Cornell Law Review

Volume 80
Issue 4 *May 1995*

Article 6

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Jonathan R. Macey

Geoffrey P. Miller

A MARKET APPROACH TO TORT REFORM VIA RULE 23

Jonathan R. Macey† and Geoffrey P. Miller‡

In a stimulating paper prepared for this symposium,[1] Professor Richard L. Marcus addresses the proposal to substitute an administrative scheme for all future mass tort claims (and some present ones). Professor Marcus cogently observes that many of the pressure points in mass tort litigation can properly be labeled "substantive"—including all the baggage that such a label carries with it.[2] When dealing with mass tort class actions, federal courts face enormous problems of case management. Creative attempts to deal with such problems, however, often involve the courts altering or amending private rights under state law. This seemingly insurmountable result is in tension with the Rules Enabling Act[3] and the *Erie* rule,[4] both of which establish that federal courts in diversity of citizenship cases lack the power to establish a general federal common law. Professor Marcus analyzes a number of recent developments in the law of class action settlements, all of which he sees as potential means for addressing the substantive problems of mass tort administration. He concludes that there is no categorical prohibition on innovative class action settlements, but believes further that "there remain very difficult questions

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† J. DuPratt White Professor of Law, Cornell Law School.

‡ Kirkland & Ellis Professor, University of Chicago Law School.

1 Richard L. Marcus, *They Can't Do That, Can They? Tort Reform Via Rule 23*, 80 CORNELL L. REV. 858 (1995).

2 *Id.* at 866.

3 28 U.S.C. §§ 2071-2074, 2076-2077 (1988). Subsections (a) and (b) of § 2072 read as follows:

> (a) The Supreme Court shall have the power to prescribe general rules of practice and procedure and rules of evidence for cases in the United States district courts (including proceedings before magistrtes thereof) and courts of appeals.
>
> (b) Such rules shall not abridge, enlarge or modify any substantive right. All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect.

Id. §§ 2072(a),(b).

4 Erie R.R. v. Tompkins, 304 U.S. 64, 78 (1938):

> Except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State. . . . There is no federal general common law. Congress has no power to declare substantive rules of common law applicable in a State whether they be local in their nature or "general," be they commercial law or a part of the law of torts.

Id.

about when and how the power to effect tort reform in this fashion may be exercised."[5]

While Professor Marcus identifies an important trend in the law of mass torts, his misgivings about the trend are not warranted. He expresses concern that, through their experimentation with new class action procedures, the federal courts are transforming substantive state law.[6] So they are. But this is a positive, not a negative development.

When applied to mass tort class actions, the *Erie* rule is unworkable. Federal courts cannot realistically apply the law of many states in their administration of such litigation. In practice, such a task would strain judicial resources and result in inequitable disparities in the recoveries of similarly situated plaintiffs.[7] These cases are nearly always settled, and the law applied in such settlements is, for all intents and purposes, federal common law. There is nothing untoward or unconstitutional about this. The constitutional basis for the *Erie* doctrine has never been obvious, although Justice Brandeis's opinion for the Court did announce ominously, if obscurely, that "the unconstitutionality of the course pursued [under the doctrine of *Swift v. Tyson*[8]] has now been made clear."[9] The federal government has the power to define rules for mass tort recovery, since the subject matter is unquestionably within the scope of the federal commerce power. And if the matter is one of jurisdiction, the Supreme Court has made it abundantly clear that limitations on a federal court's subject matter jurisdiction can be adjusted to account for the necessities of efficient adjudication.[10] One does not need to draw on an expansive notion of "equitable jurisdiction,"[11] pass new federal legislation,[12] enact uni-

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5 Marcus, *supra* note 1, at 895.

6 *Id.* at 875.

7 *See* Barbara Ann Atwood, *The Choice-of-Law Dilemma in Mass Tort Litigation: Kicking Around* Erie, Klaxon, *and* Van Dusen, 19 CONN. L. REV. 9, 11 (1986) (A "federal judge hearing a mass tort case must frequently determine what the courts of a dozen states would think the courts of a dozen different states would think on questions about which none of the courts have thought."); Paul S. Bird, *Mass Tort Litigation: A Statutory Solution to the Choice of Law Impasse*, 96 YALE L.J. 1077, 1078 (1987); Friedrich K. Juenger, *Mass Disasters and the Conflict of Laws*, 1989 U. ILL. L. REV. 105, 108-09; Larry Kramer, *On the Need for a Uniform Choice of Law Code*, 89 MICH. L. REV. 2134, 2137 (1991); Michael W. McConnell, *A Choice-of-Law Approach to Products-Liability Reform*, *in* NEW DIRECTIONS IN LIABILITY LAW 90 (Walter Olsen ed., 1988).

