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6TH ANNUAL JUDICIAL SYMPOSIUM ON CIVIL JUSTICE ISSUES GEORGE MASON JUDICIAL EDUCATION PROGRAM NOVEMBER 13-15, 2011

EDITED TRANSCRIPTS

EMERGING CIVIL JUSTICE ISSUES

Joe Hollingsworth, Robert S. Peck
Moderator: Henry N. Butler

BOB S. PECK: Determined at the beginning of every preemption case. Well, after his departure from the court, it seemed to be not so important anymore. Just as his longstanding campaign against legislative history seemed to prevail, in this case *PLIVA, Inc. v. Mensing*[1] because the court took a purely textual approach to the statute without consideration of any extraneous material. Justice Thomas, who wrote the opinion, was able to get a plurality, not quite a majority, but the plurality of the court, to agree that the presumption against preemption was not a useful interpretive tool. Let me highlight three of the preemption cases. *Bruesewitz v. Wyeth*[2] found that the National Childhood Vaccine Injury Act,[3] which created a no hold compensation program, preempted state tort law as long as there was a proper manufacturer warning about the vaccine that any remaining side effects were unavoidable.

Much like the *FCC v. AT&T Services Inc.*[4] case where it turned on the definition of the word "personal," this case, *Bruesewitz*, turned on the word "unavoidable." To the majority, "unavoidable" meant the consequences occurring after proper manufacture. To dissenters, it meant that there was no alternative way of making the vaccine. That's what this very close case turned on. In *PLIVA, Inc. v. Mensing*,[5] the Court held that state failure-to-warn cases against generic drug manufacturers were preempted even if the name brand manufacturer would be liable if the pharmacy had dispensed that name brand instead of the generic version of the drug. This was the first time the Supreme Court found impossibility preemption, that the state law requirement was impossible for the drug company to comply with.

They said that there was no way for the generic drug company to be able to put any kind of warning on their packaging when they discovered that their drug had additional adverse side effects, even though the name brand drug manufacturer could have a variety of avenues to do so. Now *Wyeth v. Levine*,[6] which found that you did not preempt name brand liability, found liability didn't depend on the fact that there were these different ways in which drug companies could notify people that the drug was no longer as safe as its original label showed. To the majority in *Mensing*, this was a critical difference. The court found that even though the FDA denied that generic drug companies had no means to manufacture, to provide a warning, and that they were not helpless, the court found, despite expert opinion, that this was so. One interesting exchange during the argument, Justice Scalia asked the Deputy Solicitor General how these generic drug

companies could possibly know about new medical evidence that their drugs were no longer as safe as they thought.

After all, he said, these are not these big enterprises that hire Ph.D.'s, they hire high school students who are good at mixing drugs. Needless to say, the generic drug industry is a multi-billion dollar industry, and almost half the generic drugs are manufactured by name brand manufacturers. So, that was one of those questions that are dizzying about the way in which the Court operates.

So what remains for the patient who uses the generic form of the drug when the warnings are inadequate? Well the defendant, the petitioner in this case, the generic drug industry, told the court that they should sue doctors for failing to inform the patient that if they used the generic drug they would have no remedy and if they used the name brand, they would have a remedy if things go wrong. Another alternative is to follow what California does.

As a result of a case called *Conte*,[7] California imposes liability on the name brand drug manufacturer even if you took the generic drug, because they're the ones responsible for making sure the labels are up to date and the generic drug manufacturer must have the same label as the name brand does. Therefore, they would be obligated to switch. Now, there are a number of jurisdictions that have rejected this approach, but they did so on the fact that there's still a remedy against the generic drug manufacturer. Since that rationale no longer exists, we can imagine that this will be revisited in a number of states. A final note on the *Mensing* case, it's very difficult to harmonize the approach the court took in *Mensing* with the approach they unanimously took in *Bruesewitz* which was a very traditional preemption analysis.

So, expect preemption law to remain confusing, requiring further pronouncements from the Court. We may get that further pronouncement in a case that the Court has taken this term called *National Meat Association v. Harris*,[8] but I doubt it.

Finally, in *AT&T v. Concepcion*,[9] the issues where three phones that AT&T advertised: "You sign up for a two-year plan, you get a free phone." But they still charged you taxes on the original price of the phone. So, a class action was brought against AT&T, saying that this was false advertising. If the phones are free, there are no taxes. AT&T defended on the basis that they had an arbitration clause in their contract when you signed up for the two-year plan and in that arbitration clause it said that you could not proceed in a class action about any complaints you had with AT&T.

The Court found that the arbitration clause was valid despite the fact that California has found it unconscionable. They found that the unconscionable analysis didn't apply to contracts generally, which would have obligated them to comply with the arbitration clause, but instead applied solely to arbitration. This was an obstacle to the Federal Arbitration Act[10] that basically said this was prejudiced against arbitration, which was against

the congressional intent behind the Federal Arbitration Act and so therefore it would not stand. As Justice Breyer pointed out in his dissent, who would bring individual actions over $23.08? The second major area was class actions.

You're going to hear more about the *Wal-Mart* case[11] later on. It was the largest class action ever and insufficient commonality is what the court said existed to not satisfy the requirements of Rule 23.[12] Now the Court also found that statistical evidence was helpful, but insufficient here because there was no uniform explanation for the differential treatment. As the majority put it, the plaintiffs wished to sue about literally millions of employment decisions at once. So this case has been looked upon as indicating a certain hostility to class actions and it certainly can be viewed that way. But at the same time, the Court one week earlier sustained an approach to class actions that differs from *Wal-Mart*. In *Smith v. Bayer*,[13] a case out of the West Virginia courts, they found that a federal court's earlier rejection of class certification did not preclude a state court from granting a different certification with different class representatives who were not part of the earlier case.

One of the key passages in the case noted that although West Virginia's Rule 23 was substantially the same as the Federal Rule 23, with the same requirements, West Virginia had the right to interpret it differently. In other words, their interpretation of Federal Rule 23, which they subsequently announced in *Wal-Mart*, is not binding on state courts interpreting their own rules. Now this is significant. It doesn't mean that there haven't been courts, state courts that have found that *Wal-Mart* is exactly right about their own equivalent rule, but there is absolutely no obligation to read your rule differently than you have always read it. Now that issue of whether due process requires state courts to read their rules the same as Rule 23 was what was presented in the *Philip Morris* case that I described earlier. It is also presented in the *Farmers Insurance Company v. Strawn*[14] case that I'm now working on.

