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A VIEW FROM WITHIN THE FORTUNE 500:  
AN EMPIRICAL STUDY OF NEGATIVE VALUE CLASS ACTIONS AND DETERRENCE

Linda Sandstrom Simard<sup>1</sup>

Introduction

The American civil justice system relies heavily upon private enforcement to deter and redress corporate wrongdoing. Theoretically, civil litigation deters wrongful conduct by threatening liability for harm caused by such conduct. The threat of liability increases the potential cost of the conduct and induces corporations to invest in precautions to avoid harm. When deterrence fails, the imposition of liability redresses the harm by compensating the victim. This private enforcement regulatory model collapses, however, when litigation is not economically viable. Specifically, when the cost of pursuing litigation exceeds the expected recovery, there is no incentive to file suit, no threat of liability to deter wrongful conduct and no compensation for victims. Thus, when a manufacturer sells a million gas grills by falsely advertising that they are “Made in U.S.A.” when in fact some of the parts are imported,<sup>2</sup> or an insurance company wrongfully rounds premiums up to the nearest whole dollar on hundreds of thousands of policies,<sup>3</sup> or a financial management company fraudulently induces stockholders to hold onto over-valued stock by misstating corporate earnings,<sup>4</sup> there is no incentive for an individual to file suit because the cost of litigation exceeds the expected recovery. While these injuries are admittedly quite small to each individual, turning a blind eye suggests to corporations that it is acceptable to engage in wrongful conduct that nickels and dimes the masses.

In 1966, the Civil Rules Advisory Committee amended the federal class action rule to address “the problem that small recoveries do not provide the incentive for any individual to bring a solo action

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<sup>1</sup> Professor of Law, Suffolk University Law School. I would like to thank Joseph Glannon, Jeffrey Lipshaw, Thomas Main, Andrew Perlman, and Jay Tidmarsh for insightful comments on earlier drafts of this paper, Caitlin Lee for valuable research assistance and Donna Moray for extensive administrative assistance in sending out the surveys and organizing the responses. Any remaining errors or oversights are mine.

<sup>2</sup> Knight Kiplinger, *Is This Class Action Really A Shakedown?*, Kiplinger’s Personal Finance, Sept. 2012, at 15.

<sup>3</sup> *Allstate Insurance Co. v. Martinez*, No. 04-96-00597-CV (Tex. Ct. Appl. 4th Dist. 1996); *Texas Farmers Insurance Co. v. Sendejo*, No. 04-96-00598 (Tex. Ct. App. 4th Dist. 1996).

<sup>4</sup> *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71 (2006)

prosecuting his or her rights.”<sup>5</sup> The modern rule paved the way for so-called negative value class actions.<sup>6</sup> By aggregating groups of small value claims together, the cost of litigation is shared by a class of similarly situated claimants, thus enabling litigation of claims that would otherwise never see the light of a courtroom.

Although the negative value class action arrived on the scene nearly half a century ago, questions about its social utility remain controversial to this day. John Frank, a member of the Civil Rules Advisory Committee that drafted the amended rule, framed the controversy aptly when he said:

For all our effort, we do not know whether this is a good or a bad thing. The great big question is whether the social utility of the large class action outweighs the limited benefits to individuals, the aroma of gross profiteering, and the transactional costs to the court.<sup>7</sup>

The answer to the so-called “great big question” depends on whether negative value class actions are an effective deterrent of wrongful conduct. If they are, the costs associated with litigating a few rare instances of undeterred harm are outweighed by the overwhelming benefits of deterrence. If they are not, the costs associated with litigating a large and recurring number of negative value class actions are harder to justify in light of the small compensatory benefits

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<sup>5</sup> *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 617 (1997)(discussing the policy underlying negative value class actions).

<sup>6</sup> John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. Chi. L. Rev. 877, 904-906 (1987)(“Negative value class actions ... refer to class actions where the costs in establishing and collecting the individual claims are greater than the potential recovery.”); *In re Monumental Life Ins. Co.*, 365 F.3d 408, 411 n.1 (5<sup>th</sup> Cir. 2004)(“A ‘negative value’ suit is one in which class members’ claims would be uneconomical to litigate individually.”) These actions are also referred to as small stakes class actions, small value class actions and Type-B class actions. See Brian Fitzpatrick, *Do Class Action Lawyers Make Too Little?*, 158 U. Pa. L. Rev. 2043, 2044 (2010)(using the phrase “small stakes” class action to refer to a class action where the cost to litigate exceeds the expected recovery); Coffee, *The Regulation of Entrepreneurial Litigation*, 54 U. Chi. L. Rev. at 904-906 (referring to positive value class actions as Type-A and negative value class actions as Type-B); Martin Redish, Chifford Berlow, *The Class Actin as Political Theory*, 85 Wash. L. Rev. 753, 793 (2007)(noting that the phrases “small value” and “negative value” are interchangeable).

<sup>7</sup> John P. Frank, Whither Rule 23: Memorandum to the Honorable Patrick E. Higginbothom (Apr. 28, 1995)(on file with the Advisory Committee); Deborah Hensler, Nicholas Pace, Bonita Dombey-Moore, Beth Giddens, Jennifer Gross, Erik Moller, *Class Action Dilemmas, Pursuing Public Goals for Private Gain*, 256, 401 (2000) (Rand Institute for Civil Justice 2000)[hereafter *Class Action Dilemmas*].

conferred on individuals. This paper delivers important new empirical evidence that suggests negative value class actions are not as effective at deterring wrongful conduct as theory has predicted.

This paper offers the first comprehensive analysis of the deterrent effect of negative value class action litigation from the perspective of large, publicly traded companies. In Section I, the paper begins with a brief discussion of the theory of deterrence. Section II analyzes previous empirical studies of deterrence in a variety of legal and factual contexts. While these studies inform our understanding of deterrence theory generally, they reach conflicting conclusions regarding the efficacy of litigation as a deterrent and they leave a number of important questions unanswered. Section III then describes the study that is the subject of this paper. The study presents new evidence based upon data collected from corporate counsel of Fortune 500 companies regarding historical experience with negative value class action litigation. Finally, armed with this new data, Section IV returns to the question that has plagued negative value class actions for decades: does the social utility of these actions outweigh the cost?

### I. The Theory of Deterrence

Deterrence theory relies on a simple, but largely untested, assumption that the threat of civil liability induces actors to avoid wrongful conduct by increasing the cost associated with that conduct.<sup>8</sup> This assumption flows from the following syllogism: (1) people are rational actors who choose their actions out of self-interest; (2) self-interest is economic and cost-benefit driven; (3) the imposition of liability for harm caused by one's conduct motivates actors to avoid inefficient injuries.<sup>9</sup> Specifically, by threatening an actor with liability for harm caused by wrongful conduct, an actor has an incentive to invest in precautions up to the equilibrium point where an extra dollar of precaution equals the additional risk avoided.<sup>10</sup> The following

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<sup>8</sup> W. Jonathan Cardi, Randy Penfield, Albert Yoon, *Does Tort Law Deter?* 9 J. Empirical Legal Studies 567, 568 (2012) ("Much of the law and economics literature relies on this assumption as if it were analytic truth"). General deterrence is focused on individual choice and relies upon cost/benefit incentives to deter undesirable conduct. Guido Calabresi, *The Cost of Accidents*, 68-69 (1970). Specific deterrence, on the other hand, involves a collective decision, often by a legislative body, regarding how much of a specific activity is allowed, who should participate in it, and how it should be performed. *Id.* at 68, 95 (legislation prohibiting prostitution and murder are examples of specific deterrence).

<sup>9</sup> Cardi, et al., *supra* note 8, at 2.

<sup>10</sup> David Rosenberg, *Mandatory-Litigation Class Action: The Only Option for Mass Tort Cases*, 115 Harv. L. Rev. 831, 843 (2002). For example, assume A and B are drivers. On average, A incurs \$200 in accident costs per year and B incurs \$25 in accident costs per year. Assume also that both A and B have the

formula represents the theoretical deterrent value derived from a threat of litigation:

$$EL * p + EC \geq I$$

Where EL represents the expected loss<sup>11</sup>;  $p$  represents the probability that the actor will be liable for the harm<sup>12</sup>; EC represents the expected cost of defending the action; and I represents the investment in precautions. The left side of the equation represents costs that may be avoided if harm is averted; the right side of the equation represents an efficient investment in precautions to avoid the harm. The formula assumes that a rational actor will invest in precautions up to, but not beyond, the expected value derived from avoiding harm. Thus, from a purely economic perspective, the deterrent value derived from a threat of litigation should be less than or equal to the avoidable cost of litigation (i.e. the expected liability plus the cost of defending the suit).

In theory, class certification increases deterrence by sweeping a large group of claimants into a single action and increasing the threat of liability. The magnitude of the increase in deterrence depends upon the likelihood that individual litigation will be filed if a class is not certified. For example, a victim of wrongful conduct will have an incentive to file an individual suit when the expected recovery exceeds the cost of the litigation. This type of claim, commonly referred to as a positive value claim, creates a threat of liability from individual litigation which in turn induces an actor to invest in precautions. When there are many similar positive value claims, an actor will anticipate a threat of liability from a series of individual suits and invest in precautions up to the value of the aggregate expected loss.<sup>13</sup> Certification of a class of positive value claims enhances deterrence only to the extent that the class sweeps the entire group of similar claims into a single suit, including those claims

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option of investing \$50 annually in brake maintenance to reduce future accident costs. A will invest in the precaution as long as the reduction in annual accident costs exceeds \$50. B will not invest in the precaution because the cost of the precaution is greater than his annual accident costs. Even if the investment in precaution would reduce his annual accident costs to zero, B would be investing \$25 more in precautions than he would reap in benefit. The Costs of Accidents, *supra* note 8, at 74.

<sup>11</sup> The expected loss is the product of the magnitude of expected harm multiplied by the probability of harm.

<sup>12</sup> The probability that the defendant will be liable for the harm is distinguishable from the probability of harm itself. The probability of harm depends upon the likelihood that events will unfold in a certain way, whereas the probability of liability depends upon whether the plaintiff will satisfy the burden of proof on each of the elements of the claim.

<sup>13</sup> The aggregate expected loss depends in part upon the likelihood that individual suits will actually be filed. As the expected net benefit decreases toward zero, the likelihood that an individual suit will be filed also decreases.

that might not actually be filed as individual suits.<sup>14</sup> Thus, positive value class actions enhance deterrence in an amount equal to the delta between the threat of loss from a class action and the threat of loss from a series of individual suits.<sup>15</sup>

Certification of a class of negative value claims presents a very different situation. A victim of wrongful conduct will have no economic incentive to file an individual suit when the expected recovery is dwarfed by the cost of pursuing the litigation. Thus, there is no threat of individual litigation and an actor has no economic incentive to invest in precautions. Certification of a class of negative value claims, however, enables litigation of the claims and creates a threat of liability that would not otherwise exist.

The following formula represents the deterrent value derived from a class action seeking damages:

$$EL_{CA} * p_{CA} + EC_{CA} \geq I_{CA}$$

Where  $EL_{CA}$  represents the expected aggregate loss to the class;  $p_{CA}$  represents the probability that the actor will be liable for the harm caused to the class;  $EC_{CA}$  represents the expected cost of defending against the class action; and  $I_{CA}$  represents the investment in precautions to avoid harm to the class.

While these formulas are useful in conceptualizing deterrence, they camouflage several potential limitations of deterrence theory.

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<sup>14</sup> Coffee, *The Regulation of Entrepreneurial Lawyers*, 54 U. Chi. L. Rev. at 904 (“Type-A class actions, or ‘Positive value’ class actions, include those class actions where individual claims are sufficiently large so that ‘each claim would be independently marketable even in the absence of the class action device.’”) Positive value class actions tend to be disfavored by courts because class action treatment is considered unnecessary when individual suits are feasible. See, e.g. *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 617 (1997); *Castano v. Am. Tobacco Co.*, 84 F.3d 734, 748-49 (5<sup>th</sup> Cir. 1996). Restrictions on positive value class actions have encouraged the use of non-class aggregation techniques that involve the use of pre-trial multi-district consolidation, unified judicial management, and collective settlement agreements. See Troy A. McKenzie, *Toward A Bankruptcy Model for Non-Class Aggregate Litigation*, 87 N.Y.U. L. Rev. 960, 962 (2012). A number of scholars have raised warning flags about the growing use of non-class aggregation because the lack of class certification requirements that protect individual claimants allows for the over empowerment of lawyers. *Id.* at 962-63. See also Elizabeth Chamblee Burch, *Financiers as Monitors: Unbundling Agency, Risk, and Rewards in Aggregate Litigation*, 87 N.Y.U.L. Rev. 1273, 1274-76 (2012).

<sup>15</sup> The magnitude of this delta depends upon a variety of factors including the likelihood that individual suits will be filed, the likelihood of success by plaintiffs in the individual suits, the likelihood that a class will be certified, and the likelihood of success by the class.