8 41 U.S. (16 Pet.) 1 (1842).

9 *Erie*, 304 U.S. at 77-78.

10 *See, e.g.*, United Mine Workers v. Gibbs, 383 U.S. 715, 723 (1966) (finding pendent jurisdiction).

11 *In re* Northern Dist. of Cal. "Dalkon Shield" IUD Prod. Liab. Litig., 526 F. Supp. 887, 894-95 (N.D. Cal. 1981).

12 *See, e.g.*, Arthur R. Miller & David Crump, *Jurisdiction and Choice of Law in Multistate Class Actions After* Phillips Petroleum Co. v. Shutts, 96 YALE L.J. 1, 74-75 (1986) (suggesting a statute creating federal subject matter jurisdiction in multistate class actions); Linda S.

form state laws,[13] federalize choice-of-law rules,[14] revive old-fashioned choice-of-law principles,[15] or adopt a hodgepodge of different reforms[16] to justify the experimentation engaged in by federal courts in the mass tort area. These courts are creating federal common law, and the fact that they are doing so might as well be forthrightly acknowledged.

Federal courts should jettison the unworkable *Erie* rule in the mass tort context and replace it with a rational approach that recognizes the necessity of federal common law in this area.[17] If federal courts indeed reject *Erie* in this context, it will be necessary for them to rethink the dogged admiration for this Supreme Court chestnut which has marked a half century of jurisprudence and commentary; as Linda Mullenix rightly observes, "The legal profession has a long-standing, collective psychological block with regard to even the mention of federal common law, and its occasional messengers are typically received with polite disregard."[18] The time has come for polite disregard to give way to respectful attention: *Erie* should be abandoned as the standard for mass tort cases—the sooner the better.

Professor Marcus's article thoroughly discusses a number of important innovations in the judicial administration of mass tort class actions but does not suggest the possible use of market-based mechanisms as a reform device. Given the obvious need to fashion innovative solutions to the daunting problems of mass tort litigation, it would be worthwhile to include market-based solutions to the mix of policy options already in the literature. Specifically, we believe that courts

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Mullenix, *Class Resolution of the Mass-Tort Case: A Proposed Federal Procedure Act*, 64 TEX. L. REV. 1039, 1060-62 (1986) (proposing a federal mass tort procedure act).

13 William D. Torchiana, *Choice of Law and the Multistate Class: Forum Interests in Matters Distant*, 134 U. PA. L. REV. 913, 935-37 (1986).

14 Andreas F. Lowenfeld, *Mass Torts and the Conflict of Laws: The Airline Disaster*, 1989 U. ILL. L. REV. 157, 168 (1989); Linda S. Mullenix, *Federalizing Choice of Law for Mass-Tort Litigation*, 70 TEX. L. REV. 1623, 1657 (1992).

15 Thomas M. Reavley & Jerome W. Wesevich, *An Old Rule for New Reasons: Place of Injury as a Federal Solution to Choice of Law in Single-Accident Mass-Tort Cases*, 71 TEX. L. REV. 1, 42-43 (1992).

16 Russell J. Weintraub, *Methods for Resolving Conflict-of-Laws Problems in Mass Tort Litigation*, 1989 U. ILL. L. REV. 129, 131 (1989).

17 For commentary recommending the use of federal common law in mass tort cases, see Mullenix, *supra* note 12, at 1077; Steven L. Schultz, *In Re* Joint Eastern and Southern District Asbestos Litigation*: Bankrupt and Backlogged—A Proposal for the Use of Federal Common Law in Mass Tort Class Actions*, 58 BROOK. L. REV. 553, 607 (1992); Georgene M. Vairo, *Multi-Tort Cases: Cause for More Darkness on the Subject, or a New Role for Federal Common Law?*, 54 FORDHAM L. REV. 167, 190 (1985); Briggs L. Tobin, Comment, *The "Limited Generosity" Class Action and a Uniform Choice of Law Rule: An Approach to Fair and Effective Mass-Tort Punitive Damage Adjndication in the Federal Courts*, 38 EMORY L.J. 457, 460 (1989) (implicitly advocating use of federal common law); Aaron D. Twerski, Essay, *With Liberty and Justice For All: An Essay on Agent Orange and Choice of Law*, 52 BROOK. L. REV. 341, 366 (1986).

18 Mullenix, *supra* note 14, at 1635.

and commentators should explore the use of auction procedures for such litigation, either as an adjunct to, or as a substitute for, other suggested approaches.

