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Aggregation by Acquisition: Replacing Class Actions With a Market for Legal Claims

Minor Myers
Brooklyn Law School, minor.myers@brooklaw.edu

C. Korsmo

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Aggregation by Acquisition: Replacing Class Actions with a Market for Legal Claims

Charles R. Korsmo & Minor Myers***

ABSTRACT: The traditional class action is broken, and we propose to replace it with a new mechanism for structuring mass claims: aggregation by acquisition. We argue that legal causes of action should be freely alienable, such that even small claims could be bought and sold. In such a world, financiers could purchase claims (or shares of claims) directly from individual claim holders, assembling a mass of claims that may be negative-value if litigated individually but positive-value when litigated together. Aggregation in this way would solve the same collective action problems as class actions and derivative actions, but without generating the serious pathologies that plague those procedural devices.

Our proposal may sound like a fanciful thought experiment, but in fact it is already at work in one small corner of corporate litigation: stockholder appraisal. We present the example of appraisal here—where claims effectively trade with shares of stock and where litigation appears strongly meritorious—as a microcosm of how aggregate litigation would work under our proposal. As we explain in this Article, our proposal would improve the deterrent effect of private litigation, would deliver faster and more concrete relief to injured persons, and would minimize the volume of nuisance litigation. While

* Associate Professor, Case Western Reserve University School of Law.

** Professor, Brooklyn Law School.

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aggregation by acquisition may hold promise across a broad swath of substantive law, it could most easily be put into practice in corporate and securities litigation. We outline the reforms necessary for doing so. Extending our proposal to other spheres of litigation would be more complex, raising many serious but potentially surmountable obstacles.

I. INTRODUCTION

The class action—the principal mechanism in our civil justice system for dealing with mass claims—is a brilliant but fundamentally flawed procedural device. When a large number of people have suffered an injury arising out of a common set of facts, many or all of the individual victims may have suffered harms that are small in relation to the cost of bringing a lawsuit. In the face of collective action problems, the injured parties may go uncompensated and—perhaps more problematically—private litigation can provide little deterrence against conduct that generates substantial aggregate harm. Scenarios abound where collective action problems threaten to paralyze litigation, ranging from mass tort actions involving toxic exposures to products liability actions to consumer antitrust actions to stockholder suits.

To solve this problem, American law currently relies on procedure. The primary procedural mechanisms are the class action and, for certain types of stockholder suit, the derivative action.[1] In such actions, an individual plaintiff

1. As discussed below, the derivative action device is an attempt to solve a somewhat different problem than the class action. In a derivative action, a stockholder in a corporation seeks to remedy an injury that is suffered, in the first instance, by the corporation. In theory, there should already exist a mechanism—the corporation itself—for overcoming the collective action problems that would otherwise plague dispersed shareholders. What the derivative action mechanism seeks to address is not so much a collective action problem as an especially acute agency problem as a result of the conflict of interest that arises when the alleged wrongdoers are the directors and officers who control the corporation. Despite these somewhat different purposes, derivative actions and class actions have sufficient similarities to be taken together for most of the purposes of this Article.

with claims that are ostensibly "typical" of the larger group seeks to bring an action on behalf of the entire group. Absent parties are bound by the resolution of the claim unless, where possible, they affirmatively opt out.[2] In theory, this individual plaintiff can represent the aggregate group unhampered by collective action problems. Although the class action has in recent years been in reputed decline,[3] it is still regarded as one of the most important innovations of modern civil procedure.[4]

In practice, however, entrepreneurial plaintiffs' attorneys in pursuit of a contingency fee are almost always the key players in aggregate litigation. The plaintiffs' attorneys typically identify and seek out a representative plaintiff, rather than the other way around. Virtually all of the key decisions—including the decision to bring a suit, the litigation strategy, and the decision to settle—are made, for all practical purposes, by the attorneys and not by the putative client. The plaintiffs' attorney will almost always have a vastly greater economic stake in the outcome of the litigation than any individual plaintiff, and will often have incentives that diverge sharply from those of the class. The tragedy of the class action is that the very same collective action problems that gave rise to the device in the first place also doom any effort to monitor the performance of the attorney acting on behalf of the class. Other players in the litigation—namely, the defendants and the court—have incentives that do not align with the interests of the class. The net result is that procedural methods of aggregation solve the collective action problems, but at the cost of generating a pervasive agency problem in their stead.

In this Article, we propose an alternative, market form of aggregation of dispersed claims—aggregation by acquisition. At least in most circumstances, we would do away with court-supervised procedural aggregation of claims and with binding results for all class members. Instead, our proposal envisions that legal claims be made freely alienable. Financiers could purchase claims (or shares of claims) directly from individual claim holders, assembling a mass of claims that may be negative-value if litigated individually but positive-value when litigated together. Such aggregation would solve the same collective

2. Opt-out class actions are very rare in corporate litigation, for example. *See, e.g.*, Transcript of Oral Argument on Class Certification at 14, Lee v. Pincus, No. 8458-CB (Del. Ch. Argued Nov. 20, 2015) ("[O]verwhelmingly cases in this Court are certified under (b)(1) and (b)(2).").

3. *See, e.g.*, Robert H. Klonoff, *The Decline of Class Actions*, 90 WASH. U. L. REV. 729 (2013) (discussing recent efforts by courts to curb the number of class actions and arguing a return to a more balanced approach to encourage class actions as a monitoring device); Georgene Vairo, *Is the Class Action Really Dead? Is That Good or Bad for Class Members?*, 64 EMORY L.J. 477 (2014) (discussing the decline of class actions as a result of court-imposed stringent certification requirements).

4. William T. Allen, *Commentary on the Limits of Compensation and Deterrence in Legal Remedies*, 60 LAW & CONTEMP. PROBS. 67, 73 (1997) ("[T]he class action is the preeminent innovation allowing the compensatory goal to serve the deterrent function more effectively."); Stephen Berry, *Ending Substance's Indenture to Procedure: The Imperative for Comprehensive Revision of the Class Damage Action*, 80 COLUM. L. REV. 299, 299 (1980) (noting that the class damage action has been "hailed by some as the most important procedural innovation of this century").

action problems as the class and derivative action mechanisms but would do so without generating the serious agency problem that arises in the class action. The financier would actually own the claims and would possess both the concentrated economic stake and sophistication to supervise whatever attorney is ultimately hired.[5]

A market for legal claims already exists, albeit one that is highly constrained and imperfect. Holders of legal claims can currently "sell" their claim in only two ways. First, they can sell it to defendants, via a settlement. The obvious downside that there is only one potential "buyer."[6] Second, the holder of a legal claim may sell a portion of it to a plaintiffs' attorney in the form of a contingency fee.[7] Again, though, this market is highly constrained in the identity of the potential buyer (plaintiffs' attorneys only), the amount of the claim that may be sold (typically not more than one-third), and in the type of consideration the buyer may provide (payment in kind in the form of legal services).[8]

A broader market would allow for greater competition and specialization in ways that should ultimately benefit injured parties. In fact, a nascent market for legal claims has begun to develop over the past two decades, in the form of the litigation finance industry. While still relatively small in scale and constrained in scope, litigation finance has become a focus of sustained scholarly attention.[9] As presently practiced, litigation financing generally

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5. Our proposal is related in many ways to Jonathan Macey and Geoffrey Miller's pioneering proposal to auction mass claims. *See* Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 105–16 (1991). For the distinct advantages of our proposal relative to an auction, see *infra* Part IV.E.

6. *See, e.g.*, Geoffrey P. Miller, Commentary, *On the Costs of Civil Justice*, 80 TEX. L. REV. 2115, 2115 (2002) ("A lawsuit is essentially a sale. The defendant buys a valuable asset from the plaintiff, in the form of a release of claims if the case is settled, or a verdict with *res judicata* effect if the case goes to a verdict."); Jonathan T. Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L.J. 65, 72 (2010) ("A lawsuit represents an asset for the plaintiff and a liability for the defendant, and in this respect, litigation settlements resemble other market transactions. But unlike the efficient markets that we routinely rely on to price all sorts of assets and liabilities accurately, the market for litigation claims is uniquely limited to just two participants. The plaintiff can sell only to the defendant and the defendant can deal only with the plaintiff." (footnotes omitted)); William B. Rubenstein, *A Transactional Model of Adjudication*, 89 GEO. L.J. 371, 372 (2001) ("In complex class actions, defendants purchase a commodity—finality. They buy from the plaintiffs' representative the plaintiffs' rights to sue.").

7. *See infra* Part III.B.

8. *See infra* Part III.B. In a recent paper, Baker explored the potential of expanded claim alienability in the context of mass tort claims. *See generally* Lynn A. Baker, *Alienability of Mass Tort Claims*, 63 DEPAUL L. REV. 265 (2014). Her focus was on the alienation of claims to attorneys—selling 100% of the claim instead of the more conventional 40% through a contingency fee. *Id.* at 275. She concluded that "there are no compelling normative or economic reasons to prohibit the sale of mass tort personal injury claims to attorneys" and suggested that this reasoning could be extended to "the sale of any type of claim to any interested purchaser or investor." *Id.* at 303.

9. Notable contributions to this literature include: Elizabeth Chamblee Burch, *Financiers as Monitors in Aggregate Litigation*, 87 N.Y.U. L. REV. 1273 (2012); Terrence Cain, *Third Party*

involves a stranger to a claim funding litigation in exchange for a stake in the proceeds, generally structured like a contingency fee. Litigation finance, however, holds out little promise for aggregate claims because their current procedural structure means that only attorneys have control.[10] There is thus no reason to believe that litigation finance will do anything to align the interests of plaintiffs' attorneys with class members. Indeed, the financier's incentives will themselves diverge from the interests of class members. Thus, rather than ameliorating the agency problem between plaintiffs and their attorneys,[11] litigation finance as currently practiced layers a new agency problem on top of the old one.

Funding of Personal Injury Tort Claims: Keep the Baby and Change the Bathwater, 89 CHI.-KENT L. REV. 11 (2014); John C. Coffee, Jr., *Litigation Governance: Taking Accountability Seriously*, 110 COLUM. L. REV. 288 (2010); Wendy Gerwick Couture, *Securities Regulation of Alternative Litigation Finance*, 42 SEC. REG. L.J. 5 (2014); Nora Freeman Engstrom, *Lawyer Lending: Costs and Consequences*, 63 DEPAUL L. REV. 377 (2014); Nora Freeman Engstrom, *Re-Re-Financing Civil Litigation: How Lawyer Lending Might Remake the American Litigation Landscape, Again*, 61 UCLA L. REV. DISCOURSE 110 (2013); Bert I. Huang, *Litigation Finance: What Do Judges Need to Know?*, 45 COLUM. J.L. & SOC. PROBS. 525 (2012); Keith N. Hylton, *The Economics of Third-Party Financed Litigation*, 8 J.L. ECON. & POL'Y 701 (2012); Jasminka Kalajdzic et al., *Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding*, 61 AM. J. COMP. L. 93 (2013); Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367 (2009); Molot, *supra* note 6; Cassandra Burke Robertson, *The Impact of Third-Party Financing on Transnational Litigation*, 44 CASE W. RES. J. INT'L L. 159 (2011); Anthony J. Sebok, *Betting on Tort Suits After the Event: From Champerty to Insurance*, 60 DEPAUL L. REV. 453 (2011); Anthony J. Sebok, *Should the Law Preserve Party Control? Litigation Investment, Insurance Law, and Double Standards*, 56 WM. & MARY L. REV. 833 (2015) [hereinafter Sebok, *Should the Law Preserve Party Control?*]; Anthony J. Sebok & W. Bradley Wendel, *Duty in the Litigation-Investment Agreement: The Choice Between Tort and Contract Norms When the Deal Breaks Down*, 66 VAND. L. REV. 1831 (2013); Maya Steinitz, *How Much Is That Lawsuit in the Window? Pricing Legal Claims*, 66 VAND. L. REV. 1889 (2013) [hereinafter Steinitz, *How Much Is That Lawsuit in the Window?*]; Maya Steinitz, *The Litigation Finance Contract*, 54 WM. & MARY L. REV. 455 (2012) [hereinafter Steinitz, *The Litigation Finance Contract*]; Maya Steinitz, *Whose Claim Is This Anyway? Third Party Litigation Funding*, 95 MINN. L. REV. 1268 (2011) [hereinafter Steinitz, *Whose Claim Is This Anyway?*]; Maya Steinitz & Abigail C. Field, *A Model Litigation Finance Contract*, 99 IOWA L. REV. 711 (2014); W. Bradley Wendel, *A Legal Ethics Perspective on Alternative Litigation Financing*, 55 CANADIAN. BUS. L.J. 133 (2014); Stephen C. Yeazell, *Re-Financing Civil Litigation*, 51 DEPAUL L. REV. 183 (2001); and Mariel Rodak, Comment, *It's About Time: A Systems Thinking Analysis of the Litigation Finance Industry and Its Effect on Settlement*, 155 U. PA. L. REV. 503 (2006).

10. *See infra* Part III.D.

11. As discussed below, it has been suggested that litigation financiers can at least partially address the agency problem between plaintiffs and plaintiffs' attorneys by serving as more effective monitors of the attorneys. *See generally* Burch, *supra* note 9 (suggesting alternative litigation financing as a tool to monitor attorneys representing plaintiffs in a mass litigation). This argument parallels the thinking of the "lead plaintiff" provisions of the PSLRA. *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104–67, § 101(a)–(b), 109 Stat. 737, 738–40, 743–45 (codified as amended at 15 U.S.C. §§ 77z-1, 78u-4 (2012)). *See generally* Elliot J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2053 (1995). As discussed more fully below, we expect that financiers will not perform much better as monitors than lead plaintiffs have under the PSLRA. *See infra* Part II.C.

Full acquisition of legal claims, as we propose here, removes the representative plaintiff and her counsel from the central role in aggregate litigation. Instead of simply adding another interested party into a situation already fraught with agency problems, aggregation by acquisition reduces the number of players, replacing a dispersed and potentially fractious group of small claimants with a concentrated and motivated acquirer. There are several reasons such aggregation promises substantial benefits and may ultimately help generate litigation outcomes more closely related to the merits. First, aggregation by acquisition can help to overcome capital constraints and risk aversion that might otherwise skew litigation outcomes. Second, our proposal turns otherwise one-shot parties into repeat players, helping to equalize bargaining power and the ability and incentive to influence legal change. Third, it could lead to specialization that could help to reduce the costs of litigation and the distortions such costs impose on litigation outcomes. Finally, our proposal would result in better—and, in some cases, more timely—compensation for injured parties.

Two notes are in order at the outset. First, a handful of prior papers to consider the economics of a market for legal claims have considered "unmatured claims"—that is, potential future injuries that have not yet occurred.[12] Such an analysis is of interest in thinking through schemes of insurance and waivers of liability, but does not necessarily involve assignment of choses of action or implicate bars on champerty or maintenance. We are concerned in this Article with matured claims—that is, with injuries that have already occurred—which pose strikingly different questions.

Second, we assume throughout that the substantive laws are themselves normatively desirable. We further assume that private enforcement of the law is also normatively desirable as a matter of public policy. That is, we assume that the laws ought to be enforced, and that they ought to be enforced by private litigation rather than, or in addition to, other tools of law enforcement, and that optimal policy would be for litigation outcomes to mirror the "merits" under the substantive law. Thus, even though one may question whether the current regime of, for example, securities fraud litigation—whereby current stockholders compensate former stockholders for out-of-pocket trading losses caused by fraudulent misrepresentations—is optimal, we push all such doubts to the side for present purposes. Doing so is justified by the sense that the best solution to bad substantive law is to modify the substantive law, rather than to distort the process of litigation in the hope that out of such distortions will fortuitously arise better outcomes from a social policy perspective.

This Article is structured as follows. Part II provides a brief summary of collective action problems in mass litigation, and the law's traditional

12. *See, e.g.*, Robert Cooter, *Towards a Market in Unmatured Tort Claims*, 75 VA. L. REV. 383, 383 (1989).

procedural responses to these problems. This Part also introduces the problem of agency costs in aggregate litigation and outlines prominent proposals and—largely unsuccessful—attempts to reduce these costs. Part III examines the limits on the purchase and sale of legal claims, given the central importance of such transactions to our proposal. Part IV introduces aggregation by acquisition—a full market for legal claims—and argues that it would deliver all of the benefits of litigation finance while also solving the agency problems inherent in both litigation finance and traditional mechanisms of claim aggregation. This Part also presents empirical evidence on appraisal litigation—a form of stockholder litigation where aggregation by acquisition is already possible—to demonstrate the promise of markets for legal claims. Part V introduces and addresses possible objections to aggregation by acquisition. Part VI suggests a number of legal reforms necessary for a robust market for legal claims to flourish in the corporate and securities context and sets out some general thoughts on how the proposal might be implemented more broadly.

II. COLLECTIVE ACTION PROBLEMS AND AGENCY COSTS

The class action is a procedural innovation that arose in response to collective action problems in mass litigation. This Part outlines the nature of that collective action problem and describes the design of the main procedural devices employed to overcome it, namely the class action and the derivative suit. Next, it introduces the agency problem that plagues such litigation and prominent proposals designed to address that problem. Finally, it describes various policy reforms implemented to minimize that basic agency problem and the failure of those reforms.

A. *PROCEDURAL SOLUTIONS TO COLLECTIVE ACTION PROBLEMS: THE CLASS ACTION AND DERIVATIVE SUIT*

Litigation suffers from the general problem of collective action.[13] Consider a securities fraud injuring thousands of people to varying degrees. Persons with only small injuries will not bring suit, as the anticipated remedy will not be worth the costs of bringing a lawsuit. This could prevent a suit from being brought even where the victims in the aggregate would stand to gain far more from a suit than the costs of litigation. Persons with larger injuries may find litigation to be worth the candle, but they would either have to each bear the full costs of litigation—potentially resulting in wasteful and redundant litigation costs—or attempt to band together with other aggrieved parties. Doing so will be plagued by the coordination issues that always attend

13. For classic accounts of collective action problems, see generally IAIN MCLEAN, PUBLIC CHOICE: AN INTRODUCTION (1987); MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (1971).

collective decision-making.[14] Each potential plaintiff has an incentive to free ride and let someone else bear the cost of litigation.[15] A plaintiff who goes it alone will bear the entire costs of a proceeding but will capture only a fraction of the benefits. In such a world, too few claims will be brought, which has two undesirable consequences. The first is sub-optimal deterrence of harmful conduct because tortfeasors are not made to internalize the full costs they impose on society. The second and related consequence is the systematic under-compensation of victims of mass harms.

Collective-action problems in mass claims are likely to be especially acute where a large number of injured parties do not have enough at stake to justify incurring litigation costs individually, a common scenario in mass accidents, products liability claims, and consumer antitrust claims, to name a few.[16]

Stockholder litigation is also virtually certain to present collective-action problems, with small groups of large stockholders and a large pool of small stockholders all injured by the same fraudulent misrepresentations or breaches of fiduciary duty on the part of the corporation's officers or directors. The cost of litigation is likely to exceed the value of any prospective gain for any but the largest individual stockholders.[17] As a result, the substantive rules of federal securities law and state corporate law are likely to go under-enforced.

While traditional joinder and other small-scale methods of consolidation can offer some level of aggregation,[18] large classes would be prohibitively costly using these mechanisms. If private litigation is to serve as an effective tool of deterrence and compensation, very large collections of injured parties must resort to representative litigation, such as a class action or derivative suit. Allowing a plaintiff to proceed on behalf of a class of similarly-situated

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14. *See* OLSON, *supra* note 13, at 53; Macey & Miller, *supra* note 5, at 9 ("Organizing the conduct of litigation with large numbers of additional parties would be a nightmare.")

15. *See* Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 535 (1991) ("The class action device makes private enforcement economically feasible for small investors by allowing a large number of small individual claims to be aggregated and permitting the costs of litigation to be recouped from the total recovery under the common fund doctrine."); Macey & Miller, *supra* note 5, at 9 ("The organizer [of a mass claim] would have no effective way of obtaining reimbursement from other plaintiffs for [litigation] costs.").

16. *See* John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 COLUM. L. REV. 1343, 1410–17 (1995).

17. *See, e.g.*, Stephen J. Choi, *The Evidence on Securities Class Actions*, 57 VAND. L. REV. 1465, 1466 (2004) ("Shareholders of large publicly held corporations face a well-known collective action problem. . . . Corporations owe their shareholders specific duties and rights. However, due to the collective action problem, no single shareholder may seek to litigate these rights."); Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 55 (1991) ("The efficacy of shareholder litigation as a governance mechanism is hampered by collective action problems because the cost of bringing a lawsuit, while less than the shareholders' aggregate gain, is typically greater than a shareholder–plaintiff's pro rata benefit.").

18. *See* FED. R. CIV. P. 20 (regarding joinder of parties); *id.* R. 24 (regarding intervention).

victims—or on behalf of an injured corporation via a derivative suit—encourages the filing of claims where the potential recovery is equal to or greater than the entire loss suffered by the victims.[19] It thus overcomes the major coordination problems that would otherwise hamper the prosecution of such claims.[20] In doing so, the class action is designed to ensure that defendants will bear the full social cost of injuries.