First, the formulas assume an actor has access to perfect information. In fact, however, estimating the relevant variables, at the relevant time, may be very difficult.<sup>16</sup> Second, the formulas assume that the underlying harm may be remediated by a change in conduct motivated by cost incentives. Some harm, however, may be undeterred by cost incentives.<sup>17</sup> Finally, the formulas assume that an actor faces a choice between an act and its accident costs. Yet, when an actor invests in insurance to protect against the risk of accident costs, the insurer pools together a variety of risks and spreads the loss among them. Grouping risks together potentially dilutes the incentive to avoid harm because a specific act no longer bears its own costs.<sup>18</sup>

A simple accident example illustrates these limitations. Assume a driver is approaching a yellow light. If the driver knows that running the light will increase accident costs by \$100<sup>19</sup> and stopping at the light will have no impact on accident costs, one would assume that the driver will be more likely to stop at the light than run through it.<sup>20</sup> Yet, at the time that the decision is made, it is very unlikely that the driver will be able to make an accurate and timely estimate of the costs and benefits of his conduct.<sup>21</sup> Moreover, if the driver is daydreaming as he approaches the yellow light, he will not have control over his conduct and the incentives will fail to deter the harm. If the driver has purchased accident insurance and agreed to pay an annual premium in exchange for protection from lump sum accident costs, he is less likely to change his behavior as he approaches the yellow light than if he didn't have insurance because the connection between his conduct at the time of the accident and the resulting accident cost is diluted by the insurance company's ability to spread the loss among a pool of risks.<sup>22</sup>

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<sup>16</sup> Rosenberg, *supra* note 10, at 838, n. 19 (the expected value of a claim depends upon a number of factors, including litigation costs and risks, the types and difficulty of proof, the complexity of factual, legal, and related public policy questions, and the novelty of the issues involved); The Costs of Accidents, *supra* note 8, at 103 (noting that individuals are unlikely to be able to estimate accurately the risk before an accident occurs); see also, Bruce Hay, David Rosenberg, *Sweetheart and Blackmail Settlements in Class Actions: Reality and Remedy*, 75 Notre Dame Law Review 1377, 1394-97(2000) (noting that courts have trouble estimating the size of a class and the expected recovery even after the underlying events have unfolded).

<sup>17</sup> The Costs of Accidents, *supra* note 8, 110 (general deterrence is not effective in stopping people from absentmindedly taking their eyes off the road).

<sup>18</sup> *Id.* at 103-04.

<sup>19</sup> The increase in accident costs is calculated by multiplying the increased probability of harm by the magnitude of the harm.

<sup>20</sup> The decision would also have to take into account the expected benefit from running the light, if any.

<sup>21</sup> *Id.* at 103.

<sup>22</sup> *Id.* at 104. Even if the driver knows that his rates are likely to increase if he causes an accident, the monetary value of the premium increase is not equal to

Although deterrence theory would suggest that the driver should stop at the yellow light to avoid the increase in accident costs, the theory fails to account for the real life variables that may cause the driver to run the light notwithstanding the increase in accident costs that may be incurred.

To analyze the how actual decision making varies from rational forecasts, the next section discusses a series of empirical studies that test the deterrence assumption in a variety of procedural and substantive contexts. Although the data collected in these studies helps to inform our understanding of deterrence theory, these studies leave many questions unanswered.

## II. Recent Studies on Deterrence Theory

Studies seeking to test the efficacy of deterrence theory have reached mixed conclusions.<sup>23</sup> While some studies have found a link between cost internalization and deterrence,<sup>24</sup> no study to date has

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the monetary value associated with the lump sum accident cost that he would incur if he did not have insurance. *Id.*

<sup>23</sup> See e.g., Tom R. Tyle & John M. Darley, *Building A Law-Abiding Society: Taking Public Views About Morality and the Legitimacy of Legal Authorities into Account When Formulating Substantive Law*, 28 HOFSTRA L. REV. 707, 713 (2000) (“Although research supports the basic premise of the deterrence model, it also suggests that estimates of the likelihood of being caught and punished have, at best, a minor influence on people’s law-related behavior. Some studies suggest that such estimates do not independently influence behavior when the influence of other factors is considered. Other studies find an independent influence, but it is typically small in magnitude.”); Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL L. REV. 1051, 1056 (2000) (“The use of rational choice theory enabled the law-and-economics movement, in its early days, to achieve significant advances in understanding the interaction between legal rules and society. But now that the movement has reached intellectual maturity, the rationality assumption severely limits its continued scholarly development. There is simply too much credible experimental evidence that individuals frequently act in ways that are incompatible with the assumptions of rational choice theory.”); Gary T. Schwartz, *Reality in the Economic Analysis of Tort Law: Does Tort Law Really Deter?*, 42 U.C.L.A. L. REV. 377, 379 (1994) (comparing the “strong” form of the deterrence argument – which assumes that tort law does in fact deter as thoroughly as economic models suggest – and a more “moderate” form of the argument – which assumes that tort law provides some amount of deterrence, but considerably less than the economists tend to predict. Author concludes that the strong form of the deterrence argument is unsound.)

<sup>24</sup> Michael J. Moore & W. Kip Viscusi, *Compensation Mechanisms for Job Risks* 133 (1990) (workers’ compensation systems result in a decrease in worker fatalities); Frank A. Sloan, Emily M. Stout, Kathryn Whetten-Goldstein & Lan Liang, *Drinkers, Drivers and Bartenders: Balancing Private Choices and Public*

been able to substantiate the assumption that the imposition of damages serves as a comprehensive deterrent.<sup>25</sup> Indeed, one study found no clear link between the threat of punitive damages and deterrence,<sup>26</sup> another study found only “thin” evidence of a correlation between liability for medical malpractice and a reduction in negligence rates,<sup>27</sup> and several studies reached mixed results on the deterrent effects of tort reform.<sup>28</sup>

Two recent studies illustrate the inconsistency of the evidence on deterrence theory. In a study published in 2012, Professors Cardi, Penfield and Yoon surveyed over 700 first-year law students and presented them with a series of vignettes involving conduct that might result in liability.<sup>29</sup> The students were given a prompt regarding the applicable law and asked to rate the likelihood that they would engage in the conduct. The prompts described the consequences of the conduct under the applicable law in one of four ways: (1) no liability; (2) criminal liability;<sup>30</sup> (3) tort liability; or (4) no mention of the applicable

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*Accountability* (2000) (liability on alcohol servers reduces fatalities from alcohol related motor vehicle accidents).

<sup>25</sup> Cardi, et al., *supra* note 8, at 5 (“Some scholars have found limited evidence that tort acts as a weak deterrent with respect to certain behaviors. Still others have found no evidence of deterrence or even, in a few cases, a negative association – that certain tort rules are associated with an increase in related injuries.”)

<sup>26</sup> W. Kip Viscusi, *The Social Costs of Punitive Damages Against Corporations in Environmental and Safety Torts*, 87 *Geo. L. J.* 285, 296-98 (1998).

<sup>27</sup> Michelle M. Mello, Troyen A. Brennan, *Deterrence of Medical Errors: Theory and Evidence for Malpractice Reform*, 80 *Tex. L. Rev.* 1595, 1598 (2002).

<sup>28</sup> See Paul H. Rubin & Joanna M. Shephard, *Tort Reform and Accidental Deaths*, 50 *J. L. & Econ.* 221 (2007) (finding some tort reforms associated with fewer motor vehicle accidental deaths); Joanna Shephard, *Tort Reforms’ Winners and Losers: The Competing Effects of Care and Activity Levels*, 55 *U.C.L.A. L. Rev.* 905, 905 (2008) (finding tort reforms in medical malpractice area correlate with an increase in deaths).

<sup>29</sup> Cardi, et al., *supra* note 8, at 5 (the vignettes included: (1) throwing a metal Frisbee with thinner than average edges in a public park; (2) allowing someone to ride your wave-runner without a life jacket; (3) using a cell phone while driving; (4) an off-duty EMT driving by an injured motorcyclist; (5) bumping a parked car to get out of a parking space; (6) a train conductor on a runaway train deciding whether to switch the track which will result in killing one person or doing nothing which will result in killing several people; (7) throwing a metal boomerang with thinner than average edges in a public park; (8) operating heavy machinery while medicated; (9) providing a recommendation for a former employee who often showed up late for work.)

<sup>30</sup> *Id.* at 12 (although the use of the word “criminal” in this situation may not be technically accurate, the authors sought to capture the moral dimension that society associates with criminal versus civil responsibility).

law at all.<sup>31</sup> Interestingly, the results of the study found that “the threat of tort liability had little to no deterrent effect” on the likelihood that participants would engage in the specified conduct.<sup>32</sup> Surprisingly, the study participants were just as likely to take risks when they were told that they might be subject to tort liability as when they were told that they would be subject to no liability.<sup>33</sup>

Several possible explanations of the study results may be available. Study participants may have underestimated the risk of incurring tort sanctions, either as a result of cognitive bias or because of a perception that only a small percentage of tortious injuries result in the filing of a civil action.<sup>34</sup> Moreover, to the extent that legal liability is imposed for breaches of social norms and shared community values, it is possible that tort sanctions had little effect on willingness to engage in risky conduct because the study participants were already inclined to abide by existing social standards of conduct.<sup>35</sup> Finally, participants may have assumed that insurance would cover the liability, thus reducing the deterrent effect of the threat of liability.<sup>36</sup>

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<sup>31</sup> *Id.* (providing no legal regime was intended to measure whether people consciously consider the possibility of legal sanctions when acting in a way that creates risk).

<sup>32</sup> *Id.* at 21 (the threat of criminal liability, on the other hand, correlated with deterrence).

<sup>33</sup> *Id.* at 24 (The authors note that “[t]his finding is counterintuitive. It contradicts not only the study’s hypothesis, but also decades-old contrary assumptions of judges, policy-makers, and academics. Moreover, the finding even belies self-reports of the study’s participants. [Participating students] reported (after having participated in the study) that they had expected to be proven less likely to engage in risky behavior in the face of potential tort liability than in its absence. The study’s results ... reveal this intuition to be inaccurate.”)

<sup>34</sup> *Id.* at 26, citing Ruther Ruttenberg, W. Jonathan Cardi, Estye Ross, *The Taxpayer’s Burden from Product-Related Injuries* 24-27 (March 1, 2011) (unpublished manuscript) (estimating that an annual average of over 131,000,000 product related injuries results in only 24-29,000 product liability suits filed). See also, Daniel Shuman, *The Psychology of Deterrence in Tort Law*, 42 Kan. L. Rev. 115, 121 (1993) (a deterrent effect is achieved when certainty of punishment reaches a sufficient level); Joyce Ehrlinger & David Dunning, *How Chronic Self-Views Influence (and Potentially Mislead) Estimates of Performance*, 84 J. Personality & Soc. Psych. 5, 5-7 (2003) (people tend to overestimate their own abilities and to underestimate their chances of becoming injured or of injuring others); Timur Kuran & Cass Sunstein, *Availability Cascades and Risk Regulations*, 51 Stan. L. Rev. 683, 706 (1999) (describing a cognitive bias that suggests people are more likely to see an event as foreseeable if they recall similar events having occurred in the past).

<sup>35</sup> Cardi, et al., *supra* note 8, at 26.

<sup>36</sup> *Id.* at 28. To the extent that at least some of the vignettes involved conduct that is not likely to be the subject of liability insurance (i.e., throwing a Frisbee), however, it is unlikely that this particular explanation is relevant to the conclusions of the study.

In light of these results, it is surprising that another 2012 study concluded that a threat of damages promotes socially desirable behavior, particularly when damages relate to a class of victims or exceed actual harm.<sup>37</sup> In this study, Professors Eisenberg and Engel tested the deterrent value of damages liability in three situations: (1) damages to an individual litigant; (2) damages to a class of litigants; and (3) damages beyond actual harm to victims, such as through a punitive damages regime.<sup>38</sup> Employing a public good experiment design,<sup>39</sup> the study sought to determine if the risk of liability in any of the three scenarios would cause participants to maintain a stable rate of cooperation toward a public good over time.<sup>40</sup>

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<sup>37</sup> Theodore Eisenberg, Christoph Engel, *Assuring Adequate Deterrence in Tort: A Public Good Experiment*, <http://ssrn.com/abstract=2041154>.

<sup>38</sup> *Id.* at 3.

<sup>39</sup> *Id.* at 5. A public good experiment provides participants with an endowment from which each participant may choose to make a contribution to the public good. The experiment is designed so that the group obtains a maximum benefit if all participants contribute 100% of their endowment to the public good but each individual obtains the most individual benefit by not contributing at all. The experiment is repeated many times to determine if contributions change in response to earlier experience. *Id.*

<sup>40</sup> The experiment lasted 30 periods and each period was divided into two stages. *Id.* at 8. In the first stage, each individual participant was given an endowment of 20 experimental currency units (ECUs) and had to decide how much of it to contribute to a public good project and how much to keep. Each participant's income was determined by subtracting the participant's contribution from the original endowment and adding a percentage of the total contributions made by all participants. Participants were informed about the other participants' contributions after individual contributions were complete. Each participant's income was determined according to the following formula:

$$\text{Income} = \text{endowment} - \text{individual contribution} + 40\% (\text{total contributions})$$

If all participants contributed all of their endowment, total social welfare would be maximized and each participant's income would be equal (20 – 20 + 40% of total contributions). If one participant contributed zero, however, and the remaining participants contributed all of their endowments, the participant who contributed nothing would freeload off the benefits conferred by the public good without paying for it (20 – 0 + 40% of the total contributions) whereas the participants who contributed would earn less (20 – 20 + 40% of the total contributions).

In the second stage, one participant was randomly chosen as the “active participant.” The active participant was allowed to take ECUs from other participants based upon how much each of the other participants invested in the public good project in the first stage. The amount of ECUs that the active participant could take from other participants sought to replicate damages in three scenarios: actual harm to an individual plaintiff, actual harm to a class of plaintiffs, and damages exceeding actual harm (i.e., punitive

The results of the experiment support the conclusion that cooperation toward a public good project improves more when actors are threatened with aggregate damages for the total harm caused to a group than when they are threatened with damages for individual harm. The baseline of the experiment supported the expected conclusion that cooperation toward a common goal deteriorates when there is no opportunity to seek damages from a freeloading party.<sup>41</sup> A decline in cooperation persisted in the model that allowed the active participant to seek damages for his own injury, but the decline was less severe than when no damages were available at all.<sup>42</sup> When the active participant was able to seek aggregate damages for the harm caused to the entire group, cooperation remained virtually stable at a higher level than both of the other two models (the baseline and individual compensatory models), at least by the later periods of the experiment.<sup>43</sup> The final treatment allowed the imposition of damages that exceeded the overall harm caused to the entire group, thus resembling a punitive damages regime. Unlike all of the earlier treatments, this scenario resulted in increased cooperation over time.<sup>44</sup> Overall the authors found evidence suggesting:

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damages). *Id.* at 9. The first scenario sought to replicate traditional bipolar litigation by allowing the active player to impose damages for harm caused to the active player – measured by the “difference between what the active player received and what she would have received in the period if the punished players had contributed as much to the project as the active player did.” *Id.* The second scenario sought to replicate class action litigation by allowing the active player to impose damages for the total harm the punished player caused to the group. The third scenario allowed the active player to impose damages up to the punished player’s income in the period, regardless of the actual harm caused to the active player or the group. *Id.* at 9-12.