It may come up as well in some of the tobacco cases that are now being filed as certiorari petitions coming out of Florida. It's those sorts of things that we continue to watch because the way the Court looks at due process deeply affects the way the trial process occurs. It operates in this unusual environment that the court operates in. When I argued a case a few years ago, I got a question about how this all happens at the trial level because none of the justices are terribly familiar with it. Now I'm an appellate lawyer. I don't have a lot of experience at the trial level, but I had read the transcript in this case. I had studied it enough to be able to answer their questions at least at the level of abstraction they asked it, and it was one of those rare times in which you saw the justices all paying complete attention, not interrupting me with a question because to them, this was fascinating news. Thank you.

HENRY N. BUTLER: Joe Hollingsworth.

JOE HOLLINGSWORTH: Thank you. Expect to see Johnny Carson after an introduction like that. May it please your honors. I'm Joe Hollingsworth on behalf of the defense. I'd like to thank Henry for inviting me. He only invites me every other year though, I learned this morning, since this is the sixth annual judicial conference and I've only spoken at three. I got to be at the Brookings Institution once, thank you. I got to be at Northwestern once and I'm delighted, so delighted to be here today.

This is close to home for me and I like it here and Judge Worthen let me know this morning that there's a couple of things about the brochure that I should note. One is that I'm listed as a partner in the Center of Constitutional Litigation which is Bob's organization. Bob and I are not partners. That may become more clear in a second. I'm from Hollingsworth LLP and Judge Worthen asked me where I'm from because if you look at the resumes it doesn't say where I'm from and the first thing I say when somebody asks me where I'm from is, I say I'm from Indiana, which is what I told Judge Worthen. I was born, raised, grew up and educated there, but I moved to Washington, DC, the day after I graduated from college in Green Castle, Indiana, and that was in late May of 1971 and I've been here ever since which is a long time and Judge Worthen also rightly pointed out that that I've actually been in Washington longer than Senator Lugar.

I thought about that and I said, yeah, when I left Indiana, Senator Lugar was mayor of Indianapolis and probably one of the things that did the least for his career was that he was—that Richard Nixon favored him with a statement that he was Richard Nixon's favorite mayor.

I have been asked to address emergent issues in civil justice. And it's a favorite topic of mine. I must tell you that I'm in my thirty-eighth year of trial and appellate practice. I've always been in private practice, I have represented industry. We represent industrial clients, we represent chemical industry clients, and we especially represent pharmaceutical industry clients, which is where I, myself, have focused my practice over the last 15 years or so. During that time, we have tried a case, pharmaceutical case, roughly about once every year or so. That's my background, like it or not.

Although I know this is a more academic setting than I'm used to speaking in, this is really a sort of a high brow meeting for me, Henry, and that's one of the reasons I'm so happy to be here. But a lot of my practice and a lot of my feelings and what I have to offer really come from the trenches. I think that the issues I'm interested in can assist the judiciary, it can help cut your workload, it can help focus you on the merits and it can help improve the odds of merits based resolution if some changes are made in our system. There has been a lot said over the last few years about the death of the trial. We could have a seminar on that and in fact, we've had seminars on that issue. So I won't belabor it but the statistics apparently still bear that out.

There are fewer and fewer trials being held every year. I think that's good if cases are being resolved and resolution is coming based on the analysis of scientific evidence at the pretrial stage or the Supreme Court required endeavor. I think it's good if it's based on *Twombly*[15] and *Iqbal*,[16] the Supreme Court's recent revisions and imposition of stricter requirements on pleading. I think it's bad if things other than merits based resolutions are happening out there that are limiting our trials, such as reliance on science that shouldn't be admitted, or aggregation, which is one of my chief issues, aggregation of claims. In consolidated litigation, both at the state and federal levels and in consolidated litigation on state and federal bases all over the country, aggregation of frivolous claims, of frivolous class claims of mass serial litigation involving products, especially pharmaceutical products, is something that I'd like to focus on.

So I came up with seven or eight ideas that I can address today. I won't belabor some of them because I know you're going to hear about some of these things later on during this two day conference which looks like an excellent conference. Henry, the topics are fantastic. Bob has already addressed a couple of these things so I won't spend too much time on some of this but issue number one, of course, I don't think we could have a statement on the defense side without talking about the *Wal-Mart v. Dukes*[17] case and what it means for class action and consolidated litigation across the country now.

I'd also like to talk, in connection with that, about a related issue that is class action tolling. More on that in a second, it's one of my pet peeves. I'd like to talk briefly about litigation funding, I know you're going to talk and hear about that as this conference proceeds. I'd like to talk about the treatment, especially the recent treatment of scientific evidence in the courts based on *Daubert*[18] and other standards. I'd like to talk about a real subtle and not well known, but very important issue for mass court litigation and serial litigation, especially in federal courts, and that's the selection of trials and consolidated litigation. I'd like to talk about a couple of discovery issues, three actually, and they break down in terms of what is the trigger, what is the scope, and what are the proper sanctions for discovery in big, big cases now that are being applied across the country and what are the problems with that?

One of the great things about being in Washington is that it's the worst place probably in the world for allergies and now we're in the heart of the allergy season and if you take the pills like I do that dry you up, you can find yourself in a tough situation which is where I'm at a little bit this morning and I'm sorry about that.

I'll start with *Wal-Mart*. As I said, I'm not going to dwell on *Wal-Mart* but think about it. If that decision had come out the other way, your courts could be flooded with cases like it, which is a case involving 1.5 million employees bringing a suit based on gender bias against the largest employer in the United States, a company that employs over a million peo-

ple. But these employees and these plaintiffs worked at different Wal-Mart stores, they worked in different cities and different states.

They worked for different employee supervisors and they worked at different jobs and they worked in different time periods, hardly the stuff of class action commonality type standards. It was a 5 to 4 decision, which to me is the only thing that's surprising about it, it's like the 5 to 4 decision, the narrow 5 to 4 decision holding our Second Amendment right to bear arms that came down a couple of years ago, that's the only thing that surprises me about it. It involved a case in which the defendant was forced to litigate and defend for over a decade. I would propose that this country and its great experiment with class actions get back to what the Anglo-Saxon system was starting over 400 years ago.

It was successful then. It involved litigation individually of individual claims on their merits and it certainly is a system that doesn't work in mass litigation involving personal injuries. Because no personal injury claim within the recent decade or so where a class claim has been made has ever survived certification on appeal, so there are a number of things wrong with our current class system and the rules surrounding it, and I think that you folks are the ones who should think about how we can do something to control it. Now class action tolling is a related issue which is a subtle, not well known issue, because it doesn't tend to get appealed, but what it means is that the filing of a class action tolls the running of the statute of limitations on every member of a putative class whether or not he's named, identified or even known at the time the class action is brought.