The class action allows the large-scale and inexpensive joining of large numbers of absent plaintiffs.[21] The dominant form of class action, governed by Federal Rules of Civil Procedure ("FRCP") 23(b)(3), allows a representative plaintiff to file an action and request the certification of a class if certain requirements are met.[22] The class must be so large that joinder is impractical, class members must share common questions of law and fact that predominate individual issues, and the class representative must have claims that typify those of other class members.[23]

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19. *See* David Rosenberg & Kathryn E. Spier, *Incentives to Invest in Litigation and the Superiority of the Class Action*, 6 J. LEGAL ANALYSIS 305, 306 (2014) ("In short, class action replaces individualized (or decentralized, fractionated) stake holders and decision making with centralized control over the classwide, indivisible stake and resulting incentives to optimally invest in maximizing the expected recovery from the plaintiffs' common question case for liability.").

20. *See, e.g.*, Joseph A. Grundfest & Michael A. Perino, *The Pentium Papers: A Case Study of Collective Institutional Investor Activism in Litigation*, 38 ARIZ. L. REV. 559, 563–64 (1996) ("The class action device is an attempt to overcome the problem of dispersed injured parties whose damage claims are sufficiently small that they lack incentives to pursue individual litigation. Absent the class action device, collective action problems can prevent the aggregation of individual claims into one action that would support economically viable litigation." (footnotes omitted)); Alexandra Lahav, *Fundamental Principles for Class Action Governance*, 37 IND. L. REV. 65, 70 (2003) ("Among other things, class actions solve the collective action problems faced by individuals with claims too small to be economically adjudicated individually . . . ."); Macey & Miller, *supra* note 5, at 8 ("The class action is a tool for overcoming the free-rider and other collective action problems that impair any attempt to organize a large number of discrete individuals in any common project." (footnotes omitted)); William B. Rubenstein, *Why Enable Litigation?: A Positive Externalities Theory of the Small Claims Class Action*, 74 UMKC L. REV. 709, 709 (2006) ("Scholars have demonstrated that the small claims class faces what economists call a 'collective action problem' and they have applauded the class mechanism as the means by which the class overcomes this problem."); Randall S. Thomas & Robert G. Hansen, *Auctioning Class Action and Derivative Lawsuits: A Critical Analysis*, 87 NW. U. L. REV. 423, 427 (1993) ("The class action aims to overcome the collective action problems inherent in any effort to organize a large group of individuals into one common project.").

21. *See, e.g.*, Deposit Guar. Nat'l Bank v. Roper, 445 U.S. 326, 338 (1980) (noting that "[t]he use of the class-action procedure for litigation of individual claims . . . may motivate [named plaintiffs] to bring cases that for economic reasons might not be brought otherwise"); *see also* U.S. Parole Comm'n v. Geraghty, 445 U.S. 388, 403 (1980) (describing some of the justifications of class actions being "provision of a convenient and economical means for disposing of similar lawsuits, and the facilitation of the spreading of litigation costs among numerous litigants with similar claims"); Arthur R. Miller, *Of Frankenstein Monsters and Shining Knights: Myth, Reality, and the "Class Action Problem*,*"* 92 HARV. L. REV. 664 (1979) (explaining the social value of providing a mechanism for the litigation of small claims).

22. FED. R. CIV. P. 23(b)(3).

23. *Id.* R. 23(a)(1)–(3).

While derivative suits, as discussed below, generate some of the same dynamics as class actions, the rationale for the derivative suit is somewhat different. Numerous stockholders might suffer small losses from harm inflicted on the corporation they own, but there is already a mechanism in place—the corporate form itself—for overcoming the collective action problems that might otherwise stand in the way of seeking a remedy.[24] The need for the derivative suit mechanism stems from an agency problem within the corporation—the fact that the incentives of the managers who control the corporation often diverge from the best interests of the stockholders.[25]

The typical derivative suit scenario involves allegations that the corporate managers have themselves harmed the corporation by breaching their fiduciary duties. In such a situation, the conflict of interest is obvious, as the managers can hardly be trusted to pursue a claim against themselves with any zeal. A derivative action enables a representative stockholder to circumvent the corporation's management and bring a claim on behalf of the entire corporation.[26] The stockholder-plaintiff stands in the shoes of the corporation, and any recovery on the claims goes to the corporation, rather than directly to the stockholders.[27]

B. *Agency Problems in Aggregate Litigation*

By solving the basic collective action problem associated with mass claims, class and derivative claims preserve the deterrent and compensation goals of our civil liability system. Representative litigation, however, is not an unalloyed good. The unavoidable problem created by both the class action and the derivative suit is one of agency costs.

The class action and the derivative suit draft absent class members into a relationship where their welfare depends on the decisions of the attorney who speaks on their behalf.[28] The interests of the plaintiffs' attorney can diverge, sometimes severely, from the interests of the class members, generating a

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24. *See* Macey & Miller, *supra* note 5, at 10.

25. *See, e.g.*, ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 277–78 (1932); Frank H. Easterbrook, *Managers' Discretion and Investors' Welfare: Theories and Evidence*, 9 DEL. J. CORP. L. 540 (1984).

26. *See* Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 548 (1949) ("Equity came to the relief of the stockholder, who had no standing to bring civil action at law against faithless directors and managers. Equity, however, allowed him to step into the corporation's shoes and to seek in its right the restitution he could not demand in his own.").

27. *See* FED. R. CIV. P. 23.1(a) (describing a derivative action as brought by "one or more shareholders . . . to enforce a right that the corporation or association may properly assert but has failed to enforce").

28. *See, e.g.*, Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976) (defining an agency relationship as one "under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent").

predictable set of costs associated with monitoring the agent and bonding the agent's performance.[29] Together with any residual cost from unfaithful performance on the part of the agent, these are typically dubbed "agency costs."

In aggregate litigation, the party controlling the litigation is almost always the plaintiffs' attorney, not the named plaintiff.[30] Plaintiffs' attorneys have a financial stake in the claim that typically far outweighs that of any individual plaintiff because they generally receive a contingency fee equal to a percentage of any ultimate recovery. Such fees are often in the neighborhood of 25% and regularly as high as 33%,[31] but even a much smaller percentage would be enough to dwarf the share of any individual plaintiff in a sizeable aggregate proceeding.

Class members have virtually no incentive to monitor the plaintiffs' attorney because their stakes are so small.[32] These small stakes also make effective monitoring by the plaintiffs highly unlikely. As Macey and Miller have argued, class action and derivative attorneys "are subject to only minimal monitoring by their ostensible 'clients,' who are either dispersed and disorganized (in the case of class action litigation) or under the control of hostile forces (in the case of derivative litigation)."[33] "As a practical matter,

29. *See, e.g.*, John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 25 (1986) (noting that "'agency costs' . . . include[] both the expenditures incurred to reduce managerial misappropriation and shirking plus the irreducible minimum of such losses"); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1424 (1989) ("The combination of monitoring, bonding, and residual costs is called 'agency costs.'").

30. Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487, 1520 (1996) (noting that "named plaintiffs are essentially figureheads, merely the 'key to the courthouse door,' . . . who play no real role in directing the litigation" (quoting Saylor v. Lindsley, 456 F.2d 896, 900 (2d Cir. 1972))); *see also* STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 367 (2002) (observing that in stockholder suits "the real party in interest—the party on the plaintiffs' side with the greatest personal interest in the outcome of the litigation—is the plaintiffs' attorney rather than the nominal shareholder-plaintiff").

31. *See* 4 ALBA CONTE & HERBERT B. NEWBERG, NEWBERG ON CLASS ACTIONS § 14:6 (4th ed. 2002 & Supp. 2014) ("[F]ee awards in class actions average around one-third of the recovery"); Brian T. Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. EMPIRICAL LEGAL STUD. 811, 835 tbl.8 (2010) (reporting that the mean and median fee awards were both around 25% over 444 federal class actions suits between 2006 and 2007).

32. Alexander, *supra* note 15, at 535 (noting that most class members "have only a nominal stake in the litigation").

33. Macey & Miller, *supra* note 5, at 3; *see also* Alexander, *supra* note 15, at 535 ("Just as [individual victims] lack sufficient economic interest to bring individual actions, they also are not motivated to sustain the information costs or expend the energy and attention required" to effectively monitor their attorney.); John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 678–79 (1986); James D. Cox et al., *Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587, 1593 (2006) ("Class members suffered profound collective action problems that prevented close monitoring of the class action attorney."); Macey & Miller, *supra* note 5, at 5 ("The named plaintiff does little—indeed, usually does nothing—to monitor the attorney in order to ensure that representation is

then, it is the plaintiffs' attorneys . . . who decide when to initiate [class and derivative] claims, how to prosecute them, and on what terms to settle them."[34] This is in many ways a necessary aspect of class action litigation; the entire premise is that none of the actual plaintiffs has sufficient incentive to bring the suit. Recognizing this, the design of aggregate litigation thus deliberately generates a strong incentive for the plaintiffs' attorney to act on behalf of the class.[35]

In theory, the prevalence of contingency fees ought to serve to align the interests of plaintiffs' attorneys and plaintiffs. The payoff of the plaintiffs' attorney ought to depend on the payoff of the class members. The better the class members do, the better the plaintiffs' attorney does. Scholars have long argued, however, that this alignment will seldom be more than partial. The attorney is virtually guaranteed to face incentives that diverge from those of the plaintiffs. In aggregate litigation, "the conflict of interest that is inherent in all lawyer-client relationships becomes acute."[36] The result of divergent incentives and no effective supervision is a serious agency problem. This problem can manifest in a multitude of ways, but three problems are characteristic.[37]

First, even in the absence of agency costs, there is always a danger that legal actions may be brought not in the hope of achieving a favorable judgment on the merits, but rather to capture the nuisance value of the lawsuit.[38] Even an entirely meritless claim is costly to defend. Defendants may,

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competent and zealous, or to align the interests of the attorney with those of the class or corporation."); Deborah L. Rhode, *Class Conflicts in Class Actions*, 34 STAN. L. REV. 1183 (1982); Weiss & Beckerman, *supra* note 11, at 2060 (arguing that lead plaintiffs are often recruited by the lawyers, rather than the other way around, and were often "poorly informed about the theories of their cases, . . . totally ignorant of the facts, or . . . illiterate concerning financial matters").

34. *See generally* Charles R. Korsmo & Minor Myers, *The Structure of Stockholder Litigation: When Do the Merits Matter?*, 75 OHIO ST. L.J. 829, 841 (2014).

35. Macey & Miller, *supra* note 5, at 3 ("[P]laintiffs' class and derivative attorneys function essentially as entrepreneurs who bear a substantial amount of the litigation risk and exercise nearly plenary control over all important decisions in the lawsuit.").

36. Alexander, *supra* note 15, at 535.

37. In a recent article, Elizabeth Chamblee Burch listed, and provided examples of, six "situations in which an attorney's interests might diverge from her client's [leading to] questionable practices." Burch, *supra* note 9, at 1292. The six she lists are: (1) "Quick Settlement Sell-Outs;" (2) "Collusive Settlements;" (3) "Underfunded Litigation;" (4) "Astronomical Fees;" (5) "Cram-Sown Settlement Practices;" and (6) "Misallocation of Settlement Funds." *Id.* at 1293–98. We focus here on the difficulties we believe to be most salient in class litigation, but do not mean to suggest that we disagree with her discussion of other difficulties that may arise.

38. Defining whether a lawsuit is "frivolous" or not "socially desirable" is a more fraught question than it may seem at first glance. *See* Robert G. Bone, *Modeling Frivolous Suits*, 145 U. PA. L. REV. 519, 529–33 (1997) (considering and rejecting a number of common definitions of "frivolous" litigation). For most purposes, however, we can consider a suit nonfrivolous where the expected benefits to the plaintiffs from a trial exceed the expected costs of litigation. Given, however, that litigation may generate externalities, even lawsuits not meeting this definition can be socially desirable if, in addition to compensating the particular plaintiffs, they provide some public benefit, such as deterrence of wrongdoing. *See* John C. Coffee, Jr., *Rescuing the Private*

if they are risk-averse or face high litigation costs, find it more economical to settle claims even when they view them as meritless.[39] Aggregate litigation may increase the profitability of nuisance claims by increasing asymmetries between plaintiff and defendant litigation costs and creating the possibility—even if only remote—of catastrophic damages. In stockholder litigation, attorney control of the litigation may increase the attractiveness of nuisance suits, as the plaintiffs' attorney will lack any ongoing interest in the firm, and thus lack an incentive to avoid value-destroying suits.

The second problem is the flip-side of the first. As risk-averse economic actors who bear the costs of litigation, including the opportunity costs of their time and effort, plaintiffs' attorneys may be tempted to settle meritorious cases for too little. As Cox and Thomas have observed, "a settlement offer that provided recovery of the attorney's tangible and opportunity costs could loom larger than the prospect of aggressively pursuing the action to a more lucrative prospective judgment or settlement."[40] In fact, almost all class actions and derivative suits are settled before trial—even more so than in other types of litigation.[41]

The final problem—which exacerbates the second—is that the plaintiffs' attorneys may abuse their control to maximize the portion of the value of a

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Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working, 42 MD. L. REV. 215, 218 (1983) ("The conventional theory of the private attorney general stresses that the role of private litigation is not simply to secure compensation for victims, but is at least equally to generate deterrence, principally by multiplying the total resources committed to the detection and prosecution of the prohibited behavior."); Romano, *supra* note 17, at 85. Conversely, if lawsuits merely consume resources and redistribute wealth without producing desirable incentive effects, they may be socially undesirable even when the benefits to plaintiffs exceed the costs. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Optimal Damages in Securities Cases*, 52 U. CHI. L. REV. 611, 639–40 (1985); Donald C. Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639, 646 (1996) (arguing that a goal of full compensation would lead to socially undesirable results).

39. As Janet Cooper Alexander summarized the economic arguments, "high litigation costs and uncertainty about trial outcomes can lead to the settlement of frivolous suits." Alexander, *supra* note 15, at 502 n.10; *see also* Lucian Arye Bebchuk, *Suing Solely to Extract a Settlement Offer*, 17 J. LEGAL STUD. 437, 437–48 (1988); Coffee, *supra* note 38, at 271–72; Jill E. Fisch, *Class Action Reform: Lessons from Securities Litigation*, 39 ARIZ. L. REV. 533, 533–59 (1997); D. Rosenberg & S. Shavell, *A Model in Which Suits Are Brought for Their Nuisance Value*, 5 INT'L REV. L. & ECON. 3, 3–10 (1985).

40. Cox et al., *supra* note 33, at 1593; *see also* Macey & Miller, *supra* note 5, at 17–18 ("Yet the contingent fee also gives the attorney an incentive to pay insufficient attention to cases where the marginal return to the attorney's time is low relative to other cases in the attorney's portfolio, and to settle early for a lower amount than the attorney could obtain for the client by putting more time and effort into the case."); *id.* at 22 ("Plaintiffs' attorneys may also wish to settle for a relatively low sum on the eve of trial, knowing that in so doing they obtain most of the benefits they can expect from the litigation while eliminating their downside risk.").

41. *See* Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 477–80 (2015); Quinn Curtis & Minor Myers, *Do the Merits Matter? Empirical Evidence on Shareholder Suits from Options Backdating Litigation*, 164 U. PA. L. REV. 291, 337–40 (2016).

settlement going to the attorneys, at the expense of the actual plaintiffs. In this, plaintiffs' attorneys are often abetted by the defendants, who typically care only about the aggregate amount of the settlement and not its division among the plaintiffs' attorneys and the plaintiffs.[42] Commentators have long noted the prevalence of settlement agreements providing little or no tangible recovery to plaintiffs, while providing generous attorneys' fees.[43]

Such settlements are pervasive in aggregate stockholder litigation. For example, an influential study by Romano found that only about half of the settlements in her sample of stockholder suits led to any monetary recovery for shareholders at all, while over 90% provided cash payments to the plaintiffs' attorneys.[44] Astonishingly, in 8% of the settlements, "the *only* relief was attorneys' fees."[45] A recent paper by Cain and Davidoff Solomon studying stockholder suits challenging large merger transactions found that approximately 87% of such challenges resulted in so-called "disclosure-only" settlements, where stockholders received no cash at all.[46] The disclosures associated with these settlements are widely regarded to be of no real value to stockholders.[47] While the stockholders themselves received no financial recovery, the average fee paid to plaintiffs' attorneys in such settlements was more than $700,000.[48]

In sum, agency problems in aggregate litigation may cause plaintiffs' attorneys to bring non-meritorious claims, to settle meritorious claims too quickly and for too little recovery, and to structure settlements so as to favor themselves over the actual plaintiffs.

C. *FIXING PROCEDURAL AGGREGATION WITH MORE PROCEDURE*

The agency problems described above strike at the very heart of most aggregate litigation, as currently practiced. It has generated an enormous theoretical and empirical literature examining the extent of the problem. At

42. *See* Minor Myers, *Fixing Multi-Forum Shareholder Litigation*, 2014 U. ILL. L. REV. 467, 506.

43. Especially notorious are so-called "coupon" settlements in consumer class action. In such settlements, the attorneys receive substantial cash fees while plaintiffs receive only coupons of dubious value, such as discounts for purchasing additional products or services from the defendant. *See, e.g.*, *In re* Cuisinart Food Processor Antitrust Litig., 38 Fed. R. Serv. 2d (Callaghan) 446, 449, 454–56 (D. Conn. 1983) (involving a consumer antitrust settlement giving class members coupons entitling them to a 50% discount on future purchases from the defendants); Steven B. Hantler & Robert E. Norton, *Coupon Settlements: The Emperor's Clothes of Class Actions*, 18 GEO. J. LEGAL ETHICS 1343 (2005); Jonathan R. Macey & Geoffrey P. Miller, *Judicial Review of Class Action Settlements*, 1 J. LEGAL ANALYSIS 167 (2009).

44. Romano, *supra* note 17, at 61.

45. *Id.*

46. Cain & Davidoff Solomon, *supra* note 41, at 481.

47. *See, e.g.*, Jill E. Fisch et al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557 (2015).

48. Cain & Davidoff Solomon, *supra* note 41, at 479.

the same time, it has also spawned a multitude of policy reforms designed to mitigate the agency costs of aggregate litigation.

Judges presiding over mass litigation could theoretically serve as a constraint on the self-interest of the attorneys by aggressively policing settlements.[49] In practice, however, a busy judge is understandably reluctant to reject a settlement that all parties before the court are pressing the court to accept.[50] Given the general judicial policy in favor of settlement,[51] and the understandable desire to clear potentially complex cases from overloaded dockets, it would be surprising if judges were frequently rejecting settlement agreements.[52] And, in fact, they are not. As a result, the vast majority of aggregate claims are settled on terms set by conflicted parties, with little meaningful oversight by either the class or the court.

The reform proposals that have had the most real-world impact focus on the role of the plaintiffs themselves. The basic problem is that the plaintiffs usually have little incentive or ability to effectively monitor the plaintiffs' attorneys. In a large class, it will generally be the case that no individual plaintiff will be willing to expend substantial resources monitoring the attorneys, because the individual would bear all the costs of doing so, but would receive only a (small) pro rata share of the benefits of any increased

49. *See* FED. R. CIV. P. 23(e)(1) ("[A] class [action] may be settled, voluntarily dismissed, or compromised only with the court's approval. . . . The court must direct notice in a reasonable manner to all class members who would be bound by the proposal."); *id.* R. 23.1(c) ("A derivative action may be settled, voluntarily dismissed, or compromised only with the court's approval. Notice . . . must be given to shareholders or members in the manner that the court orders.").

50. As Judge Henry Friendly remarked, "[o]nce a settlement is agreed, the attorneys for the plaintiff stockholders link arms with their former adversaries to defend [their] joint handiwork." Alleghany Corp. v. Kirby, 333 F.2d 327, 347 (2d Cir. 1964) (Friendly, J., dissenting); *see also* Cox et al., *supra* note 33, at 1594 ("[T]he presiding judge, overwhelmed by a crowded docket and poorly armed against the possible self-interest of the attorneys who promoted the suit's settlement, was not capable of effectively protecting the interests of the class." (footnote omitted)). It should be noted that while Cox and Thomas describe the agency problem in shareholder litigation, they exhibit some skepticism as to the conclusion that courts are ill-equipped to deal with it. *See* James D. Cox, *Making Securities Fraud Class Actions Virtuous*, 39 ARIZ. L. REV. 497, 523–24 (1997) (arguing that even before the PSLRA, courts have had the power to sanction frivolous suits and select appropriate lead plaintiffs).

51. *See, e.g.*, *In re* HealthSouth Corp. Sec. Litig., 572 F.3d 854, 862 (11th Cir. 2009) ("Public policy strongly favors the pretrial settlement of class action lawsuits." (quoting *In re* U.S. Oil & Gas Litig., 967 F.2d 489, 493 (11th Cir. 1992))); Macedonia Church v. Lancaster Hotel, LP, No. 05-0153 (TLM), 2011 WL 2360138, at *9 (D. Conn. June 9, 2011) ("Federal courts strongly favor and encourage settlements, particularly in class actions and other complex matters, where the inherent costs, delays, and risks of continued litigation might otherwise overwhelm any potential benefit the class could hope to obtain."); 4 CONTE & NEWBERG, *supra* note 31, § 11:41 ("The compromise of complex litigation is encouraged by the courts and favored by public policy.").