<sup>41</sup> *Id.* at 15.

<sup>42</sup> *Id.* at 16. (“Overall the compensatory treatment somewhat improves the public good compared to the baseline but the effect is not strong enough to avoid the common deterioration in cooperation over time.”)

<sup>43</sup> *Id.* at 20-21 (“The increased damages available in the class action treatment stem the classic ... trend of deteriorating cooperation over time. Holding the low-contributor liable for a greater share of the harm they impose leads to improved behavior from the perspective of social welfare.”) The class action treatment found a strong association between prior period punishment and contribution levels: “In the last ten periods, contributions increased by an average of 2.7 ECUs when the participant had been required to pay damages in the prior period ... and decreased by an average of 0.9 ECUs when the participant did not pay damages [in the prior period].” *Id.* at 22. This finding suggests that participants learned from prior experience and were willing to adjust their behavior in light of previous liability.

<sup>44</sup> *Id.* at 23, 27-29. (The punitive treatment raises concerns about the possibility of antisocial punishment imposed by the active player. When the concern regarding antisocial punishment is removed, the results of the punitive

a damages rule analogous to [traditional bilateral litigation] is sufficient to deter serious deterioration in cooperation over time.... A damages rule more closely tied to ... damages in class action litigation, prevented the pattern of deteriorating cooperation over time. A more Draconian rule of damages, linked to income without requiring harm, promoted increased cooperation over time but at the cost of allowing socially unjust damages.<sup>45</sup>

Although both of these recent studies were comprehensively planned and meticulously executed, they reach conflicting conclusions that suggest further research is necessary. By analyzing what the evidence in these studies shows, and fails to show, these studies point the way for further study.

Both of the recent studies analyze reported behavior, rather than actual behavior.<sup>46</sup> The studies seek to predict how actors will respond to a threat of liability based upon hypothetical factual scenarios. The nature of a hypothetical scenario raises the possibility that participants may incorrectly report how they would actually behave under similar circumstances. Indeed, by focusing the participants' attention on isolated, hypothetical situations, the reported behavior is based upon a more simplified decision making process than actual behavior would be.<sup>47</sup> Since it is impossible to measure how reported behavior varies from actual behavior, further research should focus on collecting data based upon actual historical behavior.

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treatment show non-deterioration in cooperation over time but no clear increase in cooperation over time).

<sup>45</sup> *Id.* at 35.

<sup>46</sup> Cardi, et al., *supra* note 8, at 28. (The authors recognize that reliance on reported behavior rather than actual behavior is a weakness of the study, but they suggest that the data "would, if at all, bias the findings in favor of finding a deterrent effect of tort.... Studies have shown that survey participants tend to over-report behaviors they deem to be socially acceptable and under-report those deemed to be unacceptable.")

<sup>47</sup> Christine Jolls, Cass. R. Sunstein, & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 *Stan. L. Rev.* 1471, 1477-79 (1998). (Studies have shown that actual judgments often differ from forecasts because of limited cognitive abilities by decision makers. "Bounded rationality ... refers to the obvious fact that human cognitive abilities are not infinite.... To deal with limited memories we make lists. To deal with limited brain power and time we use mental shortcuts and rules of thumb. But even with these remedies, and in some cases because of these remedies, human behavior differs in systematic ways from that predicted by the standard economic model of unbounded rationality. Even when the use of mental shortcuts is rational, it can produce predictable mistakes.")

The recent studies also provide vastly different opportunities for participants to learn from previous experience. The first study provides data on a single-period experiment and finds little or no deterrent effect from the threat of damages. By limiting the experiment to a single period, however, the study fails to provide data regarding an actor's behavioral revisions in light of previous experience. The second study, on the other hand, provides participants an opportunity to revise their behavior in 30 immediate periods of repeated play. Notably, levels of cooperation were quite different after 10 periods, 20 periods and 30 periods of play, suggesting that behavior evolved over time as experience was reinforced again and again. While each of these studies presents very different opportunities to learn from experience, it is unclear how closely these hypothetical scenarios resemble actual decision making. Data based upon actual experience would close the gap.

Both studies simplify the problem of informational deficiencies.<sup>48</sup> In order to predict a threat of liability, a corporation must estimate and then aggregate liability on individual claims.<sup>49</sup> These estimates are subject to variability.<sup>50</sup> Indeed, potential liability tends to change throughout the lifecycle of a lawsuit. For example, the expected loss from litigation at any particular point in time increases or decreases depending upon how a court rules on pivotal motions, such as a motion to dismiss for failure to state claim, class certification, admissibility of expert testimony, or summary judgment.<sup>51</sup> Reported behavior based upon hypothetical scenarios fails to account for these challenges.

Finally, both studies measure individual behavior rather than institutional behavior. To the extent that decision making processes are

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<sup>48</sup> Cardi, et al., *supra* note 8, at 34.

<sup>49</sup> George Rutherglen, *Future Claims in Mass Tort Cases: Deterrence, Compensation, and Necessity*, 88 Va. L. Rev. 1989, 1994 (2002). ("All of the plausible means for determining overall liability require first an approximation and then a summation of liability on individual claims. No mass tort case seems to come with a figure for total liability attached.")

<sup>50</sup> For example, estimates are subject to variability depending upon risk preferences. Studies involving cognitive psychology have shown that individuals tend to be risk averse with respect to moderate to high probability gains (plaintiffs with strong cases) but risk seeking with respect to moderate to high probability losses (defendants with weak cases). On the other hand, studies also show that individuals generally tend to be risk seeking as to low probability gains (plaintiffs with weak cases) and risk averse as to low probability losses (defendants with strong cases). Richard Nagareda, *1938 All Over Again? Pretrial as Trial in Complex Litigation*, 60 DePaul Law Review 647, 657-58 (2011)

<sup>51</sup> Nagareda, *supra* note 49, at 649.

different for individuals and corporations,<sup>52</sup> data based upon individual behavior may not accurately predict institutional behavior.

The next section describes a new study designed to advance our understanding of deterrence and negative value class actions by focusing on actual historical experience with negative value class action litigation from the perspective of corporate decision makers.

### III.

#### Deterrence: A View of From Within the Fortune 500

##### a. Study Goals

The goal of this study is to refine our understanding of the relationship between negative value class action litigation and the prevention of harm. Toward this end, a comprehensive Questionnaire was sent to general counsel at each of the corporations on the 2011 Fortune 500 list.<sup>53</sup> Unlike previous studies that rely upon randomly chosen study participants to report how they would respond to hypothetical situations, this study collects data from those individuals who are most likely to possess institutional knowledge regarding negative value class action litigation.<sup>54</sup> In this sense, the study fills an important gap left open by previous studies.<sup>55</sup>

The efficacy of deterrence theory depends upon the likelihood that an actor will predict a risk of future liability at a time when precautions may be taken to avoid the liability. As illustrated by the deterrence formula, a number of variables play into the decision to invest in precautions to avoid future harm.<sup>56</sup> Indeed, accurately predicting the variables that inform the left side of the equation – the avoidable cost of litigation – depends upon predicting the likelihood and

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<sup>52</sup> Cardi, et al., *supra* note 8, at 29 (“Prior research has hinted that the threat of tort sanctions might have a greater deterrent effect on firms”).

<sup>53</sup> Questionnaire, Appendix A.

<sup>54</sup> The survey was sent to general counsels on the assumption that they are most likely to possess institutional knowledge of how the companies have responded to the threat of class action litigation. To the extent that this assumption was inaccurate, survey recipients were requested to forward the survey to a person who possessed such knowledge.

<sup>55</sup> For example, in the previous studies based upon hypothetical scenarios, it was impossible to determine how informational deficiencies, risk preferences and cognitive limitations might change the reported behavior of participants. By relying upon actual historical experience, decision makers have incorporated any relevant practical limitations and made the best decision possible in light of these challenges.

<sup>56</sup> See *supra* notes 11-12 and accompanying text for a discussion of the deterrence formula:  $EL * p + EC \geq I$ .

magnitude of harm that may result from particular conduct (EL), as well as the legal implications that flow from the harm (*p*). Several decades ago, Professor Francis McGovern popularized the concept of maturity in relation to class action litigation.<sup>57</sup> He suggested that litigation is mature when “little or no new evidence will be developed, significant appellate review of any novel legal issues has been concluded, and at least one full cycle of trial strategies has been exhausted.”<sup>58</sup> Prior to maturity, evidence is still being developed, legal issues are yet to be resolved and trial strategies are uncertain. In light of the fact that deterrence depends heavily upon the ability to anticipate future liability, this study seeks to better understand the relationship between litigation maturity and deterrence.<sup>59</sup>

Intuitively, one would presume that prior litigation provides a valuable source of information from which a corporation may predict future liability. For example, a corporation that has been held liable for harm resulting from particular conduct in the past, will possess information regarding the factual and legal assertions that formed the basis for liability in the previous litigation, and this information is available to inform a prediction about the risk of future liability for similar conduct. Indeed, once a corporation is held liable for particular conduct, one would expect the corporation to take affirmative action to avoid incurring future litigation regarding the same or similar conduct.

Even when a corporation has not been a party to previous litigation, the imposition of liability against others can form the basis for predicting future liability. For example, a corporation that is aware of previous litigation against a competitor will be equipped to anticipate a risk of future liability for similar conduct. Indeed, if a corporation possesses information about the factual and legal assertions that formed the basis for the imposition of liability against a competitor, one would expect the corporation to take affirmative steps to avoid incurring future litigation regarding the same or similar conduct.

When there is no track record from previous litigation, predicting future liability is much more difficult. One would expect that cases involving novel legal theories and/or unproven factual scenarios are hard to predict precisely because there is little or no information to put a corporation on notice of the factual and legal assertions that may form the basis for liability.

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<sup>57</sup> Francis E. McGovern, *Resolving Mature Mass Tort Litigation*, 69 B.U. L. Rev. 659, 659 (1989)(describing mature mass torts as those involving “full and complete discovery, multiple jury verdicts, and a persistent vitality in plaintiffs’ contentions.”).

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

The study presented in this paper seeks to test these assumptions. The Questionnaire includes three basic parts: a statement of the study goal;<sup>60</sup> a definition section;<sup>61</sup> and thirty-two questions. The questions seek to collect data to prove (or disprove) the following three hypotheses:

1. A risk of future liability is easier to anticipate when there is a well-developed record of the factual and legal issues from previous litigation than when there is no track record from previous litigation;
2. Corporations who have been held liable for particular conduct will successfully change their conduct to avoid future litigation regarding similar conduct;
3. Corporations who are informed about lawsuits filed against their competitors and who rely upon this information in making their own business decisions will successfully change their conduct to avoid subsequent similar litigation.

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<sup>60</sup> The survey states that the “goal of the study is to refine our understanding of the relationship between small-stakes class action litigation and the prevention of injury.” A judgment was made to use the phrase “small-stakes” class action in the Questionnaire rather than the phrase “negative value” class action. The phrases are synonymous.

<sup>61</sup> To ensure that all Respondents share similar understanding of the terminology, the Questionnaire included the following definitions:  
“**Small-Stakes Class Actions**” join together claims that cannot be economically litigated on an individual basis because each claim for relief is insufficient to cover the costs of litigation. Individual claims may seek damages ranging from a few pennies to several thousand dollars. Once joined together into a class, these claims become viable because the cost of litigation is spread among a large group of class members. [The phrase small-stakes class action is synonymous with negative value class action.]  
“**First Generation Small-Stakes Class Actions**” are small-stakes class actions that involve novel legal theories and/or unproven factual scenarios. [hereinafter referred to as First Generation Action]  
“**Second Generation Small-Stakes Class Actions**” are small-stakes class actions that involve legal theories and factual scenarios that have been previously argued in other cases but have not been definitively resolved. Thus while the case theories are not novel, ambiguity exists regarding the interpretation of important legal questions and/or the existence of evidentiary support for factual allegations. [hereinafter referred to as Second Generation Action].  
“**Third Generation Small-Stakes Class Actions**” are small-stakes class actions that involve legal theories and factual scenarios that have been the subject of earlier class actions and enjoy fairly well developed legal and factual support from previous litigation. While some level of ambiguity persists, third generation class actions enjoy the most robust information from which to predict the likely outcome of a suit. [hereinafter referred to as Third Generation Action]. See Questionnaire, Appendix A, at page 1.

### b. Reducing Survey Error

The study is structured to reduce the potential for survey error. Survey error may arise from a variety of sources, including coverage error, sampling error, measurement error, and nonresponse error. Coverage error occurs when the list from which a sample is drawn fails to include all elements of a population, thus skewing the survey by failing to give all elements of the population a chance at participation.<sup>62</sup> To reduce coverage error, the Questionnaire was sent to every company on the 2011 Fortune 500 list. This gave every member of the list an equal chance to participate, and reduced the potential for coverage error. The list of Fortune 500 companies was obtained from public records, corporate counsels were identified from company websites, and all non-respondents were contacted via multiple means (i.e. multiple mailings and personal telephone calls). Finally, all packages returned to sender were checked, corrected and re-mailed. The overall risk of coverage error, therefore, is quite small.

