affording too much of an incentive to litigate can overdeter.

Fitzpatrick's proposal in particular may overdeter. If his assumption is right that substantive law accurately sets damages to achieve optimal deterrence solely through damages and under full enforcement, then a 100% attorneys' fee would get close to optimal damages deterrence; adding the reputational component would likely go soaring past the target.[308]

Attorneys' fees are not the only tools to modify litigation incentives, but similar concerns apply to other systemic tools. Treble or punitive damages[309]

304 Linda Sandstrom Simard, *Fees, Incentives, and Deterrence*, 160 U. PA. L. REV. PENNUMBRA 10, 14–15 (2011).

305 *See* R. William Ide III & Douglas H. Yarn, *Public Independent Fact-Finding: A Trust-Generating Institution for an Age of Corporate Illegitimacy and Public Mistrust*, 56 VAND. L. REV. 1113, 1132 (2003) (arguing that mere allegations can be enough to compromise public trust in a corporation); Selmi, *supra* note 126, at 1297 ("Denny's remains plagued by suits alleging diseriminatory [sic] service, including a high-profile lawsuit filed by Syracuse University students that, although ultimately dismissed, generated a new round of adverse publicity.").

306 *See* Ide & Yarn, *supra* note 305, at 1140 ("By the time the truth emerges, the harm has been done, and while wrongdoing might get front-page headlines, corrections and retractions rarely do."); Gail Ramsey & Kristen McGuire, *Litigation Publicity: Courtroom Drama or Headline News?*, 22 COMM. & L. 69, 84 (2000) ("[R]arely are the details of the story [about a dismissal] complete enough to satisfy the organization or repair the damage of negative publicity.").

307 *See* FISSE & BRAITHWAITE, *supra* note 116, at 227 (explaining that even though many companies introduced reforms in the wake of an adverse publicity crisis, in their case studies, "not one of these reformers attracted favorable notice for its good deeds which in any way approached the intensity of the original poor publicity"); Selmi, *supra* note 126, at 1257 (explaining that his sample included several cases that had only one instance of press coverage, and that instance was typically the filing of a complaint).

308 Marcus, *supra* note 202, at 162; *see also* Allen, *supra* note 56, at 70 (recognizing that "procedural devices[ ] and legal system practices" factor into optimal deterrence). Less than perfect likelihood of detection coupled with the cases that class counsel would not prosecute even for a 100% fee because of their opportunity cost means that damages alone would slightly underdeter with Fitzpatrick's proposal. *Cf.* Polinsky & Shavell, *supra* note 61, at 54 n.29, 70 (recognizing that some degree of underdeterrence is optimal to account for enforcement costs). Reputational harm would seem to more than make up for that slight underdeterrence, but that is not knowable with certainty absent further study.

309 SEAN FARHANG, THE LITIGATION STATE: PUBLIC REGULATION AND PRIVATE LAWSUITS IN THE U.S. 66 (2010) (finding damage multipliers or punitive damages in 104 federal statutes); *see also* Lemos, *supra* note 50, at 791–92.

and statutory damages[310] are also intended to increase enforcement. Let us assume the status quo on attorneys' fees: class counsel receives on average approximately twenty-five percent of the class's recovery.[311] If the available recovery was increased via treble or punitive damages but the percentage of that recovery paid to claimants remained the same, further study would be necessary to discern whether that shift would affect reputational harm. Increasing compensation in raw dollars might increase reputational deterrence and magnify the intended effect of increasing the incentive to litigate, risking overdeterrence.[312]

1. Public Enforcement

Accounting for reputational deterrence calls into question the feasibility of purely private enforcement in class action law. Public enforcement—although it faces significant resource constraints[313] and may raise agency capture concerns[314]—affords the possibility of discretionary nonenforcement in targeted cases to prevent overdeterrence, including overdeterrence caused by reputational deterrence.[315] Public enforcement allows regulatory intervention with a scalpel rather than the hatchet of attorneys' fees or damages enhancements applied across the board.