Whether or not the plaintiff's lawyers ever actually seek to certify the class action claim, whether they ever move to certify the class action claim, and of course, even if the class action claims are later found to be frivolous; the class action itself, in individual cases, tolls the running of the statute of limitations for each and every person who is a putative class member. To take it one step further, your honors, class action tolling applies in a cross jurisdictional sense conceptually according to some courts, many courts, probably the majority of the courts, by the way, such that the filing of a class action in one jurisdiction tolls the running of the statute of limitations in a state somewhere else, and if you just take *Wal-Mart v. Dukes*[19] as an example, you can see what a mess that is. You have 1.5 million people whose claims have been litigated for ten years and as to whom, according to some state and federal courts across this country, the individual action would be tolled.

The statute of limitations would not run during that time period. It's a bad deal for the defendant. It's actually a bad deal for everybody because witnesses are lost, memories recede, and it's not a good situation for resolving litigation in the way that it should be resolved. The basic legal position on that without belaboring, again, that issue is that each state is a sovereign, and each state should be able to set its own tolling and other rules without outside information. There are constitutional ramifications to this doctrine

as well, which rests, in my opinion, on the policy that the defendant is not prejudiced if he has to defend just one more claim out of hundreds or dozens or thousands or tens of thousands in some cases. I don't think that you should have to show prejudice or lack of prejudice if you're the defendant in such a situation of tolling the statute of limitations.

That's never been a requirement for statute of limitations review and that result, I think, is outrageous. The Second Circuit has certified this issue, by the way, from the *Fosamax* litigation.[20] That's from the big time litigation generally that's going on in this country now that involves thousands of claimants. And they have said that the issue is this which is well put and it goes to the Virginia Supreme Court, by the way, since the case arose out of Virginia, "Does Virginia law permit equitable tolling of a state statute of limitations due to the pendency of a putative class action in another jurisdiction?"[21] That hits both issues that I'm concerned about. I mentioned third-party litigation funding as one of my prime issues here this morning.

This, of course, is litigation funding that goes not to individual plaintiffs but to plaintiffs' law firms. This is a big business and I know you will hear more about that, and I'm happy about that, in this conference. So again, I won't belabor it either, but it is at least a $1 billion industry, probably more. It will increase litigation, not decrease it. It will remove the disincentives to pursue marginal litigation, I believe. It will generally skew loyalties and incentives, and it will make settlements harder to achieve. So we will keep our eye on that issue as we move into the next decade, I'm sure. The other issue that I mentioned on my list is the treatment of scientific evidence in the courts. It happens to be one of our own favorite issues.

There is an opinion now which is in which certification has been sought from the First Circuit called *Milward v. United States Steel*.[22] This is a big issue if you haven't guessed it and it involved a trial court decision to grant summary judgment to the defendants in the case on the basis that the plaintiffs expert witness opinion is not supported by reliable scientific evidence. The First Circuit overturned this notwithstanding the overwhelming discretion that the circuit courts are supposed to give trial judges in review of an evidentiary issue like whether or not 702[23] is being followed. The First Circuit reversed summary judgment and sent this case back to trial, and it did so on the ground that is on a group which I believe is a very basic and fundamental delusion of the *Daubert* requirements.

It said that if an expert witness believes that the weight of scientific evidence, quote "weight of scientific evidence," weight of the evidence is sufficient to support his opinion. The First Circuit would let that go to the jury even if the underlying premises for that opinion are not actually in and of themselves reliable. So what this means is that an expert witness who knows that he can't show that his epidemiology is scientifically reliable because it's not statistically significant, that he can show that his animal studies are a fit as *Joiner*[24] requires for the issue at hand ,and the issue here

was whether or not Benzene caused a rare kind of subtype of leukemia, as to which there is no epidemiology or other firm scientific data by the way.

This expert also admitted that all he had was anecdotal case reports and he also admitted that the best thing that he could put up was some theoretical mechanism that supposedly supported his opinion. The First Circuit said that there is so much evidence in terms of weight even though each and every premise for the expert's opinion is not admissible, we'll let it go because the weight of the evidence is sufficient, the expert is an expert, he knows what he's doing, he knows what he's saying, we support it. The First Circuit did that notwithstanding cases following *Daubert* over the last decade or more like *Rider v. Sandoz*[25] in the Eleventh Circuit and *Glastetter v. Novartis*[26] in the Eighth Circuit and *Hollander v. Sandoz*[27] in the Tenth Circuit, and *Schudel v. General Electric*[28] in the Ninth Circuit, and *Conde v. Velsicol Chemical Corporation*[29] in the Sixth Circuit; all of which held that in order for a scientific opinion to be accepted as a viable causal opinion under rule 702[30] that each and every premise of an expert witness's opinion must be reliable and it must be based on scientific knowledge. So we have our eye on that case, whether or not review is granted. I have no idea, but obviously I hope that it is. I said that I wanted to talk about this selection of bellwether trials and consolidated litigation. Billions of dollars hinge on this little issue. It's a very subtle issue. It never gets to appeal and I don't think it ever will but it is a big, big one for those of you, and I know some of you are, who are involved in mass consolidated litigation, especially in federal MDLs, because at the end of discovery, which takes two or three or more years, the courts ask the defendant and plaintiff to work up a test case.

The solution to that situation is usually to select two or four or five different cases, five for the defense and five for the plaintiffs and what happens, ladies and gentlemen and your honors, is that when it comes down to it, the plaintiffs' cases get tried and the defense selections either get dismissed on summary judgment or the plaintiffs voluntarily dismiss them so that every trial that gets heard is a plaintiff's case. I'd like to propose that there would be a rule or a practice in the, certainly the federal courts under the MDL system that if the plaintiffs try a case and the defense pick which is next gets dismissed voluntarily by a plaintiff, then the defendants get the next pick. It's very, very important in this litigation, if the purpose of it is to set values for cases that are dozens or hundreds or ten thousands in number, to get the first trials on an even and fair basis and indeed get a fair value. So selection of what trial gets done first is very important.

As to discovery, what's important at trial, another issue that never gets appealed, is what is the trigger, what is the trigger for the duty to preserve and when does it attach? When does a corporation, a corporate defendant in particular, have to send out these famous hold memos or not? And what evidence must be preserved? We don't know, frankly, we don't know. The rules that come into play on this very important issue are all ad hoc, with all due respect, they are judicially created. With all due respect, they are

sometimes, in some jurisdictions, basically unwritten and de facto, especially in some state jurisdictions. What happens next is we have a lot of litigation of side shows in one of these three ring circuses that involves either litigating what it is that the defendant missed or failed to find and provide or what kind of spoliation damages the defendant is liable for. Cases are being settled, or not brought, because the cost of preservation is high, another issue.