Although the Questionnaire was sent to the entire population of Fortune 500 companies, responses were not received from every recipient of the survey. Thus, the study seeks to rely upon the sample of responses received to generalize results of the Questionnaire to the entire survey population. Sampling error arises whenever data is collected from a subset of the relevant population and is used to estimate the distribution of characteristics of the entire population.<sup>63</sup> While it is impossible to remove this potential for error without collecting data from every member of a population, it is possible to estimate sampling error with considerable precision.<sup>64</sup> Thus, when estimating the characteristics of the population from the random sample of survey responses, sample results are accompanied by a 95% confidence interval which suggests that 95 out of 100 times a random sample is drawn from the population, the estimate from that sample will be within a specific range of the sample results. For example, if the results of a sample show that 20% of the respondents answered a particular question in the affirmative, a 95% confidence interval of +/- 5% would mean that 95 out of 100 times a random sample is drawn from the same population, 15-25% of the respondents will answer the same question in the affirmative.<sup>65</sup>

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<sup>62</sup> Don A. Dillman, Jolene D. Smyth, Leah Melani Christian, *Internet, Mail and Mixed-Mode Surveys: The Tailored Design Method* 17, 43 (Third ed. 2009).

<sup>63</sup> *Id.* (“[S]ampling error results from surveying only some rather than all members of the population and exists as a part of all sample surveys”).

<sup>64</sup> *Id.*

<sup>65</sup> *Id.* at 56-57.

Measurement error results from ambiguous questions that create imprecise responses.<sup>66</sup> To reduce the risk of measurement error, the Questionnaire includes a variety of question and response formats. A number of questions employ a polar-point-labeled scale response system with verbally and numerically labeled end points and numerically labeled mid points, equally spaced along a horizontal continuum (the numerical scale ranges from 1-10). This question type provides an easy method for Respondents to conceptualize relative preferences.<sup>67</sup> Other questions provide a full set of verbal category labels, equally spaced in a vertical list. This type of response system offers more control over how each response is interpreted.<sup>68</sup> Some questions ask for a yes or no response. To the extent that any questions resulted in ambiguous responses, they have been omitted from the study conclusions.

Nonresponse error occurs when those “who do not respond are different from those who do respond in a way that is important to the study.”<sup>69</sup> Since the goal of the study is to analyze how corporations respond to the threat of negative value class action litigation, it is imperative that those who respond to the survey share a similar vulnerability to this type of litigation as those who do not respond.<sup>70</sup> In other words, the sample must represent both the characteristics shared by the population and the diversity of characteristics that differentiate the members of the population in relation to the subject of the study. Although the population consists of a diverse group of companies operating in a wide variety of industries, every member of the population is a publicly traded company that is subject to state and federal securities regulation. As such, every member of the population shares a similar vulnerability to securities class action litigation. Given that securities litigation is by far the single most common type of class action, this similarity among the population reduces the risk of

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<sup>66</sup> *Id.* at 18.

<sup>67</sup> *Id.* at 143 (Some surveyors prefer this response system over a full set of verbal category labels because they believe that a numeric range may provide an easier method for some respondents to conceptualize relative preferences. A potential limitation of this method, however, is that the mid points on the scale are unlabeled and open to respondents’ interpretation.)

<sup>68</sup> *Id.*

<sup>69</sup> *Id.* at 17.

<sup>70</sup> This does not mean that data can only be collected from Respondents who have been named as defendants in such suits. Indeed, a lack of experience as a litigant may prove that a Respondent is particularly well versed at recognizing the threat of litigation and averting the harm. Such a Respondent would provide highly relevant information for this study. Rather, data must be collected from a sample that shares similar exposure to negative value class action litigation as the entire population.

nonresponse error significantly.<sup>71</sup> Indeed, to the extent that these class actions often involve negative value claims, exposure to this type of litigation is directly relevant to the subject of the study. In addition to potential securities class actions, members of the population may share similar vulnerability to employment related class actions, including civil rights, ERISA and other labor suits.<sup>72</sup> Of course, vulnerability to class action litigation is not completely uniform across the population because some industry specific class action suits are not equally prevalent for all members of the population. For example, companies in

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<sup>71</sup> The Administrative Office of the U.S. Courts reports that as of 2004, 47% of class actions pending in federal court involved securities regulation. See John C. Coffee, Jr., *Private Securities Litigation Reform Act: Reforming the Securities Class action: An Essay on Deterrence and Its Implementation*, 106 Colum. L. Rev. 1534, 1539-40 (2006)(securities class actions are “the 800-pound gorilla that dominates and overshadows other forms of class actions”). The following table shows class actions pending in federal courts as of September 30, 2002, 2003, and 2004:

<b>Type of Case</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
Contract	282	290	289
Real Property	33	38	34
Tort Actions	529	604	600
Antitrust	249	231	202
Employment Rights	164	159	173
Other Civil Rights	298	274	266
Prisons, Prisoners	66	64	82
RICO	53	76	46
ERISA	134	183	216
Other Labor Suits	180	204	262
Securities/Commodities/Exchange	2325	2339	2480
Others	522	515	529
Total	4835	4977	5179
Securities Class Actions as a Percentage of Total	47.5%	47%	47.9%

See Admin. Office of the U.S. Courts, *Judicial Business of the United States Courts 395-97 tbl.X-4* (2002), available at <http://www.uscourts.gov/judbus2002/appendices/x04sep02.pdf>; Admin. Office of the U.S. Courts, *Judicial Business of the United States Courts 393-97 tbl.X-4* (2003), available at <http://www.uscourts.gov/judbus2003/appendices/x4.pdf>; Admin. Office of the U.S. Courts, *Judicial Business of the United States Courts 400-03 tbl.X-4* (2004), available at <http://www.uscourts.gov/judbus2004/appendices/x4.pdf>. Since 2004, the Administrative Office of the U.S. Courts has not provided this data in the annual reports.

<sup>72</sup> See *id.* for the frequency of each of these categories.

the retail industry are vulnerable to consumer class actions that companies in the oil pipeline industry likely are not. Overall, the similarity of exposure to securities and employment related class action litigation tends to reduce the risk of nonresponse error, while the relatively small risk of industry specific class action litigation minimally increases the risk of nonresponse error. As such, efforts were taken to motivate survey recipients from different industries to respond.<sup>73</sup>

A number of techniques were used to motivate a variety of survey recipients to respond to the Questionnaire. Each mailing included a personally addressed cover letter that described the significance of the study,<sup>74</sup> as well as a copy of the Questionnaire, a biography of the author and a self-addressed return envelope. Approximately eight weeks after the first mailing, a follow up letter was sent to anyone from whom a response was not yet received (either a completed survey or correspondence indicating a lack of interest) along with another copy of the Questionnaire.<sup>75</sup> Approximately one to two weeks following the second mailing, a personal phone call was made to every recipient from whom a response had not yet been received. These efforts were successful to a large degree. Specifically, responses were received from 49 Respondents who participate in 31 different industries.<sup>76</sup> Nineteen of these industries were represented by a single Respondent, seven of these industries were represented by two Respondents, four of these industries were represented by three Respondents, and one industry was represented by four Respondents.<sup>77</sup>

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<sup>73</sup> Dillman, *supra* note 62, at 17.

<sup>74</sup> Cover Letter, Appendix B. The cover letter ensured complete confidentiality, offered to share the results of the study with all survey participants and provided a telephone number and email address for correspondence with the author of the study.

<sup>75</sup> Follow-up Letter, Appendix C.

<sup>76</sup> Responses were received from companies in the following industries: metals; education; communication equipment; medical products; pharmaceuticals; construction and farm machines; insurance: life and health; insurance property and casualty; engineering and construction; health care: medical facilities; information technology services; motor vehicle and parts; telecommunications; food: consumer products; food: wholesale; general merchandise; specialty retailer; industrial machinery; utility: gas and electric; chemicals; pipelines; electronic equipment; aerospace and defense; automotive retailing services; mining, crude oil products; financial data services; computer services; scientific, photographic and control equipment; entertainment; commercial bank; internet services; and retailing.

<sup>77</sup> The following industries had multiple Respondents: communication equipment (2 Respondents); construction and farm machines (2 Respondents); insurance: life and health (3 Respondents); motor vehicles and parts (2 Respondents); food: consumer products (3 Respondents); general merchandise (2 Respondents); specialty retailer (2 Respondents); utility: gas and electric (4 Respondents); chemicals (2 Respondents); electronic equipment (3

Overall, Respondents represent a diverse group of publicly traded companies that share a vulnerability to class action litigation involving state or federal securities claims, civil rights claims, ERISA claims, and other labor related claims, and may also share exposure to class action litigation involving industry specific claims.

Notwithstanding these efforts, some survey error likely remains. Although each corporate counsel had an equal opportunity to participate in the study, the sensitive nature of the subject matter likely discouraged many from participating. While the data collected provides adequate coverage of the population to draw conclusions within a 95% confidence interval for most questions, a higher participation rate would have allowed narrower confidence intervals.

Moreover, those who responded to the survey may have more experience with class action litigation and/or have a stronger opinion regarding the subject of the study than those recipients who chose not to participate.<sup>78</sup> Indeed, a small number of survey recipients communicated a hesitation to participate in the study precisely because they had little or no experience with class action litigation and therefore thought they had nothing of value to add.<sup>79</sup>

Finally, to the extent that all Respondents are vulnerable to class action suits, they have an incentive to downplay the validity of this costly regulatory device. While it is impossible to ignore this reality, the evidence does not indicate that the results are skewed to any significant degree by bias. The Respondents do not have similar experience with negative value class action litigation. Thirteen Respondents from thirteen different industries responded that they have never been named as a defendant in a negative value class action, suggesting that these Respondents are less negatively disposed to the device than a Respondent who has been dogged by such actions. Indeed, even among Respondents who have been named as defendants in such litigation, most Respondents indicate that they tend to be sued in such actions infrequently. Moreover, one would expect bias to result in

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Respondents); aerospace and defense (2 Respondents); automotive retailing services (3 Respondents).

<sup>78</sup> Of the 49 survey responses, 13 Respondents have never been a defendant in a negative value class action.

<sup>79</sup> When these thoughts were communicated, the author explained that the depth and breadth of exposure to class action litigation (or lack thereof) is, in and of itself, meaningful evidence that is relevant to the study. Notwithstanding, it is likely that some recipients of the Questionnaire chose not to respond for this reason.

uniform responses. Yet, the responses in this study tend to be spread out, often covering the entire spectrum from very low to very high. Overall, the data provides valuable evidence regarding deterrence in large, publicly traded companies.

c. Survey Results

Hypothesis 1:

*A risk of future liability is easier to anticipate when there is a well-developed record of the factual and legal issues from previous litigation than when there is no track record from previous litigation.*

In order to estimate future liability, an actor must be able to: (1) anticipate the legal and factual claims that may form the basis for liability in the future; (2) estimate the plaintiff's likelihood of success on the merits; and (3) estimate the magnitude of the potential liability. An error in any of these estimates will result in under or over deterrence. The following questions seek to gauge Respondents' ability to anticipate the variables that inform deterrence at each stage of litigation maturity.<sup>80</sup>

*With regard to the occasions when your company has been named as a defendant in a **First Generation Small-Stakes Class Action**, please rate your ability to anticipate the legal and factual claims at the time of the event or business decision that later became the subject of the class action suit. (emphasis in original)<sup>81</sup>*

The response to this question suggests that most Respondents have a very hard time anticipating the legal and factual claims that form the basis for First Generation Actions. Indeed, only 10% of Respondents rate their ability to anticipate these actions as high, 15% rate their ability to anticipate these actions as moderate, and a full 75% rate their

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<sup>80</sup> See supra note 61 for the definition of First Generation Small-Stakes Class Actions, Section Generation Small-Stakes Class Actions, and Third Generation Small-Stakes Class Actions.

<sup>81</sup> The response scale ranges from "1 = We generally have not anticipated the legal and/or factual claims" to "10 = We generally have anticipated the legal and factual claims." See Questionnaire, Appendix A, question 15.

ability to anticipate these actions as low.<sup>82</sup> One Respondent gave a rating of “1” with the explanation that “Decisions were made decades ago and preceded change in laws.”

In light of this data, it is not surprising that Respondents also have difficulty anticipating plaintiff’s likelihood of success in First Generation actions. The following question asks:

*With regard to the occasions when your company has been named as a defendant in a **First Generation Small-Stakes Class Action**, please rate your ability to estimate the plaintiffs’ likelihood of success on the merits at the time of the event or business decision that later became the subject of the suit. (emphasis in original)<sup>83</sup>*

In response to this question, 20% of Respondents rate their ability to estimate plaintiffs’ likelihood of success as high; 25% rate their ability as moderate; and 55% rate their ability as low.<sup>84</sup> Similarly, Respondents have trouble estimating the magnitude of potential liability of First Generation Actions:

*With regard to the occasions when your company has been named as a defendant in a **First Generation Small-Stakes Class Action**, please rate your ability to estimate the magnitude of the*

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<sup>82</sup> Throughout this paper, a rating between 7 – 10 is referred to as “high”, a rating between 4 – 6 is referred to as “moderate” and a rating between 1 – 3 is referred to as “low”. Among the 20 Respondents to this question, two rate their ability to anticipate these actions between 7 – 10; three rate their ability to anticipate these actions between 4 – 6 (all three rate their ability at 4); and fifteen rate their ability to anticipate these actions between 1 – 3. A 95% confidence interval is +/- 13%.

Respondents who rate their ability to anticipate actions as high, identify with the following industries: electronic equipment; and utility: gas and electric.

Respondents who rate their ability to anticipate actions as moderate, identify with the following industries: construction and farm machines; insurance: life and health; and commercial bank.

Respondents who rate their ability to anticipate actions as low, identify with the following industries: construction and farm machines; insurance: life and health; insurance: property and casualty; engineering and construction; health care: medical facilities; food: consumer products; general merchandise; specialty retailer; utility: gas and electric; automotive retailing services; food: wholesale; computer services; and entertainment.

<sup>83</sup> The response scale ranges from “1 = We have not been able to accurately estimate the plaintiffs’ likelihood of success” to “10 = We have been able to accurately estimate the plaintiffs’ likelihood of success.” Questionnaire, Appendix A, question 16.

<sup>84</sup> A 95% confidence interval is +/- 13%.