Recognizing governmental resource constraints,[316] discretionary nonenforcement could be achieved through agency gatekeeping on private enforcement much like the qui tam suit or the EEOC-charge requirement in

310 Lemos, *supra* note 50, at 791–92.

311 Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees and Expenses in Class Action Settlements: 1993–2008*, 7 J. EMPIRICAL LEGAL STUD. 248, 259 (2010); Fitzpatrick, *supra* note 163, at 814.

312 *See* Landes & Posner, *supra* note 56, at 15 (describing "overenforcement theorem"); *cf.* Bierschbach & Stein, *supra* note 81, at 1752 ("The unsure relationship between extralegal sanctions and legal penalties complicates any setoff system [that reduces damages to account for reputational harm] to the point of infeasibility.").

313 *See* Harry Kalven, Jr. & Maurice Rosenfield, *The Contemporary Function of the Class Suit*, 8 U. CHI. L. REV. 684, 720 (1941) (regarding limited resources).

314 *See* Matthew D. Zinn, *Policing Environmental Regulatory Enforcement: Cooperation, Capture, and Citizen Suits*, 21 STAN. ENVTL. L.J. 81, 107 (2002). *But see* Steven P. Croley, *Public Interested Regulation*, 28 FLA. ST. U. L. REV. 7, 7–9 (2000) (finding little consistent support for capture theories); Engstrom, *supra* note 39, at 674 ("[W]hether agencies can be 'captured' at all is a contestable issue, both theoretically and empirically." (citations omitted)).

315 Engstrom, *supra* note 39, at 630 ("Public enforcers can exercise prosecutorial discretion, enforcing only where the social cost of doing so (e.g., transaction costs, including costs imposed on affected communities and judicial resources) is less than the social benefit (e.g., the value of deterred misconduct)."); Landes & Posner, *supra* note 56, at 38 (explaining that rules of law are nearly always overinclusive and that discretionary nonenforcement can counteract that overinclusivity); Rose, *supra* note 51, at 1329 (explaining that public enforcers can respond to overdeterrence through discretionary nonenforcement, but that altering incentives for private enforcement to accomplish the same objective is difficult).

316 *See* Kalven & Rosenfield, *supra* note 313, at 720.

employment discrimination cases.[317] A government gatekeeping role may increase reputational deterrence in each case by adding the government's imprimatur to private litigation; a settled dispute would look somewhat more like an administrative enforcement proceeding with government imprimatur to legitimate the allegations.[318] Such an increase of reputational deterrence in each case would decrease the level of enforcement necessary to achieve optimal deterrence and would allow greater enforcement precision. Achieving a similar level of expected sanction through fewer cases would improve efficiency because it would reduce the level of public expenditure necessary for the court system to resolve those class actions.[319] Whether the added administrative costs of gatekeeping would be lower than the savings from resolving fewer cases judicially is not clear, but that seems plausible because the presence of gatekeepers would discourage frivolous filings.

Indeed, in the area of class action law where we might most expect litigation to harm defendants' reputations—employment discrimination—it should come as no surprise that a gatekeeping scheme already exists.[320] This Article does not suggest that the EEOC charge requirement works well in practice given incredibly limited resources and the volume of cases,[321] but the preference for private informal conciliation over public litigation that it embodies can be seen as a means to reduce reputational harm.[322] And that regime also allows for the possibility that if a charge alleges significant social harm, the government can put its imprimatur on the case and ensure that it is prosecuted just as it can in the qui tam context.

2. Judges Setting Damages

Another possibility for seeking to optimize damages while accounting for reputational deterrence is for judges to set damages in individual cases to account for reputational harm. Ideal net damages to achieve optimal deterrence should be set by deducting the benefit that the reputational harm cre-

317 *See* Rose, *supra* note 51, at 1305–07, 1354–64 (proposing a gatekeeper role for the SEC in private securities class actions); *see also generally* Engstrom, *supra* note 39 (analyzing various gatekeeping structures as ways for government to calibrate private enforcement efforts).