52. *See* Macey & Miller, *supra* note 5, at 45–46 (arguing that judges have little incentive to heavily police settlement agreements).

recovery.[53] Indeed, apart from the lead plaintiff—who in practice is usually selected by the attorney, rather than the other way around—other class members may not even be aware that litigation is pending, let alone sufficiently informed to provide effective monitoring and guidance.[54]

In 1995, Weiss and Beckerman offered an ambitious proposal to address dysfunction in federal securities litigation by prioritizing institutional investors and others with large holdings who could, in theory, serve as effective monitors in disputes for lead plaintiff status.[55] Their proposal provided the basis for important parts of the 1995 Private Securities Litigation Reform Act ("PSLRA").[56] Among other reforms, the PSLRA created a presumption that the largest stockholder should serve as lead plaintiff in securities class actions, on the theory that larger shareholders will have greater incentive and ability to monitor the performance of plaintiffs' attorneys.[57] Similarly, Delaware's rules for selecting a lead plaintiff in stockholder litigation are sensitive to the size of the plaintiff's holdings.[58] This approach capitalizes on variation among the plaintiff class—both in the exposure to the harm and in the sophistication of the claimants—which makes it uniquely

53. *See id.* at 20 ("[C]ollective action and free-rider effects allow the plaintiffs' attorney in class and derivative cases to operate with nearly total freedom from traditional forms of client monitoring.").

54. If plaintiffs typically hired the attorney, rather than the other way around, the need to maintain a reputation for faithful performance might serve as an effective constraint on attorney opportunism. The fact that lead plaintiffs are typically selected by the attorneys reduces the value of reputational bonding as a mechanism for controlling agency costs. *See id.* at 21 ("The lack of client monitoring in the class and derivative context also reduces the efficacy of reputational bonding . . . .").

55. Weiss & Beckerman, *supra* note 11, at 2058 (proposing "new practices, consistent with current procedural rules, that courts could adopt to encourage institutional investors to become lead plaintiffs"). Congress adopted this approach in the Private Securities Litigation Reform Act of 1995. *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 101(a)-(b), 109 Stat. 737, 738-40, 743-45 (codified as amended at 15 U.S.C. §§ 77z-1, 78u-4 (2012)); Elliott J. Weiss, *The Lead Plaintiff Provisions of the PSLRA After a Decade, or "Look What's Happened to My Baby,"* 61 VAND. L. REV. 543, 544 (2008).

56. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.).

57. *See* 15 U.S.C. § 78u-4(a)(3)(B)(iii); *see also* Choi, *supra* note 17, at 1475 ("The PSLRA imposes a rebuttable presumption that the plaintiff, among those seeking to become the lead plaintiff, who has the largest financial interest in the relief sought by the class and is otherwise an adequate representative of the class is presumptively the lead plaintiff."); *id.* ("In theory, a lead plaintiff with a large stake in the litigation will have more incentive to monitor the plaintiffs' attorney's effort and also be more willing to resist excessive plaintiffs' attorney fee awards."); Cox et al., *supra* note 33, at 1596 ("The theory behind [the lead plaintiff provision] was that institutions with the largest losses would have the most to gain from becoming better monitors of the conduct of the litigation."); Weiss & Beckerman, *supra* note 11, at 2111.

58. *See, e.g.*, TCW Tech. Ltd. P'ship v. Intermedia Commc'ns, Inc., No. 18336, 18289, 18293, 2000 WL 1654504, at *4 (Del. Ch. Oct. 17, 2000) (employing a lead plaintiff standard similar to that of the PSLRA).

suitable to corporate and securities suits but unsuitable to consumer class actions or mass torts.[59]

Empirical evaluations of the PSLRA have yielded equivocal results.[60] Institutions appeared to take on the enhanced role that the PSLRA envisioned for them, scrutinizing potential counsel and negotiating lower fees.[61] But the evidence is decidedly mixed on whether institutions have had any effect on recoveries and attorneys' fees. Choi, Fisch, and Pritchard compared pre-PSLRA litigation to post-PSLRA litigation and found little evidence of progress.[62] Private institutions were not associated with higher recoveries; public institutions were associated with higher recoveries, but they were unable to rule out the explanation that public institutions simply cherry-picked the best cases. On fees, they found no evidence that institutional involvement correlated with lower fees.[63] The more troubling finding in some research is that the newly empowered institutions used their influence to benefit not the shareholder class but themselves. Especially at public institutions, the risk is that they squeeze campaign contributions from plaintiffs' attorneys wishing to do be hired to represent the institution.[64] Thus, the PSLRA reforms do not appear to have altered the basic nature of the attorney–client relationship in securities class actions.[65]

Another avenue for altering the operation of class actions is to improve the incentives of class attorneys in a straightforward way, by allowing them to capture more of the recovery, and perhaps even all of it. Fitzpatrick has provocatively offered such a proposal in the context of small-stakes class actions, where the policy goal is chiefly to deter malfeasance.[66] For this reason, class members would suffer no meaningful loss in compensation and would benefit from the increased deterrence.[67] Fitzpatrick argues that courts should award to plaintiffs attorneys' considerably more of the recovery than they

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59. Jill E. Fisch, *Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction*, 102 COLUM. L. REV. 650, 725–27 (2002).

60. *See* Cox et al., *supra* note 33, at 1596; Korsmo & Myers, *supra* note 34; Weiss & Beckerman, *supra* note 11, at 2111.

61. *See* Fisch, *supra* note 59, at 703–10 (describing the sophistication of counsel selection by institutional investors).

62. Stephen J. Choi et al., *Do Institutions Matter? The Impact of the Lead Plaintiff Provision of the Private Securities Litigation Reform Act*, 83 WASH. U. L.Q. 869, 902–03 (2005).

63. *Id.* at 903.

64. *See* Stephen J. Choi et al., *The Price of Pay to Play in Securities Class Actions*, 8 J. EMPIRICAL LEGAL STUD. 650 (2011). *But see* David H. Webber, *Is "Pay-to-Play" Driving Public Pension Fund Activism in Securities Class Actions?: An Empirical Study*, 90 B.U. L. REV. 2031 (2010).

65. The muted impact of lead plaintiff-selection reforms may stem from the fact that courts have always had the ability to select sensible lead plaintiffs and perhaps were already doing as well as possible. *See* Cox, *supra* note 50, at 523–24.

66. *See* Brian T. Fitzpatrick, *Do Class Action Lawyers Make Too Little?*, 158 U. PA. L. REV. 2043, 2083 (2010).

67. *Id.* at 2069 ("[S]mall-stakes class actions serve only a deterrence function . . . .").

currently do, and in his view the optimal award is 100% of the recovery.[68] By consolidating exposure to the claims in the plaintiffs' attorney, Fitzpatrick's proposal can achieve many of the same goals as the aggregation by acquisition proposal we develop below. Placing the claims in the hands of the party who places the highest valuation on them, however, is a considerable challenge for such a proposal because it does not rely on any pricing mechanisms. Another obvious drawback of the proposal is that it holds out little hope when the compensation of injured parties is an independent policy goal.

The most ambitious proposal—and one that, like ours, is motivated by a desire to inject market forces into claim aggregation—comes from Macey and Miller,[69] who proposed severing plaintiffs from the process entirely. They would subject mass litigation to "some form of auction for plaintiffs' claims, under which attorneys (and others) could bid for the right to bring the litigation and gain the benefits, if any, that flow from success."[70] This would "overcome the agency costs that plague class and derivative litigation in its current guise" because the winning bidder would act only on its own behalf, bearing all of the costs and the benefits of litigation.[71] The Macey and Miller proposal shares our ambition of providing more effective deterrence through private enforcement and delivering faster relief to those injured.

In theory, auctions—unlike a PSLRA-style approach—would work in any type of aggregate litigation. The difficulties associated with auctions are especially relevant to aggregation by acquisition, so we lay them out here in some detail.

A threshold obstacle to auctioning aggregate claims is the same information asymmetry that plagues litigation generally. Potential bidders will not be in a good position to value the claims because they will not necessarily know enough about potential liability and damages.[72] For this reason, Macey and Miller suggest some initial round of judicially supervised discovery.[73] Moreover, the defendants, if allowed to bid, could further disrupt the auction process, given their superior knowledge of the claim. A potential bidder might worry that any bid that exceeded a defendant's bid would be an overpayment.

Their proposal also requires some first mover to file and frame the complaint, who may then fail to prevail in the auction.[74] Macey and Miller

68. *Id.* at 2083 ("[T]here is little reason as a theoretical matter not to fully incentivize class action lawyers to bring these suits by awarding them the entire class recovery. Although political and perhaps even legal constraints might prevent judges from setting fee percentages at 100% in small-stakes cases, deterrence-insurance theory nonetheless suggests that judges ought to give class counsel as much as they can, which, by any measure, is more than the 25% they usually give now.").

69. Macey & Miller, *supra* note 5, at 4.

70. *Id.* at 6.

71. *Id.* at 108.

72. *See* Thomas & Hansen, *supra* note 20, at 449.

73. Jonathan R. Macey & Geoffrey P. Miller, *Auctioning Class Action and Derivative Suits: A Rejoinder*, 87 NW. U. L. REV. 458, 467 (1993).

74. *See* Coffee, *supra* note 33, at 691–94.

propose that the first mover be compensated through some quantum meruit award to ensure the continued existence of some incentive to research and file claims.[75]

In addition, it would be difficult to ensure the cooperation of class members who have no ongoing interest in the case. Macey and Miller raise the idea of requiring class members to submit some proof of claim that the victorious bidder could use to demonstrate damages or subpoenaing class members to testify.[76] They suggest that courts may "need to develop innovative procedures for dealing with these difficulties."[77] This difficulty, however, cuts deep; few bidders would be willing to invest substantial resources in the claim if the damages claim might crumble based on the non-participation of class members.

Financing is another potentially severe problem with the Macey and Miller proposal, as they acknowledge.[78] Their general proposal envisions an auction and purchase of the entire aggregate claim, but for large claims there may not be a deep market of potential buyers. For this reason, they also contemplate an auction of a portion of the claim. In particular, they suggest that an auction of the right to serve as lead counsel might be a useful half-step short of complete sale. A number of courts have prominently experimented with this approach. In the Oracle securities litigation,[79] for example, Judge Vaughn Walker had prospective counsel submit bids on what fee they would take as a percentage of the class recovery, and the winning lead counsel was bound by its winning bid.[80] This process, in Judge Walker's view, "adequately simulated the market for legal services."[81] Other judges have experimented with similar mechanisms.[82] While the auction of the lead counsel role has had successes,[83] it has attracted sustained criticism in the literature and has failed to generate any momentum in trial courts.[84]

III. THE PURCHASE AND SALE OF LEGAL CLAIMS

Our proposal—a full market for legal claims, where the purchasers stand in the shoes of the original party to the claim and control the litigation—

75. *See* Macey & Miller, *supra* note 5, at 114–15.

76. *Id.* at 114.

77. *Id.*

78. *Id.* at 113 ("[F]inancing remains a potentially serious problem for the largest claims.").

79. *In re* Oracle Sec. Litig., 131 F.R.D. 688, 697 (N.D. Cal. 1990).

80. *Id.*

81. *In re* Oracle Sec. Litig., 852 F. Supp. 1437, 1457 (N.D. Cal. 1994).

82. *In re* Auction Houses Antitrust Litig., 197 F.R.D. 71, 78–80 (S.D.N.Y. 2000) (identifying courts that have employed legal counsel auctions).

83. In *Auction House*, Judge Kaplan observed "that the result of the lead counsel auction in this case was exceptionally beneficial to the class." *In re* Auction Houses Antitrust Litig., No. 00 Civ. 0648 (LAK), 2001 WL 170792, at *18 (S.D.N.Y. Feb. 22, 2001).

84. *See, e.g.*, Fisch, *supra* note 59, at 651–53.

presupposes that legal claims can be bought and sold. Given the importance of such transactions to our proposal, this Part examines the alienability of legal claims. It outlines the historic prohibitions on buying legal claims and the more recent trend—from contingency fees to litigation finance—that has resulted in a rudimentary market in legal claims.

A. *HISTORIC PROHIBITIONS ON SALE OF LEGAL CLAIMS*

The purchase and sale of legal claims has historically been sharply limited by laws restricting champerty, maintenance, and barratry. Roughly speaking, "barratry" refers to a third party stirring up a lawsuit among others,[85] "maintenance" refers to a third party financially or otherwise supporting another's lawsuit,[86] and "champerty" refers to maintenance in which the third party receives a portion of the spoils.[87]

In common law countries, bars on these practices originated in the medieval era.[88] Traditionally, these bans have been understood as measures intended to prevent "great men" from using their influence over the courts as a method of harassing rivals and oppressing the weak.[89]

If these bans ever served these purposes, however,[90] they no longer do so today.[91] Instead, their principal effect is to prevent capital-poor parties or

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85. Blackstone defined "barratry" as "frequently exciting and stirring up suits and quarrels." 4 WILLIAM BLACKSTONE, COMMENTARIES *134.

86. Blackstone defined "maintenance" as "an officious intermeddling in a suit that [in] no way belongs to one, by maintaining or assisting either party, with money or otherwise, to prosecute or defend it." *Id.* at *134–35.

87. *Id.* at *135; *see also* Peter Charles Choharis, *A Comprehensive Market Strategy for Tort Reform*, 12 YALE J. ON REG. 435, 461 (1995) ("In short, barratry refers to stirring up a lawsuit, maintenance involves supporting a lawsuit, and champerty means doing so in hopes of profiting."); Max Radin, *Maintenance by Champerty*, 24 CALIF. L. REV. 48, 60–63 (1935).

88. *See* 4 BLACKSTONE, *supra* note 85, at *134–36; EDWARD JENKS, A SHORT HISTORY OF ENGLISH LAW 142–43 (1912); *see also* 7 W. S. HOLDSWORTH, A HISTORY OF ENGLISH LAW 457 (1926) (discussing later statutes).

89. Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1287 ("What had happened was that 'small men' transferred their rights of action in property disputes to 'great men' in order to get the great men's support at law. Because the legal establishment was weak at the time, the great men could overwhelm the court . . . ." (citations omitted)); *see also* Thallhimer v. Brinckerhoff, 3 Cow. 623, 644 (N.Y. 1824) (identifying a statute from the reign of Henry VIII "to repress the practices of many who when they thought they had title or right to any land, for the furtherance of their pretended right, conveyed their interest in some part thereof to great persons, and with their countenance, did oppress the possessors").

90. A cynic might suspect that the bans were always intended to protect entrenched interests by blocking the only practical avenue for the non-wealthy to make effective use of the courts.

91. *Thallhimer*, 3 Cow. at 645 (noting that bars on champerty are unnecessary where the institutions of justice are strong, and courts are unlikely to be overawed by officious intermeddlers); Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 122 (2011) ("U.S. courts have never been shy about admitting that the earliest justification for limitations on assignment and champerty has almost no relevance to contemporary life.").

holders of small claims from vigorously pursuing their claims.[92] A number of influential scholars have thus called for the abandonment of restrictions on champerty and maintenance.[93]

Indeed, the general trend in modern law has been away from restrictions on claim alienation, beginning with the legalization of contingency fees, which were themselves once regarded as champertous.[94] An increasing number of states are explicitly rejecting old restrictions on champerty and maintenance, particularly in business cases.[95] Some states have even moved toward full assignability of choses of action in personal injury cases.[96] Nevertheless, these doctrines continue to exist in many jurisdictions and pose a serious obstacle to any alienation of legal claims.

B. *SETTLEMENT AND CONTINGENCY FEES AS A SALE*

In spite of these historic obstacles, claim alienation in two forms is already perfectly routine in the United States. When a plaintiff settles her claim, the result is indistinguishable from simply selling the claim to the defendant.[97]

92. *See* Molot, *supra* note 6, at 106 ("The principal purpose of champerty and maintenance restrictions is to prevent financiers from fomenting litigation—that is, from inducing plaintiffs to bring lawsuits that they otherwise would not file or to pursue lawsuits with greater vigor. But that is precisely the point of reform: when plaintiffs lack the cash or risk tolerance to pursue meritorious claims, we want to induce them to file suit and pursue their claims vigorously." (footnotes omitted)); Radin, *supra* note 87, at 66 ("In most instances, the modern objections to champerty are voiced by the more successful members of the [bar] and on behalf of propertied defendants.").

93. *See, e.g.*, Radin, *supra* note 87, at 105–09; Sebok, *supra* note 91, at 133 (arguing for the "desirability of liberal rules concerning assignment and maintenance"); Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1327 ("[E]limination of the champerty prohibition, at least as it relates to the litigation-funding context, will increase access to justice and equal participation in the judicial process.").

94. *See* Peter Karsten, *Enabling the Poor to Have Their Day in Court: The Sanctioning of Contingency Fee Contracts, A History to 1940*, 47 DEPAUL L. REV. 231, 232–49 (1998) (tracing the evolving judicial treatment of contingency fees).

95. *See* Del Webb Cmtys., Inc. v. Partington, 652 F.3d 1145, 1156 (9th Cir. 2011) (noting a "consistent trend across the country [of] . . . limiting, not expanding, champerty's reach"); Jonathan T. Molot, *The Feasibility of Litigation Markets*, 89 IND. L.J. 171, 184 (2014) ("The common law doctrines of champerty and maintenance, which long ago stood in the way of third-party financing, have been abandoned in the vast majority of states, and even where the doctrines continue to place restrictions on the financing of personal claims, they generally have no application to business disputes." (footnotes omitted)); Sebok, *supra* note 91, at 98–99.

96. *See* Cain, *supra* note 9, at 22–23 (noting that nine states allow full assignment of personal injury claims, eight states allow assignment of the proceeds but not the claim itself, and 29 states prohibit assignment of either); Sebok, *supra* note 91, at 72 (noting that the early common law barred assignment of personal claims to a third party).

97. *See* Michael Abramowicz, *On the Alienability of Legal Claims*, 114 YALE L.J. 697, 710 (2005) (likening settlement to "alienation of a plaintiff's claim to the defendant"); Choharis, *supra* note 87, at 469 (same).

This type of sale is comparatively uncontroversial,[98] but of course the obvious drawback is that there is only one potential buyer—the defendant.[99]

Similarly, when a plaintiff retains an attorney on a contingency fee basis, she essentially sells a portion of her claim—typically a quarter to a third of it—to the attorney.[100] Again, one drawback is that that the potential market is limited to a legal cartel of plaintiffs' attorneys who are limited in their ability to fully diversify.[101] Another is that the purchase price is primarily paid in kind, in the form of legal services, reducing the ability of the plaintiff to receive prompt compensation to cover living expenses. The receipt of payment in kind also hampers the ability of parties to "price-shop," as plaintiffs' attorneys compete largely on quality, which is far less easily observed than price.[102] The difficulty of comparing pricing and quality is made even more difficult by the fact that plaintiffs' attorneys are generally providing a bundled set of undifferentiated services, including legal services and financing of the litigation itself.[103] By contrast, a full market for legal claims would allow non-law firms and counterparties to bid for claims. Dedicated purchasers of legal claims would be able to employ greater capital resources and engage in more thorough diversification than is generally possible for law firms, who are limited in the number of cases they can effectively take on at any given time.[104]

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98. *But see* Owen M. Fiss, *Against Settlement*, 93 YALE L.J. 1073 (1984). Many of Fiss's objections to settlement can be characterized as problems caused by the lack of alternative buyers.

99. *See* Abramowicz, *supra* note 97, at 710 (suggesting that "affording the opposing litigant a monopoly on claim alienation might be worse for personhood than allowing a free market in alienation"); Ronen Avraham & Abraham Wickelgren, *Third-Party Litigation Funding—A Signaling Model*, 63 DEPAUL L. REV. 233, 235 (2014) (noting "the monopsony power that defendants have vis-à-vis plaintiffs' ability to sell their claim (i.e., to settle)"); Choharis, *supra* note 87, at 469 (noting that "the law gives the tortfeasor the exclusive right to buy the injured party's entire claim").

100. *See, e.g.*, Sebok, *supra* note 91, at 99 ("Technically, of course, all fifty-one jurisdictions permit at least one form of maintenance: the contingency fee.").

101. *See* Michael I. Krauss, *Alternate Dispute Financing and Legal Ethics: Free the Lawyers!*, 32 MISS. C. L. REV. 247, 253 (2013) (noting that contingency fees give lawyers "a monopsonic right to purchase shares in cases . . . leading to monopoly 'rents'").

102. *See* Lester Brickman, *The Market for Contingent Fee-Financed Tort Litigation: Is It Price Competitive?*, 25 CARDOZO L. REV. 65, 93–97 (2003) (concluding that the contingent fee market is not price competitive, in part due to the difficulty of distinguishing between a lawyer who is cheap because he is efficient and one who is cheap because he is bad).

103. A recent paper by Baker explored the ideal of complete alienation of claims to attorneys and concluded such a regime was desirable. Baker, *supra* note 8, at 302 ("This Article has embarked on a thought experiment: What would the likely effects on claimants and plaintiffs' attorneys be if an injured person had the option to sell her entire claim to a law firm rather than retaining the firm to represent her on a contingent fee basis? An analysis of the costs and benefits reveals that both groups would be expected to prefer such a regime to the current state of affairs.").

104. *See* Choharis, *supra* note 87, at 476 (noting that "in order to invest [labor] in many lawsuits, plaintiffs' law firms would have to be huge"); Richard W. Painter, *Litigating on a Contingency: A Monopoly of Champions or a Market for Champerty?*, 71 CHI.-KENT L. REV. 625, 678–80 (1995) (noting the ability of lawyers to hold a portfolio of cases and the difficulty in achieving adequate diversification).

For some types of legal claims, actual market sale is already common. For example, contract claims can often be assigned from one party to another.[105] A company's rights to pursue claims are frequently transferred to a successor company by merger.[106] Legal claims are routinely transferred along with the sale of both tangible and intangible property like real estate or patents.[107] Claims of all types often change hands via bankruptcy. Even the right to pursue claims arising from personal injury—otherwise the quintessential "personal" claim—can effectively be transferred to an insurance company via subrogation or assignment.[108] Viewed in the light of all these "exceptions" to the inalienability of legal claims, it is the "rule" itself that begins to appear anomalous.