*potential liability at the time of the event or business decision that later became the subject of the suit. (emphasis in original)*<sup>85</sup>

The response to this question suggests that many Respondents are unable to accurately estimate the magnitude of the potential liability, with 20% rating their ability to estimate the magnitude of potential liability as high, 20% rating their ability as moderate, and a full 60% rating their ability as low.<sup>86</sup>

This data suggests that a large margin of error exists for each of the relevant variables that inform the deterrence formula for first generation actions. While it is impossible to determine from this data if the margin of error on each variable is likely to give rise to under deterrence or over deterrence, common sense would suggest that Respondents are more likely to under estimate future liability than over estimate it.

While it is not surprising that corporations have a hard time anticipating First Generation Actions, these actions are a necessary precursor for more mature litigation to develop. Thus, the next series of questions focuses on Second Generation actions:

*With regard to the occasions when your company has been named as a defendant in a **Second Generation Small-Stakes Class Action**, please rate your ability to anticipate the legal and factual claims at the time of the event or business decision that later became the subject of the suit. (emphasis in original)*<sup>87</sup>

Not surprisingly, the response to this question suggests that Respondents are better able to anticipate Second Generation Actions than First Generation Actions. Indeed, Respondents are almost equally likely to rate their ability as high, moderate or low, with 31% of Respondents rating their ability to anticipate such claims as high, 34.5% rating their ability as moderate, and 34.5% rating their ability as low.<sup>88</sup>

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<sup>85</sup> The response scale ranges from “1 = We have not been able to accurately estimate the magnitude of the potential liability” to “10 = We have been able to accurately estimate the magnitude of the potential liability.” Questionnaire, Appendix A, question 17.

<sup>86</sup> A 95% confidence interval is +/- 13%.

<sup>87</sup> Responses are on a scale from “1 = We generally have not anticipated the legal and/or factual claims” to “10 = We generally have anticipated the legal and factual claims.” See Questionnaire, Appendix A, question 21.

<sup>88</sup> Among the 29 Respondents to this question, nine rate their ability to anticipate such suits between 7 – 10; ten rate their ability between 4 – 6 and ten rate their ability between 1 - 3. A 95% confidence interval is +/- 10.5%.

Respondents who rate their ability to anticipate actions as high, participate in the following industries: construction and farm machines; telecommunications;

While it is not surprising that Respondents are more prepared to anticipate a Second Generation Action than a First Generation Action, two thirds of Respondents rate their ability to anticipate such claims as moderate or low, suggesting that optimal deterrence is unlikely to be achieved in many Second Generation Actions.

A related question asks:

*With regard to the occasions when your company has been named as a defendant in a **Second Generation Small-Stakes Class Action**, please rate your ability to estimate the plaintiffs' likelihood of success at the time of the underlying event or decision that later became the subject of the suit. (emphasis in original)<sup>89</sup>*

Again, the response to this question suggests that Respondents are better able to estimate the plaintiffs' likelihood of success in Second Generation Actions than they are in First Generation Actions, with 34.5% of Respondents rating their ability to estimate the plaintiff's likelihood of success as high, 44.8% rating their ability as moderate, and 20.7% rating their ability as low. While these percentages mark an improvement over First Generation Actions, there is still a considerable margin of error in predicting future liability.

With regard to estimating the magnitude of the potential liability, the following question asks:

*With regard to the occasions when your company has been named as a defendant in a **Second Generation Small-Stakes Class Action**, please rate your ability to estimate the magnitude of the potential liability to the class at the time of the underlying*

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general merchandise; specialty retailer; utility: gas and electric; chemicals; electronic equipment; aerospace and defense; and commercial bank.

Respondents who rate their ability to anticipate these claims as moderate, participate in the following industries: construction and farm machines; insurance: life and health; insurance: property and casualty; general merchandise; chemicals; electronic equipment; automotive retailing services; computer services; and entertainment.

Respondents who rate their ability to anticipate these claims as low participate in the following industries: metals; insurance: life and health; motor vehicles and parts; specialty retailer; utility: gas and electric; automotive retailing services; food wholesale; scientific photographic and control equipment.

<sup>89</sup> The response scale ranges from "1 = We have not been able to accurately estimate the plaintiffs' likelihood of success" to "10 = We have been able to accurately estimate the plaintiffs' likelihood of success." A 95% confidence interval is +/- 10.5%. Questionnaire, Appendix A, question 22.

*event or decision that later became the subject of the suit.  
(emphasis in original)<sup>90</sup>*

In response to this question, 41.4% of Respondents rated their ability to estimate the magnitude of the potential liability as high, while 24.1% rated their ability as moderate and 34.5% rated their ability as low.

Once litigation is fully mature Respondents rate their ability to anticipate the risk of legally cognizable harm much higher, evidenced by the responses to the following question:

*With regard to the occasions when your company has been named as a defendant in a **Third Generation Small-Stakes Class Action**, please rate your ability to anticipate the legal and factual claims at the time of the underlying event or decision that later became the subject of the suit. (emphasis in original)<sup>91</sup>*

The response to this question shows an overwhelming improvement in the ability to anticipate the legal and factual claims asserted. A full 75% of Respondents rate their ability to anticipate Third Generation Actions as high, with only 12.5% rating their ability as moderate, and 12.5% rating their ability as low.<sup>92</sup> This is almost the mirror image of Respondents' ability to anticipate First Generation Actions where 10% rate their ability as high, 15% rate their ability as moderate and a full 75% rate their ability as low.

The following related questions resulted in similar responses:

*With regard to the occasions when your company has been named as a defendant in a **Third Generation Small-Stakes Class Action**, please rate your ability to estimate the plaintiffs' likelihood of success at the time of the underlying event or decision that later became the subject of the suit. (emphasis in original)<sup>93</sup>*

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<sup>90</sup> The response scale ranges from "1 = We have not been able to accurately estimate the magnitude of the potential liability" to "10 = We have been able to accurately estimate the magnitude of the potential liability." A 95% confidence interval is +/- 10.5%. Questionnaire, Appendix A, question 23

<sup>91</sup> The response scale is based upon "1 = We generally have not anticipated the legal and/or factual claims" to "10 = We generally have anticipated the legal and factual claims." See Questionnaire, Appendix A, question 27.

<sup>92</sup> Of the 24 Respondents to this question, eighteen rate their ability to anticipate these claims between 7 – 10. Three rate their ability between 4 – 6, and three rate their ability between 1 – 3. A 95% confidence interval is +/- 12%.

<sup>93</sup> The response scale ranges from "1 = We have not been able to accurately estimate the plaintiffs' likelihood of success" to "10 = We have been able to

Of the 24 responses, 75% rate their ability to estimate plaintiffs' likelihood of success as high, while 12.5% rate their ability as moderate and 12.5% rate their ability as low.<sup>94</sup>

Finally:

*With regard to the occasions when your company has been named as a defendant in a **Third Generation Small-Stakes Class Action**, please rate your ability to estimate the magnitude of the potential liability at the time of the underlying event or decision that later became the subject of the suit. (emphasis in original)<sup>95</sup>*

Here, 75% rate their ability to estimate magnitude of the loss as high, while 12.5% rate their ability as moderate, and 12.5% rate their ability as low.<sup>96</sup>

Applying this data to the first hypothesis suggests that it is easier to anticipate a risk of future liability when there is a well-developed record of the factual and legal issues from previous litigation than when there is no track record. Even when litigation is mature, however, the variables that induce a corporation to engage in anticipatory compliance are based upon estimates that are subject to variability. Indeed, 87.5% of Respondents rate their ability to anticipate even Third Generation actions as 9 or lower, suggesting that most Respondents perceive some room for error in their estimates. Thus, while the deterrence formula helps to conceptualize the notion of anticipatory compliance, it is unlikely that most litigation induces the precise calculation of deterrence predicted by the formula.<sup>97</sup> This does not necessarily mean that deterrence is ineffective, however, because a generalized perception of a risk of liability may be sufficient to induce a change in conduct. Therefore, deterrence may be more accurately assessed by how effectively an actor avoids future litigation, a question that is addressed by the second hypothesis.

#### Hypothesis #2:

*Corporations who have been held liable for particular conduct will successfully change their conduct to avoid future litigation regarding similar conduct*

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accurately estimate the plaintiffs' likelihood of success." Questionnaire, Appendix A, question 28

<sup>94</sup> A 95% confidence interval is +/- 12%.

<sup>95</sup> The response scale ranges from "1 = We have not been able to accurately estimate the magnitude of the potential liability" to "10 = We have been able to accurately estimate the magnitude of the potential liability." Questionnaire, Appendix A, question 29.

<sup>96</sup> A 95% confidence interval is +/- 12%.

<sup>97</sup> See *infra* notes 11-12 and accompanying text.

Deterrence theory suggests that if a company is sued in a First or Second Generation Action, the company will change its conduct to avoid being sued in a later generation of a suit involving a similar dispute. The following questions seek to test this premise:

*When your company has been named as a defendant in a **Second Generation Small-Stakes Class Action**, approximately how often has the company been named as a defendant in the earlier generation of a similar dispute? (emphasis in original)<sup>98</sup>*

Somewhat surprisingly, 51.7% of Respondents report that they have been named in an earlier generation of a similar dispute and 48.3% of Respondents report that they have never been named in an earlier generation of a similar dispute.<sup>99</sup> The responses to the following question are even more remarkable:

*When your company has been named as a defendant in a **Third Generation Small-Stakes Class Action**, approximately how often has the company been named as a defendant in an earlier generation of a similar dispute? (emphasis in original)<sup>100</sup>*

Here, a full 84% report that they have been named in an earlier generation of a similar dispute and only 16% report that they have never been named in an earlier generation of a similar dispute.<sup>101</sup> This data contradicts deterrence theory. Well over three quarters of the Respondents were unsuccessful in avoiding subsequent litigation, even after being named in an earlier generation of a similar dispute.

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<sup>98</sup> Responses include: (a.) Never; (b.) Infrequently (between 1 – 3 times); (c.) Somewhat often (four or more times). See Questionnaire, Appendix A, question 20.

<sup>99</sup> Based upon 29 responses to this question, fourteen Respondents answered “Never”, twelve Respondents answered “infrequently (between 1 – 3 times)” and three Respondents answered “somewhat often (four or more times).” A 95% confidence interval is +/- 16.5%.

<sup>100</sup> Responses include: (a.) Never; (b.) Infrequently (between 1 – 3 times); (c.) Somewhat often (four or more times). Questionnaire, Appendix A, question 26.

<sup>101</sup> Based upon 25 responses to this question, seventeen Respondents have been named in an earlier generation of a similar dispute “infrequently (1 – 3 times)” and four have been named in an earlier generation of a similar dispute “relatively often (more than 4 times)”. Only four Respondents have never been named in an earlier generation of a similar dispute. A 95% confidence interval is +/- 18%.

Several possible explanations exist. It is possible that Respondents were unable to change their behavior to avoid the subsequent suit either because both suits derived from the same behavior or because the time frame between the suits was short. If this is the case, Respondents may be unable to respond to the information learned in the earlier generation suit in time to avoid subsequent litigation. Even when the time between multiple suits is relatively long, it is possible that large companies lack the flexibility and nimbleness to assimilate information, make policy changes, or adapt to new procedures in time to avoid follow-on litigation. Finally, it is possible that corporations are in fact changing their behavior to avoid future litigation but frivolous suits are being filed against them anyway. While it seems unlikely that frivolous litigation is so rampant that it would impact 84% of the Respondents, if corporations are in fact making necessary changes in their conduct to avoid future litigation and they are being sued nonetheless in frivolous litigation, deterrence is not working as it should. A change in conduct to avert harm should result in protection from litigation exposure. Each of these explanations suggests that deterrence is not working as theory predicts.<sup>102</sup>

The data fails to confirm the second hypothesis.

### Hypothesis #3

*Corporations who are informed about lawsuits filed against their competitors and who rely upon this information in making their own business decisions will successfully change their conduct to avoid subsequent similar litigation.*

The following questions focus on whether litigation against a competitor induces an actor who has not yet been the target of enforcement to change its conduct to avoid future liability:

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<sup>102</sup> It is possible that deterrence theory is working. Some of the multi-generational litigation involving repeat defendants may involve situations where the cost of prevention is greater than the avoidable cost of litigation. In this scenario, companies will rationally choose to not invest in precautions, knowing that they will have to shoulder the burden of litigation if harm materializes. While this is consistent with deterrence theory, it is hard to believe that this scenario offers an explanation for all of the Respondents who have been repeat defendants in multiple generations of the same or a similar suit.

*Please rate your company's awareness of class actions against your competitors (these are class actions in which you are NOT named as a defendant)<sup>103</sup>*

The response to this question indicates that Respondents believe they are fairly well informed about class actions within their industry. Specifically, 46.9% of Respondents rate their awareness of class actions against competitors as high, 32.7% rate their awareness as moderate, and 20.4% rate their awareness of class actions against competitors as low.<sup>104</sup> From an industry perspective, the companies who rate their awareness as high hail from 19 industries,<sup>105</sup> the companies who rate their awareness as moderate hail from 15 industries,<sup>106</sup> and the companies who rate their awareness as low hail from 9 industries.<sup>107</sup> Interestingly, Respondents within a single industry do not necessarily report the same level of awareness. For example among the four Respondents representing the industry "Utility: Gas and Electric," two reported their awareness as high (7 and 9) and two reported their awareness as low (2 and 3). Similarly, among the three Respondents representing the industry "Food: Consumer Products", one Respondent reported awareness as high (7), one Respondent reported awareness as moderate (6) and one Respondent reported awareness as low (3). Overall, the data suggests that participants in the same

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<sup>103</sup> The response scale ranges from "1 = Almost No Awareness" to "10 = Very Aware." See Questionnaire, Appendix A, question 2.

<sup>104</sup> Based upon 49 responses, 23 Respondents rate their awareness between 7 – 10; 11 Respondents rate their awareness between 4 – 6; and ten Respondents rate their awareness between 1 – 3. A 95% confidence interval is +/-8%.