Mostly what I'm asking is there should be a bright line rule that says that a preservation requirement does not ensue until litigation is certain. The current rule from written cases, the few district court and other state cases that have looked at this issue, is usually a reasonable anticipation of litigation or a reasonable foreseeability of litigation standard, that is not working, it's not definitive enough. The Lawyers for Civil Justice have come out with a proposed revision to Rule 26[31] which could address these issues. I won't belabor that but they have done it. It is a long and detailed list of things that are specifically limited from production, electronic production of course which is what I'm talking about. It's an interesting approach.

I said that trigger, scope, and sanctions are important. Limiting the scope of discovery is a key problem. I would propose a couple of things that are simple. One would be that at the time a submission or a request for production is made, that the defendant be required to go back no more than two years in his own evidentiary trail and to meet his production obligation. I would propose that the list of custodians in electronic discovery cases, which is virtually 100% of your work now, be limited to ten, not the fifty or fifty-five or seventy-two that we have currently in one of our cases. That's ridiculous and outrageously expensive when we start off litigation with no more management and definitive standard than that. Finally, I would suggest that, respectfully, the courts be willing to look at the issue of either limiting the cost of this electronic discovery or shifting the cost of electronic discovery. I would propose that the courts impose a requirement to pay reasonable costs incurred by parties responding to discovery including costs of preserving, costs of reviewing, collecting, and producing electronic discovery because you can file a five page complaint, Xerox it, send it off to a big company, and put them in a position where they're required to spend a million and a half dollars virtually the next day on preservation requirements.

All of this should be measured. I'm sorry if I'm going too long here. But all of this should be measured, I think, and considered in terms of the existing proportionality requirement under Rule 26(b)(2).[32] I believe it is (b)(2)(B), which is a real helpful model. Absent a court order, I think the standard should be a little bit different, a lot different now than they are currently, just due to the overwhelming cost and overwhelming breadth of electronic information that's available. Thank you very much; I was delighted to be here.

HENRY N. BUTLER: Before we open it up for questions from the judges, we're going to give these fine gentleman a few moments each to respond to each other's comments. If you have a question that you'd like to ask, the best way to get that in the queue is to just go ahead and get in line behind one of the microphones that are out here in the aisle, that way everyone can hear the question and I'll know who's first. So you can start scurrying on up that way as we turn things over to Bob.

BOB S. PECK: Well who knew the morning would consist of so many radical ideas? I'd like to start by commenting on Joe's comments about class action tolling. One of the principles he put forth behind it was that a state is a sovereign and ought to be able to determine its own statute of limitations. It just so happens I had a Supreme Court case on that issue called –

HENRY N. BUTLER: Surprise.

BOB S. PECK: Called *Jinks v. Richland County*.[33] The South Carolina Supreme Court has ruled that the Tenth Amendment was violated by the federal supplemental jurisdiction statute. When I went to law school we called it pendent jurisdiction. Anyway, what the statute said was if you filed an action in which you had a choice in either filing in federal or state for it, and you filed in federal court, and the federal court decided that the state issues predominated, they could dismiss without prejudice and you could re-file in state court. If the statute of limitations had passed while you were pending in federal court, there was a thirty day tolling provision to allow you to re-file. As I said, the South Carolina Supreme Court unanimously held that that was a violation of the Tenth Amendment relying on a one year old opinion in which Justice O'Connor had suggested that there might be a Tenth Amendment problem.

Well when we went up to the United States Supreme Court, we talked about that issue in some length. As I pointed out, even the 1789 Judiciary Act has a similar tolling provision in it. So at least those who helped frame the Constitution didn't see this as an invasion of state sovereignty. The result was a unanimous decision finding that there was no constitutional violation and it was written by Justice Scalia. So I think the notion that there cannot be this kind of tolling when federal concerns exist, has been thoroughly rejected. I'm amused that we should end class actions all together and essentially create a license that small violations of people's property rights or things like that would be legitimate so that even though they add up to hundreds of millions of dollars of profit to a corporation there would be no way of vindicating or remedying the legal violation. Clearly, we've had class actions for a long time. There are ways to deal with class actions that are improper and they remain a necessary important

tool. I'm agnostic about third-party financing of litigation, I don't have a strong opinion one way.

I'm always somewhat amused by those who oppose it and oppose it on partial grounds that there's some inherent conflict between the funder and the client that's created that affects loyalty, but never point that out when it's an insurer who's paying the costs of litigation and even the law firms, the captive law firm. It seems to me that we've overcome those conflicts there and that's not necessarily a strong objection to third-party financing. Of course, last piece of amusement, really to me, was the statement that Joe made was that if *Wal-Mart* had come out the other way we would have been flooded with cases with 1.5 million employee plaintiffs. I'm not sure how many companies have that many plaintiffs. We know that this was an unusual lawsuit in many respects and that this was the nation's largest employer. I somewhat doubt that we would see a whole lot of lawsuits quite like that.

HENRY N. BUTLER: Just a follow-up question to you about your point about the class action lawsuits, so the class actions that you're defending, the class action, and I'm not trying to help Joe out on this, but I just want to try to parse this out, is that for cases where it's uneconomical for individual plaintiffs to bring the case then aggregation through class action is appropriate?

BOB S. PECK: Well, I think aggregation can be appropriate, not always is, but I won't limit it to that either.

HENRY N. BUTLER: That's what I was trying to ask.

BOB S. PECK: The fact of the matter is that there are many instances. I look back and the Supreme Court has referred to the asbestos litigation as an elephant team problem, and has cited many times to the judicial conference's ad hoc meeting on asbestos litigation which twenty years ago issued a report on one way that you could deal with it. They advocated aggregating for certain issues so that you don't have to re-litigate those issues over and over again because that, it seemed to the committee, which the judicial conference endorsed and obviously now the Supreme Court endorses as well, this approach, that allows you to aggregate certain issues and then create an administrative claim process.

HENRY N. BUTLER: Just a quick comment on the third-party financing point about the analogy to insurance and the issues that come up, one of the papers, presenters we have on the third-party financing panel, Michelle Boardman from this school will be talking about that issue specifically later on today. Joe?

JOE HOLLINGSWORTH: Yes.

HENRY N. BUTLER: Do you have any comments, reactions before we throw things out?

JOE HOLLINGSWORTH: Bob, you didn't mention science in the courtroom and I thought surely that would be one of your big issues.

BOB S. PECK: As I said, I'm an appellate lawyer and I don't often have to deal with science in the courtroom. I've not had any appeals dealing with such issues but nonetheless, obviously the courts have gone different ways, just as you mentioned the *Iqbal*[34] and *Twombly*[35] cases, Justice Souter sitting on the First Circuit. The author of *Twombly* has said that courts have taken that too far.

