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On Behalf of the U.S. Chamber Institute for Legal Reform
Before the Subcommittee on the Constitution and Civil Justice
of the Committee on the Judiciary
United States House of Representatives

Examination of Litigation Abuses
March 13, 2013

Good morning Chairman Franks, Ranking Member Nadler and Members of the Subcommittee. Thank you for inviting me to testify today about litigation abuses in the United States and what can be done to address them.

Today, I am testifying on behalf of the U.S. Chamber Institute for Legal Reform ("ILR"). The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector and region. The Chamber founded ILR in 1998 to address the country's litigation explosion. ILR is the only national legal reform advocate to approach reform comprehensively, by working to improve not only the law, but also the legal climate.

In recent years, significant progress has been made in addressing certain forms of litigation abuse in the United States, both at the federal and state court levels. In particular, enactment of the Class Action Fairness Act of 2005 ("CAFA") improved federal class action practice by extinguishing magnet state court jurisdictions that were once a haven for meritless and abusive class action lawsuits. CAFA has helped ensure that before they are allowed to proceed, most interstate class actions are subject to a "rigorous analysis" under Fed. R. Civ. P. 23, as mandated by the U.S. Supreme Court, and it has reduced the frequency of class settlements that benefit attorneys at the expense of consumers. But more work is needed. The U.S. still has far too much litigation abuse, and it is undermining our economy and sullying the reputation of our legal system.

My testimony today will focus on the road ahead for class actions; the risks posed by state attorney general enforcement of federal laws; and the threats presented by third-party litigation financing activity.

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I. DESPITE CAFA'S SUCCESSES, ABUSIVE CLASS ACTION PRACTICES CONTINUE.

In enacting CAFA, Congress sought to accomplish three specific goals: (1) to "assure fair and prompt recoveries for class members with legitimate claims"; (2) to "restore the intent of the framers of the United States Constitution by providing for Federal court consideration of interstate cases of national importance under diversity jurisdiction"; and (3) to "benefit society by encouraging innovation and lowering consumer prices."[2] CAFA has achieved each of these goals and more. Most notably, CAFA has drawn large number of class actions to federal courts that otherwise would have proceeded in "magnet" state courts employing lax class certification standards. CAFA has also helped consumers by requiring greater scrutiny of class action settlements.

While CAFA has undoubtedly contributed to a more equitable civil justice landscape, the engine of our nation's economy continues to be threatened by abusive class action practices. This is due in large part to the fact that some federal courts have not been entirely faithful to Congress's overarching intent that CAFA would expand federal jurisdiction over interstate class actions. In addition, federal courts have not uniformly embraced the Supreme Court's mandate that lawsuits be subjected to a "rigorous analysis" before class certification is granted. Finally, the growing use of *cy pres* in structuring class settlements is a threat to CAFA's goal of ensuring that aggrieved class members directly benefit from the class device.

A. Some Federal Courts Have Not Fully Embraced Congressional Intent When Interpreting CAFA.

Although there can be no dispute that CAFA has mitigated a number of abusive class action practices, the full Congressional intent of that law has not been embraced consistently by all federal courts. As a result, some defendants have been forced to defend against putative class actions in state courts that regularly employ class action standards far less rigorous than those observed by our federal courts.

First, some federal courts have thwarted CAFA's purpose of broadly expanding federal jurisdiction over interstate class actions by imposing a "legal certainty" requirement for satisfying CAFA's amount-in-controversy threshold, allowing plaintiffs to stipulate that they will not seek $5 million in damages; and/or refusing to consider declarations submitted in support of removal notices.

Although Congress made it clear that in cases where "a Federal court is uncertain . . . the court should err in favor of exercising jurisdiction over the case,"[3] some courts (including the

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[2] Pub. L. 109-2, § 2(b)(1)-(3), 119 Stat. 5.

[3] 151 Cong. Rec. 727 (2005) (statement of Rep. Jim Sensenbrenner); *see also* Pub.L. 109-2, § 2(b)(2), 119 Stat. 5 (2005) (stating that one purpose of CAFA is to "restore the intent of the framers of the United States Constitution by providing for Federal court consideration of interstate cases of national importance under diversity jurisdiction"); *see also* Hunter Twiford, III, et al., *CAFA's New 'Minimal Diversity' Standard for Interstate Class Actions Creates a Presumption That Jurisdiction Exists, with the Burden of Proof Assigned to the Party Opposing Jurisdiction*, 25 Miss. C. L. Rev. 7, 53 (2005) (highlighting that "CAFA Section 2, 'Findings and Purposes,' . . .

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Third and Ninth Circuits) have disregarded this presumption in favor of imposing a heightened "legal certainty" obligation on defendants with respect to the amount-in-controversy requirement.[4] Under this standard, the amount in controversy stated in the complaint controls so long as it is claimed in good faith.[5] In other words, when a plaintiff disclaims that the amount in controversy exceeds $5 million, the defendant must prove with "legal certainty" that the amount in controversy exceeds $5 million. The rationale underlying these decisions is the concept that a plaintiff is the master of his complaint. But in enacting CAFA, Congress made clear that such axioms should not supply a basis for excluding class actions from federal jurisdiction.

Most other circuits have adopted a more appropriate "preponderance of the evidence" test for establishing jurisdiction with respect to the amount in controversy under CAFA.[6] Under this standard, a defendant removing a class action from state to federal court need only show that the amount in controversy "'more likely than not' exceeds the jurisdictional threshold."[7]

A similar question of CAFA interpretation is currently before the Supreme Court in *Standard Fire Insurance Co. v. Knowles*, No. 11-1450, which will likely be decided before the end of the Court's 2013 term. The key question presented in *Standard Fire* is whether a named plaintiff may avoid removal under CAFA by stipulating that she does not seek to recover more than $5 million on behalf of the absent class members. In *Knowles*, the plaintiff filed a putative class action in state court against Standard Fire, alleging breach of contract arising out of the defendant's alleged underpayment of claims for loss or damage to real property.[8] Standard Fire removed the class action to federal court under CAFA, arguing, *inter alia*, that the plaintiff lacked the authority to limit the recovery that would bind the absent class members. The district court remanded the action on the ground that the plaintiff had signed a stipulation limiting the amount of damages to just below the jurisdictional minimum set forth by CAFA.[9] In so doing, the court rejected the defendant's argument that plaintiff sought "to circumvent CAFA and receive an award in excess of the $5 million threshold" imposed by CAFA.[10] The Eighth Circuit

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[reflects] the strong congressional policy seeking to limit class-action abuses in the state courts by allowing more interstate class actions to be maintained in the federal courts").

4 *See Campbell v. Vitran Express, Inc.*, 471 F. App'x 646, 649 (9th Cir. 2012); *Morgan v. Gay*, 471 F.3d 469, 474 (3d Cir. 2006).

5 Kalee DiFazio, *CAFA's Impact on Forum Shopping and the Manipulation of the Civil Justice System*, 17 Suffolk J. Trial & App. Adv. 133, 149 (2012).

6 *See, e.g.*, *Frederick v. Hartford Underwriters Ins. Co.*, 683 F.3d 1242, 1246 (10th Cir. 2012); *Hargis v. Access Capital Funding, LLC*, 674 F.3d 783, 789 (8th Cir. 2012); *Blomberg v. Serv. Corp. Int'l*, 639 F.3d 761, 763 (7th Cir. 2011); *Berniard v. Dow Chem. Co.*, 481 F. App'x 859, 862 (5th Cir. 2010).