C. *THE RISE OF LITIGATION FINANCE*

Litigation finance is the funding of litigation by a third party with no other connection to the underlying litigation.[109] Notably, the litigation financier is someone other than the attorneys, distinguishing litigation finance from a traditional contingency fee arrangement,. This phenomenon, which has attracted increasing attention recently in the marketplace and in scholarship, in some ways represents the seed of a market for legal claims.[110]

An early form of litigation finance in the United States is the so-called "litigation lending" or "cash advance" industry.[111] Litigation lenders—

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105. *See* RESTATEMENT (SECOND) OF CONTRACTS § 317 (AM. LAW INST. 1981).

106. *See, e.g.*, DEL. CODE ANN. tit. 8, § 259(a) (West 2006) (providing that "all the rights, privileges, powers and franchises" transfer to the surviving or resulting firm following a merger); S. Michael Sirkin, *Standing at the Singularity of the Effective Time: Reconfiguring Delaware's Law of Standing Following Mergers and Acquisitions*, 69 BUS. LAW. 429, 451 (2014) (noting that "[t]his includes legal claims").

107. *See, e.g.*, Roger D. Blair & Thomas F. Cotter, *The Elusive Logic of Standing Doctrine in Intellectual Property Law*, 74 TUL. L. REV. 1323, 1336 (2000) ("The original Patent Act of 1790 contemplated that patent owners could assign their rights, and that in such instances the assignee would have standing to sue for patent infringement.").

108. *See* Sebok, *Should the Law Preserve Party Control?*, *supra* note 9, at 871 (explaining subrogation in the insurance context).

109. Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1276 (defining litigation finance as "the provision of funds by companies who have no other connection with the litigation").

110. A list of notable contributions to the litigation finance literature is given above at *supra* note 9. In addition, a number of earlier articles have discussed more generally the practicability and desirability of some form of market for legal claims. *See, e.g.*, Abramowicz, *supra* note 97; Choharis, *supra* note 87; Cooter, *supra* note 12; Macey & Miller, *supra* note 5.

111. Molot, *supra* note 6, at 93 (noting that "[o]ver the last decade or so, a relatively new 'cash advance' industry has developed"); Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1277 (referring to litigation lending as "first-wave litigation funding"). *See generally* Andrew Hananel & David Staubitz, *The Ethics of Law Loans in the Post-*Rancman *Era*, 17 GEO. J. LEGAL ETHICS 795 (2004); Susan Lorde Martin, *Financing Litigation On-Line: Usury and Other Obstacles*, 1 DEPAUL BUS. & COM. L.J. 85 (2002); Susan Lorde Martin, *Financing Plaintiffs' Lawsuits: An Increasingly Popular (and Legal) Business*, 33 U. MICH. J.L. REFORM 57 (1999–2000); Susan Lorde Martin, *Litigation Financing: Another Subprime Industry That Has a Place in the United States Market*, 53 VILL. L. REV. 83 (2008) [hereinafter Martin, *Litigation Financing*]; Susan Lorde Martin, *The*

typically run by former contingency fee lawyers[112]—provide individual personal injury plaintiffs with cash advances that can be used both to fund litigation and to finance the plaintiff's personal expenses while their suit is pending. The cash advance is a loan charging a fixed interest rate that is usually pegged at a very high level.[113] To avoid running afoul of usury laws, the advances are mostly structured as non-recourse loans where the plaintiff is only obliged to pay back the lender out of the proceeds of the pending lawsuit.[114] The litigation lender plays no active role in litigation. However, the non-recourse nature of the loan means that the lender must feel comfortable that the claim will result in a sufficient recovery to pay back the funds advanced.

Due to the high rates charged, and the often vulnerable and unsophisticated nature of its customers, litigation lending has been criticized as a form of predatory lending.[115] While some jurisdictions have given their blessing to litigation lending in one form or another,[116] several states have taken or considered steps to limit litigation lending or place caps on the fees and rates charged.[117] Nonetheless, litigation lending does arguably assist in the funding of claims that might otherwise not be able to be maintained. Like other forms of subprime lending, litigation finance provides credit to parties who would otherwise lack access to it, allowing plaintiffs to finance their living expenses by moving some of the expected future value of a claim forward in

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Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed, 10 FORDHAM J. CORP. & FIN. L. 55 (2004) [hereinafter Martin, *The Litigation Financing Industry*]; Julia H. McLaughlin, *Litigation Funding: Charting a Legal and Ethical Course*, 31 VT. L. REV. 615 (2007); Rodak, *supra* note 9.

112. *See* Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1277 (noting that litigation lenders are "often relatively small operations set up by former contingency fee lawyers who recognized the demand for such lending services").

113. *See* Molot, *supra* note 6, at 93 (noting "the very high interest rates charged by cash advance firms—typically 3% to 5% monthly interest, and often much higher").

114. *Id.*; *see also* Kalajdzic et al., *supra* note 9, at 129 ("The nonrecourse character of the loans allows the circumvention of usury laws, which bar ultra-high interest loans.").

115. *See* Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1277 (suggesting that litigation lenders "oftentimes engaged in predatory lending"). Molot has also suggested that the high rates charged by litigation lenders might distort litigation outcomes by increasing the pressure on the plaintiff to settle quickly to get out from under a loan. Molot, *supra* note 6, at 93–94.

116. *See, e.g.*, OHIO REV. CODE ANN. § 1349.55 (West Supp. 2015). A minority of states apply usury laws even to non-recourse loans, thus sharply limiting the ability of litigation lenders to operate. *See, e.g.*, Odell v. Legal Bucks, LLC, 665 S.E.2d 767, 779 (N.C. Ct. App. 2008); Kalajdzic et al., *supra* note 9, at 129 n.150.

117. *See, e.g.*, ARK. CODE ANN. § 4-57-109 (Supp. 2015) (applying usury laws with a maximum rate of 17%—as stated in § 4-57-104 and ARK. CONST. amend. 89, § 3—to litigation lenders and requiring various disclosures). *See generally* JOHN H. BEISNER & GARY A. RUBIN, U.S. CHAMBER INST. FOR LEGAL REFORM, STOPPING THE SALE ON LAWSUITS: A PROPOSAL TO REGULATE THIRD-PARTY INVESTMENTS IN LITIGATION (2012), http://www.instituteforlegalreform.com/uploads/sites/1/TPLF_Solutions.pdf (proposing increased oversight for litigation lenders).

time.[118] An injured party facing emergency medical or other expenses may rationally have an extremely high discount rate, making attractive even the high rates charged by litigation lenders.[119]

More recently, in what Steinitz has referred to as "second-wave litigation funding,"[120] specialized investment funds have begun investing directly in litigation. In contrast to the relatively numerous litigation lenders, thus far only around two dozen litigation finance firms are in operation in the United States.[121] Among the largest and most prominent are Juridica Investments and Burford Capital, each of which manage portfolios in the hundreds of millions of dollars, and both of which are publicly traded on the London Stock Exchange.[122]

While litigation finance companies typically keep the details of their arrangements confidential, the basic structure has been for the finance company to approach individual plaintiffs or plaintiffs' firms who have pending litigation that is of potential interest. They offer to provide funds to finance the litigation in exchange for a percentage of the ultimate recovery.[123] Depending on the amount of financing provided and the litigation funder's estimate of the potential recovery, the contingency fee can range from quite low up to as high as fifty percent, usually capped at some multiple of the amount of funding provided. Obviously, "pricing" the investment properly—in terms of setting the size of the contingency fee appropriately—depends on the funder's ability to accurately assess the expected ultimate recovery.

D. *THE LIMITED PROMISE OF LITIGATION FINANCE FOR AGGREGATE CLAIMS*

The rise of litigation finance holds out little promise as a means to address the agency problem in aggregate litigation. In the U.S., litigation finance has almost exclusively involved funding of plaintiffs and their attorneys.[124] The claims financed are rarely personal injury claims, but rather

118. *See* Martin, *Litigation Financing*, *supra* note 111, at 87; Martin, *The Litigation Financing Industry*, *supra* note 111, at 74–75.

119. *See* Abramowicz, *supra* note 97, at 736 (explaining that "[s]ome tort plaintiffs face liquidity problems, particularly if they face unexpected bills attributable to the tort, such as medical expenses," and thus may have abnormally high discount rates).

120. Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1277.

121. *See* Kalajdzic et al., *supra* note 9, at 130 ("Reports put the number of major litigation lenders in the United States at roughly 19.").

122. *Id.*

123. *See id.* at 100; Molot, *supra* note 95, at 178–81; Steinitz, *The Litigation Finance Contract*, *supra* note 9, at 480.

124. Some litigation finance firms have expressed interest in financing defense-side litigation, essentially providing a form of post-claim liability insurance. *See* Deborah R. Hensler, *The Future of Mass Litigation: Global Class Actions and Third-Party Litigation Funding*, 79 GEO. WASH. L. REV. 306, 322 (2011); Kalajdzic et al., *supra* note 9, at 132 ("With very few exceptions, litigation funders support primarily plaintiff-side efforts, although some lenders have expressed interest in expanding their funding to defendants and their lawyers as well."); Ralph Lindeman, *Third-Party*

large commercial claims between corporations, including price-fixing cases, patent litigation, and contract disputes.[125]

Third-party financiers have to date been involved in very few aggregate claims of any kind.[126] More importantly, there appear to be no cases involving third-party financing of class actions or derivative claims.[127] Some of the largest litigation finance firms have disclaimed any intention to fund class actions.[128]

This reluctance to invest in class actions likely stems from several considerations. First, class actions may simply be viewed as less predictable and more risky than the commercial claims that are currently the focus of litigation funding activity. Second, given the availability of the class action mechanism, litigation funders—who would likely need to secure the affirmative assent of individual plaintiffs to any fee agreement—operate at a serious disadvantage against plaintiffs' lawyers who can use the class mechanism to impose a contingency fee on the entire class on an opt-out basis. While litigation finance firms could conceivably contract directly with plaintiffs' firms to take on the costs of litigation, the need for class counsel to depend on outside financing may interfere with the ability to be appointed lead counsel in the first place.[129]

The rather limited market for litigation finance in the United States stands in contrast to the more developed markets in Australia and, to a lesser extent, England. In Australia, a handful of large—relative to the Australian market—litigation finance firms invest in a wide variety of cases, including class claims.[130] Indeed, the largest Australian litigation finance firms now concentrate the bulk of their efforts on securities class actions and other class claims.[131] As in the United States, financing deals typically involve the

Investors Offer New Funding Source for Major Commercial Lawsuits, BNA: Daily Reports for Executives, Mar. 5, 2010.

125. Kalajdzic et al., *supra* note 9, at 132–33.

126. Two exceptions are the World Trade Center Respiratory Illness lawsuit, which involved a litigation finance firm providing a loan to the plaintiffs' law firm to cover litigation expenses, and the controversial funding of a suit in Ecuador against Chevron involving environmental despoliation. *See* Binyamin Appelbaum, *Investors Put Money on Lawsuits to Get Payouts*, N.Y. TIMES (Nov. 14, 2010), http://www.nytimes.com/2010/11/15/business/15lawsuit.html; Roger Parloff, *Have You Got a Piece of This Lawsuit?*, FORTUNE (June 28, 2011, 6:06 PM), http://fortune.com/2011/06/28/have-you-got-a-piece-of-this-lawsuit-2.

127. *See* Hensler, *supra* note 124, at 323; Kalajdzic et al., *supra* note 9, at 133.

128. Hensler, *supra* note 124, at 323; Kalajdzic et al., *supra* note 9, at 133; *see, e.g.*, *Our Public Policy Statement: Pioneering Corporate Claim Finance for Commercial Litigation*, JURIDICA, http://www.juridicainvestments.com/about-juridica/our-public-policy-statement.aspx (last visited Mar. 14, 2016).

129. *See* Kalajdzic et al., *supra* note 9, at 133–34 ("[I]n the context of lawyers wrangling to represent the class, the inability of class counsel to self-fund may prove fatal to lead counsel status.").

130. For a more comprehensive overview of litigation finance in Australia, see *id.* at 96–113.

131. *Id.* at 97 ("In pure dollars, the bulk of commercial funding in Australia is now concentrated in class action litigation.").

litigation finance firm agreeing to pay the costs of litigation in exchange for a percentage of the recovery.[132]

The Australian and English examples may be misleading, though. They do not represent the future of American litigation finance so much as they reveal adaptive responses to the different legal rules in those countries surrounding the prosecution of aggregate claims. Perhaps most importantly, while contingency fees are the dominant form of compensation for plaintiffs' attorneys in the United States, contingency fees are forbidden in most cases in Australia and most of Europe.[133] As a result, plaintiffs' firms are unlikely to be willing and able to self-finance, and class claims face formidable collective action problems in raising sufficient funds to pay by the hour. In addition, in contrast to the "American Rule," whereby each party bears its own legal expenses, these jurisdictions apply the "English Rule," requiring the losing party to reimburse the legal expenses of the winning party.[134] The English Rule greatly amplifies the risk of an unsuccessful suit, particularly in a class claim where the lead plaintiff bears all of the risk of an adverse costs allocation, but only a pro rata share of any recovery.[135] A litigation finance firm, by investing in a portfolio of cases, is able to diversify away the additional risk caused by the English Rule.

Not only do Australian and English litigation finance firms routinely invest in class actions, but in Australia it is common for the funder to exercise substantial control over the selection of the attorneys and the conduct of the litigation.[136] In a pair of landmark cases, the Australian High Court explicitly blessed a funding agreement where the funder bore the costs of the proceeding in exchange for 33% of the recovery, and also retained the ability to select the attorney, conduct the proceedings, and even settle the claims.[137]

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132. *Id.* at 100 (noting that the fee "is commonly in the range 25–40% with escalation within this range depending on the time taken and/or whether there are appeals").

133. *See* Winand Emons & Nuno Garoupa, *US-Style Contingent Fees and UK-Style Conditional Fees: Agency Problems and the Supply of Legal Services*, 27 MANAGERIAL & DECISION ECON. 379 (2006) (discussing the ban on contingent legal fees in Europe); Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1278–79 n.23 (tying the development of litigation finance in Australia and the U.K. to the fact that "the legal availability of contingency fees . . . is much more limited" than in the United States).

134. *See* Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1278 n.23 (noting that "developments in the United Kingdom and in Australia must be viewed in light of the fact that both jurisdictions are governed by the so-called British rule which requires the losing party to pay the winner's attorneys' fees"); John F. Vargo, *The American Rule on Attorney Fee Allocation: The Injured Person's Access to Justice*, 42 AM. U. L. REV. 1567, 1635–36 (1993) (expressing skepticism of the English Rule's utility in the United States).

135. *See* Kalajdzic et al., *supra* note 9, at 98 ("Because a representative party is potentially liable for the costs of an unsuccessful action . . . there is great financial disincentive to take on the role of representative party.").

136. *See id.* at 147.

137. *See Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 ALR 58, 66 (Austl.); *Mobil Oil Austl Pty Ltd v Trendlen Pty Ltd* (2006) 229 ALR 51, 52 (Austl.).

The High Court emphasized the benefits of litigation finance and expressed a reluctance to interfere with arrangements entered into by individuals of "full age and capacity . . . untainted by infirmity."[138] The English Court of Appeal has also approved of litigation financing arrangements, though has suggested that control must remain with the plaintiff in order to avoid limitations on champerty.[139]

American litigation financiers often explicitly disclaim any control over the proceedings they finance. Jonathan Molot, a law professor at Georgetown and co-founder of Burford Capital, described the firm as "a passive provider of financing."[140] He emphasizes that Burford "does not control litigation or settlement decisions and does not interfere with the traditional attorney–client relationship."[141] Of course, it is difficult to believe that the party paying the bills has no influence, as a practical matter, and Molot acknowledges that "clients and their lawyers rely on Burford to monitor cases should there be a need for additional financing, and they often ask Burford for input on major litigation decisions."[142] Nonetheless, litigation funders in the U.S. have a strong incentive to appear to leave control with the original plaintiff in order to reduce the chances of running afoul of lingering restrictions on champerty and maintenance.[143]

Perhaps the most serious problem with litigation finance is that it creates a new agency problem, compounding the existing attorney–client agency problem. In place of the two-way relationship between lawyer and client, litigation finance creates a three-way triangle of divergent incentives and divided loyalties.[144] Holding a portfolio of cases—which, as explained

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138. *Campbells*, 229 ALR at 82.

139. *See* Arkin v. Borchard Lines Ltd. [2005] EWCA (Civ) 655 [40] (Eng.) ("Our approach is designed to cater for the commercial funder who is financing part of the costs of the litigation in a manner which facilitates access to justice and which is not otherwise objectionable. Such funding will leave the claimant as the party primarily interested in the result of the litigation and the party in control of the conduct of the litigation.").

140. Molot, *supra* note 95, at 178.

141. *Id.*

142. *Id.* at 178–79. Molot suggests that clients and attorneys solicit Burford's input because "they know that Burford has experienced litigators on staff and that Burford's financial interests are aligned with those of the client," but one can also imagine that the parties have an incentive to keep the party with the purse happy. *Id.* at 179; *see also* Kalajdzic et al., *supra* note 9, at 137 (noting that "it is difficult to imagine that in all cases of [third-party litigation financing] the holder of the purse strings would have no influence over the handling of the litigation.").

143. *See supra* Part III.A.

144. *See, e.g.*, Hylton, *supra* note 9, at 724 (noting "divergent enforcement incentives"); Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1322 ("A second problem, which may offset the potential positive effects of litigation finance, is the fragmentation of the triangular attorney-client-funder relationship."); *id.* at 1324 ("While both attorneys and funders, as savvy repeat players, have an interest in creating and preserving reputational gains, this interest may pull them in different directions in any given litigation and may not be aligned with the client's interest in, say, resolving a suit and moving on with her life."); *id.* at 1323 n.195 ("Each of the three members of the triangular relationship may have different views on which strategies should be employed

below,[145] holds out great promise for leveling bargaining disparities and creating the ability to play for rules—also drives a wedge between the incentives of the funder and the client in any individual case. The funder, for example, might wish to take a high-risk position in one case in the hope that it will lead to a legal rule change that will benefit the funder in future cases. The original party, of course, would wish to simply maximize the expected value of the case at hand. Similarly, the funder might decide it has a more attractive case in which to invest its capital, and desire to settle an existing case quickly, against the wishes of an original party who desires to hold out for full value. The conflict of interest is likely to be made even more acute by the fact that both the plaintiffs' lawyer and the funder are repeat players likely to have an ongoing relationship.[146] As a result, each has an incentive to facilitate the other even at the expense of the nominal client, who is more likely a one-shot player. In particular, regardless of any formal obligation on the part of the attorney to serve the client's interests, it is inevitable that attorneys will seek to curry favor with the funder who is actually paying the bills.

The existing literature on litigation finance has devoted little attention to the attorney–client agency problem or the possibility that litigation finance might help to address the problem.[147] As Burch has noted, "neither economists, ethicists, nor complex litigation scholars have considered financing as a means for addressing the distorted lawyer-client relationship in mass litigation."[148] In part, this is undoubtedly because of the scant attention given to class and derivative litigation, where agency problems are at their worst. While much of the descriptive and comparative work on litigation finance discusses the use of financing in aggregate litigation in Australia and the United Kingdom,[149] the theoretical literature has focused almost entirely on the types of individual claims—generally commercial claims—that dominate litigation finance in the United States. As noted above, litigation finance is as likely to generate an agency problem as to solve one in these contexts.

An exception to this neglect of the agency problem is the work of Burch herself. In her recent article, Burch suggests that litigation funders may help

in the litigation, when and for how much to settle, whether the client can withdraw the lawsuit altogether, and whether the client or funder gets to pick counsel." (citing VICKI WAYE, TRADING IN LEGAL CLAIMS: LAW, POLICY & FUTURE DIRECTIONS IN AUSTRALIA, UK & US 222–26 (2008))).

145. *See infra* Part IV.D.2, 4–5.

146. *See* Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1306 n.140 (explaining that the Australian experience has revealed "a repeat play amongst funders and attorneys that then further complicates the client's bargaining position within the triangular relationship").

147. One recent exception is Samuel Issacharoff, *Litigation Funding and the Problem of Agency Cost in Representative Actions*, 63 DEPAUL L. REV. 561, 582 (2014) (suggesting that litigation funders would have incentives aligned with the class counsel and might be able to monitor then so as to reduce agency costs).

148. Burch, *supra* note 9, at 1279.

149. *See, e.g.*, WAYE, *supra* note 144; Kalajdzic et al., *supra* note 9.

to reduce attorney–client agency costs by serving as an effective monitor of plaintiffs' attorneys.[150] Financiers can pay attorneys by the hour and have the kind of concentrated economic stake and repeat player expertise that will give them the incentive and wherewithal to effectively monitor the course of the litigation.[151]

As noted in Part II, the empirical evidence for the benefits of institutional lead plaintiffs are equivocal. We suspect that litigation funders may likewise fall short as monitors of class counsel, at least in terms of protecting the interests of the plaintiff class. Thus, even if funders are, as seems likely, wonderfully effective in controlling the conduct of the litigation, they will do so in pursuit of their own interests, rather than those of the client.

IV. AGGREGATION BY ACQUISITION: OUR PROPOSED MARKET FOR LEGAL CLAIMS

Given the pathologies of the class action, we propose an alternative mechanism for aggregating small claims: allowing the purchase and sale of legal rights. Would-be class members could sell their claims to buyers who specialize in evaluating and pressing claims. Having accumulated a large number of similar claims, the buyer could then press them on its own behalf. By harnessing the power of market forces in service of mass claimants, our proposal would offer a potent alternative to the class action and derivative suit as a method for aggregating claims, and one that would better serve the deterrence and compensation goals of aggregate litigation. This Part sets forth the details of our proposal.