In a 1991 article published in the *University of Chicago Law Review*, we advocated the use of auctions for class action lawsuits.[19] The article focused on securities law class actions and corporate shareholder's derivative litigation. The single most salient feature of such litigation is that it tends to be dominated by entrepreneurial plaintiffs' attorneys who are largely free of effective monitoring by the members of the class who comprise their ostensible "clients."[20] This fundamental problem creates a serious risk that plaintiffs' attorneys in class action cases will not fairly and adequately represent the interests of the class. The devices currently in use for regulating the conduct of class action attorneys, and for reducing the so-called agency costs, are not particularly effective. For example, judicial review of settlements and attorneys' fee requests rarely involve a thorough investigation of whether the settlement or fee is in the best interests of the class.[21] Attempts to regulate the named plaintiff for typicality and adequacy are similarly ineffective.[22] Furthermore, ethics rules applicable to plaintiffs' attorneys are unworkable and counterproductive in some cases.[23]

In order to appropriately address these problems, we proposed an approach to large-scale class action litigation that would use an auction procedure.[24] The basic elements of the procedure are quite simple. Upon the filing of a class action complaint, the judge could conduct an initial investigation to determine whether the case would be appropriate for auction treatment. Features that indicate the potential utility of litigation auctions include: whether a large number

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19 Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1 (1991) [hereinafter *Class Action Auctions*]. For subsequent debate on the auction idea, see Randall S. Thomas & Robert G. Hansen, *Auctioning Class Action and Derivative Lawsuits: A Critical Analysis*, 87 N.W. U. L. REV. 423 (1993); Jonathan R. Macey & Geoffrey P. Miller, *Auctioning Class Action and Derivative Suits: A Rejoinder*, 87 N.W. U. L. REV. 458 (1993).

20 Macey & Miller, *Class Action Auctions*, *supra* note 19, at 7. Others, notably Professor John C. Coffee, Jr., have also investigated the implications of the fact that plaintiffs' attorneys in large-scale class actions act essentially as self-serving entrepreneurs. *See* John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877 (1987); John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter is Not Working*, 42 MD. L. REV. 215, 235-36 (1983); John C. Coffee, Jr., *Rethinking the Class Action: A Policy Primer on Reform*, 62 IND. L.J. 625 (1987); John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of the Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 676 (1986); John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 LAW & CONTEMP. PROBS., Summer 1985, at 5, 12.

21 *Class Action Auctions*, *supra* note 19, at 44-61.

22 *Id.* at 61-96.

23 *Id.* at 96-105.

24 *Id.* at 105-18.

of plaintiffs are included in the proposed class, whether more than one lawsuit has been filed to redress the same injury, whether the claims are sufficiently defined to warrant auction treatment, and whether there are any other factors that bear on auction treatment (such as individualized issues that might require extensive participation by class members).[25] If the judge determined that auction treatment were appropriate, he or she would define the claim as precisely as possible, and would cause notice of the auction, along with a description of the bidding protocol to be used, to be posted in suitable journals. Bidders would not need to be attorneys; anyone could bid at the auction, including the defendant. Indeed, one of the potential benefits of the auction approach is that it might facilitate settlement. If the defendant placed the high bid, the judge would award the claim to the defendant, who, in turn, would pay the bid amount to the court. In other words, if the defendant were the highest bidder at the auction, the case would automatically settle. The judge would deduct expenses from any settlement amount. Such expenses would include the costs of investigation and publication, and, subject to the judge's discretion, an amount appropriate to compensate the lawyers who initially filed the litigation or who assisted the judge in investigating the claims and packaging them for sale.

After deducting all expenses from the settlement amount the judge would distribute the remaining funds. In class action cases, the plaintiffs could be asked to submit proofs of claim to the degree that such proofs would be necessary in order to establish damages in a trial on the merits. The court would then distribute the funds as it would in a standard class action case except the funds would be distributed before trial, not after. As a result, the members of the plaintiff class would obtain an early recovery as opposed to a later one, and a certain recovery as opposed to an uncertain one.

After the judge distributed the remaining funds to the plaintiffs, the winning bidder would prosecute the case (unless the defendant submits the high bid). The litigation would proceed much like a standard class action case, except that the party prosecuting the case would have the right incentive to do so fully and vigorously. The danger of "sell-out" settlements or other actions harmful to the interests of the plaintiff class would be eliminated, since the owner of the claim would be the only one who would lose if the case settled for too little.