7 DiFazio, *supra* note 5, at 147.

8 *Knowles v. Std. Fire Ins. Co.*, No. 4:11-cv-04044, 2011 U.S. Dist. LEXIS 139077 (W.D. Ark. Dec. 2, 2011), *cert. granted*, 133 S. Ct. 90 (2012).

9 *Id.* at *10-11.

10 *Id.* at *11.

refused to grant an interlocutory appeal of the District Court's ruling, but the Supreme Court granted certiorari.[11]

By contrast, some courts have taken the opposite approach to this question, rejecting the stipulation practice as a means to avoid federal jurisdiction. For example, in *Smith v. Nationwide Property & Casualty Insurance Co.*, the Sixth Circuit explained that "[a] disclaimer in a complaint regarding the amount of recoverable damages does ***not*** preclude a defendant from removing the matter to federal court upon a demonstration that damages are 'more likely than not' to 'meet the amount in controversy requirement.'"[12] Several other district courts have also rejected such damages stipulations in the CAFA context.[13]

If the Supreme Court in *Knowles* condones the practice of using stipulations to defeat CAFA jurisdiction, plaintiffs' lawyers will be able to evade federal jurisdiction under CAFA with great ease. Such a result would allow class counsel to sell out the interests of the putative class simply to ensure that they can litigate in state court forums that are hostile to out-of-state defendants. It would also represent an end-run around Congress's clear intent behind CAFA, which was enacted to keep interstate class actions out of these magnet state courts.

Yet another related question that has arisen in CAFA removals is the propriety of relying on extrinsic documents to demonstrate jurisdiction. For example, in *Thomas v. Bank of America Corp.*, the Eleventh Circuit determined that a defendant seeking to remove a putative mass action to federal court could not rely on extrinsic evidence where "the complaint provided no information indicating the amount in controversy or the number of individuals in the alternative classes."[14] The *per curiam* ruling suggests that a defendant may not be able to supplement its notice of removal with evidence outside the complaint, at least in "mass action" cases where the complaint is silent regarding the amount in controversy or the number of individuals encompassed by the mass action.

The Ninth Circuit has followed a similar path. In *Coleman v. Estes Express Lines, Inc.*, the plaintiff commenced a class action in California state court seeking recovery of unpaid overtime and other wages under California law. One of the defendants removed the case to federal court, and plaintiff moved to remand under the local-controversy exception.[15] In support of removal, the defendant submitted a declaration that it did not have the funds to satisfy any

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11 Notably, the Eighth Circuit made its views on this issue clear in another case, *Rolwing v. Nestle Holdings, Inc.*, where it held that a "stipulation limiting damages . . . to an amount not exceeding $5 million ***can*** be used to defeat CAFA jurisdiction." 666 F.3d 1069, 1072 (8th Cir. 2012) (emphasis added) (affirming grant of remand in shareholder suit).

12 505 F.3d 401, 407 (6th Cir. 2007) (citations omitted, emphasis added).

13 *See, e.g.*, *Proffitt v. Abbott Labs.*, No. 2:08-CV-149, 2008 U.S. Dist. LEXIS 72470, at *4-5 (E.D. Tenn. Sept. 23, 2008) ("[A] disclaimer in a complaint regarding the amount of recoverable damages does not preclude a defendant from removing the matter to federal court upon a demonstration that damages are 'more likely than not' to 'meet the amount in controversy requirement[.]'") (citations omitted).

14 570 F.3d 1280, 1282-83 (11th Cir. 2009) (per curiam).

15 631 F.3d 1010, 1013 (9th Cir. 2011).

judgment obtained by the plaintiff.[16] The district court refused to consider this extrinsic evidence and remanded the action. The Court of Appeals affirmed, holding that any inquiry regarding the local-controversy exception must be limited strictly to the complaint.[17] Notably, other district courts have relied on *Coleman* in refusing to consider extrinsic evidence in assessing the propriety of removal under CAFA.[18]

Second, a few courts have interpreted CAFA's "home-state" exception much more liberally than Congress intended. These courts have applied an expansive approach to the "home-state" exception, which has generated mounting state court class action activity in certain jurisdictions. Under the home-state-controversy exception, "[a] district court shall decline to exercise jurisdiction [where] . . . two-thirds or more of the members of all proposed plaintiff classes in the aggregate, and the primary defendants, are citizens of the State in which the action was originally filed."[19] In a class action in which greater than one-third but less than two-thirds of the class are citizens of the forum state, the district court "***may*** . . . decline to exercise jurisdiction" "in the interests of justice and looking at the totality of the circumstances."[20] Most courts have appropriately recognized that "the plaintiff has the burden of persuasion on the question whether the home-state . . . exception[] appl[ies]."[21] But while Congress intended this exception to be construed "narrowly" and in favor of exercising diversity jurisdiction, not all courts have adhered to Congress's clear intent.

Hirschbach v. NVE Bank[22] is illustrative. In that case, a federal district court *sua sponte* remanded an action to state court under CAFA's home-state exception. The case was a consumer-fraud class action filed initially in New Jersey state court, alleging that the defendants, NVE Bank (a New Jersey state-chartered bank) and its holding company, issued certificates of deposit to the class members at competitive interest rates and then fraudulently applied below-market interest rates to renewed certificates.[23] Plaintiff defined the class as "all persons who invested in a CD issued by NVE Bank at competitive market rates and renewed at least once by NVE Bank after the initial maturity date and have received or are receiving interest on their renewed CD at below competitive market rates."[24] NVE Bank removed the case to federal court, asserting federal-question and CAFA jurisdiction. Even though the plaintiff did not file a motion to remand, the district court remanded the action to state court *sua sponte*.

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16 *Id.* at 1014.

17 *Id.* at 1020.

18 *See, e.g.*, *Smith v. Kawailoa Dev. LLP*, No. 11-00350 JMS/BMK, 2011 U.S. Dist. LEXIS 147955, at *8 (D. Haw. Dec. 22, 2011) (remanding action, relying on "*Coleman's* clear explanation that a district court cannot consider extrinsic evidence").

19 28 U.S.C. § 1332(d)(4)(B).

20 28 U.S.C. § 1332(d)(3) (emphasis added).

21 *See Hart v. FedEx Ground Package Sys.*, 457 F.3d 675, 681 (7th Cir. 2006).

22 496 F. Supp. 2d 451 (D.N.J. 2007).

23 *Id.* at 452-53.

24 *Id.*

The court initially found that all of the *prima facie* CAFA removal elements were met – i.e., that the amount in controversy was present, that there was minimal diversity between the putative class and the defendants, and that the putative class contained at least 100 members.[25] However, instead of ending the inquiry there – after all, the plaintiff had never contested defendant's removal – the court proceeded to examine whether the case fell within the home-state exception. The court remanded the action under the discretionary prong of the home-state exception after finding that at least one-third of the class consisted of New Jersey residents.[26] The court concluded that the home-state exception was satisfied because, *inter alia*, the case involved a purely state-law claim.[27] This decision is contrary to CAFA since its very purpose was to allow removal of cases in which federal claims were not asserted. Moreover, the *Hirschbach* court disregarded ample caselaw holding that the burden of establishing a CAFA exception rests with the plaintiff. The ruling thus sets a troubling precedent for *sua sponte* remands of class actions that otherwise satisfy CAFA's minimal-diversity and amount-in-controversy requirements.[28]

The home-state exception was included in CAFA in order to ensure that only truly local class actions could be litigated in state court. However, as the rulings summarized above demonstrate, some courts have taken this exception too far, allowing plaintiffs to circumvent CAFA and maintain abusive class actions in state court.