318 *See* Karpoff et al., *supra* note 85, at 582 (finding significant reputational harm from SEC enforcement actions).

319 *See* Polinsky & Shavell, *supra* note 61, at 53 ("[B]ecause any particular level of deterrence can be achieved with different combinations of the fine and the probability of detection, society should employ the highest possible fine and a correspondingly low probability of detection in order to economize on enforcement expenditures."); Shavell, *Social Versus Private Incentive*, *supra* note 289, at 333 (explaining that plaintiffs' private costs of litigation are lower than the social costs).

320 *See* 42 U.S.C. § 2000e-5(e)(1) (2012).

321 *See* Engstrom, *supra* note 39, at 695–99 (criticizing effectiveness of EEOC charge process).

322 *See, e.g.*, Patterson v. McLean Credit Union, 491 U.S. 164, 180–81 (1989) (explaining that the purpose of the EEOC charge requirement is to allow discrimination allegations to be resolved through conciliation rather than public litigation).

ates for third parties from the amount of harm the defendant's conduct caused.[323] Because damages class actions are nearly always resolved by settlement, as a technical matter, this would require judges to reject settlements that did not set damages ideally with an indication of the damages that would warrant approval.[324] Even leaving aside compensation's role in reputational deterrence, estimating the benefit from the defendant's reputational harm in a particular case before awarding damages is difficult.[325] Using reputational harm as a proxy for benefit simplifies this inquiry slightly but leaves a great deal of guesswork.[326]

Accounting for compensation's role in reputational deterrence complicates the task further. Considering changes to class action compensation over time and the degree to which they reduce reputational harm will be more difficult still. Empirical work modeling the relationship between compensation and reputational deterrence would help but may not yield a model with strong predictive power.

Even leaving aside the notion of getting damages exactly right, to protect reputational harm in class actions, courts should be skeptical of settlements that do not directly compensate victims such as those limited to *cy pres* awards and attorneys' fees. The ALI's Principles of the Law of Aggregate Litigation suggests approving such settlements only when individual distributions (or additional individual distributions) are not economically viable.[327] That approach is sensible and would preserve class action deterrence when compensation is impractical but would also protect reputational deterrence by preserving a role for compensation wherever feasible.[328]

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323 Cooter & Porat, *supra* note 18, at 408–09, 415; *supra* Section II.B. There are of course noneconomic reasons why reducing plaintiffs' damages to prevent overdeterrence seems perverse.

324 This approach outlines a strong judicial role not only rejecting unfair settlements but also guiding the parties to the right settlement value. But that strong judicial role is not inconsistent with the existing practice in which judges typically take a more active and more inquisitorial role in complex litigation. *See* Howard M. Erichson, *Mass Tort Litigation and Inquisitorial Justice*, 87 GEO. L.J. 1983, 1985 (1999).

325 Buell, *supra* note 20, at 512.

326 Cooter & Porat, *supra* note 18, at 415–17.

327 A.L.I., PRINCIPLES OF THE LAW OF AGGREGATE LITIGATION § 3.07 (2010); *see also id.* Reporters' Notes ("Case law has taken various approaches in terms of the types of cy pres remedies, if any, that are permissible. In some jurisdictions, a rule change may be necessary to establish the precise circumstances in which cy pres awards may be allowed."). *Compare* Pearson v. NBTY, Inc., 772 F.3d 778, 784 (7th Cir. 2014) (reversing settlement approval and explaining that "[a] *cy pres* award is supposed to be limited to money that can't feasibly be awarded to the . . . class members."), *with* Lane v. Facebook, Inc., 696 F.3d 811, 817–18, 820 (9th Cir. 2012) (awarding all proceeds to charity and attorneys with a $9.5 million settlement fund and a class of 3.6 million people), *and* Fraley v. Facebook, Inc., 966 F. Supp. 2d 939, 940, 943 (N.D. Cal. 2013) (distributing relief to claimants from $20 million settlement fund and class of 150 million people but also distributing additional money to charity and attorneys).

