THE LAW AND ECONOMICS OF CLASS ACTIONS: YESTERDAY, TODAY, AND TOMORROW

James Langenfeld and Raleigh Richards

Legal and economic analyses overlap and interact in many areas. Recent U.S. Supreme Court and lower court decisions on class action lawsuits clearly focus on the critical role that economic analysis plays in determining the outcome class actions. Class action decisions, such as The *Wal-Mart Stores, Inc. v. Dukes*[1] and *Comcast Corp. v. Behrend*,[2] have made national headlines, and are affecting how class action cases are evaluated and managed. For example, *Comcast*, *Dukes*, and other recent cases have arguably raised the bar in class certification for showing common impact and predominance through expert testimony. In these and other class actions, one critical question is whether there exists a plausible systematic way to identify the class members who have been economically impacted by a wrongful act and to formulate a reliable generally accepted economic methodology to measure their damages. If there is no reliable systematic approach to identifying which class members have been affected, then class members must pursue the case individually, which often means the case does not go forward because of the cost of the litigation is too high for a single class member. These class action decisions have turned on the adequacy of the analyses put forth by expert economists, finding the basic economic and

The Law and Economics of Class Actions
Research in Law and Economics, Volume 26, 1–9

ISSN: 0193-5895/doi:10.1108/S0193-589520140000026001

statistical analyses of the plaintiffs' economists to be insufficient. The decisions are likely to have significant implications for use of expert testifiers in class certification and in estimation of monetary damages, and will present challenges to both attorneys and economists in antitrust and other class actions going forward.

On October 25, 2013, Research in Law and Economics and Navigant Consulting sponsored the conference *Class Action Landscape: Yesterday, Today, and Tomorrow* in Boston. The conference was composed of four sessions. Each session was focused on one or more articles related to class actions that had been refereed and accepted for publication in this issue of Research in Law and Economics. In addition to the authors presenting their research, discussants involved in class actions and related research offered comments and critiques. These articles and critiques by lawyers and economists concern the changing landscape of class action law and its interaction with the economic analysis of key issues in class actions. These articles examine the elements of class action law from diverse viewpoints, featuring articles with defendant and plaintiff perspectives, concerning domestic and international law, and written by lawyers and economists. The balance of this introductory article briefly summarizes the articles and the comments that were offered at the conference.

Well-known defense class action attorneys James Keyte, Paul Eckles, and Karen Lent of Skadden, Arps, Meagher and Flom LLP in "From *Hydrogen Peroxide* to *Comcast*: the New Rigor in Antitrust Class Actions" collect, assess, and categorize U.S. Rule 23(b)(3) direct purchaser antitrust cases since *Hydrogen Peroxide*[3] and in the wake of the Supreme Court's decision in *Comcast*. They find that economic testimony has become a critical part of class certification, and the U.S. Supreme Court has raised the standard for these analyses. The authors explore the meaning of "rigor" as it is used today in antitrust cases, suggest future developments based on current principles, and envision an increasingly important role for *Daubert* motions that are used to attempt to exclude experts and expert testimony. The new rigor the authors see suggests a more stepwise analytical framework for assessing class certification beginning with *Daubert* issues, proceeding to questions surrounding issues of common proof of impact, and finally, if necessary, concluding with a rigorous analysis of proffered class-wide proof concerning damages. The article identifies the types of challenges to class certification that defendants should consider making and suggests where the future analytical framework for assessing class certification may eventually settle.

Professor Joshua Paul Davis, of the University of San Francisco School of Law, is the author of several class action articles. He submitted a formal comment on the Keyte, Eckles, and Lent article, titled "The Class Cert Games: Coach, Commentator, or Critic?" In his comment, Davis finds that Keyte, Eckles, and Lent have done an excellent job presenting a "playbook" for defense counsel to challenge plaintiffs' attempts to get class certification and to exclude plaintiffs' experts. Davis does not see Keyte, Eckles, and Lent as completely objective in their reading of the cases, and he raises questions about some of the policy implications in their article. He points out some specific areas where he disagrees with Keyte, Eckles, and Lent's interpretation of existing case law, particularly what is necessary to estimate classwide damages.