Third, some plaintiffs' counsel have also pursued abusive litigation tactics with respect to another category of cases removable under CAFA: "mass actions."[29] According to CAFA's legislative history, "[m]ass action cases function very much like class actions" and "are simply class actions in disguise. They involve a lot of people who want their claims adjudicated on an aggregate basis, and they often produce the same abuses as class actions. In fact, sometimes the abuses are even worse because the lawyers seek to join claims that have little to do with each other and confuse a jury into awarding millions of dollars to individuals who have suffered no real injury."[30] Therefore, not only does CAFA expand federal jurisdiction over class actions, but it also provides for federal jurisdiction over mass actions, which are defined as "any civil action . . . in which monetary relief claims of 100 or more persons are proposed to be tried jointly on the ground that the plaintiffs' claims involve common questions of law or fact . . . ."[31]

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25 *Id.* at 458.

26 *Id.* at 460-61.

27 *Id.* at 461.

28 *See also Bey v. Solarworld Indus. Am.*, No. 3:11-cv-1555-SI, 2012 U.S. Dist. LEXIS 181717, at *12 (D. Or. Dec. 26, 2012) (declining to exercise federal jurisdiction under home-state exception *sua sponte* because, *inter alia*, "[t]he complaint pleads only Oregon law").

29 *Tanoh v. Dow Chem. Co.*, 561 F.3d 945, 956 (9th Cir. 2009).

30 S. Rep. 109-14, at 16-17.

31 28 U.S.C. § 1332(d)(11)(B)(i).

CAFA's mass action provision represents a "[c]ongressional attempt to address notorious joinder abuses at the state level."[32] Congress sought to define the term "class action" broadly to avoid "jurisdictional gamesmanship"; hence, it follows perforce that the "potentially more-abusive mass actions should be construed just as liberally."[33] However, not all courts have embraced this line of reasoning. Instead, in applying the "mass action" provision of CAFA quite narrowly, several courts have explained that the "removal statute is to be 'strictly construed against removal jurisdiction and any doubt must be resolved in favor of remand.'"[34] As one court recently explained in rejecting removal under the "mass action" provision, "Congress intended to limit the numerosity component of mass actions quite severely[.]"[35]

Some courts have even gone so far as to hold that whether "plaintiffs have deliberately divided their cases in order to avoid the mass action threshold is ***irrelevant***."[36] In *Tanoh v. Dow Chemical Co.*, 561 F.3d 945 (9th Cir. 2009), for example, the Ninth Circuit affirmed a lower court's order remanding the claims of 664 named plaintiffs to state court because the claims did not satisfy CAFA's jurisdictional requirements as a "mass action."[37] There, the 664 plaintiffs asserted tort claims based on their exposure to the defendant's products containing an allegedly toxic chemical in ***seven*** separate lawsuits filed in state court in California.[38] Each lawsuit had fewer than 100 plaintiffs, none of whom appeared as plaintiffs in more than one of the suits. Further, none of the lawsuits asserted class claims.[39] Dow removed the cases to federal court, arguing, *inter alia*, that the seven individual lawsuits taken together constituted a "mass action" under CAFA.[40] The Ninth Circuit rejected Dow's argument, applying a strict interpretation of CAFA's statutory language defining a "mass action."[41] According to the Court of Appeals, the provision creating "mass actions" is a "narrow" one, which applies "only to civil actions in which the 'monetary relief claims of 100 or more persons are proposed to be tried jointly.'"[42]

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32 Anthony Rollo & Gabriel A. Crowson, *Mapping the New Class Action Frontier - A Primer on the Class Action Fairness Act and Amended Federal Rule 23*, 59 Consumer Fin. L.Q. Rep. 11, 14 (2005).

33 *See* Jacob Durling, *Waltzing Through a Loophole: How Parens Patriae Suits Allow Circumvention of the Class Action Fairness Act*, 83 U. Colo. L. Rev. 549, 569 (2012) (citing *Louisiana ex rel. Caldwell v. Allstate Ins. Co.*, 536 F.3d 418, 424 (5th Cir. 2008)).

34 *Barria v. Dole Food Co.*, No. CV 09-213-CAS(VBKX), 2009 WL 689903, at *4 (C.D. Cal. Mar. 9, 2009) (remanding cases; "Nothing in CAFA suggests that plaintiffs, as masters of their complaint, may not 'file multiple actions, each with fewer than 100 plaintiffs, to work within the confines of CAFA to keep their state-law claims in state court.'") (citation omitted).

35 *Gutowski v. McKesson Corp.*, No. C 12-6056 CW, 2013 WL 675540, at *1 (N.D. Cal. Feb. 25, 2013) (granting motion to remand) (internal quotation marks and citation omitted).

36 *Nunn v. Monsanto Co.*, No. 4:11-CV-1657 (CEJ), 2011 U.S. Dist. LEXIS 128375, at *8 (E.D. Mo. Nov. 7, 2011) (emphasis added).

37 561 F.3d 945.

38 *Id.* at 950-51.

39 *Id.*

40 *Id.* at 951.

41 *Id.* at 953-54.

42 *Id.* at 953 (quoting 28 U.S.C. § 1332(d)(11)(B)(i)).

The court reasoned that because "none of the seven state court actions involve[d] the claims of one hundred or more plaintiffs, and neither the parties nor the trial court ha[d] proposed consolidating the actions for trial," the cases did not qualify as a "mass action."[43]

The Third and Seventh Circuits have embraced the Ninth Circuit's approach in *Tanoh*, rejecting similar arguments to those advanced by Dow in that case. For example, in *Abrahamsen v. ConocoPhillips, Co.*, the Third Circuit vacated the dismissal of four separate actions and remanded them to state court, finding that the requirements for a "mass action" under CAFA had not been met.[44] In that case, plaintiffs, totaling 123 persons, brought four separate cases against defendant for injuries they sustained while working on vessels, rigs and platforms for defendant. Relying on *Tanoh*, the Third Circuit reasoned that "[b]ecause each suit includes fewer than one hundred persons, none of Plaintiffs' four suits meets CAFA's definition of a 'mass action' and therefore no suit qualifies for removal jurisdiction."[45] Similarly, in *Anderson v. Bayer Corp.*, the Seventh Circuit denied the defendants' petition for leave to appeal the district court's remand orders on the ground that four "mostly identical complaints in state court" did not satisfy the requirements for a "mass action" under CAFA because none of the cases contained 100 or more plaintiffs.[46] The appellate court rejected defendants' argument that plaintiffs' actions were "a transparent attempt to circumvent CAFA," siding with the Ninth Circuit's view that "[t]he mass action provision gives plaintiffs the choice to file separate actions that do not qualify for CAFA jurisdiction."[47]

B. Some Courts Are Failing To Undertake A "Rigorous Analysis" Of The Rule 23 Prerequisites To Class Certification.

In *Wal-Mart Stores, Inc. v. Dukes*, the Supreme Court reversed an *en banc* ruling of the U.S. Court of Appeals for the Ninth Circuit, putting an end to a sprawling nationwide class action consisting of 1.5 million female Wal-Mart employees who alleged discrimination and sought injunctive relief, declaratory relief and back pay. In its ruling, the Court confirmed that analysis of the class action requirements under Rule 23 must be "rigorous."[48] In reversing the Ninth Circuit's ruling, the Supreme Court explained that "Rule 23 does not set forth a mere pleading standard"; rather, a plaintiff must "prove that there are *in fact* sufficiently numerous parties, common questions of law or fact, etc."[49]

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43 *Id.*

44 No. 12-CV-1199, 2012 WL 5359530, at *2 (3d Cir. Nov. 1, 2012).

45 *Id.* at *2 n.4 (citing *Tanoh*, 561 F.3d at 950); *see also Rodriguez v. Monsanto Co.*, No. 4:11-CV-01658 AGF, 2011 WL 5245251, at *2-3 (E.D. Mo. Nov. 2, 2011) (remanding 11 cases, each containing fewer than 100 plaintiffs, explaining that "[t]his precise issue has been addressed by the Seventh and Ninth Circuits, which both held that plaintiffs could avoid federal removal jurisdiction under CAFA by carving their filings into separate pleadings").