First, we introduce the concept of claim alienation; if it were fully allowed, claims could be aggregated in several recurring contexts. Next, we show how outright claim purchase would allow the aggregation and prosecution of small, widely dispersed claims. Third, we explain how aggregation through acquisition would avoid the agency problems inherent in traditional procedural aggregation mechanisms. Finally, we provide a tangible example of aggregation by acquisition in action in one of the few contexts where it is currently possible: the corporate law statutory appraisal action.

150. *See* Burch, *supra* note 9, at 1280 ("If . . . transactions are structured according to this Article's blueprint, [litigation funders] might likewise supply the oversight and attorney monitoring that nonclass aggregation lacks."). Burch focuses on non-class aggregate litigation, on the theory that class plaintiffs are already protected somewhat by monitoring by lead plaintiffs and courts. *Id.* at 1276–78. As shown in Part II, this protection is often illusory, and many of Burch's insights would apply with equal force in the class or derivative context.

151. *See id.* at 1277.

A. A MARKET FOR LEGAL CLAIMS

Our proposal is simple: allow full alienability of matured legal claims.[152] Following the sale of the claim, the purchaser would own the claim outright and have full control over the proceedings. The seller would have no ongoing authority over the claims and not need be involved in any further aspect of their prosecution. Of course, the original holder might wish to sell only a portion of the claim or might agree by contract to assist in the prosecution of the claims by providing evidence in the litigation.

For individual claims—the sort that are not aggregated procedurally under current law—the market would operate in much the same way as the one that already exists for the small subset of claims that are already alienable. For example, patent claims may be alienated by simply selling the patent, or by assigning the patent to a corporation and selling shares to outside investors.[153] Similarly, under our proposal an individual claim—be it personal injury or otherwise—could be sold directly to an investor. Larger, riskier, or more uncertain claims could be assigned to a corporation, with shares issued to the purchaser (or purchasers, if multiple parties wish to spread the risk).[154] In a developed market, numerous diversified claims could be held by a single corporation, with bonds or other securities issued backed by the future proceeds of litigation, akin to the securitization of mortgages or other classes of assets.[155]

The situation would be somewhat more complicated for mass claims that would presently be brought as class actions. Identifying potential claimants and valuing their claims would obviously be more burdensome than in the single-plaintiff scenario. Nonetheless, the difficulties should not be insuperable. We envision the process as working similarly to the existing procedures for class notice and proof of claims in class actions.[156] The would-be aggregator could send out solicitations to potential plaintiffs, including forms designed to elicit the kinds of information that would be filed in a proof of claims, in order to help them value each plaintiff's potential claim. The aggregator could then make offers to any would-be plaintiffs whose claims appear positive value. Just as before, the claims could simply be held by the

152. Baker recently explored the possibility of the holder of claims alienating it in full to an attorney and concluded it would constitute a desirable policy change. *See generally* Baker, *supra* note 8.

153. *See supra* Part III.B.

154. *See* Abramowicz, *supra* note 97, at 739–40 ("A corporation could easily be established to prosecute a single large claim, and its shares could even be publicly traded, to further facilitate diversification of risk.").

155. *See generally* STEVEN L. SCHWARCZ, STRUCTURED FINANCE: A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION (Adam D. Ford, ed., 3d ed. 2010); Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133 (1994).

156. For summaries of these processes, see 3 CONTE & NEWBERG, *supra* note 31, §§ 8:1–10:25; 7AA CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 1787 (3d ed. 2005).

aggregator or placed in a special purpose corporation, with shares issued to the ultimate owners. Aggregation along these lines will often be practical in mass torts, such as toxic exposures, in consumer antitrust claims, and in product liability actions.

A unique case involving payphones illustrates both the incentive to aggregate claims and the difficulties of doing so under existing law.[157] Under federal telecommunications law, payphone operators were entitled to collect a fee from a long-distance carrier when a customer uses the payphone but makes a call using a 1-800 number.[158] Each of these claims by payphone operators against carriers were positive-value trivially small.[159] Only when aggregated did it make any sense to bring them. Aggregators emerged to collect claims from payphone operators, and the claims were passed by assignment.[160] Carriers challenged the standing of the aggregator to bring the claim, but the Supreme Court held that the arrangement passed Constitutional muster.[161] The Court observed that "we do not think that the aggregators should be denied standing simply because the payphone operators chose one aggregation method over another."[162] Samuel Issacharoff observed approvingly of this aggregation that "[i]n the context of repeat players . . . there should be a presumption in favor of private ordering."[163] The proposal here provides precisely such a system to facilitate private ordering in the aggregation of legal claims.[164]

B. VALUING LEGAL CLAIMS

One basic worry is that any market in legal claims might falter because such claims are not susceptible to accurate valuation by traditional financial methods.[165] Legal claims involve a wide distribution of possible damage awards, from zero to beyond the estimate of harm where punitive damages are possible. In most circumstances, there will be large information asymmetries between the parties and any outside entity attempting to value the claims. Moreover, a lawsuit may be especially difficult to model because

157. Sprint Commc'ns. Co. v. APCC Servs., Inc., 554 U.S. 269 (2008).

158. *Id.* at 271.

159. *Id.*

160. *Id.* at 271–72.

161. *Id.* at 291–92.

162. *Id.* at 291.

163. Samuel Issacharoff, *Private Claims, Aggregate Rights*, 2008 SUP. CT. REV. 183, 191–92.

164. The aggregation in APCC Services was structured as a series of assignments from the payphone operators to the aggregators all right in the claims, appoints the aggregators as attorney-in-fact, and the aggregators will remit all proceeds on the claims to the operators. *Sprint Commc'ns. Co.*, 554 U.S. at 272. The aggregators receive a quarterly fee. *Id.* This elaborate structure was necessary to avoid the historic obstacles to alienation of claims. *See* Issacharoff, *supra* note 163, 189–91.

165. *See generally* Robert J. Rhee, *The Effect of Risk on Legal Valuation*, 78 U. COLO. L. REV. 193 (2007) (discussing difficulties in valuing lawsuits).

so many factors are thought to affect its outcome: from the performance of lawyers and witnesses to the proverbial breakfast of the judge. While it is true that legal claims are often subject to great uncertainty, the notion that these difficulties are insuperable is belied by theory[166] and, more importantly, by actual experience.

Legal claims are routinely assigned some value by a wide array of parties. This valuation exercise is often implicit: law firms deciding whether to take a case on contingency; insurance companies offering liability insurance or contemplating claim settlement; accountants assigning some value to contingencies; corporations evaluating mergers; and, of course, individual parties deciding whether litigation is worthwhile or on what terms to settle a claim. Indeed, numerous litigation finance firms have been in (apparently profitable) operation for a number of years now in the United States, and for decades in other jurisdictions.[167] The success or failure of these firms depends in large part on their ability to value claims with some accuracy.

To the extent that legal claims, as financial assets, pose special problems of valuation, a number of standard tools are available to deal with these problems. Steinitz has written extensively on the uncertainties, information asymmetries, and other agency problems afflicting litigation finance, analogizing them to the difficulties faced by venture capital firms investing in tech startups.[168] Steinitz argues persuasively that the standard tools used by venture capital firms to overcome these problems—particularly staged financing, funder control, and a highly incentivized compensation structure—could also be adapted to the litigation context.[169]

Of course, it may be very difficult to evaluate the value of a claim without the benefit of discovery. Most third-parties that could purchase the claim will, initially at least, be comparatively ignorant of its merits. We expect that in such scenarios a venture capital model of the sort Steinitz proposes for litigation finance could be more generally useful in transactions involving legal claims. Purchasers, like venture capitalists investing in a risky startup, could make their purchase in stages, allowing for frequent repricing at key junctures of the litigation (i.e., after motions to dismiss; at the close of discovery; after trial), taking an increasing share of the claim over time. To the extent the original plaintiff's participation will be necessary to litigate the claim, their cooperation could be secured by contractual obligation, as in typical

166. *See generally* Joseph A. Grundfest & Peter H. Huang, *The Unexpected Value of Litigation: A Real Options Perspective*, 58 STAN. L. REV. 1267 (2006); Steinitz, *How Much Is That Lawsuit in the Window?*, *supra* note 9.

167. *See* Kalajdzic et al., *supra* note 9, at 94–96; Molot, *supra* note 95, at 180.

168. *See generally* Steinitz & Field, *supra* note 9; Steinitz, *The Litigation Finance Contract*, *supra* note 9.

169. *See* Steinitz & Field, *supra* note 9, at 723–49.

insurance contracts,[170] or by leaving some percentage of the claim with the necessary party.[171]

C. AGGREGATION BY ACQUISITION IN CORPORATE LITIGATION

Stockholder litigation is of particular interest in terms of aggregation by acquisition. We lay out our proposal in that context in some detail, while the particulars of its application to other areas of law must await future work.

At public companies, the instruments of ownership—shares of stock—are already traded on deep, liquid markets. In theory, then, aggregators could assemble a large position simply by buying shares of the relevant company after a cause of action arises. Consider, for example, a company that is revealed to have released fraudulent earnings numbers in its IPO, resulting in a sharp drop in the stock price when the true numbers are revealed. Stockholders who happened to own shares at the time the fraud is revealed may be too dispersed to effectively bring securities fraud claims against the directors and officers, absent a class action mechanism. An aggregator could, however, after the fraud is revealed, buy up a large enough block of shares to make a claim economical. Such an aggregator could specialize in estimating the value of the potential fraud claim and also in pursuing legal rights. Just as activist hedge funds specialize in agitating for change in firms, dedicated entities may emerge to enforce legal rights.

Two impediments currently stand in the way of an aggregator doing so. First is the so-called "contemporaneous ownership" requirement in stockholder suits. To bring a derivative fiduciary claim in Delaware, section 327 of the Delaware code requires that a plaintiff have been an owner at the time of the alleged wrongdoing.[172] This requirement of contemporaneous ownership means that those who acquire stock after that time have no power to enforce the claims. One influential treatise summarizes the policy behind the rule as follows: "The purpose of this requirement is to eliminate abuses associated with derivative suits, and in particular to prevent the purchasing of shares in order to maintain a derivative action attacking a transaction that occurred prior to the purchase."[173]

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170. *See* Choharis, *supra* note 87, at 482 ("As in insurance subrogation, a victim could contractually commit herself to assist in the litigation as part of the sales agreement between herself and the buyer." (footnote omitted)); Sebok, *Should the Law Preserve Party Control?*, *supra* note 9, at 874–75 (discussing contractual obligations of an insured to cooperate with an insurer in prosecuting a lawsuit).

171. *See* Choharis, *supra* note 87, at 482 (noting that "[a] victim might also be offered a continued stake in the claim" to secure cooperation); Molot, *supra* note 6, at 108 ("Given funders' incentives to ensure that plaintiffs still have some 'skin in the game,' we might rely on the market to ensure that plaintiffs have adequate incentives to cooperate . . . .").

172. DEL. CODE ANN. tit. 8, § 327 (West 2006) (requiring that a derivative stockholder allege that it held the stock "at the time of the transaction of which such stockholder complains").

173. 3 EDWARD P. WELCH ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 327.03[A] (6th ed. 2016 supp.). Delaware is of particular interest as the home jurisdiction of

The contemporaneous ownership is also at work in the class action context, albeit with a peculiar wrinkle. Delaware law has not squarely confronted the question of whether after-acquiring stockholders are members of a merger class action, for example.[174] Given this uncertainty, however, such stockholders have been precluded from serving as lead plaintiff in a merger class action.[175] They are nevertheless often eligible to receive any benefits of the class action settlement because settlement classes are commonly defined to include transferees.[176] Inclusion in the recovery class without an ability to influence the litigation is of dubious practical utility, given the extreme rarity of monetary recovery in stockholder class actions. We have been unable to locate an instance of an after-acquiring stockholder seeking to bring an individual, non-class claim. It thus remains unclear whether Delaware courts would block such a claim using the contemporaneous ownership requirement. Nonetheless, uncertainty as to the viability of such a claim doubtless plays a role in the absence of such claims.

The second impediment to buying into a stockholder suit after the fact is that purchasing a company's stock in order to pursue a lawsuit exposes the aggregator to the risk of owning the company as well as the risk of owning the claim. An aggregator seeking, for example, to assemble a large position to sue Apple directors' breach of fiduciary duty, would also have exposed itself to the risk of simply holding Apple's shares. The aggregator, presumably, would be in the business of evaluating and enforcing legal rights, not evaluating makers of laptops and portable telephones. This undesired risk may be expensive or impossible to fully hedge. Moreover, the capital required to purchase Apple's stock would almost certainly greatly exceed the value of the claim itself, potentially reducing the attractiveness of the investment. An aggregator could potentially address these constraints by simultaneously

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the majority of large, publicly traded companies, but other jurisdictions have similar requirements. *See, e.g.*, N.Y. BUS. CORP. LAW § 626(b) (McKinney 2003) ("In [a derivative] action, it shall be made to appear that the plaintiff is such a holder at the time of bringing the action and that he was such a holder at the time of the transaction of which he complains, or that his shares or his interest therein devolved upon him by operation of law.").

174. *See* 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 13.25 (3d ed. 2015 supp.) ("[A] stockholder who purchases shares of stock after the announcement of the challenged merger should not be permitted to maintain a class action challenging the merger since he is not truly a member of the class.").

175. Dieter v. Prime Comput., Inc., 681 A.2d 1068, 1072–73 (Del. Ch. 1996) ("The Dieters were not stockholders at the time of the alleged breach of fiduciary duty. They purchased their stock months later. While this conclusion does not address the merits of the defense, the spectre [sic] of the defense does disqualify the Dieters as appropriate class representatives. The Dieters are not typical of the class which owned Prime stock before the announcement of the amended Merger Agreement.").

176. *See In re* Prodigy Commc'ns Corp. S'holders Litig., No. Civ. A. 19113, 2002 WL 1767543, at *4 (Del. Ch. July 26, 2002) ("[W]hen a claim is asserted on behalf of a class of stockholders challenging the fairness of the terms of a proposed transaction under Delaware law, the class will ordinarily consist of those persons who held shares as of the date the transaction was announced *and their transferees, successors and assigns*." (emphasis added)).

buying shares and selling the shares short. But doing so would expose the aggregator to substantial legal risk because a court might find that such "empty" ownership of shares does not give the holder standing to press a claim.[177]

What a litigation investment firm would really want to own is simply the legal claim, not the whole company. The ability to purchase the claim without purchasing the entire share of stock would, thus, be appealing. Doing so, however, raises serious practical issues. In the first place, the vast majority of shares of stock are held in trust in undifferentiated bulk by the Depository Trust Company ("DTC").[178] When an individual purchases shares via a broker, DTC does not trace the individual shares, shifting them from the seller to the new beneficial owner. Instead, in clearing trades, DTC simply ensures that the ledgers balance for each registered broker at the end of the day. As a result, it is generally impossible to trace individual shares to individual beneficial owners.[179] If a stockholder were to sell the right to bring a certain claim for her shares, there would be no way of "marking" the shares as being "ex-claim," so to speak, or of tracing them on an ongoing basis such that subsequent purchasers would be aware of what they were and were not purchasing.

Given advances in information technology, of course, it would be relatively straightforward to solve these issues by keeping records of individual shares and tracing trades on a share-by-share basis.[180] It is not altogether clear, though, whether doing so would be desirable. One of the major advantages of the corporate form is that the shares are fungible—one need not investigate their provenance when deciding to purchase. If stockholders were allowed to hive off and sell aspects of their share ownership, this would no longer be the case. A would-be purchaser would need to determine whether she wished to purchase shares with or without rights to pursue various claims, and determine how much more or less she should be willing to pay. Indeed, given the multiplicity of claims a given company may face, search costs could escalate quickly, impairing the efficient functioning of capital markets.

177. *See In re* Appraisal of Transkaryotic Therapies, Inc., No. Civ. A. 1554-CC, 2007 WL 1378345, at *2 (Del. Ch. May 2, 2007) (noting that "most securities issued by domestic companies listed on the NYSE and on the Nasdaq are 'on deposit' with central securities depositories, such as the Depository Trust Company ('DTC')"); George S. Geis, *An Appraisal Puzzle*, 105 NW. U. L. REV. 1635, 1636 (2011) (noting that "almost all . . . publicly held companies" list "an obscure firm named Cede & Company . . . as the registered owner for most of [their] stock").

178. *See Transkaryotic Therapies*, 2007 WL 1378345, at *2 ("The securities deposited as a part of this system are held in an undifferentiated manner known as 'fungible bulk,' which means that . . . no investor who might ultimately have a beneficial interest in securities registered to Cede, has any ownership rights to any particular share of stock reflected on a certificate held by Cede."); Geis, *supra* note 177, at 1637 ("Cede merely holds a large pool of undifferentiated shares and does not specifically trace stock certificates to beneficial owners.").

179. *See* Geis, *supra* note 177, at 1637.

180. *See id.* at 1665–70 (discussing possible technical reforms).

Derivative claims are somewhat different, in that the recovery goes to the company in the first instance. In some ways, this makes the analysis simpler, in that the claim must obviously remain appended to stock ownership. An aggregator would not wish to purchase the claim alone, given that the claim belongs to the corporation and any recovery must go through the corporation. As a result, the only way the aggregator could benefit from the suit would be to share in the ownership of the corporation.[181] Thus, an aggregator would only find an investment worthwhile if the expected value of winning the envisioned derivative suit would increase the value of the company—and thus, derivatively, the value of their stock—by enough to justify their investment. The problem of untraceable shares, therefore, does not arise in the derivative context. The contemporaneous ownership requirement, however, could still stand in the way of an aggregator buying stock after a claim arises and then serving as lead plaintiff.

Before discussing the benefits of aggregation by acquisition, it is worth mentioning the possibility that competing aggregators might each amass large blocks of claims for a single case. This poses little challenge, however, in that the numbers of distinct aggregators would likely be low enough to be susceptible to traditional procedural devices like joinder or consolidation.[182]

D. *THE BENEFITS OF A MARKET FOR LEGAL CLAIMS*

Our proposed scheme of aggregation through acquisition holds out substantial benefits to both litigants and society generally. We explore those benefits in this Subpart, using procedural aggregation as a baseline comparison. Our proposal is no panacea, of course, and we confront some objections and qualify our proposal in the Part V.

1. The Diminished Problem of Attorney Agency Costs

Aggregation by acquisition promises to greatly reduce otherwise pervasive attorney–client agency costs. Even in individual claims, claim purchase stands to reduce agency costs considerably. An unsophisticated, resource-poor plaintiff may have little practical ability to monitor and control an attorney working on contingency, whose incentives may diverge from those of the client.[183] Claim purchase replaces such a plaintiff with an experienced

181. Of course, one could imagine a litigation investment firm seeking to buy the claim from the corporation itself. This scenario does not involve aggregation, however, and is outside the scope of this Article.

182. As is discussed below, it is routine in appraisal litigation for multiple petitioners to seek appraisal, and for the resulting claims to be consolidated for trial.

183. *See* Abramowicz, *supra* note 97, at 738 ("[C]ontingency fees can create tensions between optimal strategies for the lawyer and the client. A lawyer may have a greater incentive to settle a case if he will bear the cost of preparing the case or a lesser incentive if he is less risk-averse than the client, and the incentives will cancel out only by happenstance." (footnotes omitted)).

party—who will likely pay her attorneys by the hour—with the necessary expertise and resources to effectively monitor the attorneys.[184]

It is in the class and derivative context, however, where the reduction in agency cost promises to be greatest. In a class action, the attorney decides whether to bring a claim, locates a representative plaintiff, and controls the litigation, including the terms on which to settle.

Aggregation by acquisition changes this calculus entirely. The claim purchaser aggregates a large number of small claims into a single large claim, transforming what would otherwise have been part of a class or derivative action into an individual action. The aggregator subsequently has both the ability and the incentive to provide effective monitoring of the attorneys and of the progress of the litigation. It will be the plaintiff making the decision to bring a claim and hire an attorney, rather than the other way around.

Litigation finance can complicate agency costs in class actions because the financier's interest diverges from the class members'.[185] Our proposal avoids sticky issues of control, privilege, and professional ethics that arise in the presence of an interested non-party. When a claim purchaser buys a claim, it becomes the party to the claim, displacing the original party entirely. To be sure, the purchaser may leave some of the claim with the original party to ensure cooperation in the litigation—or provide the seller with a contingency fee—but for the most part, control and interest in the claim will pass to the buyer.[186] Questions of privilege waiver, control, and divergent incentives are thus dissolved. The purchaser simply acts in his own interests, and the agency problem between the buyer and seller is obviated.[187]

2. Improved Compensation for Those Harmed

As an initial matter, plaintiffs will often be able to recover money damages more quickly when selling their claims than when financing their prosecution or litigating as a class.[188] A plaintiff receiving litigation finance is able to offload the cost of prosecuting his claim, along with some of the risk, but does not receive the cash value of his claim upfront unless he avails himself of litigation lending, which is generally available only at very high

184. *See id.* ("Although [the claim purchaser] may hire a lawyer to actually prosecute the claim rather than pursuing it pro se, she will presumably be in the business of buying claims and thus be in a better position to monitor the lawyer and reduce the danger of agency costs.").

185. *See supra* Part II.C.

186. To the extent that the claim purchaser only buys a portion of the claim, some residual agency costs will be foreseeable, and the purchaser will either need to provide some reliable assurance against them or pay a premium for the purchase.