In the "Antitrust Class Proceedings – Then and Now," leading plaintiffs' attorney Michael Hausfeld of Hausfeld LLP and economists Gordon Rausser and Gareth Macartney of OnPoint Analytics Inc. track the evolution of Rule 23 on class certification since its inception, and analyze the impact of the *Hydrogen Peroxide* and *Wal-Mart* decisions on the Rule's interpretation. The authors then examine the current and future role of economics in post*Comcast* antitrust class certification, specifically in the areas of liability, common impact, and damages. They explain how liability evidence can be used by economists to support a finding of common impact for certification purposes, and how statistical techniques such as averaging, price-dispersion analysis, and multiple regressions have and should be employed to establish common proof of damages. They make several policy recommendations, and conclude that the emerging class-certification standards require greater diligence and impose greater obligations on both the parties and the courts.

Robert Kneuper of Navigant Economics, who has worked on many class actions, provided general comments about the economic analyses needed to certify classes after *Comcast* and related decisions. First, he argued that showing common impact and damages need to be based on sound economic analyses that apply reliable economic and statistical techniques. Second, any economic analysis of common impact and damages must be done in the context of specific liability and causation theories of the case and the appropriate scope of the proposed class. Given these constraints and what the courts have found unacceptable, he believes it will often be better to narrowly focus the liability theory of the case so the class-certification analysis does not have to stretch to take into account too many different effects for different class members. Kneuper concluded that

defining a smaller class based on a clear liability theory is better than a larger class with a less precise liability theory with more chances for members who may not be impacted.

Statistical and econometric analyses are often used in class certification to estimate the impact of an alleged wrongful act independent of other potential market influences, and now may be more important if there is increased rigor required. In "Econometric Tests for Analyzing Common Impact," Kevin Caves and Hal Singer propose econometric methods and statistical tests for detecting the existence of common impact across class members and determining what proportion of a proposed class suffered injury. This work addresses the tension between today's standard econometric methods that measure the average effects of challenged conduct on prices, and the legal standard of common impact that is concerned with determining whether individual class members were harmed. They propose a specific econometric approach for class-certification analyses that allow for the systematic estimation of differing effect of an action on the prices paid by individual class members and controls for the average impact of other market forces on prices on class members. This approach depends on the availability of sufficiently detailed customer by customer data before and during (or during and after) an allegedly wrongful act, such as price-fixing. Singer had used this approach in a litigated case under appeal at the time, and had found that 90 percent of customers were significantly affected based on standard statistical tests.

Laila Haider of Edgeworth Economics is the coauthor of an article commenting on the Caves and Singer approach, where she evaluates the feasibility of systematically estimating the impact and effect of an allegedly wrongful act. Haider provided comments on the Caves and Singer article, and argued their approach inappropriately assumes influences other than the allegedly wrongful act should be estimated as the average across class members. Haider's proposed econometric testing differs from Caves and Singer's in that it not only allows the impact of the allegedly wrongful act to vary across class members, but also allows for the possibility that other influences on prices vary from customer to customer. The added complexity of her model can place additional demands on the amount of data needed to perform reliable tests, and this approach can find individual inquiry is needed when the Caves and Singer approach does not.

Jeff Leon of Complex Litigation Group LLP has worked with both plaintiffs and defendants in his career. He commented on the work of both Caves and Singer and Haider, attempting to put the disagreements as to which economist model is more appropriate in the context of litigation and

what is most effective. Given the complexity of the econometrics methods, Leon explained the need for economists to be simple and clear, or run the risk of being ignored. He raised some questions about whether Haider's approach would almost invariably find a need to engage in individual inquiry, and Haider admitted that to date they had only run their model on complex markets where they did not find a certifiable class.

"Assessing Market Efficiency for Reliance on the Fraud-On-The-Market Doctrine after *Wal-Mart* and *Amgen*" is authored by Mukesh Bajaj and Sumon Mazumdar of Navigant Economics and the Haas School of Business at the University of California-Berkley, and Daniel McLaughlin of Sidley Austin LLP. Although not presented at the conference, the article concerns class actions, was accepted for publication by the journal, and so has been included in this issue. In the article, the authors address specific aspects of the certification of securities class actions that have been discussed in Supreme Court cases as recently as 2013 in *Amgen*.[4] In particular, the authors explain the economic analyses they believe are required for class plaintiffs to invoke the "rebuttable presumption of reliance on public, material misrepresentations regarding securities traded in an efficient market" (the "fraud-on-the market" doctrine) to prove *classwide* reliance. They find that lower courts have frequently granted class certification based on a mechanical review of some factors that are considered intuitive "proxies" of market efficiency, but do not actually show market efficiency according to recent studies and analyses that the authors present in the article. The authors argue that plaintiffs must first establish the security traded in an efficient market using well-accepted economic tests before invoking fraud-on-the market. Only then do event study results, which are commonly used to demonstrate "cause and effect" across a class, have any merit. To show full *classwide* reliance, plaintiffs must additionally prove such cause and effect relationship throughout the class period, not simply on selected disclosure dates identified in the complaint. The authors point out that these issues have major policy implications because defendants frequently settle once a class is certified to avoid the magnified costs and risks associated with a trial.