46 *Anderson v. Bayer Corp.*, 610 F.3d 390, 393 (7th Cir. 2010).

47 *Id.* at 393-94 (citing *Tanoh*, 561 F.3d at 954).

48 131 S. Ct. 2541, 2551 (2011).

49 *Id.*; *see also In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 312 (3d Cir. 2008) (class certification "calls for the district court's ***rigorous*** assessment of the available evidence and the method or methods by which

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Most federal courts have taken heed of this key holding of *Dukes*, employing a "rigorous analysis" of the Rule 23 requirements for class certification.[50] But *Dukes* has not eliminated lax certification standards altogether, because some courts have resisted the Supreme Court's pronouncements. For example, recent rulings by the U.S. Courts of Appeals for the Sixth and Seventh Circuits constitute troubling precedents for class actions regarding allegedly defective consumer products. In two recent cases involving allegedly defective washing machines, these courts approved sprawling class actions, even though the vast majority of class members had not experienced any problems with their products.[51] According to the Seventh Circuit, the decision whether to certify is primarily one of "efficiency," and the presence of uninjured class members is no barrier to class treatment.[52] In so holding, the court appears to have forgotten a fundamental principle of U.S. law: the "benefits of efficiency can never be purchased at the cost of fairness."[53] By focusing exclusively on efficiency – without subjecting the putative class action to the type of "rigorous analysis" mandated by the Supreme Court – the Seventh Circuit departed from *Dukes* and set a troubling precedent for unwieldy consumer class actions that do not satisfy Rule 23 prerequisites.

Some federal courts in California similarly continue to apply weak certification standards to consumer class actions.[54] For example, in *Johnson v. General Mills, Inc.*, a federal judge in California refused to decertify a class action involving alleged misrepresentations regarding yogurt products.[55] The plaintiff asserted consumer-fraud claims under California law, alleging that the defendant misrepresented the ameliorative effects of the yogurt products on the human digestive system.[56] The court granted plaintiffs' motion for class certification before the Supreme Court decided *Dukes*. In the wake of *Dukes*, the defendants moved to decertify the class, arguing that a class action in the *Johnson* case "denies them of their due process right to

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plaintiffs propose to use the evidence to prove impact at trial") (emphasis added).

50 *See, e.g., In re Bisphenol-A (BPA) Polycarbonate Plastic Prods. Liab. Litig.*, 276 F.R.D. 336, 340 (W.D. Mo. 2011) (conducting a "rigorous analysis," which required that it "look[] behind the pleadings and ascertain[] the nature of Plaintiffs' claims as well as the nature of the evidence"); *Scott v. First Am. Title Ins. Co.*, 276 F.R.D. 474, 476 (E.D. Ky. 2011) (describing *Dukes* as a "landmark decision" that has strengthened the requirements for class certification).

51 *See In re Whirlpool Corp. Front-Loading Washer Prods. Liab. Litig.*, 678 F.3d 409 (6th Cir. 2012); *Butler v. Sears, Roebuck & Co.*, 702 F.3d 359 (7th Cir. 2012). Petitions for certiorari have been filed in both of these cases.

52 *Butler*, 702 F.3d at 362.

53 *Malcolm v. Nat'l Gypsum Co.*, 995 F.2d 346, 350 (2d Cir. 1993); *see also Amchem Prods. v. Windsor*, 521 U.S. 591, 615 (1997) (class certification is only appropriate where it will "'achieve economies . . . without sacrificing procedural fairness'") (quoting Fed. R. Civ. P. 23 Advisory Committee Notes).

54 *See, e.g., Keegan v. Am. Honda Motor Co.*, 284 F.R.D. 504 (C.D. Cal. 2012) (certifying consumer-fraud claims under California law in defective car case where majority of class members experienced no issues with their vehicles' rear suspension); *Johnson v. Gen. Mills, Inc.*, 276 F.R.D. 519, 521-22 (C.D. Cal. 2011) (refusing to decertify class of yogurt purchasers where a large portion of the class likely continued to consume the product and were therefore not misled by the defendant's alleged misconduct).

55 *Johnson*, 276 F.R.D. 519.

56 *Id.* at 520.

defend the individual aspects of the class claims on a case-by-case basis."[57] The defendants specifically claimed that the reliance and causation requirements of California's consumer-protection statutes could not be "resolved 'in one stroke,'" as required under *Dukes* for class certification to be proper.[58] After all, many class members continue to buy the same yogurt to this day, despite the allegations in their suit that they were misled. The court rejected the defendants' arguments, however, opining that "*Wal-Mart* does not mandate that every element of a cause of action must be common."[59] The California federal judge then proceeded to deny the defendants' motion, concluding that "[t]he requirement of predominance in Rule 23(b)(3) itself implies that a court may certify a class even though there will, at some point, be issues that must be determined individually."[60]

Rulings like the ones summarized above will no doubt be relied upon by other district courts that seek to limit *Dukes* and resist heightened standards for class certification. The result could be a small but troubling group of magnet ***federal*** jurisdictions that employ lax class certification standards reminiscent of those followed by state courts before CAFA. Beyond damaging the vitality of American businesses, such a trend would also hurt American consumers as companies raise the prices of their products to alleviate the costs of imprudent class certification rulings and settlements.

C. Some Consumer Class Action Settlements Still Do Not Provide Benefits To Class Members.

Another problem that continues to plague federal class action litigation is increasing reliance on *cy pres* settlements. *Cy pres* refers to the practice of distributing unclaimed settlement money in class actions to third-party charities. *Cy pres* may seem like a solution to the problem of lawyer-driven class action settlements, but it is really just covering the problem up. In essence, *cy pres* is a way for class lawyers to justify their big fees without having to craft settlements that deliver any direct benefit to those individuals actually injured by the defendant's alleged misconduct. And because "[t]here is no indirect benefit to the class from the defendant's giving the money to someone else,"[61] it is questionable whether most *cy pres* distributions "effectuate . . . the interests of the silent class members."[62]

Recognizing these concerns, some jurists, including Judge Edith Jones of the Fifth Circuit, have emphatically rejected *cy pres* in favor of returning any unclaimed funds to the defendant.[63]

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57 *Id.* at 521.

58 *Id.* at 521-22.

59 *Id.* at 522.

60 *Id.*

61 *Mirfasihi v. Fleet Mortg. Corp.*, 356 F.3d 781, 784 (7th Cir. 2004).

62 *Six Mexican Workers v. Ariz. Citrus Growers*, 904 F.2d 1301, 1308-09 (9th Cir. 1990) (rejecting the use of *cy pres* in the case because the beneficiaries were too remote from the class).

63 *See Klier v. Elf Atochem N. Am., Inc.*, 658 F.3d 468, 481-82 (5th Cir. 2011) (Jones, J., concurring) ("district courts should avoid the legal complications that assuredly arise when judges award surplus settlement funds to charities and civic organizations").