JOE HOLLINGSWORTH: I love Souter because he wrote the opinion, the majority opinion in the only case that I ever argued in the Supreme Court and won, luckily. Since we're talking about Supreme Court opinions, and I did mention science in the courtroom, there is an opinion, I think, that answers one of the questions that I raise which is: is this weight of the evidence mantra really one that passes muster under *Daubert* and under Rule 702? I should have pointed out also that that issue is referred to directly by Justice Stevens in his dissenting opinion, it was an 8 to 1 opinion in a case called *General Electric v. Joiner*[36] which was the second case in the *Daubert* trilogy that I'm sure you know, Bob. What was interesting about that is that the whole weight of the evidence argument was argued pretty extensively in a couple of amicus briefs which is what I think Justice Stevens was referring to in his dissent, both filed by a prominent plaintiffs' law firm like Weitz & Luxenberg in New York.

There is a sentence, a single sentence in the majority opinion by Justice Rehnquist, which rejects the weight of the evidence approach, so hopefully something will be done about the First Circuit opinion. It's interesting also that Justice Rehnquist wrote the majority opinion in *Joiner*,[37] he clearly drank the Kool-Aid because he was one of the dissenters, two dissenters in *Daubert* so one case later than *Daubert* is *General Electric v. Joiner* and you have Justice Rehnquist totally on board because that's what the precedents said. That's what happens in mass cases. It's not that we're relitigating things over and over again and that we need the class action system to decide things in a reasonable and efficient way. Precedent gets established in mass litigation, in serial litigation, and that is what dictates where we are when we go forward. That's what we learned in law school is the Anglo-Saxon judicial system, and that's the system that's worked pretty efficiently for 400 years following the rule of law.

BOB S. PECK: Well, I don't recall terms where there was only seventeen. They've been hovering around eighty for some time now. When I was in law school it was around 160 at term. But, nonetheless, the volume of writing that comes from the court seems to not have diminished and so therefore opinions are longer, there are more concurrences at the sense it seems and so I'm not sure they're working any less hard, but certainly during Chief Justice Rehnquist's term and continuing through Chief Justice Roberts, the court seems to think that fewer means higher quality and therefore also less need for them to harmonize the law among others.

I'm not sure I necessarily agree. I think there are a number of cases where all of us have watched anxiously. This morning they're going to be announcing the results of their latest conference in which we expect to hear about the healthcare reform cases that have been filed. While those are going to be big cases and they will involve enormous numbers of amici, and that is something else that has grown in size, that the court has to deal with, although as Justice Ginsburg has put it, we don't read every one of them because we don't think that they do much to add to the party's briefs. They will read those of people who have an interesting opinion and flag to them, people that they have great respect for, but not necessarily every one. I must say looking at some of the briefs that have been filed in some of my cases, I can understand it.

Because they don't seem to be talking about the same case even, or haven't done much of their homework. So while I think there are other cases that deserve their attention, which ought to have been taken, it's hard to say that they're working any less hard, I don't think they are.

HENRY N. BUTLER: Other questions? Here we go.

AUDIENCE MEMBER: I wasn't sure, Mr. Hollingsworth, whether you mentioned that there were some instances where class action was appropriate? Is there a class action that you would like? Are there any class actions that you would like?

JOE HOLLINGSWORTH: Well there are some class actions, for example, in the antitrust area that seem to be possibly an efficient way to proceed, but in the area that I'm more familiar with, which is mass and class and consolidated actions involving serial product liability claims and personal injury claims, I think not. I don't think those are an efficient way to proceed. I said for the last ten years or so they haven't even been successful on certification. But overall, I think the claims and defenses that get adjudicated on an individual basis is the way that we ought to proceed. I think the whole class action thing has been a big failed experiment, but I'd be willing to say that there are a couple of cases, like *American Pipe*,[38] an old Supreme Court case involving class actions on antitrust claims, which do make some sense to me. But certainly for a great majority of the class action claims I'm fa-

miliar with, class action jurisprudence just hasn't worked. I mean it hasn't worked.

BOB S. PECK: Well it seems that if it hasn't worked, if it wasn't worth bringing we wouldn't see them, whether you look at it with an Adam Smith sort of point of view that people will only gravitate to those that seem like they're going to have a level of success then you certainly would expect that class actions continue as they have. While Mr. Hollingsworth says that it's not been successful, I think that we've seen too many successes to say that.

AUDIENCE MEMBER: My other question was about technology and scientific litigation. I've come to a point now with both sides in those issues who would be interested in reinventing the wheel so to speak and creating panels that can deal with those issues and take those cases out of the court system?

BOB S. PECK: There are no neutral scientists. People do their research, they sort of take positions and I think the idea that you can have neutral scientific experts being able to tell you what something is, particularly in the area of novel scientific principles, which is what *Daubert* is all about, I think is kind of hard. I think that one of the things that we have to do, is we have to struggle with our inadequate knowledge and do the best as an advisory system allows us to do.

JOE HOLLINGSWORTH: Well, your Honor, the *Daubert* opinion pays lip service to the notion that those issues could perhaps be taken out of the court system by the tenor of the opinion of course, and the two opinions that follow it from the United States Supreme Court, is that it's the duty of the judge to act as gatekeeper to determine whether the opinions of experts on causation are based on sound science and science that fits and that's what the law is not, at least at the federal level.

HENRY N. BUTLER: We have time for one more. Going, going, gone. All right, thank you.

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2 131 S. Ct. 1068 (2011).
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9 AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740 (2011).
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15 Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007).
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18 Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579 (1993).
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21 *Id.* at 97.
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23 FED. R. EVID. 702.
24 Gen. Elec. Co. v. Joiner, 522 U.S. 136 (1997).
25 Rider v. Sandoz Pharm. Corp., 295 F.3d 1194 (11th Cir. 2002).
26 Glastetter v. Novartis Pharm. Corp., 252 F.3d 986 (8th Cir. 2001).
27 Hollander v. Sandoz Pharm. Corp., 289 F.3d 1193 (10th Cir. 2002).
28 Schudel v. Gen. Elec. Co., 120 F.3d 991 (9th Cir. 1997).
29 Conde v. Velsicol Chem. Corp., 24 F.3d 809 (6th Cir. 1994).
30 FED. R. EVID. 702.
31 FED. R. CIV. P. 26.
32 FED. R. CIV. P. 26(b)(2).
33 538 U.S. 456 (2003).
34 *Iqbal*, 556 U.S. 662 (2009).
35 *Twombly*, 550 U.S. 544 (2007).
36 522 U.S. 136 (1997).
37 *Joiner*, 522 U.S. 136 (1997).
38 Am. Pipe & Const. Co. v. Utah, 414 U.S. 538 (1974).