<sup>105</sup> The Respondents who report the highest awareness of class action litigation against their competitors represent the following industries: education; pharmaceuticals; construction and farm machines; insurance: life and health; insurance: property and casualty; information technology services; telecommunications; food: consumer products; general merchandise; specialty retailer; utility: gas and electric; electronic equipment; automotive retailing and service; food: wholesale; mining, crude oil products; scientific, photographic and control equipment; entertainment; commercial bank; and internet services.

<sup>106</sup> The Respondents who report moderate awareness of class action litigation against their competitors represent the following industries: communication equipment; medical products; construction and farm machines; insurance: life and health; engineering and construction; health care: medical facilities; motor vehicle and parts; food: consumer products; chemicals; pipelines; electronic equipment; aerospace and defense; automotive retailing services; financial data services; and computer services.

<sup>107</sup> The Respondents who report the lowest awareness of class action litigation against their competitors represent the following industries: metals; communication equipment; food: consumer products; industrial machinery; utility: gas and electric; chemicals; electronic equipment; aerospace and defense; automotive retailing services.

industry do not necessarily undertake the same effort to become aware of class action litigation against their competitors.<sup>108</sup>

The Questionnaire also asks:

*Please rate the quality of information (level of detail, reliability, accuracy, etc.) that your company learns about the legal theories and factual assertions in class actions against your competitors.*<sup>109</sup>

The response to this question suggests that many Respondents believe the quality of information they possess about class actions against their competitors is relatively strong. Indeed, 44.7% of Respondents rate the quality of information they possess as high, 46.8% rate the quality of information as moderate, and only 8.5% rate the quality of information as low.<sup>110</sup> From an industry perspective, the Respondents who rate the quality of information they possess as high hail from 18 industries,<sup>111</sup> Respondents who rate the quality of information they possess as moderate hail from 17 industries,<sup>112</sup> and Respondents who rate the quality of information they possess as low

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<sup>108</sup> Of the twelve industries represented by more than one Respondent, eight industries have Respondents who rate their awareness in a different category (high, moderate, or low) than another Respondent from the same industry. These eight industries are: construction and farm machines; communication equipment; food: consumer products; utility: gas and electric; chemicals; electronic equipment; automotive retailing and service; insurance: life and health.

<sup>109</sup> The response scale ranges from “1 = The quality of information is very poor” to “10 = The quality of information is excellent.” See Questionnaire, Appendix A, question 4.

<sup>110</sup> Based upon 47 responses, 21 Respondents rate the quality of information they possess between 7 – 10; 22 Respondents rate the quality of information they possess between 4 – 6; and four Respondents rate the quality of information they possess between 1 – 3. A 95% confidence interval is +/- 8%

<sup>111</sup> The Respondents who report the highest quality of information regarding class action litigation against their competitors represent the following industries: insurance: property and casualty; education; pharmaceuticals; construction and farm machines; insurance: life and health; information technology services; food: consumer products; computer services; entertainment; general merchandise; specialty retailer; utility: gas and electric; pipelines; electronic equipment; food: wholesale; mining, crude oil products; commercial bank; and internet services and retailing.

<sup>112</sup> The Respondents who report moderate quality of information regarding class action litigation against their competitors represent the following industries: metals; communication equipment; medical products; construction and farm machines; insurance: life and health; engineering and construction; health care: medical facilities; motor vehicles and parts; telecommunications; food: consumer products; utility: gas and electric; chemicals; electronic equipment; aerospace and defense; automotive retailing and service; financial data services; and scientific, photographic and control equipment.

hail from 3 industries.<sup>113</sup> Again, Respondents from the same industry do not necessarily rate the quality of information they possess similarly. For example, Respondents representing “Utility: Gas and Electric” rate the quality of information they possess about class actions against their competitors from the very low to the very high (four Respondents rated: 1, 3, 5, 9).<sup>114</sup>

Of course, a company that possesses high quality information about class actions against its competitors will not be deterred from wrongful conduct unless it considers this information in making its own business decisions. Thus, the follow question asks:

*Please rate the **relevance** of the information you acquire about class actions against your competitors **to your company's business decisions**: (emphasis in original)<sup>115</sup>*

Here, 41.7% of Respondents report that information about class actions against competitors is highly relevant to their own business decisions, 25% report that such information is moderately relevant to their own business decisions, and 33.3% report that such information is not very relevant to their own business decisions.<sup>116</sup> Those who report that the information is highly relevant to their own business decisions hail from 16 industries,<sup>117</sup> those who report that the information is moderately relevant hail from 9 industries,<sup>118</sup> and those who report that the

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<sup>113</sup> The Respondents who report the lowest quality of information regarding class action litigation against their competitors represent the following industries: motor vehicles and parts; utility: gas and electric; and aerospace and defense.

<sup>114</sup> Of the 12 industries that are represented by more than one Respondent, five industries include at least one Respondent that rates the quality of information they possess in a different category than another Respondent in that same industry. These five industries are: construction and farm equipment; food: consumer products; utility: gas and electric; electronic equipment; and insurance: life and health.

<sup>115</sup> The response scale ranges from “1 = Not relevant” to “10 = Highly relevant.” See Questionnaire, Appendix A, question 5.

<sup>116</sup> Based upon 48 responses, twenty Respondents rate the relevance of such information between 7 – 10; twelve Respondents rate the relevance of such information between 4 – 6; and sixteen Respondents rate the relevance of such information between 1 – 3. A 95% confidence interval is +/- 8%.

<sup>117</sup> The Respondents who report that information about class actions against competitors is highly relevant to their own business decisions represent the following industries: education; pharmaceuticals; insurance: life and health; information technology services; motor vehicles and parts; food: consumer products; general merchandise; specialty retailer; utility: gas and electric; chemicals; pipelines; electronic equipment; food: wholesale; computer services; entertainment; internet services and retailing.

<sup>118</sup> The Respondents who report that information about class actions against competitors is moderately relevant to their own business decisions represent the following industries: construction and farm machines; insurance: life and

information is of low relevance hail from 13 industries.<sup>119</sup> Moreover, Respondents within a single industry report varying degrees of reliance upon class action information against their competitors in making their own business decisions.<sup>120</sup>

Not surprisingly, there is a relationship between the quality of information possessed and Respondents' willingness to rely on that information. Specifically, Respondents who have high quality information overwhelmingly report that the information is highly relevant to their own business decisions.<sup>121</sup> Overall, 16 Respondents reportedly possess high quality information concerning class actions against their competitors that is also highly relevant to their own decision making, and 33 Respondents reportedly possess low or moderate quality information that is not highly relevant to their own business decisions. If deterrence theory holds water, the 16 Respondents who rely upon high quality information about class actions against their competitors in making their own business decisions should be named in fewer suits than the 33 Respondents who have lower quality information and/or find the information less relevant to business decisions. [For ease of discussion, the 16 Respondents will be referred to as "The Best Practices Group" and the 33 Respondents will be referred to as "The Common Practices Group"]. The following questions probe this hypothesis.

*To your knowledge, has your company ever been named as a defendant in a **First Generation Small-Stakes Class Action**?  
(emphasis in original)*

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health; insurance: property and casualty; health care: medical facilities; food: consumer products; electronic equipment; automotive retailing services; mining, crude oil products; and scientific, photographic and control equipment.<sup>119</sup> The Respondents who report that information about class actions against competitors are of low relevance to their own business decisions represent the following industries: metals; communication equipment; medical products; engineering and construction; motor vehicles and parts; telecommunications; utility: gas and electric; chemicals; electronic equipment; aerospace and defense; automotive retailing and service; financial data services; and commercial banks.

<sup>120</sup> Of the 12 industries with multiple Respondents, six industries have at least one Respondent who rates the relevance of information about class actions against competitors in a different category than another Respondent from the same industry. These industries are: food: consumer products; utility: gas and electric; chemicals; electronic equipment; automotive retailing and service; and insurance: life and health.

<sup>121</sup> Specifically, of the 21 Respondents who report possessing high quality information about class action litigation involving competitors, 16 of them report that such information is highly relevant to their own business decisions, 4 report that such information is moderately relevant to their own business decisions and only 1 reports that such information is of low relevance.

The responses to this question indicate that 35.4% of all Respondents have been named as defendants in a First Generation Action, while 64.6% have not been named in such suits.<sup>122</sup> Among The Best Practices Group of Respondents, 37.5% have been named as defendants in a First Generation Action, and 62.5% have not been named in such an action.<sup>123</sup> Among The Common Practices Group of Respondents, 34.4% have been named in a First Generation Action, and 65.6% have not been named in such an action.<sup>124</sup> Overall, Respondents from 14 industries were named as defendants in First Generation Actions, with 8 industries represented by Respondents in The Best Practices Group<sup>125</sup> and 10 industries represented by Respondents in The Common Practices Group.<sup>126</sup>

The data suggests that The Best Practices Group of Respondents have no advantage in avoiding First Generation Actions, with 62.5% of the Best Practice Group reporting that they have never been named as a defendant in a First Generation Action and 65.6% of the Common Practices Group reporting that they have never been named as a defendant in a First Generation Action.<sup>127</sup> This is not surprising when

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<sup>122</sup> The question called for a “Yes” or “No” response. Based upon 48 responses, seventeen Respondents report that they have been sued in a First Generation action. A 95% confidence interval is +/- 13.5%. Questionnaire, Appendix A, question 13.

<sup>123</sup> Because the number of Respondents who meet defining characteristics of The Best Practices Group is only 16, a 95% confidence interval is +/- 24%. Further study is necessary to narrow the confidence intervals.

<sup>124</sup> Because the number of Respondents who meet defining characteristics of The Common Practices Group is 33, a 95% confidence interval is +/- 16.5%. Further study is necessary to narrow the confidence intervals.

<sup>125</sup> In The Best Practices Group, Respondents from the following industries report having been named in a First Generation action: insurance: life and health; food: consumer products; general merchandise; utility: gas and electric; electronic equipment; food: wholesale; computer services; and entertainment.

<sup>126</sup> In The Common Practices Group, Respondents from the following industries report having been named in a First Generation action: communication equipment; construction and farm equipment; insurance: life and health; insurance: property and casualty; health care: medical facilities; food: consumer products; utility: gas and electric; electronic equipment; automotive retailing and service; and commercial bank.

<sup>127</sup> The Questionnaire also asks:

How frequently does your company tend to be named as a defendant in **First Generation Small-Stakes Class Actions**? (emphasis in original)

Three verbal category responses were: “infrequently (approximately 3 or fewer cases in any 5 year period of time)”; “A moderate number of times (approximately 4-10 cases in any 5 year period of time)”; “Frequently (more

one considers that First Generation Actions involve novel assertions that have not been aired in previous litigation. While The Best Practices Group does a better job learning about previous class actions against their competitors and using that information in making business decisions than The Common Practices Group, this effort is not likely to help them anticipate the novel theories that are the subject of First Generation Actions. One would expect the data to be very different for Second Generation Actions, which are the subject of the following question:

*To your knowledge, has your company ever been named as a defendant in a **Second Generation Small-Stakes Class Action**? (emphasis in original)*

The response to this question indicates that 58.3% of all Respondents have been named in a Second Generation Action.<sup>128</sup> Among The Best Practices Group of Respondents, 56.3% have been sued in a Second Generation Action and 43.8% have not been named in a Second Generation Action.<sup>129</sup> Among The Common Practices Group of Respondents, 59.4% of The Common Practices Group Respondents have been sued in a Second Generation Action and 40.6% have not been named in such an action.<sup>130</sup>

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than 10 cases in any 5 year period of time)". Questionnaire, Appendix A, Question 14.

The data shows that among the Best Practices Group, 5 Respondents (62.5%) answered that they were named as a defendant in a First Generation Action "infrequently", 2 Respondents (25%) answered that they were named as a defendant in a First Generation Action a "moderate number of times" and 1 Respondent (12.5%) answered that it was named as a defendant in a First Generation Action "frequently." In the Common Practices Group, 11 Respondents (78.6%) answered that they were named as a defendant in a First Generation Action "infrequently", 2 Respondents (14.3%) answered that they were named as a defendant in a First Generation Action a "moderate number of times" and 1 Respondent (7.1%) answered that it was named as a defendant in a First Generation Action "frequently." Unfortunately, because the number of Respondents that have been named in First Generation Actions is so small (particularly the Best Practices Group with only 8 Respondents) no statistically significant comparison of frequency can be drawn.

<sup>128</sup> Specifically, 28 Respondents report being sued in a Second Generation Action and 20 Respondents report never being sued in a Second Generation Action. A 95% confidence interval is +/- 13.5%. Questionnaire, Appendix A, question 18.

<sup>129</sup> A 95% confidence interval is +/- 24%.

<sup>130</sup> A 95% confidence interval is +/- 16.5%.

The data raises several interesting points worth noting. The overall percentage of Respondents named in Second Generation Actions is higher than the overall number of Respondents named in First Generation Actions (58.3% compared to 35.4%). This makes sense when we consider that Second Generation Actions benefit from the novel claims that are tested in First Generation Actions. Once a novel claim has been litigated in a First Generation Action, the theory can be copied and litigated repeatedly in Second Generation suits. Thus, the fact that more Respondents report being sued in a Second Generation Action is expected.

A slightly larger percentage of The Best Practices Group (43.8%) has never been named in a Second Generation Action than The Common Practices Group (40.6%). This is precisely the opposite of what the data showed with regard to First Generation Actions, where a slightly smaller percentage of The Best Practices Group (62.5%) has never been named as a defendant in a First Generation Action than The Common Practices Group (65.6%). One possible explanation for this reversal is that deterrence is working more effectively in The Best Practices Group than it is in The Common Practices Group. To the extent that The Best Practices Group is collecting and relying upon high quality information about class action litigation against their competitors, and The Common Practices Group is not, we would expect The Best Practices Group to reduce its likelihood of being sued in a Second Generation Action as compared to The Common Practices Group. The data suggests, however, that the effect of collecting and relying upon high quality information about class actions against competitors is quite modest.<sup>131</sup>

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<sup>131</sup> The Questionnaire also asks:

How frequently does your company tend to be named as a defendant in **Second Generation Small-Stakes Class Actions**? (emphasis in original)

Three verbal category responses were: “infrequently (approximately 3 or fewer cases in any 5 year period of time)”; “A moderate number of times (approximately 4-10 cases in any 5 year period of time)”; “Frequently (more than 10 cases in any 5 year period of time)”. Questionnaire, Appendix A, Question 19.