Judge Lee Rosenthal has similarly cautioned against unfettered use of *cy pres*, recognizing the potential of such awards to undermine the very purpose of the class device. As Judge Rosenthal has recognized, "[a] consumer class action is superior to individual suits because it allows people with claims worth too little to justify individual suits – so called negative-value claims – to obtain the redress the law provides. But if the consumer class action is likely to provide those with individual claims no redress . . . the consumer class action is likely not superior to individual suits."[64] Legal scholars have similarly criticized the practice, lamenting that *cy pres* renders "[t]he real parties in interest in . . . class actions . . . the plaintiffs' lawyers, who are the ones primarily responsible for bringing th[e] proceeding."[65]

A recent decision by the Third Circuit demonstrates that the use of *cy pres* promotes class actions as primarily lawyer-driven lawsuits. In *In re Baby Products Antitrust Litigation*, the Third Circuit vacated the district court's orders approving a class action settlement consisting of a substantial *cy pres* award in an antitrust class action brought against toy retailers and baby product manufacturers.[66] There, the defendant agreed to pay $35.5 million into a settlement fund with no reversionary rights; any unclaimed funds would be paid to specified charities. The trial court approved the settlement, which included payment of $14 million in attorneys' fees and expenses. In the wake of the district court's approval of the class settlement, it became clear that a measly $3 million of the settlement fund was actually claimed by class members, leaving $18.5 million to be paid to charities.[67] In other words, the attorneys received nearly five times the amount that actually ended up in the pockets of their clients. The Third Circuit reversed the class settlement, making several observations, including that *cy pres* awards reinforce the lawyer-driven nature of class actions. In particular, the Third Circuit explained that "inclusion of a *cy pres* distribution may increase a settlement fund, and with it attorneys' fees, without increasing the direct benefit to the class."[68] This recent ruling is a refreshing confirmation that some courts are finally starting to recognize that the propriety of class settlements should be tied to what class members actually receive.

Other courts, however, have not been as vigilant as the Third Circuit. In *Lane v. Facebook, Inc.*, which arose out of alleged privacy violations by Facebook, the Ninth Circuit affirmed a *cy pres* award aimed at establishing a new charity organization called the Digital Trust Foundation ("DTF") whose purpose it is to "fund and sponsor programs designed to educate users, regulators, and enterprises regarding critical issues relating to protection of identity and personal information online through user control, and the protection of users from online threats."[69] The Ninth Circuit denied a petition for rehearing *en banc*, but several judges dissented, explaining that the *cy pres* award was not "reasonably certain to benefit the class" and

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64 *Hoffer v. Landmark Chevrolet Ltd.*, 245 F.R.D. 588, 603 (S.D. Tex. 2007).

65 Testimony of Martin H. Redish, at 7, Hearing: *Class Actions Seven Years After the Class Action Fairness Act*, June 1, 2012, http://judiciary.house.gov/hearings/Hearings%202012/Redish%2006012012.pdf.

66 *In re Baby Prods. Antitrust Litig.*, Nos. 12-1165, et al., 2013 U.S. App. LEXIS 3379 (3d Cir. Feb. 19, 2013).

67 *Id.* at *6-7.

68 *Id.* at *16-17.

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

did not "advance the objectives of the [privacy] statutes relied upon in bringing suit."[70] Because the newly created charity has "***no*** record of service," the judges noted, its asserted commitment to "funding 'programs' regarding 'critical issues' says ***absolutely nothing*** about whether class members will truly benefit from this settlement."[71] In addition, the dissenting judges were unconvinced that the *cy pres* award would actually advance the objectives of the privacy statutes underlying the lawsuit, most of which prohibited the "***unauthorized*** access of disclosure of private information."[72] According to these judges, because the class claims concerned "***misconduct*** by Internet companies" – and not "users' lack of 'education'" – the DTF had virtually nothing to do with the basis of the lawsuit, which was further grounds for invalidating the settlement.[73]

II. STATE ENFORCEMENT OF FEDERAL LAW RAISES SERIOUS CONFLICT-OF-INTEREST AND PUBLIC CORRUPTION CONCERNS.

Another significant impetus for abusive aggregate litigation is the proliferation of arrangements under which state attorneys general hire outside counsel on a contingency basis to represent the state in civil litigation. This problem threatens to grow worse as more and more federal statutes give state attorneys general authority to enforce federal laws, including the Truth in Lending Act,[74] the Health Insurance Portability and Accountability Act,[75] the Consumer Financial Protection Bureau in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,[76] the Restore Shoppers Online Confidence Act of 2010,[77] and the Consumer Product Safety Improvement Act of 2008.[78] Some commentators contend that partnerships between attorneys general and private counsel are a good idea because such suits are prosecuted without using tax dollars and are therefore in the public interest. However, these arrangements raise serious conflict-of-interest and other ethical questions.

Contingency-fee contracts between AGs and private counsel became popular during the landmark tobacco litigation of the 1990s. In that litigation, 36 states retained private contingency-fee attorneys to help them prosecute their lawsuits against the tobacco industry.[79] The litigation was highly successful from the perspective of plaintiffs' counsel, resulting in

70 *Lane v. Facebook, Inc.*, Nos. 10-16380, 10-16398, 2013 U.S. App. LEXIS 3935, at *2-3 (9th Cir. Feb. 26, 2013).

71 *Id.* at *4-6.

72 *Id.* at *6-7.

73 *Id.*

74 15 U.S.C. § 1640(e).

75 42 U.S.C. § 1320d-5(d).

76 12 U.S.C. § 5552.

77 Restore Online Shoppers' Confidence Act, Pub. L. No. 111-345 (2010).

78 15 U.S.C. §§ 1194(a), 1264(d), 1477.

79 Lise T. Spacapan, Douglas F. McMeyer & Robert W. George, *A Threat to Impartiality: Contingency Fee Plaintiffs' Counsel and the Public Good*, In-House Defense Quarterly, at 13 (Winter 2011).

approximately $14 billion in attorneys' fees for trial lawyers throughout the nation.[80] Since then, contingency-fee arrangements have extended well beyond the tobacco arena and have been employed in other mass-tort contexts.[81] In Rhode Island, for example, the state employed outside counsel to sue lead paint manufacturers from 2003 to 2008.[82] Similarly, AGs have entered into contingency-fee contracts with outside counsel to prosecute a wide range of lawsuits related to prescription medications, alleging failure to warn, fraudulent advertising and off-label promotion.[83]

In an effort to fully grasp the current state of the AG contingency-fee practice, three practitioners served Freedom of Information Act ("FOIA") requests on the AGs of all 50 states and the District of Columbia.[84] Of the 50 responses to the FOIA requests, 36 responses indicated that the AG's office uses or had used contingency-fee counsel outside the tobacco context.[85] The recent economic downturn and the budget problems faced by state governments are almost certain to make these arrangements even more popular. As one commentator noted in The Wall Street Journal, "trial lawyers representing public clients on contingency fee are suing businesses for billions over matters as diverse as prescription drug pricing, natural gas royalties and the calculation of back tax bills."[86]

> Trial lawyers love these deals. Even aside from the chance to rack up stupendous fees, they confer a mantle of legitimacy and state endorsement on lawsuit crusades whose merits might otherwise appear chancy. Public officials find it easy to say yes because the deals are sold as no-win, no-fee. They're not on the hook for any downside, so wouldn't it practically be negligent to let a chance to sue pass by?[87]

But there is a considerable downside to these lawsuits as well: they create an opportunity for unseemly liaisons between public enforcement officials and private, profit-motivated lawyers. For this reason, the growing use of contingency-fee contracts by state AGs has generated substantial criticism over the last few years. As one former attorney general who has been an outspoken critic of these arrangements explained, "[t]hese contracts . . . create the potential for

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80 *See* Leah Godesky, *State Attorneys General and Contingency Fee Arrangements: An Affront to the Neutrality Doctrine?*, 42 Colum. J.L. & Soc. Probs. 587, 588-89 (2009).