THE AMERICAN LAW INSTITUTE'S NEW *PRINCIPLES OF AGGREGATE LITIGATION*

Sam Issacharoff, Judge Carolyn Kuhl, Francis McGovern, Stephanie Middleton
Moderator: John Beisner

JOHN BEISNER: We have an extremely distinguished group of panelists here for our next discussion. I'm going to introduce Stephanie Middleton, who's going to introduce the panel. Stephanie is the deputy director of the American Law Institute. I'm going to turn it over to you, Stephanie. Take it away.

STEPHANIE MIDDLETON: I want to thank Henry and Linda for inviting us to participate today. I've been a fan of Henry's for many years and I'm glad he's not in Kansas anymore. It's a lot easier to get here. No offense to Kansas. It's just hard to get there. So I want to talk for a minute about the American Law Institute (ALI).

I practiced law for many years and used restatements from time to time. But it never dawned on me to wonder where they came from. So I'll talk about the ALI for a minute and then I will introduce this panel in a little more detail. Henry said you could read about it but they're such an amazing group of people that I will say a word about each of them before I turn it over to them for the program.

So, the American Law Institute is the source of the restatements, the Restatement of Courts, Foreign Relations, Law of the U.S., Restatement of Contracts. Also, more recently, the ALI has produced *Principles of Law, Principles of Local Governance*, and *Principles of Aggregate Litigation* which we're going to hear about today. We do the UCC in partnership with the Uniform Law Commission. Also, the Model Penal Code is ours. During WWII, the ALI worked on the Statement of Essential Human Rights which was relied upon by the United Nations along with other sources in adopting the Universal Declaration Rights in 1948. And that was all in response to atrocities in WWII.

So who is the American Law Institute? Who writes these things? It's a group of about 3,000 elected members. We also have life, honorary, and ex-officio members. It is judges, academics, and practitioners who are at the top of their field. Somebody referred earlier to sausages and law. If you care about either, you don't want to see how it's made.

But actually, the process at ALI is a wonderful process. It's the process they've had since 1923. I want to talk about that a little bit. I'll mention that my previous job, before I came to ALI, was working for the Senate Judiciary Committee.

So, I can't tell you how much of a pleasure it is to work at ALI with the process that's there which is very transparent and collegial and civil and quite interesting. The first step on a project is to find a reporter. It's usually a law professor, or a team of them, who is not only well known in the field but will be able to listen to diverse views and somehow get it right, like we saw in the previous panel. Sam Issacharoff was our reporter on the *Aggregate Litigation Principles* who was able to get people who are on opposite ends of the spectrum, as our two speakers were earlier this morning, and get them to agree—this is the way it should be.

This is the statement of ALI—these are the rules we want to have and these are the explanations. That's not always easy, in this project in particular. We have others where you really do have, sort of, two sides and they have to be brought together. So the reporter is selected and approved by our council and then begins drafting chapters and then brings these chapters to the advisor's group. Judge Kuhl was an advisor on the *Aggregate Litigation Principles* project. There is also the Members Consultant Group, which is any ALI member who is interested in the project. They can read the draft and either come to the meetings or send comments to the reporter. After the advisor meeting, the reporter may revise the draft. Then, he takes it to our council, which is our board of sixty members, and gets beaten up by our council a little bit; makes further changes, and brings the draft to our annual meeting of our membership, which has several hundred members usually.

At our annual meeting you sit around and look at drafts and restatements and you go live online. After the draft has gone through the council, and approval by the membership, it becomes the official position at ALI. It may be in draft form and called a draft. If you go to our website it will say draft, but it is the official position of the ALI because some of these projects take a long time, we just finished one that took twenty-one years. It was the Wills project and they did away with the rule against perpetuities. I guess some of the projects take a long time. Fortunately for the Aggregate Litigation project, it was done in a record amount of time, four or five years.

So we're trying to get to these shorter projects. A little history of the ALI, it was founded in 1923. The first director was the dean at the University of Pennsylvania Law School and he had a wealthy wife and she funded this. Somehow we ended up in Philadelphia at the edge of the Penn Campus and we've been there ever since. But we do have people all over the place—our director is a Professor at Columbia Law School, and our President is a lawyer out in New Mexico. So, although our offices are in Philadelphia, we are spread out throughout the country.

The group of legal giants who started the ALI in 1923 decided that they needed a perpetual society to improve the law and the administration of justice in a scholarly and scientific manner. They were responding to what they saw in the early 20th century: American law as just a mess of

uncertainty and complexity. Jurisdictions varied within each other and within jurisdictions and amongst each other in terms of just agreement on fundamental principles of common law. So that's what the ALI does.

It doesn't just restate—the restatements aren't just a compilation of what different cases have said. There's a lot of work going into coming up with the principles that people can agree on as underlying some of these common law principles. As we increasingly get into more statutes, and more regulations, there's still a lot of gaps and room for common law, even in interpreting statutes. There was consideration, when they finished the first restatement, right before the beginning of WWII, of whether ALI should shut down. We've restated the law once but they decided it needed to keep being restated.

So we're now in our third, Restatement (Third) is our series and we may be about to start our first Restatement (Fourth). We usually have about ten or fifteen projects at any time. We've recently finished Aggregate Litigation. We have a couple of torch projects going on at any one time. We just finished a wonderful—and I commend your work on—Restitution and Unjust Enrichment that I would think would be useful across all—lots of disciplines and areas.

We're trying to get it out to practitioners and judges because it's something that's not taught in law school anymore and a lot of practitioners—it just doesn't occur to them that the answers may be in this book. So that's for another day, but it's a wonderful book. We have a project on sentencing and employment. We may start something on Indian law. We have a project on liability insurance and nonprofits. We're about to come out with something called the application of the UCC to mortgage notes. And we have international projects, we have one on the world trade organization, and we have some on transnational civil procedures.

So we're all over the place. If you are interested in ALI, I left some materials in the back of the room and my business card. I'd be happy to hear from any of you. So with that, I'm going to introduce the panel.

One more thing I need to mention. One of our members, Judge Hornby, from Maine, asked me to mention to you—I don't know how many of you have cross-border, Canada–United States class actions, but in the back of the room, are protocols for court-to-court communications when you have a class action involving Canadian and American plaintiffs. So that's in the back of the room. It's been adopted. It's from the CBA but it's been adopted by relevant bodies in Canada and by the CBA.

Our moderator for this panel is John Beisner. I think many of you know John. He's on the ALI council. He was an advisor on this project, the *Aggregate Litigation* Project. He's the co-head at Skadden Arps's mass torts and insurance litigation group. He has argued cases in the Supreme Court. He's handled more than 600 reported class actions at the trial or appellate level in federal and state courts. These have been RICO cases,

fraud, security, employment discrimination, environmental, and securities litigations.