328 The advisory committee proposed incorporating this standard into Rule 23, but it later balked away from that proposal.

It is difficult to know how well government gatekeepers or judges could estimate reputational costs in trying to optimize deterrence through a gatekeeping role or setting ideal net damages. Accounting for compensation's role in reputational deterrence makes those challenges greater still. Both approaches are preferable to sweeping changes to attorneys' fees across all class action law, but whether they are worth the candle or whether optimizing deterrence is simply too fraught with error costs is not knowable in the abstract.

B. Normative Role of Reputational Harm

Leaving aside questions of optimizing deterrence, there are reasons that eliminating reputational harm may be a bad idea. Reputational harm may be more efficient than damages sanctions in class actions. One reason is that certified damages class actions that are not dismissed on procedural grounds are nearly always resolved via settlement and frequently without significant discovery;[329] judgments reached via settlement may not be nearly as effective at achieving optimal deterrence as those reached after trial because trial helps complete the informational picture.[330]

Reputational harm may also be more socially efficient than damages sanctions because it tends to better reflect social harms that the defendant has inflicted on non-plaintiffs. In employment discrimination cases, for instance, a practice of discrimination[331] harms more than just the members of the protected class who were employed by the defendant.[332] Rather, such practices harm all members of the protected class and social equality more broadly.[333] A damages sanction would, at best,[334] force internalization of only the class's harm, but a reputational sanction will instead tend to match the social harm of the challenged behaviors by its very nature.

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329 *See* Fitzpatrick, *supra* note 163, at 812 ("[V]irtually all cases certified as class actions and not dismissed before trial end in settlement."); Issacharoff, *supra* note 89, at 3173 (describing settlement as "the overwhelming form of resolution of any case in which a class is certified").

330 *See* Polinsky & Shavell, *supra* note 61, at 65.

331 *See* Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541, 2551 (2011) (requiring a "common contention . . . of such a nature that it is capable of classwide resolution—which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke").

332 *See* Samuel R. Bagenstos, *"Rational Discrimination," Accommodation, and the Politics of (Disability) Civil Rights*, 89 VA. L. REV. 825, 837–70 (2003) (arguing that employment discrimination law is justified because it prohibits employers from contributing to entrenched social inequalities); Richard A. Epstein & Erwin Chemerinsky, *Should Title VII of the Civil Rights Act of 1964 Be Repealed?*, 2 S. CAL. INTERDISC. L.J. 349, 358 (1993) (Chemerinsky: describing "the terrible social harms of employment discrimination").

333 Epstein & Chemerinsky, *supra* note 332, at 358.

334 *See supra* text accompanying notes 329–30.

Moreover, reducing reputational harm undercuts the extent to which class actions can serve a public informational function.[335] As discussed above, reputational harm in class actions can come in various forms, including harm from settling a class action or harm from facts or evidence that emerge through investigation of the claims, discovery, or at trial.[336] And defendants have some flexibility as to which of these forms of reputational harm to incur. If defendants are particularly concerned about revealing otherwise nonpublic information or creating bad evidence through discovery or public trial, they can raise their settlement offer to the level necessary to settle before discovery becomes risky.[337] It seems that the NFL did just that in the concussion lawsuit brought by its former players.[338] If compensation were slighted in class actions (or reputational harm from class settlements were reduced for any reason), the filing and settlement harms would become cheaper relative to discovery or trial harms than they are now.[339] The reason is that reducing compensation would not affect discovery or trial reputational harms; those harms depend on the evidence that the case creates rather than on the procedure as a proxy. Settlement would become somewhat cheaper than before, however. The relative change in defendants' costs would encourage more quick settlements, which would mean that fewer class actions survive long enough to reveal or generate information about widespread harms.