81 *See* Martin H. Redish, *Constitutional and Political Implications: Private Contingent Fee Lawyers and Public Power*, 18 S. Ct. Econ. Rev. 77, 81-82 (2010).

82 *See* Godesky, *supra* note 80, at 588-89.

83 Spacapan, McMeyer & George, *supra* note 79, at 14.

84 *See id.* Forty-nine states and the District of Columbia responded to the FOIA requests. *Id.* Due to a paper work error, New York was the only state that did not reply to the FOIA request. *Id.*

85 *Id.* Of the 14 states that did not report using contingency-fee counsel, only three states had statutes that explicitly limit the ability to hire private attorneys on a contingency-fee basis. *Id.* The remaining 11 do not appear to have any statutory prohibition. *Id.*

86 Walter Olson, *Tort Travesty*, Wall St. J., May 18, 2007.

87 *Id.*

outrageous windfalls or even outright corruption for political supporters of the officials who negotiated the contracts."[88] Critics have also condemned the practice as promoting "regulation through litigation," by empowering states to attack a wide variety of behavior by corporations merely by wielding the power of private attorneys.[89] But perhaps the most troubling consequence of these contracts is the violation of important constitutional rights of defendants, who find themselves facing lawsuits that combine the political power of the state and the financial power of deep-pocketed plaintiffs' lawyers. This concern was recently noted by Judge Danny Reeves in a case challenging the State of Kentucky's retention of contingency-fee counsel to sue a drug manufacturer. According to Judge Reeves: "If there is evidence that private counsel 'have ever engaged in any conduct that invaded the sphere of control' reserved to the AG's office, then the door is opened to a conclusion that the contingency fee arrangement violated the defendant's rights."[90]

Notably, federal prosecutors can only enter into these arrangements under limited circumstances. When the executive branch of the federal government enforces federal laws, a number of safeguards come into play, including statutes prohibiting public corruption, rules limiting the political activities of individuals hired by the government to assist in enforcing the federal laws, and Executive Order 13,433, which prohibits the use of contingent-fee arrangements with outside counsel retained by the federal government "unless the Attorney General has determined that the . . . entry into the agreement is required by law."[91] State AGs and the private attorneys they hire are generally not subject to these safeguards. As a result, the delegation of enforcement authority to state AGs poses serious conflict-of-interest and public corruption concerns that are generally absent in the federal arena.

What can be done about this practice? Some public officials are raising questions about private AG partnerships. For example, the Attorney General of Colorado, John Suthers, has stated that his "office policy is not to hire outside lawyers on a contingency-fee basis when the state's police power is being asserted (such as when the state brings an action based on a claim of public nuisance or when bringing a consumer-protection action)."[92] Similarly, former Florida attorney general Bill McCollum has also been an outspoken critic of the practice, warning that "[a]t the very least, use of such counsel without proper safeguards can give the appearance of impropriety and undermine public confidence in our legal system."[93]

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88 Adam Liptak, *If You Win, You Lose*, N.Y. Times, July 9, 2007, Section A, page 10 (quoting William H. Pryor Jr.).

89 *See* Brief of Chamber of Commerce of the United States of America & the American Tort Reform Ass'n as Amici Curiae in Support of Motion for Judgment as a Matter of Law in Light of Plaintiff's Constitutional Violations, at 20-21; *Oklahoma v. Tyson Food, Inc.*, No. 05-cv-00329-GKF-SAJ (N.D. Okla. June 12, 2007).

90 *Merck Sharp & Dohme Corp. v. Conway*, No. 3: 11-51-DCR, 2012 U.S. Dist. LEXIS 40940, at *12 (E.D. Ky. Mar. 26, 2012).

91 Exec. Order No. 13,433, Protecting American Taxpayers From Payment of Contingency Fees, 72 Fed. Reg. 28,441 (May 16, 2007).

92 John Suthers, *Avoiding Contingency-Fee Land Mines: New Attorneys General Should Use Outside Counsel Only as a Last Resort*, Wash. Times, Dec. 2, 2010, http://www.washingtontimes.com/news/2010/dec/2/avoiding-contingency-fee-land-mines/.

93 Testimony of Bill McCollum at 2, House Judiciary Subcommittee, Hearing: *Contingent Fees and Conflicts*

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But these voices of concern are not enough to stop the tide, and while some state legislative efforts on this front have helped reform the practice, federal intervention is also needed. As such, Congress should consider enacting legislation mandating that contracts between state AGs and outside counsel hired to enforce federal law be reasonable and prohibiting state AGs from retaining contingency-fee counsel to enforce federal law. Such legislation would promote the integrity of enforcement proceedings and safeguard the constitutional rights of defendants.

III. THIRD-PARTY LITIGATION FUNDING IS ANOTHER THREAT TO OUR CIVIL JUSTICE SYSTEM THAT WARRANTS ROBUST FEDERAL REGULATION.

Third-party litigation financing ("TPLF") describes the practice whereby a profit-motivated third party provides money to a litigant. TPLF generally falls into two broad categories: (1) ***consumer lawsuit lending***, which typically involves individual personal-injury cases; and (2) ***investment financing***, which includes investments in large-scale tort and commercial cases and alternative dispute-resolution proceedings. My focus today is on the latter: the growing practice under which investment firms provide financing to plaintiffs or their attorneys in exchange for a share of any recovery.

TPLF investments of this sort have several negative impacts on civil justice. ***First***, TPLF increases the filing of questionable claims. TPLF companies are mere investors, and they base their funding decisions on the present value of their expected return. As such, even if a lawsuit has little or no merit, it may be a worthwhile investment if there is a potential (however small) to recover a very large sum of money. In addition, TPLF providers can mitigate their downside risk by spreading the risk of any particular case over their entire portfolio of cases and by spreading the risk among their investors. For these reasons, TPLF providers have higher risk appetites than most contingency-fee attorneys and will be more willing to back claims of questionable merit.[94]

The most notorious example of this problem was the investment by a fund associated with Burford Capital Limited in a lawsuit against Chevron filed in an Ecuadorian court, alleging environmental contamination in Lago Agrio, Ecuador. Burford invested $4 million with the plaintiffs' lawyers in the Lago Agrio suit in October/November 2010 in exchange for a percentage of any award to the plaintiffs. In February 2011, the Ecuadorian trial court awarded the plaintiffs an $18 billion judgment against Chevron.[95] In March 2011, Judge Lewis Kaplan of the Southern District of New York issued an injunction barring the plaintiffs from trying to

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of Interest in State AG Enforcement of Federal Law, Feb. 2, 2012, http://judiciary.house.gov/hearings/Hearings%202012/McCollum%2002022012.pdf.

[94] *See generally* Paul H. Rubin, *On the Efficiency of Increasing Litigation*, paper presented to the Public Policy Roundtable on Third Party Financing of Litigation, Northwestern University Searle Center on Law, Regulation, and Economic Growth (Sept. 24, 2009).