187. *See* Abramowicz, *supra* note 97, at 738 ("If a legal claim is sold in its entirety, however, the new owner of the claim will be acting entirely in her own interest.").

188. *See id.* at 735 ("A simple argument for allowing plaintiffs to sell claims for money damages is that they will be able to recover more quickly."); Baker, *supra* note 8, at 275 ("[T]he clients would be able to receive their settlement funds sooner and with greater certainty regarding the net value of their claim."); Choharis, *supra* note 87, at 444.

interest rates.[189] By selling their claims, plaintiffs will benefit from receiving money upfront rather than having to wait for their claims to be resolved. Accident victims are likely to face a high discount rate, as many victims will face emergency costs as a result of their injury.[190] Even where courts provide for pre- and post-judgment interest, it is not tailored to the discount rate of the particular plaintiff, and is likely to be far below the discount rate for many accident victims.[191]

In addition to receiving their compensation sooner under our proposal, plaintiffs selling claims are also likely to receive more in nominal terms.[192] This is because claims will be worth more to claim aggregators than to individual plaintiffs. First, the claim aggregator will almost certainly have a lower discount rate than an individual victim, reducing the cost to the victim of the delay between the accident and final resolution.

Second, unlike an individual victim, the claim aggregator will be able to hold a diversified portfolio of claims, greatly reducing the risk from any particular claim and rendering the aggregator essentially risk-neutral.[193] As explained further below, a risk-averse plaintiff would be sorely tempted to accept an offer at the median result at trial, which is often only a fraction of the mean.[194] A diversified aggregator, however, can either bear the risk of trial or hold out for a settlement at the expected value of the claim—the mean result at trial.

A third reason a claim will be worth more to a claim purchaser is that the purchaser, as a repeat player, will be able to develop specialized expertise and economies of scale that will reduce the costs of litigating a claim. For risk-neutral parties, the value of a claim is the value of the expected judgment minus the cost of litigating the case to realize that value. The same claim will thus be worth more to an aggregator than to even a risk-neutral plaintiff with a higher cost of litigation.[195]

189. *See supra* Part III.C.

190. *See* Abramowicz, *supra* note 97, at 736 ("Some tort plaintiffs face liquidity problems, particularly if they face unexpected bills attributable to the tort, such as medical expenses, and their discount rate may be higher than the prejudgment interest rate.").

191. The fact that so many plaintiffs are willing to borrow at the extraordinarily high rates offered by litigation lenders provides some indication of the very high discount rates of many accident victims. *See supra* Part III.C.

192. *See* Choharis, *supra* note 87, at 480 ("[T]he sale of tort claims will almost always provide tort victims with greater compensation than would be available under the present tort system.").

193. *See* Abramowicz, *supra* note 97, at 736 ("A tort claim . . . will often be a significant asset in a plaintiff's portfolio, while a purchaser of tort claims may be able to diversify—for example, by purchasing a variety of different tort claims, some of which will be more successful than others.").

194. *See infra* Part IV.D.4.

195. *See* Abramowicz, *supra* note 97, at 745–46; Hylton, *supra* note 9, at 715 ("[T]here is room for the alter ego to profit from [buying a claim] if the alter ego's litigation expenses are lower than the victim's expenses.").

In a competitive market, the seller will receive the bulk of the additional value that a claim provides to an aggregator. This is so because the price paid by a buyer in a competitive market will need to be equal to its value to other potential buyers, rather than the value to the seller.[196] Even in a less-than-fully-competitive market, buyers and sellers will negotiate to a price somewhere between the value to the buyer and the value to the seller.[197] As a result, the plaintiff can be expected to receive a higher price by selling than by litigating, even where the market is not fully competitive. This conclusion is strengthened by the fact that the plaintiff can simply decide to litigate the case rather than sell if, for whatever reason, that is the more attractive option.

The policy goal is generally not to provide plaintiffs with maximal compensation; the goal is to provide them with accurate compensation. The promise of risk-neutrality and lower litigation costs provided by repeat player aggregators should tend to drive settlement outcomes closer to the mean outcome at trial.[198] In a competitive market, this would also represent the amount aggregators would be willing to pay victims for their claims. Thus, instead of settling claims for the median or participating in the often all-or-nothing lottery of trial, plaintiffs will receive approximately the expected value of their claim. To the extent that the average outcome is considered "accurate," then, the seller of a claim will almost always receive more accurate compensation than a plaintiff who settles or litigates a claim herself.[199]

3. Improved Deterrence

A related benefit is that deterrence will also be more accurate. Defendants will be forced to either litigate claims to judgment on the merits or to settle with a risk-neutral aggregator for the mean result at trial. To the extent that the mean result at trial is "accurate," this will force the defendant to fully internalize the harms generated, providing optimal deterrence. In contrast, where the defendant is able to settle with risk-averse individual plaintiffs for the median result at trial, the result could be substantial under-deterrence.[200] Taken together, more accurate compensation and more

196. *See* Abramowicz, *supra* note 97, at 736 ("Plaintiffs will surely pay a premium, in the form of a reduction in the amount received, for moving the risk [of a claim] onto the purchasers of the claims. But in a competitive market, the premium should be equal to the burden of the risk on the purchaser rather than to that on the seller.").

197. *See id.* ("Even if there were a monopoly purchaser of legal claims, the risk premium would ordinarily be between the burden of the risk on the plaintiff and the burden of the risk on the purchaser, because the plaintiff and purchaser would have to negotiate a fee that benefited both.").

198. Molot, *supra* note 6, at 86–87; *see also infra* Part IV.D.4.

199. *See* Abramowicz, *supra* note 97, at 737 ("If accuracy is defined as what the average decisionmaker would decide, sales of claims may well produce more accurate results than complete litigation." (footnote omitted)).

200. We are speaking here of a risk-averse plaintiff and a risk-neutral defendant, though the situation may obviously be reversed. *See infra* Part IV.D.4; *see also infra* note 208. In general, where risk-averse parties can sell claims to risk-neutral parties, accuracy will be enhanced.

accurate deterrence represent more accurate private enforcement of the substantive law where sale of claims is permitted.

4. Increased Accuracy and Access in Civil Justice

Another straightforward benefit of a market in legal claims is that it would increase access to justice. Parties who are cash-poor, and who would otherwise be unable to pursue even a claim with positive expected value, can sell all or part of the claim to someone who has the wherewithal to pursue it. In theory, of course, litigation finance and contingency fee arrangements can serve the same function,[201] but as noted above there is little reason to think that these will deliver benefits for small claimants. Our proposal presents the prospect of a far broader, deeper, and more competitive market. The potentially greater scale of a market for legal claims and aggregators' ability to diversify should enable them to take on cases that would be too costly or too risky for litigation financiers or for law firms working on contingency.[202]

The actual outcomes that result from this increased access will also be more accurate. In part, this is a corollary of the improved compensation and deterrence discussed above. Molot has explored the issue of accuracy in detail in the context of litigation finance, emphasizing the potential for financiers to rectify imbalances in bargaining power that might otherwise lead to inaccurate litigation outcomes.[203] Consider an individual plaintiff in a slip-and-fall case against Wal-Mart. Wal-Mart is likely to have a substantial advantage in bargaining power over the plaintiff. First, Wal-Mart, with its tremendous financial resources, can credibly threaten to play hard-ball, increasing the cost and duration of litigation to an extent the plaintiff cannot afford, thus increasing the pressure to settle. Second, the plaintiff is likely to be risk-averse, while Wal-Mart is likely to be risk-neutral. This is in part because Wal-Mart is the wealthier party, for whom the cost of losing is less devastating than the cost of losing would be for the plaintiff. In addition, however, Wal-Mart is a repeat player, diversified across hundreds of similar lawsuits, while the plaintiff is a one-shot player with all her eggs in one basket. As a result, the consequences of an adverse judgment will be far more devastating for the plaintiff than for the defendant.[204]

201. Indeed, the typical contingency fee arrangement can be thought of as a form of litigation finance, though restricted only to plaintiffs' attorneys. *See supra* Part III.B.

202. *See, e.g.*, Marc Galanter, *Anyone Can Fall Down a Manhole: The Contingency Fee and Its Discontents*, 47 DEPAUL L. REV. 457, 468 (1998) (discussing the limitations of contingency fee financing); Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1305 n.135 (noting that "[i]ndividuals, sovereigns from the developing world, and some classes—especially in very complex and therefore very expensive cases that the Plaintiffs' Bar cannot absorb—will gain the largest increase in access to justice" from litigation finance).

203. *See* Molot, *supra* note 6, at 82–90; Molot, *supra* note 95, at 175–77.

204. *See* Molot, *supra* note 6, at 84 ("A one-time, risk-averse party will be more fearful of the worst-case scenario than a repeat player because the risk-averse party cannot absorb and

The likely result of this bargaining power imbalance is that the accuracy of proceedings will be impaired. Personal injury suits, along with other types of claims, show a wide spread in the size of damages awarded. A small number of plaintiffs obtain large judgments, while roughly half receive nothing at all.[205] As a result, the median award (the amount that is greater than half of all awards and less than half of all awards) is typically substantially less than the mean award (the mathematical average of all judgments).[206] Wal-Mart, with its large portfolio of cases, will have little incentive to settle for more than the expected value of a judgment at trial—that is, the mean damages award.[207] The risk-averse plaintiff, meanwhile, fearing a bad result at trial, will typically be willing to settle for substantially less. An offer at or above the median award—what the plaintiff is "likely" to receive—will be extremely tempting for a plaintiff facing a significant risk of receiving nothing.[208]

Not only do these bargaining imbalances give inadequate compensation to plaintiffs, they also lead to insufficient deterrence.[209] The overwhelming majority of civil cases settle, and for the substantive law to achieve its objectives, defendants should pay in settlement amounts that reflect the expected trial outcomes, adjusted for time and risk.[210] In personal injury cases, assuming courts resolve cases accurately on average, this amount would be sufficient to cause defendants to bear the costs of the harm they have imposed on others. This result would obtain if defendants settled for the mean award, which is simply the sum of all judgments divided by the number of cases. If defendants are typically able to settle cases for the median award—which is

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redistribute the costs imposed by an adverse ruling, unlike the repeat player who holds a diverse pool of litigation risk.").

205. *Id.* at 85 (citing Samuel R. Gross & Kent D. Syverud, *Getting to No: A Study of Settlement Negotiations and the Selection of Cases for Trial*, 90 MICH. L. REV. 319, 335 fig.1, 338 fig.2, 339 fig.3 (1991)).

206. Robert J. MacCoun, *Media Reporting of Jury Verdicts: Is the Tail (of the Distribution) Wagging the Dog?*, 55 DEPAUL L. REV. 539, 543 tbl.2 (2006) (listing studies measuring mean and median trial awards for various jurisdictions); Molot, *supra* note 6, at 85 ("The mean damages award for personal injury suits in jurisdictions for which data are available is much greater than the median damages award—roughly three to five times bigger according to a number of studies.").

207. *See* Molot, *supra* note 6, at 84.

208. *See id.* at 86–87 (explaining why a risk-averse party is likely to settle for the median award).

209. While our example involves a repeat-player defendant with a bargaining advantage over a one-shot plaintiff, many situations might involve a repeat-player plaintiff and a one-shot defendant. Examples might include patent infringement claims, or securities fraud and merger class actions, where a plaintiffs' firm might have a portfolio of suits while any individual firm is an infrequent target. In such cases, the dynamics described in the text would be reversed, with the plaintiff receiving excessive compensation and the defendant being over-deterred. *See id.* at 84 (noting that "a one-time defendant worried about a catastrophic loss may agree to pay more than the mean expected damages award to eliminate that risk").

210. As noted above, we assume that the substantive laws themselves—and the decision to allow private plaintiffs to enforce the substantive law—represent good policy. *See supra* Part I.

substantially lower than the mean—they will bear only a fraction of the harms they impose.[211] The net result is under-enforcement of the substantive law.[212]

Molot has shown that the negative effects of bargaining power imbalances can be addressed by plaintiffs selling some or all of a claim to a litigation funder. Doing so replaces a financially weak, one-shot plaintiff with a financially capable repeat player. Because the purchasing firm can hold a diversified portfolio of claims, it need not worry about outlier outcomes in any given case, and can—like the repeat-player defendant—hold out for the mean expected damages award.[213] Of course, one might be concerned about purchasing firms themselves abusing their bargaining power advantage in dealing with plaintiffs. But as Molot points out, market competition among potential buyers would protect risk-averse plaintiffs in a way that it cannot protect them in settlement negotiations, where the defendant functions as a monopsonist.[214]

Our proposal would go even further than litigation finance in equalizing the bargaining power of plaintiffs and defendants. It could deliver rapid and competitively-priced relief to claimants, regardless of the per-person magnitude of the injury.

5. Equalized Influence on Legal Rules

Another benefit of our proposal's transformation of one-shot parties into repeat players is that it would increase the ability of such parties to "play for rules" as a part of litigation strategy. Our proposal would again deliver similar benefits as litigation finance but to a larger class of claimants.

Steinitz has explored this issue in detail in the context of litigation finance. Her work builds on that of Galanter, who argued that institutional repeat players have structural advantages over one-shot players in affecting the legal system.[215] In part, this is due to the dynamic discussed by Molot—

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211. *See* Molot, *supra* note 6, at 87 (noting that if "a defendant routinely settles cases at the median, rather than the mean, it substantially undermines our goal of ensuring that settlements approximate what defendants would pay at trial").

212. *See id.* at 83 ("[B]y holding out for a better deal in every case, a repeat-player defendant who faces many suits from one-time plaintiffs can routinely expect to settle cases below the mean damages award, thereby undermining substantive law goals like accurate deterrence, just compensation, and retributive justice.").

213. As Molot puts it, "[i]ntroducing a repeat-player, risk-neutral entity on the plaintiffs' side would not only promote more accurate deterrence—by ensuring that defendants pay amounts closer to the mean expected damages award—but also improve plaintiffs' compensation." *Id.* at 89.

214. *See id.* at 89–90 ("There might be a bargaining imbalance between the plaintiff and the middleman, just as there currently is between the plaintiff and the defendant, but market forces could counter the effect of that bargaining imbalance and permit the plaintiff to shop around his claim and get the best offer possible. No longer forced to deal with a single counterparty, even the most risk-averse plaintiff would have a chance at a fair recovery.").

215. *See generally* Galanter, *supra* note 202.

that repeat players are able to play the odds, while a risk-averse one-shotter is more likely to try to minimize the chance of a highly negative outcome.[216]

Moreover, repeat players are able to invest in seeking favorable rule changes that will benefit them in future cases. They can do this in several ways. They can trade off gain in one case for gains in future cases, either by investing more resources in litigating for a rule change than would be strictly optimal in the case at hand, or by settling claims where a negative rule change appears possible.[217] Repeat players can also engage in extra-judicial lobbying of legislatures and regulators. In contrast, one-shot parties will only invest in seeking rule changes if the benefits in the single case at hand are large enough to justify the risk and expense. Benefits to other similarly situated parties down the road are simply externalities from the point of view of the one-shotter, arguably resulting in under-investment in seeking rule changes by infrequent litigants. The resulting imbalance is likely exacerbated by the repeat players' development of greater expertise and understanding of the legal system and how to change it.[218] Over the long term, Galanter and Steinitz argue, this dynamic leads to litigation serving as a "guardian of the status quo in favor of society's haves."[219]

The introduction of a market for legal claims and professional claims aggregators can transform large groups of plaintiffs from one-shot parties into repeat players, capable of playing for rules.[220] In theory, of course, law firms—both defense and plaintiff-side—can serve as repeat players and might seek legal changes that benefit their clients over the long-term. At least two factors, however, hamper the ability of law firms to be effective in this role. First, law firms have an incentive to seek legal rules that maximize legal fees, which are unlikely to be entirely congruent with rules that would maximize the welfare of their clients. To the extent that the incentives of litigation financiers are more aligned with the funded parties, they will function as superior "guardians" in this regard, but will still be inferior to outright claim purchasers who actually *are* the client. The second limitation is common to both law firms and to litigation finance as currently practiced—the fact that the client retains

216. *Id.* at 99–100 (noting that while repeat players "can play the odds[,] [t]he larger the matter at issue looms for [the one-shotter], the more likely he is to adopt a minimax strategy (minimize the probability of maximum loss)").

217. *Id.* at 101 (arguing that a repeat player "may be willing to trade off tangible gain in any one case for rule gain . . . . We would then expect [repeat players] to 'settle' cases where they expected unfavorable rule outcomes").

218. *See id.* at 98–102; Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1301 ("In short, repeat players both understand the system and have the long-term perspective that allows them to game the system. One-shotters, on the other hand, may not have enough experience with the system to understand it. Even when they do, they may not have the desire or the flexibility to risk a short-term loss in favor of a long-term gain that will likely accrue to someone else.").

219. Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1272. *See generally* Galanter, *supra* note 202.

220. Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1303.

ultimate discretion over settlement.[221] Whatever the incentives of firms or financiers to seek rule changes that will be beneficial over the long term, they will be ineffective if the client—who will not share in the benefits—is unwilling to bear the risks associated with seeking them. Our proposal eliminates this barrier.

6. Diminished Litigation Costs

A final benefit of this proposal is that it would lead to lower costs of litigation. This is no doubt counterintuitive, given that claim that sales have long been regarded as something that would cause litigation to metastasize. But as we explore below, litigation should proceed under our proposal only when the claim is strong enough to induce someone to invest in it. We expect that many claims currently pressed as class actions are brought for their nuisance value to plaintiffs' attorneys and would not be sufficiently attractive when viewed as an investment. Even if the level of litigation under our proposal were to remain the same as it is now, a market for legal claims may also function to reduce litigation costs on a per case basis. Claims aggregators, as repeat players, will offer specialized expertise and economies of scale, potentially routinizing and streamlining many types of cases, particularly where the other side is also a repeat player. Litigation financiers can offer similar benefits in the types of claims where they are active.[222] Furthermore, claims aggregators will invest in reputation such that the fact of their investment will serve as a reliable signal to the other side of the case's quality, potentially leading to faster settlement of meritorious suits, which minimizes litigation costs.[223]

E. *ACQUISITION VERSUS AUCTIONS*

In comparing our proposal to the status quo of procedural aggregation, we may be picking on too easy of a target. The agency costs of the class action are so severe that by comparison nearly any reform proposal looks like an improvement. The auction proposal from Macey and Miller is a more formidable comparison, and perhaps, a more natural one.[224] That proposal holds out considerable promise, and where practicable would be a serious

221. As discussed below, this would not be true in the fuller market for legal claims we propose. *See infra* Part IV.F.

222. *See* Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1305 (suggesting that recipients of litigation finance will "reap the benefits of economies of scale [and] accumulated expertise" of litigation finance firms).

223. *See id.* ("In fact, an institutional commercial funder's willingness to fund a lawsuit, if known to the opposing party, may itself function as a signal to the opposing party regarding the strength of the claim. Such a signal can strengthen the funded party's bargaining position and enhance the chances of an early and high settlement. This, in turn, may create positive externalities as cases get settled and taken off courts' dockets early." (footnotes omitted)).

224. *See supra* Part II.D.

improvement over the status quo. Aggregation by acquisition nevertheless offers some distinct and substantial advantages as a structure for pressing mass claims.

Under the auction proposal, the claim would be sold shortly after the commencement of the filing. The ability to accurately value claims at this early stage of the proceeding is thus critical to the success of the auction. For this reason, Macey and Miller propose some form of initial discovery so that bidders can refine their valuation estimates. An auction, however, unavoidably entails a one-time valuation at a relatively early stage, with all the attendant risk of getting it wrong. To the extent that claims are difficult to value and the risk of error is high, the resulting market is likely to be thin.

By contrast, our proposal has no single critical moment at which the claims must be valued. Claims could trade freely before, during, and after litigation (including after someone else's litigation on similar claims). An acquirer may decide to make an initial investment based on a preliminary valuation of some minimum amount necessary to make the claims cost-justified. As litigation proceeds, that valuation may become more refined as motion practice and the discovery process generate more information about liability and damages. In short, one of the crucial methods for managing the risk of investing in hard-to-value assets—staged investment—is available under our proposal but not under an auction system.[225]

The availability of staging investment will likely result in a far thicker and more competitive market. If during the course of litigation the acquirer finds the claims to be more valuable than originally estimated, it may purchase additional claims to supplement the original position. Remaining claim holders can share in this appreciation, as the price at which they can sell the claims will rise along with the acquirer's reservation price. Crucially, the acquirer pressing the claims in court will not be a monopsonist. Multiple acquirers could enter the market at any time and seek to buy any remaining claims and press them. Any holder of valid claims can sell into this market or seek to pursue the claims themselves. Similarly, capital constraints would pose less of a problem in aggregation by acquisition because parties could structure their acquisitions—with pilot purchases and options on additional blocks of claims—such that securing financing would be relatively easy when necessary. Under an auction regime, any bidder who does not have sufficient internal capital on hand would need to have a valuation sufficiently reliable to induce outside lenders or equity investors.