So, he's got a wealth of practical experience. He's handled MDLs, worked on the Vioxx matter. He's worked on the settlement of the Countrywide Financial matter with the state attorneys general. One thing I enjoy about ALI is you have these reporters who are brilliant academics and they come out with these drafts, but the judges and the practitioners are always raising their hands saying "that's really interesting professor but in real life this is what would happen," or "help us out with how this would happen in real life." So the nice thing about this group is that they all really have a lot of practical experience, trial level, and appellate level.

Judge Kuhl is a graduate of Princeton and Duke Law. She clerked for Justice Anthony Kennedy when he was on the Ninth Circuit. She held a high level in the Department of Justice and practiced at a law firm in Los Angeles and then has been on the bench in California at the Superior Court for the county of L.A. since 1995. And she was an advisor on this project as well.

Sam Issacharoff was the reporter on this project. We had a couple of reporters but Sam really led the effort. He managed to somehow get this right even though he had people on the left and the right screaming at him. He managed to get it right, and it's a work that's already very quickly being cited by the courts and very influential in this area.

Finally, Professor Francis McGovern, who's at Duke Law, brings practical experience, as well as abstract thinking, and really sophisticated thought, to the area of ADR in this kind of case. He's currently the special master on the BP litigation—we didn't have in the bio but he's worked as a neutral expert or special master in most of the really big mass or class action cases in the U.S. including DDT toxic exposure, Dalkon Shields, and silicone breast implants.

One thing he does, is he comes up with computerized models, sophisticated models, to help the parties put values on these mass claims so that you can narrow what these claims may be worth. This lets the parties figure out how to settle them. And I'm going to tell you other tricks of the trade, but that's why he is sought out by the courts in the U.S. and he's also working on the international scene. He's working with the U.N. Compensation Commission which was set up to ensure that Iraq compensates citizens and businesses for losses suffered in the Persian Gulf War. And he's working on some transnational ADR projects with entities in Europe.

So I'm going to turn it over to our wonderful panel. And I thank them for coming to talk to you today.

JOHN BEISNER: Well thanks very much, Stephanie. I would like to start this morning by noting that my mentors at the bar taught me that when you go into court, candor is extremely important. You should try to get everything out on the table. I was also told that courts don't like surprises. And

so, particularly given the audience this morning, I think some disclosures are important.

First of all I need to tell you that we are all here today to shamelessly promote this book, the *ALI Principles of Aggregate Litigation*. And I should note today that our pitch may strike you as being a little unusual, because our primary purpose isn't to urge you to buy the book. That wouldn't be bad but that's not our main goal. Our main goal—

STEPHANIE MIDDLETON: Coupons in the back.

JOHN BEISNER: There are coupons in the back. That demonstrates my point. But our main purpose is to urge that the book be used. I also need to note what Stephanie alluded to, we are not third-party endorsers of this book.

We all played varying roles in drafting it. I hope that during the presentation you'll hear some very concrete reasons for that recommendation. But, I'd like to start by noting a few things that you should be on the lookout for. First, the subject matter of this book, I think, is extremely important. It addresses cutting edge issues on class actions and mass torts.

It's one of the most challenging arenas that our judicial system is being asked to address—perhaps indicated by the extent to which our first two speakers this morning, who were looking at an overview of hot issues, talked about those two subject areas. Second, I think the book is important because it offers a conceptual framework for analyzing the difficult issues that arise in the aggregation context every day. It's an area that I practice in, and I have to tell you, you can never say you've seen everything under the sun. Every day there are new issues being presented by the types of claims that are being asserted and by the different approaches that council take.

I have to say, you're not going to find the answers necessarily in this book. What you're going to find is a framework to think about these issues. What's important, what isn't so important. I think that's the contribution that it makes.

The third observation that I'd like to make about the book is that it has already been quite influential. We'll be spending a fair amount of time in our discussion talking about areas in which we believe the book may advance thinking in this area, but for present purposes, let me note that in the last term of the United States Supreme Court, the *Principles* volume was cited extensively by the Court in one of the cases that the prior panel spent a fair amount of time on. That's the *Smith v. Bayer Corporation*[1] case.

That was a case out of the Eighth Circuit that considered the priority of a federal district court invoking the Anti-Injunction Act to enjoin state courts from, as the Court put it, relitigating issues and class certification. The Supreme Court in ruling in that case, and in reversing the Eighth Circuit's decision, relied extensively on the analysis in the *Principles* that sug-

gested a preferable approach. And this context would be the principles of comity, that it made more sense for courts to embrace comity principles, that if one court denied class certification, then subsequent courts certifying that issue ought to give due consideration to their earlier decision even if the governing principles of class certification differ. Although somewhat less explicitly, the effects of the Principle's monograph can also be seen in the Supreme Court's ruling in the *Wal-Mart Stores, Inc. v. Dukes*[2] case that you've also heard about this morning.

The writings of the late Professor Richard Nagareda, who joined Sam as one of the reporters on this project, are highlighted throughout the *Dukes* decision and the Court's analysis tracks the analysis of the *Principles* document on the distinction on (b)(2) and (b)(3) classes.[3] The list doesn't end there. There are many other decisions, both federal and state court, which have embraced the *Principles* or at least cited the book. We'll be talking in more detail about those. But let's get into our discussion.

We'll reserve a fair amount of time for questions at the end. I thought a place to start would be to turn to you, Sam, for some initial thoughts, first of all on the difference between this *Principles* document versus the restatements that I'm sure all of you have been exposed to in the past, and how this book came into being.

SAM ISSACHAROFF: Okay. Thanks, John. The restatements had a central core insight, which was that the law was developed quickly at the turn of the 19th century to the 20th century in many states. The reporting system was inadequate.

There was a lot of common law being developed without a centralizing body of thought to how it should be integrated, what principles were emerging, or which ones were being disfavored. The restatement took as its ambition the effort to capture what the doctrinal decisions were, of primarily state courts, in the United States and tried to lend in some coherence. The term "restatement" was always, more or less, a misnomer because these are done with the heavy hand of advocacy, that is, of a sense that there was a right way and a wrong way emerging from the court decisions. The genesis of the idea was primarily bottom up, from the experiences of the courts. The problem in this area of law, the mass litigation area is twofold.