[95] The Ecuadorian trial court awarded $9 billion in damages to the plaintiffs, which would be doubled if Chevron did not publicly apologize to them. Chevron did not apologize, and the damages were doubled to $18 billion.

collect on their judgment because of what he called "ample" evidence of fraud on the part of the plaintiffs' lawyers.[96] Long before Burford had made its investment in the case, Chevron had conducted discovery into the conduct of the plaintiffs' lawyers under a federal statute that authorizes district courts to compel U.S.-based discovery in connection with foreign proceedings, and at least four U.S. courts throughout the country had found that the Ecuadorian proceedings were tainted by fraud.[97]

According to a December 2011 press release, Burford "conclude[d] that no further financing w[ould] be provided" in the Lago Agrio case as a result of "[f]urther developments."[98] Nevertheless, its year-long involvement – and its initial decision to invest $4 million despite allegations of fraud in the proceedings – powerfully demonstrate that TPLF investors have high risk appetites and are willing to back claims of questionable merit.

Second, TPLF changes the traditional way litigation-related decisions are made. Traditionally, the plaintiff in a case and his or her counsel make strategy decisions together. TPLF interferes with that dynamic, because an investor will likely seek to exert control over strategic decisions in order to protect its investment. And realistically, if a plaintiff's lawyer is being paid by the investor, it will be difficult to resist that pressure. Even when the TPLF provider's efforts to control a plaintiff's case are not overt, the existence of TPLF funding naturally subordinates the plaintiff's own interests in the resolution of the litigation to the interests of the TPLF investor.

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96 *See Chevron Corp. v. Donziger*, No. 11-cv-0691 (S.D.N.Y. Mar. 7, 2011), at 82-83. The Second Circuit later vacated Judge Kaplan's injunction on jurisdictional and procedural grounds, but his factual findings stand. *See Chevron v. Naranjo*, No. 11-1150 (2d Cir. Jan. 26, 2012).

97 *See, e.g.*, *In re Chevron Corp*., No. 10-MC-21 (J/LFG) (D.N.M. Sept. 13, 2010) (finding "that . . . discussions trigger the crime-fraud exception, because they relate to corruption of the judicial process, the preparation of fraudulent reports, the fabrication of evidence, and the preparation of the purported expert reports by the attorneys and their consultants."); *In re Application of Chevron Corp.*, No. 10-cv-1146-IEG (Wmc) (S.D. Cal. Sept. 10, 2010) (crime-fraud exception applies because "[t]here is ample evidence in the record that the Ecuadorian Plaintiffs secretly provided information to Mr. Cabrera, who was supposedly a neutral court-appointed expert, and colluded with Mr. Cabrera to make it look like the opinions were his own."); *Chevron Corp. v. Champ*, No. 1:10-mc-0027 (GCM-DLH) (W.D.N.C. Aug. 30, 2010) ("While this court is unfamiliar with the practices of the Ecuadorian judicial system, the court must believe that the concept of fraud is universal, and that what has blatantly occurred in this matter would in fact be considered fraud by any court. If such conduct does not amount to fraud in a particular country, then that country has larger problems than an oil spill."); Hr'g Tr. at 44, *In re Application of Chevron Corp.*, No., 10-2675 (SRC) (D.N.J. June 11, 2010) ("In short, the provision of materials and information by consultants on the litigation team of the Lago Agrio plaintiffs in what appears to be a secret and an undisclosed aid of a supposedly neutral court-appointed expert in this Court's view constitutes a prima facie demonstration of a fraud on the tribunal."). On the Lago Agrio suit, *see generally* Roger Parloff, *Have You Got a Piece of this Lawsuit? The Bitter Environmental Suit Against Chevron in Ecuador Opens a Window on a Troubling New Business: Speculating in Court Cases*, Fortune, Vol. 163, Issue 8, June 13, 2011, at 68.

98 *See* Press Release, Burford Capital Limited, Burford Reports Continued Activity and Entry into UK Market (Dec. 12, 2011), http://www.burfordfinance.com/pressroom/press-releases. In January 2013, Burford released a letter it had sent to the Lago Agrio claimants' counsel in September 2011 accusing counsel of defrauding Burford into investing in the litigation. *See* Burford Group to Purrington Moody Weil LLP, Sept. 29, 2011, http://lettersblogatory.com/wp-content/uploads/2013/01/Burford.pdf.

Recent commercial arbitration between a company called S&T Oil Equipment & Machinery Ltd. and the Romanian government is illustrative. S&T had sought financing for its case from Juridica Investments Limited, and, under their agreement, Juridica paid some legal fees for S&T in exchange for a percentage of arbitration proceeds. After Juridica withdrew funding, causing S&T's case to collapse, a sealed complaint filed by S&T against Juridica in Texas federal court alleged that S&T's own lawyers had begun seeking legal advice from Juridica after Juridica began paying their fees, and that Juridica required the lawyers to share their legal strategy for the arbitration, along with factual and legal developments in the case.[99]

Third, TPLF prolongs litigation by deterring settlement. A plaintiff who must pay a TPLF investor out of the proceeds of any recovery can be expected to reject what may otherwise be a fair settlement offer, hoping for a larger sum of money in order to help pay off the investor.[100] The Chevron/Lago Agrio case powerfully demonstrates this problem. The investment agreement in that case included a "waterfall" repayment provision, which provided Burford with a heightened percentage of recovery on the first dollars of any award. Under the agreement, Burford would receive approximately 5.5% of any award, or about $55 million, on any amount starting at $1 billion.[101] But, if the plaintiffs settled for less than $1 billion, the investor's percentage would go up – in fact, the investor would receive the same $55 million for any recovery over $70 million. This sort of arrangement incentivizes plaintiffs to continue litigating in hopes of a higher settlement.

Fourth, TPLF investments compromise the attorney-client relationship and diminish the professional independence of attorneys by inserting a new party into the litigation equation whose sole interest is making a profit on its investment. In the litigation regarding injuries to 9/11 Ground Zero workers, for example, one of the plaintiffs' firms representing the workers was financed by a TPLF investment that provided for passing the interest charges on the investment on to the plaintiffs, to be paid out of any recovery by them. After settling with the defendants, the firm sought to pass along $6.1 million in interest payments to the plaintiffs. The judge overseeing the settlement acknowledged that passing on the interest to the plaintiffs may be permissible, but disapproved doing so in this case because it was not clear that the plaintiffs had understood or approved the charges.[102]

So what should be done about this problem? ILR believes that there needs to be a robust federal regulatory regime overseeing these investors and their activities. Specifically, ILR proposes the following measures: (1) designation of a federal agency to oversee TPLF investors

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99 *See* B.M. Cremades, Jr., *Third Party Litigation Funding: Investing in Arbitration*, Transnational Dispute Management, Vol. 8, Issue 4 (Oct. 2011), at 25-33, 27 n.105 (citing *S&T Oil Equip. & Mach. Ltd. v. Juridica Invs. Ltd.*, No. H-11-0542 (S.D. Tex. Feb. 14, 2011), sealed complaint, ¶¶ 29, 30.

100 *See Rancman v. Interim Settlement Funding Corp.*, 789 N.E.2d 217, 220-21 (Ohio 2003) (noting that the amount the plaintiff-appellant owed to litigation financiers was an "absolute disincentive" to settle at a lesser amount).

101 *See* Funding Agreement Between Treca Financial Solutions and Claimants, *Chevron Corp. v. Donziger*, No. 11-cv-0691 (S.D.N.Y.), Docket No. 356, Ex. B.