The ability to stage investment also means that the standard modes of discovery are sufficient to support aggregation by acquisition. Because there

225. *See* Charles R. Korsmo, *Venture Capital and Preferred Stock*, 78 BROOK. L. REV. 1163, 1219–21 (2013); Steinitz & Field, *supra* note 9, at 735, 741–45 (discussing the benefits and some challenges of staged financing); Steinitz, *The Litigation Finance Contract*, *supra* note 9, at 504–06 (discussing the benefits of staged financing).

is no single pivotal moment when the claims must be valued, and thus no time by which all relevant information must be known to all interested parties, there is no need to fashion a novel pre-auction discovery process. More broadly, aggregation by acquisition calls for far less intervention and innovation from courts than would a court-conducted auction. While an auction procedure poses substantial procedural and practical difficulties for the supervising judge, aggregation by acquisition leaves such problems to be surmounted by the creative energies of the market participants. Under our proposal, one entrepreneurial acquirer can test the viability of a claim for little upfront cost beyond the cost of compensating the original claims-holders.

A final, related benefit of aggregation by acquisition is that it empowers the claims holders, relying on voluntary alienation of claims rather than coercive exercises of judicial power. Under our proposal, claim-holders can choose from a multitude of potential purchasers, which generates its own benefits, but importantly they can also choose *not* to sell, or to sell only to particular parties. A claim holder may wish to press her claim individually, and having the initial acquirer clearing a path to liability can permit the determined victim to tag along. Or she may wish not to have her claim pressed at all. In this way, aggregation by acquisition is more respectful of the agency of the initial claim holder. Instead of being forced into an involuntary alienation of claims through some procedural mechanism, the holder is empowered to sell outright, sell under some option contract, alienate less than all of the claim, or decline to sell and seek—or decline to seek—some relief under collateral estoppel later on.

F. An Example of Aggregation by Acquisition: Appraisal Arbitrage

To illustrate the potential for aggregation by acquisition for the reduction of agency costs and the effective private enforcement of the substantive law, it is worth examining one of the few contexts in which such aggregation is currently possible: appraisal litigation.[226] Appraisal allows a stockholder to dissent from a merger and forego the merger consideration in favor of filing a judicial proceeding to calculate the "fair value" of the stock cancelled in the merger.[227]

Appraisal can offer an alternative avenue of redress for minority shareholders who believe that the price being offered for their shares in a merger transaction is too low. As such, appraisal can address, in a rough way, the same general wrong that other forms of merger litigation seek to address:

226. We have recently examined appraisal litigation in more depth in two articles: Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U. L. REV. 1551 (2015); and Korsmo & Myers, *supra* note 34.

227. *See generally* DEL. CODE ANN. tit. 8, § 262 (West 2006 & Supp. 2015) (setting forth rules governing appraisal rights); MODEL BUS. CORP. ACT § 13.02 (AM. BAR ASS'N 2010) (setting forth a shareholder's right to an appraisal). For a fuller description of appraisal, see Korsmo & Myers, *supra* note 34, at 859–67.

failure to obtain a high enough price in the sales process. Two major differences between appraisal and other forms of merger litigation, however, make appraisal an excellent example of aggregation by acquisition in action. First, there is no class mechanism in appraisal. Appraisal petitioners must affirmatively opt in to a proceeding by complying with the procedural requirements of the appraisal statute.[228]

Second, there is no contemporaneous ownership requirement in appraisal. As a result, an investor who acquires the stock after the announcement of the merger may still pursue appraisal. The cutoff for acquiring stock with appraisal rights depends on the structure of the transaction, but investors generally have long enough to examine proxy statements, tender offer statements, or other informational material before deciding whether to acquire stock with appraisal rights. This means that an investor can accumulate a large stake in a company *after* the announcement of a merger—buying shares from dispersed stockholders for whom filing a claim would be uneconomical—and still pursue appraisal rights in court.

Taken together, these features make appraisal an example of the kind of market for legal claims we envision. It allows us an opportunity to examine two major questions about aggregation by acquisition. First, is a market like this practical—that is, does anybody actually take advantage of the opportunity to essentially purchase a lawsuit? Second, does aggregation by acquisition appear to reduce or eliminate the agency problems that plague procedural aggregation? The answer to both questions appears to be "yes," at least in the appraisal context.

In a recent article, we report a burgeoning market for appraisal, involving specialist firms accumulating shares after a merger has been announced.[229] At least a half-dozen funds appear to be active in the market, with one fund reportedly raising a targeted amount of $1 billion for a dedicated appraisal fund in 2013.[230] This activity suggests that, at least under some conditions, professional investment funds will find attractive opportunities in buying the right to pursue a legal claim.

In another recent article, we compare appraisal to traditional merger class actions involving the same universe of merger deals to see whether the pathologies that afflict the latter also afflict appraisal.[231] For the fiduciary duty class actions, we find that the incidence of litigation is strongly associated with

228. *See* DEL. CODE ANN. tit. 8, § 262; Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 84 GEO. L.J. 1, 41 (1995) ("No provision is made for a class action or other means that would permit shareholders in a common situation to share an attorney and other expenses of litigation easily.").

229. *See generally* Korsmo & Myers, *supra* note 226.

230. Miles Weiss, *Dell Value Dispute Spotlights Rise in Appraisal Arbitrage*, BLOOMBERGBUS. (Oct. 2, 2013, 11:00 PM), http://www.bloomberg.com/news/articles/2013-10-03/dell-value-dispute-spotlights-rise-in-appraisal-arbitrage.

231. Korsmo & Myers, *supra* note 34.

the presence of deep pockets and that the raw size of the deal has far greater explanatory power than measures for the adequacy of the merger price. Our findings suggest that the merits count for little in the decision to bring suit and that such actions are frequently brought primarily for their nuisance value.[232] In contrast, we find that appraisal activity is not correlated with deal size at all, and is instead strongly correlated with measures of the adequacy of the merger price.[233] Mergers with smaller premium over the market price are more likely to attract appraisal actions, precisely as we would expect if the decision to seek appraisal is based on the merits of the underlying claim.[234]

In addition to the decision of an aggregator to bring an appraisal claim being more merit-driven than the decision of a plaintiffs' attorney to bring a class action, it also appears that appraisal functions better as a tool of private enforcement of the substantive law, in terms of deterrence and compensation. Merger class actions almost exclusively settle and the overwhelming bulk of them settle with no financial recovery at all for shareholders. For example, a recent article by Cain and Davidoff Solomon studying shareholder challenges to large merger transactions in 2010 finds that approximately 80% of the ensuing class actions resulted in so-called "disclosure-only" settlements, with legal fees provided to the plaintiffs' attorneys but no monetary recovery to shareholders at all.[235] It is plain that such collusive settlements can provide little or no deterrence against underpricing a merger, in addition to providing no real compensation to mistreated minority shareholders.

Again, appraisal stands in stark contrast. In our sample of appraisal cases, approximately 10% of cases had been tried to judgment, and the median award at trial was a nearly 20% premium over the merger consideration.[236] While we cannot observe settlement outcomes,[237] a disclosure-only settlement is not possible in appraisal, where the only issue is the fair value of the shares—particularly where a professional appraisal fund is seeking monetary returns. An appraisal case will settle for cash, or not at all.

In short, in appraisal—where aggregation is by acquisition—the merits of the claim appear to be the main determinant of whether a petition is filed, and the outcomes appear to provide significant compensation to shareholders and potentially meaningful deterrence. In class actions involving the same mergers—where aggregation is procedural—the merits of the claim appear to be largely irrelevant in determining whether a suit will be filed, and the outcomes compensate the plaintiffs' attorneys without providing significant compensation or deterrence. These results strongly

232. *See id.* at 875–77.

233. *Id.*

234. *Id.* at 889.

235. Cain & Davidoff Solomon, *supra* note 41, at 478–79.

236. Korsmo & Myers, *supra* note 34, at 881–82.

237. Because there are no classes in appraisal, settlements do not bind any absent parties and need not be filed with the court.

suggest the promise of aggregation by acquisition as a superior method of claim aggregation.

Another important lesson of the appraisal example is the overall level of litigation. Conventional merger class actions follow nearly all transactions and are regularly criticized as nuisance litigation that generally produces no benefit for stockholders. Far fewer claims attracted appraisal petitions, and as we note above we find a strong connection to proxies for merit in those cases. As one of the most active appraisal litigants has noted, "[t]he vast majority of deals are fair" and his focus is on "outliers."[238] The appraisal example demonstrates that the level of litigation may be markedly lower where claims must be purchased and plaintiffs' attorneys do not control the suits.

V. OBJECTIONS TO CLAIM PURCHASE AND AGGREGATION BY ACQUISITION

A number of objections to the alienability of legal claims are possible. Some of these objections are of ancient vintage and are the rationales for the historic practice if banning maintenance, champerty, and barratry. Most have been argued to apply to contingency fee arrangements—which are still illegal in many countries—and to litigation finance as currently practiced. We confront these objections in this Part, and where appropriate qualify our proposal for alienable legal claims in response to them.

A. *PERSONHOOD AND COMMODIFICATION*

Perhaps the most fundamental objection to alienability of any type of "property" that is personal to an individual is that doing so will commodify an essential attribute of personhood that would better be left uncommodified.[239] Radin argues that "universal market rhetoric does violence to our conception of human flourishing."[240] While this argument is undoubtedly more compelling when applied to Radin's examples of "love, friendship, and sexuality,"[241] it at least arguably applies to legal claims. If one takes a strong corrective justice view of litigation, what a plaintiff seeks is not merely "compensation," but rather restitution, including a public determination that

238. Liz Hoffman, *Hedge Funds Wield Risky Legal Ploy to Milk Buyouts*, WALL STREET J. (Apr. 13, 2014, 7:47 PM), http://www.wsj.com/articles/SB10001424052702303887804579500137701 63966.

239. Margaret Jane Radin, *Market-Inalienability*, 100 HARV. L. REV. 1849, 1879–81 (1987). For a more extended discussion of Radin's arguments, as applied to alienability of legal claims, see Abramowicz, *supra* note 97, at 703–11.

240. Radin, *supra* note 239, at 1885. Michael Walzer makes a related argument that there are certain "goods," such as children or public honors, that are—and ought to be—considered incommensurable, and thus should not be distributed by exchange of money. *See* MICHAEL WALZER, SPHERES OF JUSTICE: A DEFENSE OF PLURALISM AND EQUALITY 95–103 (1983); *see also* Sebok, *Should the Law Preserve Party Control?*, *supra* note 9, at 849 ("Walzer makes a strong case that as a formal matter, there are incommensurable goods, *and that for this reason*, the state is justified in preventing people from using money to distribute those goods.").

241. Radin, *supra* note 239, at 1912.

she has been wronged by the defendant. Furthermore, the plaintiff's control over the proceeding might be thought to be an important aspect of her individual dignity. One might question whether the plaintiff's dignity can be undermined by a voluntary choice to sell a claim, but of course the possibility exists that such a decision will be effectively coerced by financial exigencies.[242] At least arguably, "litigants should be prevented from debasing themselves by selling their proceeds or (to take another variation), society should not be allowed to develop the view that legal rights are just another commodity that can be bought and sold."[243]

The most basic difficulty with such arguments is that they are largely divorced from the practical realities of litigation in the modern world. Even setting aside more recent developments, claim alienation in one form or another has long been the rule in the bulk of cases.[244] Contingency fees, subrogation, liability insurance, and assignment of contract claims all function as claim alienation. And, most tellingly, the vast majority of cases end when the plaintiff sells her claim to the defendant via settlement. Unless one is willing to condemn settlement,[245] it is difficult to see how giving a plaintiff the right to sell to anyone she pleases is more destructive of her personhood than giving a monopoly to her injurer,[246] or why it is appropriate to allow claim sale to a plaintiffs' attorney or insurance company, but not to an investment fund.

Arguments from personhood are even less plausible when applied to aggregation by acquisition. In a typical class claim, the individual class members possess only small claims, unlikely to be important to their personhood or self-conception. Moreover, under the current class action mechanism, individual plaintiffs play no role at all in controlling the litigation, and are often entirely unaware that it even exists. If anything, aggregation by acquisition promises plaintiffs more—in terms of genuine control and choice—than the typical opt-out class action.

242. *See* Abramowicz, *supra* note 97, at 707 ("[T]here is a strong possibility that a plaintiff's decision to sell a legal claim will be coerced. An initial inability to obtain satisfactory legal representation, or immediate financial demands, for example, may coerce a plaintiff to sell her legal claim.").

243. Sebok, *Should the Law Preserve Party Control?*, *supra* note 9, at 848 (characterizing an argument from W. Bradley Wendel, *Alternative Litigation Finance and Anti-Commodification Norms*, 63 DEPAUL L. REV. 655 (2014)). *See generally* ELIZABETH ANDERSON, VALUE IN ETHICS AND ECONOMICS (1993); MICHAEL J. SANDEL, WHAT MONEY CAN'T BUY: THE MORAL LIMITS OF MARKETS (2012); Cass R. Sunstein, *Incommensurability and Valuation in Law*, 92 MICH. L. REV. 779 (1994).

244. *See* Abramowicz, *supra* note 97, at 710 ("Perhaps the most serious problem with justifying bans on claim sales on the grounds that they threaten personhood is that we already allow some forms of claim alienation.").

245. *See generally* Fiss, *supra* note 98.

246. *See* Abramowicz, *supra* note 97, at 710 ("[A]ffording the opposing litigant a monopoly on claim alienation might be worse for personhood than allowing a free market in alienation.").

B. PREDATORY PRACTICES

A second argument against sale of claims is that claim purchasers will engage in predatory practices, taking advantage of injured parties. This criticism is already leveled against litigation finance, and litigation lending in particular.[247] The basic fear is that sophisticated investment firms will take advantage of ignorant and vulnerable plaintiffs, paying them less than their claims are actually worth. This possibility is made more plausible by the fact that—as discussed above in the context of litigation lending[248]—injury victims may face emergency expenses and possess abnormally high discount rates.

As an initial matter, plaintiffs who decide to sell their claims would be doing so voluntarily. They would only do so if they conclude alienation is superior to the other options available to them, such as hiring an attorney on contingency and litigating the claim themselves. Absent some fraudulent inducement, it is not necessarily clear why sale of legal claims would be especially fraught, compared to the sale of any other asset.

More importantly, systematic underpricing would only be possible in an uncompetitive market. An ignorant consumer purchasing a microwave oven (while knowing little or nothing about its operation or manufacture) is protected from overpaying by a large number of competing firms bidding to sell at the lowest profitable price. In the same way, sellers of legal claims would be protected by a number of competing firms bidding to buy the claims at the highest profitable price. Holders of legal claims would be protected more by efforts to expand the market for legal claims than by efforts to constrain it.

Indeed, to the extent that litigation investment firms offer upfront cash payments for claims, price competition is likely to be far more vigorous and transparent than the current market for contingency fee representation. The current market for claims is highly restricted to a cartel of contingency fee lawyers. Claims are "paid" for in the form of an opaque mix of legal services and financing of litigation expenses.[249] There is, in fact, little evidence that contingency fee lawyers compete on price at all.[250] The result is that claim holders typically "sell" plaintiffs' attorneys approximately the same percentage of their claim, no matter how much the claim is worth, and no matter how difficult, expensive, or risky the claim is for the attorney to litigate.[251] In

247. *See, e.g.*, Sebok, *Should the Law Preserve Party Control?*, *supra* note 9, at 847 n.55 ("[L]itigation investment has been compared to usury, subprime lending, and payday lending."); *see also* Richard L. Abel, *How the Plaintiffs' Bar Bars Plaintiffs*, 51 N.Y. L. SCH. L. REV. 345, 366 (2006–2007); Martin, *Litigation Financing*, *supra* note 111, at 83; McLaughlin, *supra* note 111, at 637–38.

248. *See supra* Part III.C.

249. *See* Abramowicz, *supra* note 97, at 739 ("The market for contingency fee lawyers is effectively restricted to firms that can afford large risks . . . ."); Brickman, *supra* note 102, at 77.

250. *See* Abramowicz, *supra* note 97, at 739 ("Contingency fees are remarkably constant in particular geographic regions across lawyers, and there is thus no obvious relationship between fees and lawyer quality." (footnotes omitted)); Brickman, *supra* note 102, at 77.

251. *See* Brickman, *supra* note 102, at 78–81.

theory, plaintiffs' attorneys compete on quality.[252] In practice, however, it will be difficult for most claim holders to accurately assess attorney quality, let alone determine how much greater quality will be worth in a particular case. A full market for legal claims is, thus far, more likely than the current system to result in price competition and transparent pricing, offering comparatively greater protection to claim holders.

Again, this is particularly so in the case of aggregate claims. In class actions, claim holders frequently have their claims settled for attorneys' fees with no meaningful financial recovery at all. In contrast to the attorney in opt-out class actions, firms seeking to aggregate claims by acquisition would need to compete to provide at least some tangible value to claim holders to induce them to voluntarily alienate their claims. Aggregation by acquisition can hardly help but represent an improvement to dispersed claim holders.

C. *MERITLESS AND VEXATIOUS LITIGATION*

Perhaps the most natural criticism of creating a market in legal claims is that it will lead to an increase in the amount of frivolous and vexatious litigation.[253] While this argument may at first glance have some plausibility—people are buying lawsuits!—it wilts under scrutiny.[254] There is every reason to believe that overall rates of aggregate litigation would decrease under our proposal, relative to the baseline scenario where the volume of litigation depends on the decisions of contingency fee lawyers. All else being equal, a claim purchaser would rather invest money and effort into strong claims that promise high returns rather than weak claims.[255] While it is possible that high litigation costs may make it possible to settle even a frivolous claim profitably,[256] such suits are, if anything, less likely to be brought by claim purchasers than by contingency fee lawyers.

A contingency fee lawyer need invest little upfront in order to bring a claim that threatens significant litigation costs for the defendant. The claim

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252. *See* Abramowicz, *supra* note 97, at 739 n.185 ("The contingency fee system thus depends on clients identifying the best lawyers . . . ."); *see also* Michael Abramowicz, *How Lawyers Compete*, REGULATION, Summer 2004, at 38–39.

253. This argument has been deployed against litigation finance. *See* JOHN BEISNER ET AL., U.S. CHAMBER INST. FOR LEGAL REFORM, SELLING LAWSUITS, BUYING TROUBLE: THIRD-PARTY LITIGATION FUNDING IN THE UNITED STATES 1–2 (2009), http://www.instituteforlegalreform.com/uploads/sites/1/thirdpartylitigationfinancing.pdf.

254. *See* Molot, *supra* note 6, at 106 (arguing that "the claim makes little sense").

255. *See id.* ("Why an investor would purposely invest money in a case that is weak on the merits and likely to lose is hard to understand."); *see also* Molot, *supra* note 95, at 191 ("To the extent that the Chamber acknowledges a distinction between meritorious and meritless suits, it also fails to recognize what is self-evident to litigation funders: investors can only make money if they fund meritorious suits. Funding meritless suits is a sure way to lose money.").

256. *See* Bebchuk, *supra* note 39, at 437; Rosenberg & Shavell, *supra* note 39, at 3. *But see* Warren F. Schwartz & Abraham L. Wickelgren, *Advantage Defendant: Why Sinking Litigation Costs Makes Negative-Expected-Value Defenses but Not Negative-Expected-Value Suits Credible*, 38 J. LEGAL STUD. 235, 236 (2009).

can be dropped at any time with little or no financial or reputational cost. Filing a claim is thus essentially a riskless option for the contingency fee lawyer. A claim purchaser, however, must pay to purchase the claims ahead of time, and thus faces significant risk in bringing a low-quality suit.[257]

This dynamic can be seen vividly in the contrast between merger class actions and appraisal petitions.[258] A merger class action can be brought almost costlessly, and the plaintiffs may keep the merger consideration. An appraisal petitioner must undertake the expense of purchasing a block of stock and forgoing the merger consideration—a cost that is analogous to purchasing claims in other contexts. The result is that class actions are brought fairly indiscriminately against large transactions, while appraisal petitioners are far more discriminating in targeting the worst deals. This dynamic is likely to repeat in other contexts where claim purchase is allowed.

It might be argued that claim purchase would increase the level of frivolous litigation simply by expanding the amount of capital available to finance such suits. Given, however, the extremely low cost of filing a claim under current rules, this argument strikes us as unconvincing. In any case, if nuisance suits are profitable, the more sensible reform would seem to be to reduce the costs of disposing of such suits or to increase sanctions for bringing meritless suits until they become unprofitable, rather than to foreclose markets for meritorious and nuisance suits alike.

More problematically, if claim purchase is allowed, a company might purchase and bring low-quality claims in an effort to harm a competitor. Burger King, for example, might form an entity to buy up meritless claims from McDonald's customers claiming to have suffered food poisoning, in the hope that the negative publicity would harm McDonald's even if the claims were ultimately dismissed. Again, though, targeted sanctions against such practices would be preferable to a blanket ban on claim purchase.

D. *Claim Purchase Would Not Be Suitable for Claims Seeking Non-Monetary Relief*

Another limitation of our proposal is that a market for legal claims may provide very little benefit in situations where a party is seeking non-monetary relief, such as an injunction against a merger or a continuing nuisance.[259] A

257. *See* Molot, *supra* note 6, at 106–07 (arguing that "third-party funders would be less likely to bring [frivolous] suits (at least on purpose) than contingent fee attorneys and their clients"); Molot, *supra* note 95, at 191 (arguing that bringing a frivolous suit "is potentially more costly for a litigation funder than for a contingent fee attorney" because "[a] litigation funder—which has invested cash, rather than just opportunity cost—may not have the same flexibility to mitigate its losses"); Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1327 ("A commercial funder needs to make a rational economic decision to invest in a claim. It would not do so if the claim does not have merit and is unlikely to succeed.").

258. *See supra* Part IV.F.