Under such circumstances, cases would likely settle for more than they would settle in the hands of an entrepreneurial attorney representing absent class members. The owner of a claim would have a strong incentive to litigate his or her case vigorously. Private enforce-

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25 *Id.* at 106.

ment of the law would potentially improve, since defendants would know that they could not expect to separate a plaintiffs' attorney from his or her client by offering a cheap settlement in exchange for a generous fee. The higher expected damages would in turn induce better *ex ante* compliance by defendants with the applicable legal regime, since defendants would expect to pay a higher amount of damages if they violated the law. Some of the higher damages would find their way into the pockets of the members of the plaintiff class, since the bidders at the auction would increase their bids knowing that they would prosecute the case vigorously, and that other bidders would do the same.

The procedure just outlined describes the sale of an entire claim through an auction process. This is the optimal method, in theory, to overcome the agency costs that result from the plaintiffs' attorneys overlooking the interests of their class action clients.[26] If for any reason it is not feasible to auction off an entire claim, however, a court could alternatively conduct a sale of lead counsel rights. Here, the winning bidder would be the attorney willing to conduct the litigation for the lowest percent of the attorney's fee recovery.

While the sale of lead counsel rights retains some of the advantages of the auction, it does not wholly eliminate agency costs. It is necessary in such cases for courts to supervise the quality of the bidders, since the low bidder may be able to win the auction simply because he or she is a poor attorney who is willing to work for a low return. Such a result would be in the interests of neither the class action clients nor the litigation system. Further, in a lead counsel auction, the winning bidder would continue to have a conflict of interest with his clients because the attorney could still choose to settle the case for a relatively small amount at the outset of the litigation in order to avoid funding substantial litigation costs. In short, lead counsel auctions are not optimal from the standpoint of economic theory. However, because they do not require the prepayment of funds into a court, and because they bear a stronger resemblance to traditional class action litigation than does the auction of an entire claim, they are more likely to be implemented by judges in actual cases. In fact, one innovative federal district court judge, Judge Vaughn Walker, met with positive results after experimenting with lead counsel auctions.[27]

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26 In such a case, the plaintiffs' attorney has a conflict of interest with his clients and is subject, at best, to only minimal monitoring costs.

27 *See, In re* Oracle Sec. Litig., 136 F.R.D. 639, 641 (N.D. Cal. 1991) (Walker, J.) (denying motion for reconsideration by losing bidder in a common fund securites litigation, reiterating that competitive bidding was appropriate means of determinng class counsel); *In re* Oracle Sec. Litig., 132 F.R.D. 538, 548 (N.D. Cal. 1990) (selecting law firm after receiving competitive bids); *In re* Oracle Sec. Litig., 131 F.R.D. 688, 689-90 (N.D. Cal. 1990) (ruling that competitive bidding would determine selection of class counsel and determi-

Would the auction approach work for mass tort litigation? There are reasons to believe that it would, although the unique features of mass tort cases create special difficulties. First, it should be evident that an auction of a mass tort case would be facilitated if, as we recommend, courts jettison the *Erie* rule in such cases. If the applicable law in federal court mass tort cases is federal common law, the value of a case will not depend on the venue in which the case is adjudicated. The same law will be applied across the board, at least at the federal level. This would not address the problem of parallel state court mass tort class actions; as to these, the winning bidder in the auction for the federal case might be able to obtain a dismissal of the parallel state action on the ground that the bidder is now the owner of the claims of all plaintiffs except those who have opted out of the federal case. After judgment at the federal level, the court might be able to enjoin parallel state court litigation pursuant to the exception to the Anti-Injunction Act[28] for injunctions necessary to protect or implement its judgments.[29]

The implementation of an auction procedure as a means for resolving mass tort cases may create additional difficulties. First, in order to obtain a judgment against the defendant, mass tort cases will sometimes require cooperation between members of the plaintiff class. Even if all plaintiffs do not testify, some will have to do so in order to establish the defendant's liability or the extent of damages. In such a case, the auction of an entire claim (although not the auction of lead counsel rights) and the consequent prepayment of class members will effectively remove the incentive of any class member to testify vigorously on behalf of the plaintiff class. If the class member has been fully paid already and has no continuing stake in the case, it may be difficult for the winning bidder at the auction to secure the willing cooperation of the necessary witnesses—and, indeed, witnesses might even be induced by defendants to testify adversely. While this is a theoretical problem with class action auctions, it is not clear that the cooperation of witnesses would be very difficult to obtain. Most people probably testify truthfully when called as witnesses, and attempts by defendants to subvert testimony would be illegal and subject to serious penalties.

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nation of counsel's compensation). For favorable comments about the auction method from a distinguished federal district court judge in Illinois, see *In re* Telesphere Int'l Sec. Litig., 753 F. Supp. 716, 721 n.12 (N.D. Ill. 1990) (Shadur, J.) (praising Judge Walker's use of the competitive bidding process in the *In re Oracle* case).