102 *See* Tr. Of Proceedings, *In Re World Trade Center Disaster Site Litig.*, No. 1:21-mc-00100 (S.D.N.Y. Aug. 27, 2010).

and make regulations concerning TPLF investments; (2) enactment of statutory safeguards to avoid TPLF-related abuses; (3) barring the use of TPLF in class actions; and (4) amending the Federal Rules of Civil Procedure to address TPLF arrangements.

A. Appointment Of A Federal Agency To Oversee TPLF Investments

First, ILR believes Congress should enact legislation appointing a federal agency to oversee TPLF investments, with three specific grants of authority: (i) to license TPLF investors; (ii) to make rules and regulations governing TPLF investments; and (iii) to enforce any laws, rules and regulations governing TPLF investments.

Licensing will permit effective oversight of TPLF investors and guard against potential abuses by them. Any effective licensing regime would require a TPLF investor, as a condition of obtaining a license to operate, to disclose the identity and interest of all members of the TPLF investor's board of directors and all senior executive officers. In addition, ILR proposes that any applicant for a license to invest in lawsuits be required to pay a $1 million fee. This money would remain in an account administered by the federal agency, with any interest or dividends going to fund enforcement and oversight activities by the agency.

The TPLF regulating agency should also be authorized to promulgate such rules and regulations as are necessary to carry out its mandate. This authority would enable the agency to create a comprehensive regulatory regime appropriate to carry out the intent of Congress in passing the legislation to govern TPLF, much as the Securities and Exchange Commission ("SEC") has done with respect to the statutes, like the Securities Act of 1933 and the Securities Exchange Act of 1934, that are within its purview.

Finally, the agency should have meaningful authority to enforce all laws, rules and regulations governing TPLF investments. As part of this authority, the agency should be empowered to bring lawsuits in federal court and obtain civil penalties for violations. Again, Congress's grant of authority to the SEC to bring civil actions to enforce the securities laws and its rules and regulations is instructive. The agency should (like the SEC) have the power to seek scaled monetary penalties against violators, based upon the seriousness of the offense and to seek enhanced penalties for repeat violations.

B. Statutory Safeguards Against Abuses In TPLF Investments

In addition to legislation designating a federal agency to oversee TPLF investments, Congress should implement specific safeguards that the agency may enforce. These safeguards should include the following:

- Barring law firm ownership of TPLF investors;

- Requiring any person who is responsible for repaying a TPLF investment to be a party to the investment agreement and explicitly consent to all of its terms;

- Prohibiting TPLF investors from controlling the litigation they are financing;

- Requiring each TPLF investor to post a bond with respect to each lawsuit it funds;
- Holding TPLF investors jointly and severally liable with the plaintiff for satisfying any cost awards; and
- Requiring TPLF investors to pay the attorneys' fees and costs of the prevailing party if the party they fund does not prevail at trial.

C. Barring The Use Of TPLF In Class Actions

Congress should also enact legislation barring TPLF in class actions. Proponents of TPLF insist that it is necessary to increase access to justice for plaintiffs. In the United States, however, we already have two methods to increase court access: contingency fees and the "American rule" against fee shifting. A plaintiff wishing to commence a suit in the United States can therefore do so without risk: there is no cost to the plaintiff to retain an attorney to file and prosecute the suit, and generally no consequences if the plaintiff loses. This is true from the simplest individual slip-and-fall case to the most complex class action. Because plaintiffs' attorneys are willing and available to take class representations on a contingency-fee basis that can produce far greater compensation than individual cases (and indeed, they often compete for the opportunity to do so), TPLF is simply not necessary in the class action context.

Moreover, class actions, by their nature, already raise significant concerns regarding lawsuit abuse because the individual class members generally do not control the litigation, which is spearheaded by class counsel. In a large consumer class action, the average plaintiff often has only a dollar or two at stake. The "representative" plaintiffs who are empowered to speak for the class in such cases tend to be friends, neighbors or even employees of the attorney bringing the suit. As a result, the lawyers fully control the cases – not the individual plaintiffs.

This concern would be exacerbated if the person driving the litigation is not even a lawyer with fiduciary obligations to the supposed clients or the court. In a case with a legitimately aggrieved plaintiff who is following the litigation and concerned about its outcome, there is, at least, someone watching the lawyer and the funding company – and that person can raise concerns if the funding company acts against his or her interests. In a class action, by contrast, there is rarely a truly interested plaintiff. Thus, the TPLF company can effectively run the litigation with no check on its actions. For these reasons, TPLF should not be permitted in class actions.

D. Promulgation Of Court Rules Addressing TPLF

The last aspect of a comprehensive federal TPLF oversight regime would be new rules of civil procedure. The focus of such rules, like the proposed licensing scheme discussed above, would be disclosure of TPLF arrangements at the outset of civil litigation. Meaningful disclosure requirements would shine much-needed light on TPLF investments. As previously discussed, one of the biggest consequences of TPLF is the erosion of a plaintiff's control over his or her own lawsuit. Lawsuit investors seek to control their investments by managing strategic decisions in litigation they finance. As a result, TPLF undermines the bedrock principle that a party to a lawsuit has the ultimate decision-making authority with respect to that suit. The pernicious effect on defendants is clear: because TPLF agreements are typically made under a "veil of secrecy,"[103] a defendant facing a claim funded by TPLF may not even realize who is guiding litigation strategy and decisions on the other side, making it unfairly difficult to mount an adequate defense.

Strong disclosure requirements will correct this problem. In particular, ILR proposes amending Federal Rules of Civil Procedure 26 (requiring initial disclosures) and 7.1 (requiring corporate disclosure statements) to provide for specific disclosures of TPLF investments in funded cases. Requiring disclosure of information pertaining to TPLF investments is sensible. If a company has an interest in litigation that is contingent on the outcome, it is in many respects a real party to the litigation. Parties have the right to know who is on the other side of litigation.

CONCLUSION

The past decade has witnessed a number of meaningful reforms to our civil justice system – most notably, the enactment of CAFA. This has resulted in a fairer class action landscape. However, despite these significant advances, litigation abuses continue to mar our nation's civil justice system, hurting both businesses and consumers. For one thing, while CAFA has leveled the class action playing field by shifting countless interstate class actions into federal court, some courts have deviated from Congress's intent to expand federal jurisdiction over such proceedings. Specifically, by imposing heightened standards for removal and broadly construing certain narrow exceptions to federal jurisdiction under CAFA, these courts have forced class action defendants to continue defending interstate class actions in magnet state court jurisdictions that employ lax class certification standards. In addition, some federal courts have undermined the import of CAFA by failing to apply the Supreme Court's "rigorous analysis" standard for class actions filed in – or removed to – federal court. Beyond these serious concerns, another abusive form of aggregate litigation, the enforcement of federal law by state AGs and private contingency-fee counsel, remains largely unchecked and poses troubling conflict-of-interest and ethical issues in state enforcement proceedings. And finally, the advent of third-party litigation funding represents another serious challenge to our civil justice system. This growing practice, which threatens to transform American courts into unseemly investment vehicles, will foster frivolous litigation, jeopardize client control over litigation and compromise the attorney-client relationship, among other consequences.

These litigation abuses represent significant challenges to our civil justice system, but there are a number of potential legislative responses that would mitigate them. For example, Congress should enact legislation prohibiting state attorneys general from using contingency-fee arrangements to enforce federal law. In addition, Congress should institute a comprehensive regulatory regime for TPLF that is supported by stringent disclosure requirements to minimize the deleterious effects of this practice on our nation's civil justice system.

Thank you for inviting me to testify today, and I am happy to answer any questions you may have.

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[103] Parloff, *supra* note 97, at 68, 72.