The data shows that among the Best Practices Group, 6 Respondents (66.7%) answered that they were named as a defendant in a Second Generation Action “infrequently”, 3 Respondents (33.3%) answered that they were named as a defendant in a Second Generation Action a “moderate number of times” and 0

It is possible that the Respondents in The Best Practices Group would have been sued more than the Respondents in The Common Practices Group but for the efforts taken to reduce their exposure to such suits. Since The Best Practices Group was approximately 3% more likely to be sued in a First Generation Action than The Common Practices Group, we might assume that The Best Practices Group of Respondents hail from industries that shoulder greater exposure to class action litigation than The Common Practices Group of Respondents. Using this as a baseline, we might assume that The Best Practices Group should be approximately 3% more likely to be sued in a Second Generation Action than The Common Practices Group. Thus, if 40.6% of Respondents from The Common Practices Group have never been sued in a Second Generation Action, we might predict that only 37.6% of The Best Practices Group would never have been sued in a Second Generation Action but for the efforts taken to reduce exposure. Under these assumptions, the efforts taken by The Best Practices Group resulted in an approximately 6% reduction in exposure from the baseline prediction.

When we focus on Third Generation Actions, however, the data shifts in a surprising manner:

*To your knowledge, has your company ever been named as a defendant in a **Third Generation Small-Stakes Class Action**? (emphasis in original)*

The response to this question indicates that 48.9% of all Respondents have been named as a defendant in a Third Generation action and 51.1% have not been named in such an action.<sup>132</sup> If we isolate The Best Practices Group, 53.3% have been named as a defendant in a Third Generation action, and 46.7% have never been

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answered that they were named as a defendant in a Second Generation Action “frequently.” In the Common Practices Group, 15 Respondents (68.2%) answered that they were named as a defendant in a Second Generation Action “infrequently”, 5 Respondents (22.7%) answered that they were named as a defendant in a Second Generation Action a “moderate number of times” and 2 Respondents (9.1%) answered that they were named as a defendant in a Second Generation Action “frequently.” Unfortunately, because the number of Respondents that have been named in Second Generation Actions is so small (particularly the Best Practices Group with only 9 Respondents) no statistically significant comparison of frequency can be drawn.

<sup>132</sup> Among the 45 responses to the question, 23 have been named in a Third Generation Action and 22 have not been named in such an action. A 95% confidence interval is +/- 14%. Questionnaire, Appendix A, question 24.

named in such an action.<sup>133</sup> Among The Common Practices Group, 46.9% have been named in a Third Generation action, and 53.1% have never been named in such an action.<sup>134</sup>

The data suggests that the overall percentage of Respondents named in Third Generation Actions is lower than the overall percentage of Respondents named in Second Generation Actions (48.9% compared to 58.3%). This is not surprising when we consider that Third Generation Actions benefit from the legal and factual issues that have been resolved in Second Generation suits. At this stage of maturity, the outcome of litigation is more predictable and weak claims are not likely to be filed. Indeed, for precisely this reason we would expect that companies who collect and rely upon high quality information regarding class action litigation against their competitors will avoid being sued in Third Generation Actions more successfully than the Common Practices Group. Yet, the data fails to support this notion. Indeed, the data indicates that 46.7% of the Respondents in The Best Practices Group have never been sued in a Third Generation Action, while a significantly larger percentage (53.1%) of Respondents in the Common Practices Group have never been sued in a Third Generation Action. This is precisely the opposite of the data for Second Generation Actions. To the extent that the data supports a slight deterrent effect in Second Generation Actions, the data fails to support this conclusion in Third Generation Actions.<sup>135</sup>

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<sup>133</sup> Among the 16 Respondents in The Best Practices Group, nine have been sued in a Third Generation Action and seven have not been named in such an action. A 95% confidence interval is +/- 24%.

<sup>134</sup> Among the 33 Respondents in The Common Practices Group, 32 responded to this question. Fifteen Respondents report that they have been sued in a Third Generation Action, and seventeen Respondents report that they have not been sued in a Third Generation Action. A 95% confidence interval is 16.5%.

<sup>135</sup> The Questionnaire also asks:

How frequently does your company tend to be named as a defendant in **Third Generation Small-Stakes Class Actions**? (emphasis in original)

Three verbal category responses were: "infrequently (approximately 3 or fewer cases in any 5 year period of time)"; "A moderate number of times (approximately 4-10 cases in any 5 year period of time)"; "Frequently (more than 10 cases in any 5 year period of time)". Questionnaire, Appendix A, Question 25.

The data shows that among the Best Practices Group, 6 Respondents (66.7%) answered that they were named as a defendant in a Third Generation Action "infrequently", 2 Respondents (22.2%) answered that they were named as a

The data fails to confirm the hypothesis that Corporations who are informed about lawsuits filed against their competitors and who rely upon this information in making their own business decisions will successfully change their conduct to avoid subsequent similar litigation.

Overall, the data collected in this study supports the notion that a relationship exists between litigation maturity and deterrence. Corporations report that it is easier to anticipate a risk of future liability when there is a well-developed record of the factual and legal issues from previous litigation than when there is no track record from previous litigation. In light of this finding, however, it is somewhat surprising that over three quarters of the Respondents have been sued in multiple generations of the same or a similar suit. Equally surprising is the finding that corporations armed with high quality information about previous litigation against their competitors are virtually no more successful in avoiding subsequent litigation than corporations who lack this information. The following section draws upon these conclusions to analyze relevant policy implications.

#### IV. Policy Implications

This paper offers new evidence to answer the primary question that has swirled around negative value class actions for decades: when, if ever, does the social utility derived from these actions outweigh “the limited benefits to individuals, the aroma of gross profiteering, and the transactional costs to the court.”<sup>136</sup> The answer to this question hinges on deterrence. When wrongful conduct is deterred, there is no need for litigation, no transactional costs imposed on the courts and no attorney’s fees to create an “aroma of gross profiteering.”<sup>137</sup> It is only when wrongful conduct is not deterred that these costs arise.

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defendant in a Third Generation Action a “moderate number of times” and 1 Respondent (11.1%) answered that it was named as a defendant in a Third Generation Action “frequently.” In the Common Practices Group, 10 Respondents (58.8%) answered that they were named as a defendant in a Third Generation Action “infrequently”, 6 Respondents (35.3%) answered that they were named as a defendant in a Third Generation Action a “moderate number of times” and 1 Respondent (5.9%) answered that it was named as a defendant in a Third Generation Action “frequently.” Unfortunately, because the number of Respondents that have been named in Third Generation Actions is so small (particularly the Best Practices Group with only 9 Respondents) no statistically significant comparison of frequency can be drawn.

<sup>136</sup> John P. Frank, Whither Rule 23: Memorandum to the Honorable Patrick E. Higginbothom (Apr. 28, 1995)(on file with the Advisory Committee).

<sup>137</sup> *Id.*

The data presented in this paper suggests that negative value class actions have not been as effective at deterring wrongful conduct as theory predicts them to be. Before we conclude that these actions are ineffective deterrents, however, we must consider whether corporations are partly to blame for the disappointing deterrence statistics. Indeed, with 84% of Respondents reporting that they have been named as a defendant in multiple generations of the same (or a similar) dispute and a majority of Respondents reporting that they do not collect high quality information about class actions against their competitors and/or consider such information when making their own business decisions, it is impossible to conclude that these corporations are investing their best efforts to avoid liability. While this data indicates there is room for improvement, the data also indicates that corporations who take extra effort to collect and rely upon quality information about class actions against their competitors are sued at approximately the same rate as those who do not. These mixed results suggest that much work needs to be done to determine the types of information that will best enable corporations to avoid future liability and to encourage corporations to make these efforts. To the extent that the data presented in this study brings attention to areas of weakness and highlights action that may be taken to address these weaknesses, everyone wins. Corporations do not want to be sued in negative value class actions any more than society wants to bear the expense associated with them. If this study motivates corporations to take efforts to improve deterrence, the study will have accomplished a great deal.

Even with increased efforts, however, it is likely that some informational deficiencies will persist and actual deterrence will remain less than predicted deterrence. Thus, we return to the basic question: does the social utility of negative value class actions exceed their cost? Social utility is maximized when deterrence is increased and litigation is decreased. As long as an opportunity for class action treatment exists, the threat of liability from a negative value class action will encourage some level of deterrence. When wrongful conduct is deterred, litigation is unnecessary and the associated costs are not incurred. When wrongful conduct is not deterred, however, we must consider if the value derived from litigating a class of small value claims justifies the associated costs. To the extent that Rule 23 seeks to respond to “the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights,”<sup>138</sup> negative value class actions are intended to serve a valuable social purpose. Indeed, when claimants have a desire to adjudicate their claims, negative value class actions enable claimants to enforce their

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<sup>138</sup> *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 617 (1997)(discussing the policy underlying negative value class actions).

legal rights.<sup>139</sup> Few would contest that negative value class actions confer social utility under these circumstances. When claimants lack the desire to adjudicate their claims, however, negative value class actions create needless litigation and confer little, if any, social value.<sup>140</sup> Indeed, it is only when a reasonable proportion of the proposed class – something that represents more than a handful or smattering -- has a desire to prosecute their claims, that we can be sure a negative value class action is serving the social function that was intended at the time the modern class action rule was adopted. Thus, the next big question surrounding negative value class actions should be: how can a certifying court determine if a reasonable proportion of a proposed class has a desire to adjudicate? This question reaches beyond the subject of this paper, but sets the stage for future research.

### Conclusion

This paper presents compelling evidence to answer the question that has plagued negative value class actions for nearly half a century: when, if ever, does the social utility of these actions outweigh their cost? The empirical study that is the subject of this paper focuses on the relationship between litigation maturity and deterrence by testing three inter-related hypotheses: (1) future liability is easier to anticipate when there is a well-developed record of the factual and legal issues from previous litigation than when there is no track record from previous litigation; (2) corporations who have been held liable for particular conduct will successfully change their conduct to avoid future litigation regarding similar conduct; (3) corporations who are informed about lawsuits filed against their competitors, and who rely upon this information in making their own business decisions, will successfully change their conduct to avoid subsequent similar litigation. The new data suggests that although there is a relationship between litigation maturity and deterrence, corporations are not successfully protecting themselves from future litigation by relying upon information learned from earlier suits.

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<sup>139</sup> For example, a \$5,000 loss may be too small to justify the expense of individual litigation but most claimants would be motivated to pursue a recovery if they could join in a class.

<sup>140</sup> A class action lawyer's incentive may not always coincide with the desires of potential class members. Taking an extreme example, most claimants would be ambivalent about pursuing litigation for a loss of ten cents. Yet, if enough claimants have similar claims, the aggregate loss may create an incentive for a lawyer to file a class action. If such a class is certified, the social benefit (pennies recovered by each class member) will be far outweighed by the transactional costs imposed on the courts and the appearance of profiteering by the class action attorney.



**APPENDIX A****Small-Stakes Class Action Survey****I. Introduction**

The goal of this study is to refine our understanding of the relationship between small-stakes class action litigation and the prevention of injury.

**II. Definitions**

For purposes of this survey, please apply the following definitions in answering the questions:

**“Small-Stakes Class Actions”** join together claims that cannot be economically litigated on an individual basis because each claim for relief is insufficient to cover the costs of litigation. Individual claims may seek damages ranging from a few pennies to several thousand dollars. Once joined together into a class, these claims become viable because the cost of litigation is spread among a large group of class members.

**“First Generation Small-Stakes Class Actions”** are small-stakes class actions that involve novel legal theories and/or unproven factual scenarios.

**“Second Generation Small-Stakes Class Actions”** are small-stakes class actions that involve legal theories and factual scenarios that have been previously argued in other cases but have not been definitively resolved. Thus while the case theories are not novel, ambiguity exists regarding the interpretation of important legal questions and/or the existence of evidentiary support for factual allegations.

**“Third Generation Small-Stakes Class Actions”** are small-stakes class actions that involve legal theories and factual scenarios that have been the subject of earlier class actions and enjoy fairly well developed legal and factual support from previous litigation. While some level of ambiguity persists, third generation class actions enjoy the most robust information from which to predict the likely outcome of a suit.

**\*\*Please note:** The following questions do not ask you to categorize specific class actions into one of these categories. Rather, the questions seek general impressions regarding your experience with class actions at various stages of maturity. The questions ask you to gauge the maturity of class actions in which you have been involved according to **your own knowledge and impressions**. It is NOT necessary to conduct research to supplement your knowledge of earlier generations of class actions to respond to these questions.

**“You”** refers to the entity or corporation on whose behalf you are responding.

**III. Completed Surveys**

Please return all survey responses to:

Professor Linda Simard  
Suffolk University Law School  
120 Tremont St.  
Boston, MA 02108-4977

**IV. Questions**

1. Please state your company's industry:

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2. Please rate your company's awareness of class actions against your competitors (these are class actions in which you are NOT named as a defendant):

---

1      2      3      4      5      6      7      8      9      10

1= Almost No Awareness (We generally don't learn about class actions against our competitors)

10 = Very Aware (We learn about all class actions against our competitors very soon after they are filed)

Comment: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

3. Does your company have a system in place to learn about class actions against your competitors? (i.e. a formal or informal network of general counsels, a trade organization, etc)

Yes

No

Comment:(please describe the system)  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

4. Please rate the quality of information (level of detail, reliability, accuracy, etc.) that your company learns about the legal theories and factual assertions in class actions against your competitors:

---

1    2    3    4    5    6    7    8    9    10

1 = The quality of information is very poor.