Defendants' temptation to settle quickly is further heightened because of reasonable concern that a single document may be taken out of context in the media to be far more damning than it actually is.[340] Evidence in the *Wal-Mart* record about adult dance clubs shows only that three managers once mentioned going to an adult dance club and that it was far from regular

335 This informational function is largely nonexistent in piggyback class actions. In such cases, class counsel relies on the existence of a government investigation and its subsequent findings for settlement leverage.

336 *See supra* text accompanying notes 163–71.

337 *See* S. Todd Brown, *Plaintiff Control and Domination in Multidistrict Mass Torts*, 61 CLEV. ST. L. REV. 391, 421 (2013) (explaining that defendants may pay a premium to settle class actions quickly); Shavell, *supra* note 37, at 605 ("[W]hen parties settle, various facts that would have emerged at trial do not come to the notice of the broader public. . . . For example, a defendant firm whose product was defective may not want this information to come to public light and may be willing to pay an extra amount for that reason to achieve settlement. . . ."); *see also* Cooter & Porat, *supra* note 18, at 416 n.17 ("[A]voiding nonlegal sanctions motivates the settlement of suits.").

338 *See* Charles P. Pierce, *The Crisis*, GRANTLAND (Sept. 4, 2013), http://www.grantland.com/story/_/id/9632293/the-nfl-concussion-settlement ("That $765 million was to buy silence. It was to abort an embarrassing discovery process. It was to bury the evidence of how little the NFL ever has cared about the health of the people who work for it.").

339 Nothing in this Section is meant to suggest that discovery actually occurs in most class actions but rather that the number of class actions that proceed to discovery could be lower still if filing and settlement reputational harms were reduced.

340 *See* U.S. CHAMBER INST. FOR LEGAL REFORM, THE NEW LAWSUIT ECOSYSTEM 90 (2013), http://www.instituteforlegalreform.com/uploads/sites/1/The_New_Lawsuit_Ecosystem_pages_web.pdf.

practice.[341] Plaintiffs' treatment of that evidence,[342] however, led to news coverage that Wal-Mart required women to attend meetings at strip clubs.[343]

Quick settlement would, at first glance, appear to enhance efficiency. Both sides would spend less money on litigation, lowering the deadweight loss of litigation expenses and the transaction costs of resolving the dispute.[344] And as a private matter between the defendant and class counsel, that would be right.

But civil litigation serves an important societal function insofar as it can reveal or generate information about wrongdoing and wrongdoers that informs the broader public.[345] This positive informational externality complicates the efficiency calculus about quick settlement.[346] And indeed, class members may, at least in some instances, value obtaining the sort of information that only litigation can unearth.[347] One scholar explains, "Litigation is when the facts come out. . . . Litigation over the safety of a drug or product reveals all of the research on that drug or product—whether published or

341 *E.g.*, Decl. of Christine Webber, Dukes v. Wal-Mart Stores, Inc., No. 01-cv-2252 (N.D. Cal. Apr. 28, 2003) Ex. 42 at 321, Ex. 40 at 196; *see also* Reply Brief for Petitioner at 8–9, Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541 (2011) (No. 10-277).

342 Brief for Respondents at 19, Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541 (No. 10-277) ("Numerous Wal-Mart managers admitted that they regularly go to strip clubs when they attend company management meetings.").

343 *Female Wal-Mart Workers: Meetings Held at Strip Clubs*, *supra* note 170.

344 *See* Jennifer H. Arlen & William J. Carney, *Vicarious Liability for Fraud on Securities Markets: Theory and Evidence*, 1992 U. ILL. L. REV. 691, 694 (referring to litigation costs as "a deadweight loss that only benefits attorneys"); James D. Miller, *Using Lotteries to Expand the Range of Litigation Settlements*, 26 J. LEGAL STUD. 69, 69 (1997) ("Litigating parties incur deadweight losses that they could avoid if they settled their case.").