259. Maya Steinitz has identified this dynamic in the context of litigation finance. *See* Steinitz, *Whose Claim Is This Anyway?*, *supra* note 9, at 1321 ("[A] unique, possibly socially undesirable,

claim purchaser is likely to be interested only in monetary recovery, while a class action attorney can often convince a court to award substantial fees based on non-monetary relief. Claims with a substantial non-monetary component might simply make poor candidates for claim purchase. Two points, however, are worth making.

First, it is likely a somewhat rare situation where a plaintiff would be unwilling to trade off non-monetary relief in exchange for additional money, at least at some price. We can imagine, for example, that in civil rights cases alleging discrimination, non-monetary relief would be essential. Even in such cases, however, a large enough monetary recovery would create an ongoing deterrent effect that may serve the same function as an injunction. In stockholder actions, on the other hand, non-monetary relief is almost never essential, and plaintiffs would almost always be willing to trade such relief for a greater cash recovery. Plaintiffs of course commonly bring claims for injunctive or other relief, but this is typically done purely as a tactical move to create leverage for a larger monetary settlement.

Second, in many types of litigation, non-monetary relief appears to be part of a not-so-elaborate con. Class action attorneys can get court-awarded fees for non-monetary relief, and that relief provides cover for collusive settlements. The defendant gets to agree to a number of non-monetary measures that cost nothing (and benefit plaintiffs little or not at all), and the plaintiffs' attorneys get to point to this window-dressing in supporting their fee requests. The "disclosure-only" settlement in merger litigation is a classic example: the defendants agree to produce additional disclosures about the proposed transaction, and the plaintiffs' attorneys use these disclosures to justify their fee requests.[260] This example suggests that, in some cases, the ability to seek non-monetary relief can work to the disadvantage of plaintiffs. In stockholder suits, among others, the irrelevance of non-monetary relief to claim purchasers is thus not an unalloyed negative, if it is a negative at all.

E. AGGREGATION BY ACQUISITION WOULD RESULT IN INSUFFICIENT DETERRENCE

In theory, a class action should provide optimal deterrence by requiring a defendant to make good all of the harm generated by her wrongful conduct.[261] Unless a substantial number of injured parties affirmatively opt out of the class, all or almost all injured parties will be part of the class. For

element to the commodification of legal claims is purely to monetize all legal recovery, thereby dramatically affecting choice of remedies. Nonmonetary remedies, such as injunctions, declaratory relief, and specific performance, become unattractive . . . because the funder pressures for a simple monetary award instead of a socially desirable remedy such as injunction or clean-up.").

260. As noted above, approximately 80% of merger class actions result in disclosure-only settlements. *See supra* Part II.C.

261. *See, e.g.*, David Rosenberg, *Mandatory-Litigation Class Action: The Only Option for Mass Tort Cases*, 115 HARV. L. REV. 831 (2002) (arguing that for tort victims to maximize recovery, they must pool their wealth and bring an aggregate claim).

this reason, all or most of the harm generated by the defendant will be included in damages, with the result approaching optimal deterrence.[262] By contrast, except in the unlikely event one or more aggregators are able to acquire almost every claim, aggregation by acquisition is likely to result in only a portion of the injured parties' claims being before the court. The result is that the defendant will only be required to compensate for a portion of the damages she causes, and will thus be under-deterred.

The problem with this story is that it ignores the realities of class litigation. Collective action and agency problems are so serious in class litigation as to render any notion of optimal deterrence a fantasy. As discussed above, any deterrence provided by merger class actions is almost certainly trivial at best,[263] and empirical studies have reached similar conclusions in other class litigation settings.[264] Aggregation by acquisition generates real plaintiffs with real economic stakes, unhindered by collective action and agency problems. As the example of appraisal litigation shows, this dynamic can result in greater actual financial recovery for plaintiffs than the seemingly broader class action, with correspondingly greater deterrent effect. Given the frequent ineffectiveness of the class action mechanism at generating genuine monetary recoveries for the class, we regard it as likely that, in practice, aggregation by acquisition—while it will certainly under-deter—will still provide greater real deterrence than the current class action system.

F. AGGREGATION BY ACQUISITION IS IMPRACTICAL

A final criticism of aggregation by acquisition is that any such market would simply be impractical. The argument comes in several forms. Most basically, it has sometimes been argued that the risks involved in legal claims are different in kind from other financial risks, and are simply not amenable to valuation by standard financial methods.[265] A second objection is that the transaction costs associated with aggregation by acquisition would be prohibitive, given the small value of most claims. Finally, Abramowicz has argued that a market for legal claims would be subject to an especially pernicious "lemons" problem.[266] An initial, and perhaps sufficient, response to these objections is to simply say: "so what?" The fact that markets for legal

262. *See, e.g.*, A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 HARV. L. REV. 869, 878 (1998) ("[I]f a defendant will definitely be found liable for the harm for which he is responsible, the proper magnitude of damages is equal to the harm the defendant has caused.").

263. *See supra* Part IV.F.

264. *See, e.g.*, Coffee, *supra* note 16, at 1355–56 (noting that "some commentators have argued that neither the goals of deterrence nor corrective justice are realizable in the mass tort setting").

265. This conventional wisdom is encapsulated in the old Wall Street folk wisdom to "[n]ever buy into a lawsuit." BENJAMIN GRAHAM, THE INTELLIGENT INVESTOR: THE DEFINITIVE BOOK ON VALUE INVESTING 175 (rev. ed. 2006).

266. *See* Abramowicz, *supra* note 97, at 743–45.

claims would not be a panacea, and may in fact be fairly limited in scope, is no reason at all to throw up legal barriers to whatever market might ultimately emerge. Nonetheless, it is worth considering each claim briefly.

That legal claims are simply not amenable to valuation is unconvincing. If literally true, it would justify replacing the judicial system with a lottery. In fact, legal claims are valued in one form or another on a routine basis: by lawyers deciding to take a claim on contingency; by insurance companies setting premiums and determining settlement targets; by parties engaging in settlement negotiations; by contracting parties pricing terms; by corporate acquirers valuing claims held by a potential acquisition target; by investors valuing stock in companies holding legal claims among their assets; and by the burgeoning cadre of litigation finance firms.[267] That legal claims can be highly risky assets, for which investors might demand a substantial premium, is plain. That this premium is infinite is preposterous.

More serious is the contention that high transaction costs will often render aggregation by acquisition impossible. Importantly, this consideration does not apply in stockholder claims, where the aggregator can simply purchase shares on the public markets. Even for non-stockholder claims, it bears noting that class actions face the same difficulty in identifying and notifying potential members of the class, as well as getting proofs of claim for large numbers of small claimants. The same methods courts and attorneys have developed for overcoming these challenges could also be applied by aggregators to identify, solicit, and transact with potential claim sellers. Mass acquisitions will undoubtedly not be practicable in all cases, but that is no reason to block acquisition where it is practicable. The costs of any wasted effort would fall on the would-be aggregators themselves.

Finally, Abramowicz suggests that litigation markets are "likely to be beset by an adverse selection or 'lemons' problem."[268] Holders of legal claims will have better information about the quality of their claims, and those with the best claims will be more likely to keep them. The result is that "parties who choose to alienate their claims will not be a random sample of all parties, but those who anticipate that buyers will most overvalue their claims relative to other claims."[269] Anticipating this adverse selection problem, buyers will be forced to "discount their offers correspondingly."[270] Given that settlement is allowed,

> [a] third party who purchases a plaintiff's claim not only must worry that the plaintiff might withhold information but also must wonder

267. *See generally* Molot, *supra* note 95 (describing how the litigation market works for various players).

268. Abramowicz, *supra* note 97, at 743. To deal with this adverse selection problem, Abramowicz suggests—at least as a thought experiment—mandatory alienation of legal claims. *See id.* at 757–69.

269. *Id.* at 743.

270. *Id.*

> why the defendant did not offer a better deal than the third party. The defendant, after all, also is likely to have an informational advantage over the third party.[271]

At its extreme, this "[a]dverse selection [problem] can cause markets to unravel completely."[272]

The lemons problem is potentially serious in the market for individual claims. The rapid growth of litigation finance for individual claims suggests that the problem is not crippling. Moreover, the problem is likely to be much reduced or non-existent in the market for aggregate claims. In stockholder claims, the existing stockholders are unlikely to have any personal information that would give them an informational advantage over an expert aggregator. The information necessary for valuing the claim would come from public filings, news reports, books and records requests, or from discovery.

In non-stockholder class actions, the typical member of a mass class knows almost nothing about the proceedings at all, and may be entirely unaware of it. Thus, large information asymmetries and adverse selection are again unlikely. Moreover, given the small value of any individual's claim, the holder of a "high-quality" claim has no practical ability to simply keep her claim and pursue it individually. If the claim is to be litigated at all, the holder *must* alienate it—either coercively to a plaintiffs' attorney in exchange for a share of the proceeds of litigation, or voluntarily by sale to an aggregator. The situation approaches the thought experiment proposed by Abramowicz for overcoming the lemons problem: a regime where claim alienation is mandatory, causing adverse selection problems to disappear.[273] Nor must an aggregator worry why the defendant has not simply "purchased" the claims by settlement. Until aggregation has taken place, either through procedural device or market transactions, the defendants lack any effective method for settling with individual plaintiffs.

VI. NECESSARY REFORMS FOR ENABLING AGGREGATION BY ACQUISITION

A number of legal hurdles stand in the way of the development of a mature market for legal claims, and the viability of aggregation by acquisition. If our proposal is to fulfill its promise as a superior alternative to procedural aggregation, these barriers will need to be removed. The full specifics of such reforms on a jurisdiction-by-jurisdiction basis are beyond the scope of this paper, but a brief outline of the necessary reforms is the focus of this Part. In short, jurisdictions must: (1) remove lingering bans on claim alienation, including outmoded restrictions on champerty, maintenance, and barratry; (2) eliminate the contemporaneous ownership requirement; (3) retire the class action in stockholder suits; and (4) require a judicial finding that

271. *Id.* at 744.
272. *Id.* at 743.
273. *Id.* at 757–69.

aggregation by acquisition is impractical before certifying a class action in other contexts.

A. *ELIMINATE REMAINING RESTRICTIONS ON CLAIM ALIENATION*

The most obvious step that will need to be taken before markets for legal claims can mature is to eliminate outmoded bars on claim alienation. Chief among these are ancient laws restricting champerty, maintenance, and barratry, which serve no useful purpose in modern society.

The general trend has been away from restrictions on claim alienation, beginning with the legalization of contingency fees, which were once regarded as champertous.[274] States that have not yet acted to eliminate these archaic doctrines[275] must do so in order to foster and benefit from a full market for legal claims.

B. *ELIMINATE THE CONTEMPORANEOUS OWNERSHIP REQUIREMENT*

The contemporaneous ownership requirement currently blocks—or at least casts doubt upon—the standing of stockholders to bring claims that arose before they bought their stock.[276] In the absence of the contemporaneous ownership requirement, specialist investors could assess the potential strength of a potential lawsuit after the event and, if the claim looks strong enough, seek to accumulate a large position to mount a claim, just as is now happening in appraisal litigation.[277] The contemporaneous ownership requirement should be jettisoned, which would allow a similar dynamic to emerge in other forms of stockholder litigation.[278]

The contemporaneous ownership requirement is simply another restraint on alienation—it bars stockholders from alienating the ability to bring a claim in one's own name or serve as lead plaintiff. Indeed, it is worse, in that in many cases courts require that a lead plaintiff remain a stockholder during the pendency of litigation, thus precluding a seller from serving as lead

274. *See supra* Part III.A.

275. For jurisdiction-by-jurisdiction summaries of the state of play on the relevant restrictions, see Cain, *supra* note 9, at 19–25. *See generally* AM. BAR ASS'N COMM'N ON ETHICS 20/20, INFORMATIONAL REPORT TO THE HOUSE OF DELEGATES (2012), http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf (discussing alternative litigation finance).

276. *See supra* text accompanying notes 174–76.

277. *See supra* Part IV.F.

278. A full market for legal claims would entail allowing a stockholder to sell the right to bring a claim separately from the underlying stock. As explained above, however, doing so would create considerable practical difficulties, not least of which is rendering shares not perfectly fungible. *See supra* Part V.A. Eliminating the contemporaneous ownership requirement would allow specialist investors to pursue especially high-value claims without generating these serious deleterious side-effects.

plaintiff, as well.[279] A stockholder who wishes to sell her shares is thus forced to destroy a valuable attribute of the shares—the ability to control a stockholder claim—in order to alienate them.

The policy behind the contemporaneous ownership requirement is rarely stated with clarity, but it appears—like restrictions on champerty and maintenance—to be designed to prevent meritless "strike suits." The policy, however, gets things precisely backwards.[280] One source of the dysfunction in stockholder class actions is this artificial limitation on who can bring claims. Stockholders who acquire their stock after a claim has arisen would have considerable time to evaluate the merits of the potential claim before investing. By contrast, the only investors who are currently in a position to enforce the board's fiduciary duties are those are those who happened to own stock at the time of the culpable conduct—and who presumably invested in the stock for reasons unrelated to the enforcement of fiduciary duties. By freezing the universe of potential plaintiffs at the time of the wrongdoing, the contemporaneous ownership requirement keeps out new investors possessing expertise at identifying and prosecuting claims for breach of fiduciary duty or securities fraud. The scarcity of suitable lead plaintiffs is thus an artificial scarcity. To be sure, an existing investor could hire an expert attorney to help prosecute an action. But attorney control of the claims is often at the very root of the problems with stockholder litigation. A specialized investor affirmatively choosing to buy into a fiduciary or securities claim for investment purposes should signal to the court and to the defendants that the investor believes the case to have merit and is willing to dedicate significant time and resources into pursuing the claim. The ironic result is that a policy purportedly instituted to avoid strike suits may, in fact, be blocking pursuit of meritorious claims while doing little to prevent strike suits.[281]

A full market for legal claims would entail allowing a stockholder to sell the right to bring a claim separately from the underlying stock. As explained

279. Malaika M. Eaton et al., *The Continuous Ownership Requirement in Shareholder Derivative Litigation: Endorsing a Common Sense Application of Standing and Choice-of-Law Principles*, 47 WILLAMETTE L. REV. 1, 3 (2010) ("[T]he overwhelming majority of jurisdictions (including federal courts) have concluded that a plaintiff who voluntarily or involuntarily ceases to be a shareholder, even momentarily, during the pendency of a derivative action loses standing to pursue the lawsuit.").

280. We are neither the first commentators nor the most influential to criticize the contemporaneous ownership requirement. *See, e.g.*, J. Travis Laster, *Goodbye to the Contemporaneous Ownership Requirement*, 33 DEL. J. CORP. L. 673, 673 (2008) (arguing that the rule "is fundamentally incoherent[,] . . . [i]t operates largely at random, and it arbitrarily mandates the dismissal of potentially meritorious claims"); Macey & Miller, *supra* note 5, at 77 ("The rationale for the contemporaneous ownership rule . . . appears questionable at best.").

281. For a more comprehensive argument for eliminating the contemporaneous ownership requirement, see Laster, *supra* note 280.

above, however,[282] doing so would create considerable practical difficulties, not least of which is rendering shares not perfectly fungible.

C. *ELIMINATE CLASS ACTIONS IN STOCKHOLDER LITIGATION*

Where the class action mechanism is available, it is likely to threaten the viability of aggregation by acquisition. An attorney able to get a court to certify an opt-out class will generally face a lower cost of aggregation than an acquirer. Where aggregation by acquisition is likely to be practical, therefore, the class action mechanism should be eliminated. In particular, the class action should be eliminated in stockholder litigation.

In stockholder litigation, aggregation by acquisition is always possible simply by buying up stock. Moreover, aggregation by acquisition is likely to be adequate in this context—sufficient to generate compensation and deterrence superior to that created by class actions. Furthermore, it is highly unlikely that existing shareholders would desire non-monetary relief, which would otherwise render aggregation by acquisition problematic.

The downside of this reform, of course, is that it would effectively strip many small stockholders of their ability to pursue fiduciary and other claims. This downside, however, is more symbolic than real. As things currently stand, there is little evidence to suggest that minority stockholders—indeed, any stockholders—obtain substantial benefits from the operation of stockholder class actions. Thus, eliminating stockholder class actions would not strip minority shareholders of anything they do not already lack. On the contrary, any loss would be more than offset by the benefits associated with an enforcement regime with genuine deterrent power, together with the development of a market for arbitrageurs willing to pay a premium when aggregating shares for litigation.[283]

Derivative claims raise a somewhat different set of issues. Because a derivative suit is technically brought on behalf of the firm, with the recovery going to the firm, it is not possible to eliminate the collective aspect of derivative suits without fundamentally altering them. With the recovery going to the firm, however, any aggregator would benefit only on a pro rata basis with its percentage share ownership, with all other stockholders able to free-ride and still receive a pro rata share. As a result, an aggregator will only find investment worthwhile if it can either obtain a very large percentage position or if the claim is so valuable that even a pro rata share of the recovery is worth bearing the cost of acquisition together with the entire cost of litigation. Inevitably, however, this dynamic will lead to under-investment in litigation.

282. *See supra* Part V.

283. In fact, we observe substantial trading *above* the merger price in transactions that ultimately result in appraisal petitions being filed. It is possible this trading is in expectation of a topping bid or other increase in the merger price, but it also suggests that appraisal arbitrageurs bid up the price of the stock, effectively allowing minority shareholders to share in some of the expected gains from the appraisal suit.

The traditional solution to this dynamic is for the court to award the plaintiff a share of the award, on top of any litigation costs. To put aggregators on an equal footing, courts should do the same for them—allowing them a "bounty" for bringing a successful derivative claim. For example, an aggregator owning 20% of the stock of a company will gain 20% of the benefit of any recovery to the firm simply by virtue of its stock ownership. The aggregator should also get an individual award equal to a percentage of the entire cash recovery, just as a successful plaintiffs' attorney would. Restricting the bounty to a percentage of the cash recovery limits any divergence of interest between the aggregator and the remaining beneficiaries of the claims.

D. *REQUIRE CLASS ACTIONS TO BE SUPERIOR TO AGGREGATION IN OTHER CONTEXTS*

In some cases—generally all outside the stockholder context—aggregation by acquisition may not be a suitable replacement for procedural aggregation. When injunctive or other non-monetary relief is an important component of the relief sought—as may be the case, for example, in civil rights cases or cases involving continuing nuisances—the claims will be most valuable in the hands of the actual plaintiffs.[284] In other cases, the transaction costs associated with aggregation by acquisition will be prohibitively high.

Due to the variety of possible circumstances, a blanket rule is not possible, and case-by-case determinations will be necessary. Fortunately, a mechanism for case-by-case determination already exists. FRCP 23(b)(3) requires federal courts[285] certifying a class based on the predominance of common questions of law or fact to find "that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy."[286] To avoid snuffing out a market for aggregation by acquisition, courts should use this provision to scrutinize whether aggregation by acquisition is infeasible in a case, prior to certifying a class. Moreover, there are strong reasons for requiring courts to make the same finding when certifying a class under FRCP 23(b)(1) or 23(b)(2). Given the extreme agency problems inherent in class litigation, plaintiffs' attorneys seeking class certification should be required to explain convincingly why aggregation by acquisition is not possible, with a presumption that it would be superior where it is possible.

Among the factors a court might consider are whether non-monetary relief is an essential part of a meaningful remedy. Courts should be leery, however, of arguments that high transaction costs render aggregation by acquisition impractical. Indeed, when presented with a claim brought as a

284. *See supra* Part V.D.

285. Most states have parallel rules for certifying a class. *See, e.g.*, ME. R. CIV. P. 23(b)(3) (stating that the court must conclude that "a class action is superior to other available methods for the fair and efficient adjudication of the controversy").

286. FED. R. CIV. P. 23(b)(3).

traditional class action and where the lead plaintiff has not acquired any additional claims, a judge should presume that the claim is meritless. If the plaintiff were confident that the claim had merit, the plaintiff would seek to increase her exposure to the upside of the claim, and if the plaintiff's estimate of merit were commercially reasonable, the plaintiff would be able to obtain external investment to make such investments. Where that does not happen, courts should be skeptical. Any attorney seeking to pursue a traditional class action on the argument that the valuation and purchase of claims is impractical for an aggregator should be required to explain why those same transaction costs would not render identification and proof of claims impractical in the class action. If an acquisition effort is already underway, a court should be highly reluctant to preempt it by certifying a class. One possible solution would be to allow potential aggregators to contest class certification, or to have it delayed for a reasonable period while aggregation efforts proceed.

VII. CONCLUSION

The development of the class action in the twentieth-century marked an important advance in the ability of our civil justice system to surmount the collective action problem in mass claims. Its design promised optimal deterrence, class-wide compensation, and economies of scale in litigation. Long experience has revealed, however, that the promise of the class action is unattainable; the very collective action problem that creates the need for the class action also ensures that no class members can monitor the performance of the attorneys acting on behalf of the class.

Our proposal abandons the class action in favor of a market-based system of allocating entitlements to pursue claims. We would clear away the vestiges of common law restrictions on alienating claims in hopes of nurturing a system where legal claims end up in the hands of those in the best position to enforce them. This promises the most notable benefits in the context of aggregate litigation. Like the class action, aggregation by acquisition would overcome the collective action problem in mass claims. But our proposal is superior to procedural aggregation because it does not generate any new agency problem. Those who aggregate claims may of course agree to contingency fee arrangements, but because their own investment is on the line they will monitor the performance of the attorney closely and ensure that the ultimate resolution of the claims serves, albeit indirectly, the interests of the claimants. Not only would this better serve the interests of potential victims of small-scale injury, it would also likely eliminate much nuisance litigation, ensure better enforcement of substantive legal rules, and increase access to justice.