10 = The quality of information is excellent.

Comment: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

5. Please rate the **relevance** of the information you acquire about class actions against your competitors **to your company's business decisions**:

---

1    2    3    4    5    6    7    8    9    10

1 = Not relevant

10 = Highly relevant

Comment: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

6. Please rate the effectiveness of small-stakes class actions in regulating your competitors' conduct (for example, do small-stakes class actions deter your competitors from breaking legal rules to gain a competitive advantage?):

---

1    2    3    4    5    6    7    8    9    10

1 = Small-stakes class actions have not been effective in regulating our competitors' conduct.

10 = Small-stakes class actions have been very effective in regulating our competitors' conduct.

Comment: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

7. To your knowledge, has your company ever been named as a defendant in a small-stakes class action filed in a state or federal court in the United States that **includes foreign citizens (non U.S. citizens) as class members**?

- a. No (please go on to question 9)
- b. Yes

8. How frequently does your company tend to be named as a defendant in small-stakes class actions filed in state or federal court in the United States that **include foreign citizens as class members**?

- a. **Almost never** (approximately 0- 1 case in any 5 year period of time)
- b. **Infrequently** (approximately 2-3 cases in any 5 year period of time)
- c. **A moderate number of times** (approximately 4-10 cases in any 5 year period of time)
- d. **Frequently** (more than 10 cases in any 5 year period of time)

9. To your knowledge, has your company ever been named as a defendant in a small-stakes judicial action filed in a court outside of the United States (i.e. an action involving a large number of people alleging small-stakes injuries)?

- a. No
- b. Yes.

If yes, please rate your impressions of the process offered in these forums (efficiency, opportunity to present your case, outcome, availability of appellate review, etc)

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1    2    3    4    5    6    7    8    9    10

1 = Quality of the process was poor

10 = Quality of the process was excellent

Comments: (please identify the countries where the proceedings occurred)

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10. To your knowledge, has your company ever been the subject of a **non judicial** legal proceeding outside of the United States to redress a large scale, small-stakes dispute (ie. an administrative or regulatory proceeding)?

- a. No
- b. Yes

If yes, please rate your impressions of the process offered in these forums (efficiency, opportunity to present your case, outcome, availability of review or reconsideration, etc.)

---

1    2    3    4    5    6    7    8    9    10

1 = Quality of the process was poor

10 = Quality of the process was excellent

Comments: (please identify the countries where the proceedings occurred)

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11. To your knowledge, has your company ever been the subject of a legal proceeding outside of the United States (judicial or non judicial) **regarding a dispute that had previously been the subject of a class action suit in the United States?**

- a. No
- b. Yes

If yes, did the foreign forum recognize the US class action judgment and accord it preclusive effect?

- a. No
- b. Yes

12. Do you believe that your foreign competitors have a competitive advantage over your company because they are less likely to be named as defendants in small-stakes class actions filed in state or federal courts in the United States?

- a. No
- b. Yes

13. To your knowledge, has your company ever been named as a defendant in a **First Generation Small-Stakes Class Action**?

- a. No (please go on to question 18)
- b. Yes

14. How frequently does your company tend to be named as a defendant in **First Generation Small-Stakes Class Actions**?

- a. **Infrequently** (approximately 3 or fewer cases in any 5 year period of time)
- b. **A moderate number of times** (approximately 4-10 cases in any 5 year period of time)
- c. **Frequently** (more than 10 cases in any 5 year period of time)

15. With regard to the occasions when your company has been named as a defendant in a **First Generation Small-Stakes Class Action**, please rate your ability to anticipate the legal and factual claims at the time of the event or business decision that later became the subject of the class action suit:

---

1      2      3      4      5      6      7      8      9      10

1= We generally have not anticipated the legal and/or factual claims of First Generation Small-Stakes Class Actions.

10 = We generally have anticipated the legal and factual claims of First Generation Small-Stakes Class Actions.

Comments: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

16. With regard to the occasions when your company has been named as a defendant in a **First Generation Small-Stakes Class Action**, please rate your ability to estimate the plaintiffs' likelihood of success on the merits at the time of the event or business decision that later became the subject of the suit:

---

1    2    3    4    5    6    7    8    9    10

1 = We have not been able to accurately estimate the plaintiffs' likelihood of success in First Generation Small-Stakes Class Actions.

10 = We have been able to accurately estimate the plaintiffs' likelihood of success in First Generation Small-Stakes Class Actions.

Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

17. With regard to the occasions when your company has been named as a defendant in a **First Generation Small-Stakes Class Action**, please rate your ability to estimate the magnitude of the potential liability at the time of the event or business decision that later became the subject of the suit:

---

1    2    3    4    5    6    7    8    9    10

1 = We have not been able to accurately estimate the magnitude of the potential liability at the time of the underlying event or decision.

10 = We have been able to accurately estimate the magnitude of the potential liability at the time of the underlying event or decision.

Comment: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

18. To your knowledge, has your company ever been named as a defendant in a **Second Generation Small-Stakes Class Action**?

- a. No (please go on to question 24)
- b. Yes

19. How frequently does your company tend to be named as a defendant in **Second Generation Small-Stakes Class Actions**?

- a. **Infrequently** (approximately 3 or fewer cases in any 5 year period of time)
- b. **A moderate number of times** (approximately 4-10 cases in any 5 year period of time)
- c. **Frequently** (more than 10 cases in any 5 year period of time)

20. When your company has been named as a defendant in a **Second Generation Small-Stakes Class Action**, approximately how often has the company been named as a defendant in the earlier generation of a similar dispute?

- a. **Never**
- b. **Infrequently (between 1-3 times)**
- c. **Somewhat often (four or more times)**

21. With regard to the occasions when your company has been named as a defendant in a **Second Generation Small-Stakes Class Action**, please rate your ability to anticipate the legal and factual claims at the time of the event or business decision that later became the subject of the suit:

---

1    2    3    4    5    6    7    8    9    10

1 = We generally have not anticipated the legal and/or factual claims of Second Generation Small-Stakes Class Actions.

10 = We generally have anticipated the legal and factual claims of Second Generation Small-Stakes Class Actions.

22. With regard to the occasions when your company has been named as a defendant in a **Second Generation Small-Stakes Class Action**, please rate your ability to estimate the plaintiffs' likelihood of success at the time of the underlying event or decision that later became the subject of the suit:

---

1    2    3    4    5    6    7    8    9    10

1 = We have not been able to accurately estimate the plaintiffs' likelihood of success in Second Generation Small-Stakes Class Actions.

10 = We have been able to accurately estimate the plaintiffs' likelihood of success in Second Generation Small-Stakes Class Actions.

Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

23. With regard to the occasions when your company has been named as a defendant in a **Second Generation Small-Stakes Class Action**, please rate your ability to estimate the magnitude of the potential liability to the class at the time of the underlying event or decision that later became the subject of the suit:

---

1    2    3    4    5    6    7    8    9    10

1 = We have not been able to accurately estimate the magnitude of the potential liability at the time of the underlying event or decision.

10 = We have been able to accurately estimate the magnitude of the potential liability at the time of the underlying event or decision.

Comment: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

24. To your knowledge, has your company ever been named as a defendant in a **Third Generation Small-Stakes Class Action**?

- a. No (please go on to question 30)
- b. Yes

25. How frequently does your company tend to be named as a defendant in **Third Generation Small-Stakes Class Actions**?
- a. **Infrequently** (approximately 3 or fewer cases in any 5 year period of time)
  - b. **A moderate number of times** (approximately 4-10 cases in any 5 year period of time)
  - c. **Frequently** (more than 10 cases in any 5 year period of time)

26. When your company has been named as a defendant in a **Third Generation Small-Stakes Class Action**, approximately how often has the company been named as a defendant in an earlier generation of a similar dispute?

- a. **Never**
- b. **Infrequently (between 1 and 3 times)**
- c. **Relatively often (more than 4 times)**

27. With regard to the occasions when your company has been named as a defendant in a **Third Generation Small-Stakes Class Action**, please rate your ability to anticipate the legal and factual claims at the time of the underlying event or decision that later became the subject of the suit:

---

1      2      3      4      5      6      7      8      9      10

1= We generally have not anticipated the legal and/or factual claims of Third Generation Small-Stakes Class Actions.

10 = We generally have anticipated the legal and factual claims of Third Generation Small-Stakes Class Actions.

Comments: \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

28. With regard to the occasions when your company has been named as a defendant in a **Third Generation Small-Stakes Class Action**, please rate your ability to estimate the plaintiffs' likelihood of success at the time of the underlying event or decision that later became the subject of the suit:

---

1    2    3    4    5    6    7    8    9    10

1 = We have not been able to accurately estimate the plaintiffs' likelihood of success in Third Generation Small-Stakes Class Action.

10 = We have been able to accurately estimate the plaintiffs' likelihood of success in Third Generation Small-Stakes Class Action.

Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

29. With regard to the occasions when your company has been named as a defendant in a **Third Generation Small-Stakes Class Action**, please rate your ability to estimate the magnitude of the potential liability at the time of the underlying event or decision that later became the subject of the suit:

---

1    2    3    4    5    6    7    8    9    10

1 = We have not been able to accurately estimate the magnitude of the potential liability at the time of the underlying event or decision.

10 = We have been able to accurately estimate the magnitude of the potential liability at the time of the underlying event or decision.

Comment: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

30. Please identify the factors that your company uses to determine whether to invest in precautions that may reduce the likelihood of a class action suit:

(circle all that apply)

- a. Cost benefit analysis (invest in precautions when the cost of precaution < the expected loss from a class action lawsuit)

- b. Customer relations (invest in precautions to maintain good customer relations, even when the cost of the precaution exceeds the expected loss from a class action suit)
- c. Publicity (invest in precautions to avoid bad publicity, even when the cost of the precaution exceeds the expected loss from a class action suit)
- d. Other (please describe below)

Comment: \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

31. Based upon your experience, please rate the quality of the procedures applied in small-stakes class action litigation in the United States (ie. efficiency, opportunity to present your case, outcome, availability of review or reconsideration, etc.):

---

1      2      3      4      5      6      7      8      9      10

1 = Quality of the process is poor

10 = Quality of the process is excellent

32. Please indicate if someone from your company would be willing to participate in a follow up interview via telephone?

- a. No
- b. Yes (Please provide the name and contact information below)

\_\_\_\_\_  
 \_\_\_\_\_

Please feel free to include any additional comments (in the space below, on the back of this page, or on a separate sheet):

Thank you for your time in responding to these questions.

Please return all completed surveys to:

Professor Linda Simard  
 Suffolk University Law School  
 120 Tremont St.  
 Boston, MA 02108-4977

**APPENDIX B**

October 24, 2011

Dear \_\_\_\_\_:

I am writing to solicit 10-15 minutes of your time for a research project concerning so-called "small-stakes class actions." The phrase "small-stakes class action" refers to a class action that joins together claims that cannot be economically litigated on an individual basis because each claim for relief is insufficient to cover the costs of litigation. When joined together into a class, these claims become viable because the cost of litigation is spread among a large group of class members. Notwithstanding the name "small-stakes class action," these suits are anything but "small-stakes" to the defendants who are threatened with massive liability.

Academic theory suggests that small-stakes class actions serve important societal goals.<sup>1</sup> Yet, very little empirical evidence exists to support or refute the academic theory. This study provides you with an opportunity to provide valuable empirical evidence regarding the role small-stakes class actions play in corporate decision making. The goal of this study is to refine our understanding of the relationship between small-stakes class actions and the prevention of injury.

In exchange for your participation in the study, you will be provided with the survey results and study conclusions. The survey is being sent to all Fortune 500 companies and a high response rate will offer significant insights and valuable information regarding small-stakes class action litigation from the defense perspective. In an effort to reduce the perceived risk associated with participation in the study, all information collected from the study will maintain the anonymity of the participants in the study. Specifically, all survey responses will be kept strictly confidential; results, calculations, and conclusions will be communicated without attribution to any participant in the study (including information released to study participants); and no individual company or counsel will be identified as a participant in the study. Survey responses will be used to develop one or more scholarly papers discussing the results of the study.

---

<sup>1</sup> Specifically, small-stakes class actions are intended to: (1) minimize injury costs through prevention (deterrence) and (2) compensate for injuries that are not prevented. Most class members receive relatively small compensation from small-stakes class actions, making the deterrence function the primary rationale for these suits.

I have enclosed a brief personal biography to provide you with information regarding my scholarly background. Please do not hesitate to contact me with any questions or comments.

Thank you for your contribution to the success of this study.

Sincerely,

Linda Sandstrom Simard

**APPENDIX C:**

February 16, 2012

Dear (name):

Several months ago, I requested your participation in an empirical study on class action litigation. Specifically, the study focuses on “negative value” or “small-stakes” class actions involving class members who allege very small losses. These class actions involve individual claims that are too small to justify individual suit because the cost of litigation exceeds the potential recovery for any individual class member. Thus, class certification under these circumstances allows litigation that otherwise would not be viable. This study seeks to determine when, if ever, these class actions make sense. The study promises to make a significant contribution to the ongoing debate by collecting empirical, anonymous, evidence from corporate decision makers who will provide a perspective that has been noticeably absent from academic literature on the subject.

To date, a number of your colleagues at other Fortune 500 companies have participated in the study. In order to generate credible results, however, I need your participation. I assure you that all information collected from the study will maintain the anonymity of the participants in the study. All survey responses will be kept strictly confidential; results, calculations and conclusions will be communicated without attribution to any participant in the study; and no individual company or counsel will be identified as a participant in the study. In exchange for your participation, I will provide you with access to the study results and conclusions, without attribution or identification of participants. Survey responses will be used to develop one or more scholarly papers for publication.

Thank you for your contribution to the success of this study. Please do not hesitate to contact me with any questions or comments.

Sincerely,

Linda Sandstrom Simard