345 *See, e.g.*, Shavell, *supra* note 37, at 605 (explaining that litigation can bring damaging facts to light and that "if the public learns about the defect, perhaps people can take precautions to reduce harm"); *see also* David Luban, *Settlements and the Erosion of the Public Realm*, 83 GEO. L.J. 2619, 2648–52 (1995) (describing concerns about informational loss from secret settlements); Polinsky & Shavell, *supra* note 61, at 65 ("[S]ettlements also sometimes allow defendants to keep aspects of their behavior secret . . . ."); Schwartz, *supra* note 44, at 1057 (explaining in the context of informational benefits to defendants that "lawsuits can unearth information about misconduct that organizations have hidden from regulators and the public at large").

346 *See* A. Mitchell Polinsky & Daniel L. Rubinfeld, *The Deterrent Effects of Settlements and Trials*, 8 INT'L REV. L. & ECON. 109, 109 (1988) ("[O]nce deterrence is taken into account, trials may be superior despite their higher transaction costs."). Offset against this positive externality are judicial expenditures that the parties have no reason to take into account.

347 *See* Gillian K. Hadfield, *Framing the Choice Between Cash and the Courthouse: Experiences with the 9/11 Victim Compensation Fund*, 42 L. & SOC'Y REV. 645, 647–48 (2008) (describing nonmonetary values that may have caused claimants to wait before bringing claims on the 9/11 Victim Compensation Fund including obtaining "information from otherwise inaccessible sources (the decision makers who determined airline and World Trade Center fire safety procedures, for example)"); *see also id.* at 661 (recounting survey response of some who filed lawsuits instead of filing claims in the 9/11 Victim Compensation Fund because "[they] wanted a trial to find out more about what happened and whether people had failed to do their job to keep us safe").

'proprietary.' Litigation over an asset-securitization transaction may bring to light how parties constructed the transaction."[348] Judicial filings are presumptively public and thus typically serve this informational function.[349] Private mass–dispute resolution systems need not be public, however, and their lack of transparency about widespread injuries has caused some scholars pause.[350] Reducing reputational harm would raise some of the same concern.

Publicly revealing information allows consumers to make more informed choices as to their primary behavior and avoid future harm.[351] Product safety litigation presents the clearest case. Informed consumers can opt not to buy risky products.[352] Consider the pharmaceutical context: litigation brought to light dangers of Vioxx and Neurontin of which consumers had been largely unaware.[353] The problems with General Motors' ignition switches that led to massive recalls also first emerged through litigation investigation.[354] Big tobacco's reputation was severely damaged by the release of internal documents procured through discovery.[355]

348 LoPucki, *supra* note 43, at 510.

349 *See* Gannett Co., Inc. v. DePasquale, 443 U.S. 368, 386 n.15 (1979) (noting that "[f]or many centuries, both civil and criminal trials have traditionally been open to the public" and explaining that "in some civil cases the public interest in access, and the salutary effect of publicity, may be as strong as, or stronger than, in most criminal cases").

350 Remus & Zimmerman, *supra* note 301, at 157; Thornburg, *supra* note 186, at 210 ("When disputes are litigated in a court, the public generally has access to this information. Privatized processes, in contrast, . . . may result in the public, or even the government, lacking information about important issues of public health or safety or product reliability.").

351 Cooter and Porat identify informing the public to enable others to avoid injury as one of the value-creating aspects of reputational harm to defendants. *See* Cooter & Porat, *supra* note 18, at 405.

352 *See* Thornburg, *supra* note 186, at 210 ("Privatized processes, in contrast, . . . may result in the public, or even the government, lacking information about important issues of public health or safety or product reliability."). If the product is not too dangerous, consumers can continue to buy it but might be willing to pay less.