Ethan Litwin and Morgan Feder of Hughes Hubbard and Reed LLP have a great deal of experience with class action in the U.S. and the European Union (E.U.). In "European Collective Redress: Lessons Learned from the US Experience," they raise a number of questions about the effectiveness of class action lawsuits in the U.S. and propose alternative approaches to reimburse class members using other approaches in the U.S. and the European Commission. Litwin and Feder describe the steps

already taken by the European Commission to research and develop European standards of compensatory collective redress, and then also propose, as well as criticize, alternatives to class actions based on both U.S. and E.U. experiences. They argue that all class action models essentially force the majority of class members to sacrifice their individual due process rights for the chance to aggregate claims. The opt-out mechanism in the United States presumes that all members of a proposed class are being represented by plaintiff lawyers unless they explicitly "opt-out" to pursue the case on their own. Litwin and Feder argue that this system where litigants cannot meaningfully participate in the adjudication of their rights (or even to decide whether a case should be brought at all) promotes just the kind of wasteful, unmeritorious over-litigation that E.U. lawmakers expressly wish to avoid. However, the authors also see the E.U. proposal as not being workable because of the limitations on third-party funding, preventing contingency fees, the opt-in rule, and the "loser pays" principle. Litwin and Feder instead describe how alternatives to class action litigations such as SEC Fair Funds and the September 11th Victim Compensation Fund could eliminate many of the disadvantages of the U.S. system and the problems with the E.U. proposals for collective redress.

Barbara Hart, of Lowey Dannenberg's securities litigation practice and Vice-Chair of the Executive Committee of the New York State Antitrust Committee, raised questions about how well the Litwin and Feder proposals could be implemented, and whether the U.S. mass tort system experience is as flawed as many Europeans and Litwin and Feder imply. Hart sees this article as a conscientious effort to propose a middle ground in light of the foreign aversion to adopting the contingent class action model. However, she believes that aversion to the U.S. system is born of false belief that the state of class actions has not evolved beyond its inception and the incidental abuses for which it is pilloried. Other countries should not stay focused on past shortcomings and dated caricatures of what the Rule 23 practice was. The old practice of simple oral argument and bare bones economic analysis for class certification are being supplanted by full- or multiday *evidentiary* hearings and detailed economic analyses based on the facts of the case. Industry and economic experts are put on the stand, fully examined and crossed. The standards for class certification have been ratcheted up as the defense bar often deluges the court with contentions-specific transactions involve bargaining and variations in terms that make a proposed class unmanageable. Litigating a class case is complex from start to finish for this and other reasons, but Hart sees class actions as the best and ever improving model to address large-scale legal matters. Class

certification depends on Rule 23, which is a case management invention, and she believes the problem with some class actions is not with the rule but with the execution. Courts and practitioners can and do engage in large-scale problem solving, taking care to derive the best possible solution. As such, she sees the state of class action practice in the U.S. as worthy, sophisticated, and remedial. Hart believes the U.S. class action provides the best model because it is constantly criticized, and thereby sharpened and improved. She argues that opt-in and government-sponsored victim redress funds cannot, have not, and will not succeed to the same measure as U.S. class actions. As other jurisdictions embark on the alternatives, she believes we will all learn from their experiments in mass problem solving and should increasingly appreciate the U.S. system.

Heidi Dalenberg, partner with Schiff Hardin, LLP, has extensive experience representing clients in asserted class actions involving breach of contract, consumer fraud, and common law fraud. Unlike Hart, Dalenberg sees many of the same problems with the mass tort redress system in the U.S. that Litwin and Feder discuss. All agreed that the E.U. proposals with an opt-out system, etc., would not achieve the goal of providing redress to class members. Dalenberg also agreed with Hart that the Litwin and Feder's proposals were not likely to be able to be workable in most instances.