28 28 U.S.C. § 2283 (1988) ("A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments.").

29 For discussion of the problems of parallel federal and state class actions, see Geoffrey P. Miller, Overlapping Class Actions (1995) (unpublished manuscript, on file with author).

Another difficulty with auctions of mass tort cases is appraising the value of the claim. At the outset of a mass tort case, a defendant's potential liability may be very difficult to measure, and the amount of damages to which a plaintiff is entitled may be equally problematic. As time passes and the case goes to trial, a mass tort cause of action can be said to "mature."[30] Once a case has matured, it becomes easier to appraise the value of the class claim as a whole. For the auction approach to work in many mass tort settings, it may be initially necessary for a number of individual cases to be tried. The outcome of such preliminary litigation will provide information to potential bidders about the value of the larger item for which they will bid. A court interested in conducting a mass tort litigation auction might hold the auction in abeyance while several individual cases are tried.

An additional potential difficulty with the auction of mass tort actions arises when future claims are factored into the picture. When some members of the class may only be identified in the future, it is not possible for the court conducting the auction to simply pay out the auction proceeds to present claimants. A substantial amount of the proceeds would have to be held in reserve for future claimants. To accomplish this it would be necessary for a court to establish some type of claims facility with appropriate staffing and technical support. This could place a burden on courts. It should be noted, however, that a court would be free, under an auction model, to draw on some of the proceeds of the auction to construct appropriate relief for its claimants. Courts have established or approved the establishment of claims facilities under different circumstances,[31] and there appears no reason in principle why such a facility could not be established pursuant to a litigation auction.

There are likely to be other cogent objections to the use of auction procedures in mass tort cases. A number of the papers prepared for this Symposium illustrate the enormous difficulties that settlements of such cases have posed.[32] However, we doubt that any of the objections we have discussed, or others that might be advanced, are sufficient to destroy the potential effectiveness of litigation auctions in

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30 The phrase is borrowed from Francis McGovern. *See* Francis E. McGovern, *Resolving Mature Mass Tort Litigation*, 69 B.U. L. REV. 659, 659 (1989).

31 *See, e.g.*, *In re* Silicone Gel Breast Implant Prods. Liab. Litig., Nos. CV92-P-10000-S, CV94-P-11558-S, MDL No. 926 1994 U.S. Dist. LEXIS 12521, at *4 (N.D. Ala. Sept. 1, 1994) (settlement contained an innovative feature that allowed for receipt of claims over a 30-year period).

32 *See, e.g.*, Roger C. Cramton, *Description and Comparison of Two Mass Tort Class Action Settlements*, 80 CORNELL L. REV. 811 (1995); Susan P. Koniak, *Feasting While the Widow Weeps:* Georgine v. Amchem Products, 80 CORNELL L. REV. 1045 (1995); Carrie Menkel-Meadow, *Ethics and the Settlements of Mass Torts: When the Rules Meet the Road (Building, Pipe, Boat and Person)*, 80 CORNELL L. REV. 1159 (1995). *See also* John C. Coffee, Jr., Summary, *The Corruption of the Class Action: The New Technology of Collusion*, 80 CORNELL L. REV. 851 (1995).

mass tort cases. Given the extremely difficult problems posed by the conflict between attorneys and clients in the mass litigation setting, the auction approach may be the best way to protect the interests of absent class members while enhancing the substantive enforcement of the law, despite its undeniable shortcomings. Peter Schuck, in his incisive analysis contributed to this Symposium,[33] agrees that the auction approach has promise in this regard. As Professor Schuck observes, a system in which mass tort claims could be purchased at an auction would offer advantages as a way of overcoming agency problems, and would not be inconsistent with traditional practice in which part of the claim is "sold" to the plaintiff's attorney through the contingent fee arrangement.

Professor Schuck's insightful paper documents the institutional evolution of mass tort litigation. If such litigation is, indeed, evolving in the direction of auctions, we believe this is a positive and constructive development. Like other innovative approaches to the problems of mass torts—approaches that are often constructive and positive in their own right—the auction approach offers a market-based method for aligning the interests of the plaintiff class with those of its attorney, thus ameliorating or even overcoming the agency costs that plague this type of litigation at present. We recommend that judges and commentators undertake a thorough analysis of the potential utility of litigation auctions in the mass tort setting as part of the ongoing search for constructive approaches to a significant public policy issue.

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33 Peter H. Schuck, *Mass Torts: An Institutional Evolutionist Perspective*, 80 CORNELL L. REV. 941, 982-85 (1995).