353 *See* Alex Berenson, *Plaintiffs Find Payday Elusive in Vioxx Cases*, N.Y. TIMES (Aug. 21, 2007), http://www.nytimes.com/2007/08/21/business/21merck.html?_r=0 (describing evidence introduced at trial against Merck, in which Merck's top scientists expressed concern about increased risks of cardiovascular events and later confirmed the risks through clinical trial); Heidi Li Feldman, *Pushing Drugs: Genomics and Genetics, the Pharmaceutical Industry, and the Law of Negligence*, 42 WASHBURN L.J. 575, 587–88 (2003) (explaining that litigation discovery demonstrated that the "new product committee" for Neurontin decided to expand sales of drugs by running small studies and placing results in medical journal articles it hired advertising agencies to write as a means of promoting off-label use); Melody Petersen, *Memos Cast Shadow on Drug's Promotion*, N.Y. TIMES (Dec. 20, 2002), http://www.nytimes.com/2002/12/20/business/memos-cast-shadow-on-drug-s-promotion.html (same).

354 Vlasic, *supra* note 44.

355 *See* Robert L. Rabin, *Reflections on Tort and the Administrative State*, 61 DEPAUL L. REV. 239, 257 (2012) (explaining that "release of internal documents severely damage[ed] the reputation of the industry"); Roberta B. Walburn, *The Role of the Once-Confidential Industry*

For examples of class actions serving this public informational function, consider two examples discussed earlier. Merrill Lynch's CEO acknowledged in a deposition that black brokers might have had a harder time at the company because the prospective client base was mostly white.[356] A Wal-Mart employee filed a declaration stating that she attended a business meeting at a Hooters restaurant.[357] To the extent that these facts make employees, potential customers, or investors uncomfortable, they can vote with their feet.

CONCLUSION

There is reason to think that the extent of victim compensation in damages class actions affects the amount of deterrence that class actions generate and not simply as one of many equal ways to force defendants to incur costs. Rather, compensation affects reputational deterrence in ways that other forms of relief do not because the American public expects and values compensation in civil litigation, including in class actions. Thus, class actions are more procedurally legitimate when they comport with those expectations and are more likely to be seen to signal wrongdoing because of that greater procedural legitimacy.

Scholars have rightly recognized that a firm anticipating a $10 million damages award incurs $10 million worth of damages deterrence no matter whether it expects to pay class counsel, the class members, or charity through a *cy pres* award. But firms are not deterred only $10 million if their expected damages from a lawsuit are $10 million. When a defendant settles a class action, its reputation may be harmed internally with its employees and externally with customers and business associates. Anticipating that reputational harm provides additional deterrence.

The magnitude of reputational deterrence depends in part on whether victims are typically compensated in class actions. If class actions as a whole typically fail to provide the compensation the public expects, the social legitimacy of the class device will decrease and the culpability that the public attaches to settling a class action or being named as a class action defendant will decrease with it.

That compensation affects deterrence through reputational harm has several important implications. Perhaps most importantly, achieving optimal deterrence in class litigation broadly is even more complicated than has been previously recognized. Seemingly straightforward approaches such as eliminating compensation to focus only on deterrence do not actually allow social policymakers to effectively control deterrence. Indeed, it is not clear whether increasing attorneys' fees at the expense of compensation would

Documents, 25 WM. MITCHELL L. REV. 431, 436 (1999) (describing protracted discovery fights that led ultimately to production by big tobacco companies of highly damaging documents including documents belying testimony that "smoking isn't addictive").

356 McGeehan, *supra* note 45.

357 Hawkes, *supra* note 46.

increase or decrease overall deterrence because of the countervailing effect on reputational deterrence that reducing compensation would cause.

Allowing the government to play a gatekeeping role in enforcement similar to the qui tam suit offers greater promise. Judges setting damages in individual cases to optimize deterrence may also offer some hope. Nonetheless, the ability to estimate reputational harm even reasonably accurately remains to be seen and would benefit from empirical work trying to model expectations of reputational harm and fleshing out factors that affect the magnitude of harm.

Lastly, this Article has argued that there is some benefit to reputational harm from litigation. It increases deterrence more efficiently than increasing the volume of litigation does. Moreover, reducing expected reputational harm from settlement by reducing compensation is likely to make defendants even less willing to subject themselves to discovery in class actions than they are now. Such a shift would thus undermine the potential for class actions to generate a public informational externality that informs consumer choice.