Finally, Professor John Connor of Purdue University contributed "Cartel Overcharges," which is a comprehensive study of overcharges in antitrust cartel cases that surveys economic studies and judicial decisions that contain more than 2,000 estimates of overcharges from 532 cartels from the 19th century through present day. These sources met minimal quality standards, and Connor examined the estimates for systematic differences in reliability across sources and methods of calculating overcharges. In general, Connor did not apply any sophisticated quality filters for excluding possibly questionable sources for his overcharge estimates. Many of these matters involve class actions, and the author finds the median overcharge due to the cartel activity in these cases to be approximately 23 percent. The analysis indicates that average overcharges are much higher than the average level presumed by antitrust authorities. This sizable overcharge suggests that fines and damages may not adequately compensate class members or deter illegal behaviors such as price-fixing and bid-rigging. Among other interesting aspects of the data, Connor finds that international cartels on average impose higher overcharges, and that overcharges on average have fallen slowly since the 19th century.

Terry Calvani and John Kwoka discussed Connor'sarticle, and offered their views on the reliability and usefulness of Connors work. Professor John Kwoka of Northeastern University has a distinguished career as a scholar, former. Federal Trade Commission economist, and a widely published author on antitrust issues, including price-fixing class actions. Kwoka pointed out that before Connor's work the Chicago School of Economics concluded, without an empirical basis, that cartels are hard to form and impossible to sustain. Kwoka noted that the U.S. Sentencing Commission in the 1980s concluded that average gain from a cartel was a 10-percent overcharge. However, Connor's work shows that cartels have existed with many members, have been long-lasting, and have had a price effect well above 10 percent in many instances. Kwoka raised some questions about (1) the reliability of a number of the studies that Connor includes in his data set, and (2) how Connor counts different episodes of price-fixing in the same industry during different periods and by different authors. The latter could result in biasing upward some of Connor's results if the multiple episode and multiple studies involve industries where the cartels were particularly effective. Nevertheless, Kwoka doubted that addressing these potential shortcomings would substantially affect one of the main implications of Connor's work: fines and damage awards under deter cartel behavior, so "crime pays," and more aggressive enforcement is merited.

Terry Calvani practices law in antitrust and class actions at Freshfields, and has served as Acting Chairman of the Federal Trade Commission, and as a Member of the Irish Competition Authority and Director of the Criminal Cartels Division. Calvani did not comment on the quality of the studies that form the basis of Connor's work and did not agree with all of Connor's conclusions. However, Calvani was familiar with Connor's work, and found it to be extremely useful when at the Irish Competition Authority because it provides an important empirical basis for cartel and class actions that are absent from other economic research. However, Calvani pointed out that fining cartel firms does not always benefit class members, especially in instances where the money may largely go to attorneys or antitrust think tanks through Cy Pres funds. Calvani also disagreed that there is insufficient deterrence of cartel activity if corporate fines are lower than the estimated overcharges. Calvani explained that individuals, and not corporations, form cartels. Companies are often fined for actions by individuals who no longer work for the company when the cartel actions are discovered. Instead, Calvani reasoned that sanctions should primarily be placed on the individuals who engaged in the illegal acts, and not the companies.

In general, there does not appear to be a consensus on how well the current U.S. approach to class actions is working or on how to address any shortcomings. However, the articles and the comments agree that recent Supreme Court decisions appear to require more rigorous economic analysis to certify a class, and that this trend started several years ago with lower court decisions. As the lower courts now begin to apply these more rigorous standards, one can anticipate the development of more sophisticated economic approaches and more extensive discovery for class certification. The full impact of these developments on the number of successful class actions will likely depend on how effective the economic approaches prove to be, and on whether alternative approaches to consumer redress can be successfully implemented. These changes may have a substantial impact on the parties involved, and on the overall economy.

NOTES

1. *Wal-Mart Stores, Inc. v. Dukes*, 113 S. Ct. 2541 (2011).
2. *Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013).
3. *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305 (3d Cir. 2008).
4. *Amgen v. Connecticut Ret. Plan & Trust Funds*, 133 S. Ct. 1184 (2013).