One is that for most judges the experience of a truly mass case has a one off quality to it. That is, judges will handle—come across one, two, maybe three in their career. In some sense you will have to confront the questions of aggregation all the time. As soon as you have three people injured in a car accident and there's one insurance policy on the other side, you have an aggregate claim and you have the ethical issues that confront the lawyers. You have the aggregate settlement problems. All of that is presented. It's just that the complexity mounts just as the number of parties grows, as the amount in controversy grows, and as the potential different sources of law begin to assert themselves.

So, the one-off quality means that there's less of a systematic body of thought here than there is, for example, in tort cases or contract cases where you're likely to see a repeated pattern of cases across any individual judge's traditional career. The second feature of this area is that there is rarely a front to back resolution of the case. That is, these are mass cases that we're talking about: they almost never go to trial as such.

Pieces of them will be tried; there will be judicial resolutions of discrete issues. But if you look at the mass cases that formed the corpus of our understanding of how to handle aggregate proceedings, they are resolved sometimes on class certification, sometimes a jurisdictional issue, sometimes a statute of limitations issue. All these sorts of things are testing the waters by the parties who then have to try to work out a mass settlement in the shadow of a couple of decisions, but decisions which rarely address the merits and certainly never provide a complete, comprehensive picture for appellate review in these cases. In this circumstance, there is law out there, but the law doesn't have a robust feel to it, the way it does in common law areas where there is routine presentation, front to back, in one proceeding.

So the idea of the *Principles* is to try to derive, from the lived experiences, the courts, and the way that the practitioners handle these cases in the day-to-day application—including the way that the supervising courts handle them—a way to think about this overall area of law. That's the genesis of a *Principles* project. The idea is that you get the right people in the room as advisors, and as consultants, and as reporters, and you figure out what the practice has actually already figured out, what the principles of law should be, and you can provide guidance from that. Carolyn, you have, as one of the members of this panel, I think, obviously the best perspective on the value of this book for jurists, our audience this morning. I thought it might be useful for you to give your perspectives on that point.

JUDGE KUHL: Why is the *Aggregate Litigation* Project important? Let me say one thing. From a very general perspective, I have been noticing, and I think colleagues have been noticing, that what is done in the academy—that is, what the best and brightest minds in our legal profession do—those people who have Supreme Court clerkships and then go to the law schools—what they do, increasingly, is more and more disconnected from what those of us in the courtroom do—from a judging and from the lawyering perspective.

The American Law Institute is a place where the academy and the real practicing part of the profession come together. And to me, it has been a very valuable, legal, professional experience to reconnect with those brilliant minds in the academy to try to help solve the problems that we're grappling with day-to-day. So I really have to add to what Stephanie said, and just endorse this experience of the American Law Institute, which has historically brought these two groups together. From the standpoint of the *Principles* project, as has just already been mentioned, this is an area of the

intersection of class actions and mass torts that is of great importance. I think the remainder of the agenda for this meeting lends credence to that. But many of us, as Sam has mentioned, may only encounter these cases once in a great while.

So, it's important to know that there is a source that provides a perspective on these problems where, if they crop up on your docket once in a while, you can turn to some conceptual guidance, as John has said. A second reason why this project is so important, I think, to the trial judges, is that it addresses areas where trial courts are frequently opulent. Why do I say, as trial judges we would be on our own in these areas? I think we are most comfortable in the adversary process. I think we are most comfortable where you have a plaintiff arguing every case and every perspective for the plaintiff's position. You have the defendant arguing every case and every perspective and every factor of that defendant's position. We feel comfortable, that's our job. We make decisions in that environment.

In the area of class actions there are times when we do not have the benefit of the adversarial process. How does that come about? We are asked, for example, to decide whether the plaintiff's proposed class counsel is adequate. How do you think about adequacy of representation? You're not ordinarily going to have an adversary process to guide you on that. The *Principles* project addresses this in § 1.05. So you have, as a judge, a situation there without the adversarial process.

Another area where trial judges end up being on their own is in approval of settlements. Usually the dismissal that comes in is a great day for trial judges. The dismissal comes in: the case is off your docket. It's a wonderful thing. But when it's a class settlement we're asked to do something that's really different from our usual experience. I was thinking of analogous areas, minors compromises perhaps also presents us with a situation where we have to stand, really by ourselves, without an adversarial process, and make judgments.

When we are deciding when a settlement is fair and reasonable and properly protects the class, we are really on our own. Again, the *Principles* project has placed great emphasis on some areas, to give courts guidance, in an area where we are without the benefit of the adversary process. In addition, the appellate process, I've really not kept up with what's going on in the trial courts to a great extent, both in class action and mass torts. So again the *Principles* project has drawn not just on the appellate case law. It's not a summary of case law. I look at what's going on, on the ground in the trial courts, in an attempt to put some sense around that and to derive general principles that ought to guide what's going on in the courts.

So again, to take, as an example, class action settlement, lots of times those are not appealed. It's not much to have an objector, which in California; you can't have any objectors in state court. It's not much to have an objector and an objector who's not somehow bought out in the process, and who can persist to the appellate level, which makes you have really little

guidance around the process of approval of the settlements. So again, we don't have a lot of guidance and this is the place to look.

One final point, if I may. I think that this work gives us not just answers, but it gives us solutions. I'm going to try to make that distinction by again referring to the *Smith v. Bayer*[4] case that's been mentioned. And again, briefly, the Supreme Court gave me an answer. They said if you have a federal class action and a state class action and the federal court said that the class cannot be certified, that doesn't bar the state client, or that doesn't bar the state class action from trying to proceed. That's an answer, but it's not really a solution because you still have this problem of what you do with overlapping litigation in the class action area.

The Supreme Court mentions this principle of comity, which they suggest ought to help. But if you look at the *Principles* project, it really puts some meat on the bones of that. Just to give you a bit of an idea of the conceptual scope, this problem is actually addressed in § 2.11 that says a judicial decision to deny aggregate treatment, in other words to deny class certification for a common issue, or related claims, raises a rebuttable presumption against the same aggregate in other courts as a manner of comity. Then the commentary behind that gives further meat of the solution, on what I could call the bones of the problem, and says that, for example, in comment B, that even where the court's respective class actions rules are not identical, even if there's divergence of the state law from Rule 23, the state court really ought to consider, as a matter of comity, the denial of certification in the federal case or any other state case.

So many of these problems are anticipated and treated in a way that gives a more holistic solution than what you will find as a result of any particular case.

JOHN BEISNER: Thank you. I think if you look at the areas in which the *Principles* book has been cited, it's been most frequently cited in an area that Carolyn alluded to, and that is the area of seeking resolution of class actions and mass torts. Francis, that's one of your many stock and trades. It would interesting to get your perspectives on how the *Principles* book is useful in that context.

FRANCIS MCGOVERN: In a way, I feel like a presidential candidate, because I'm not going to answer that question quite yet.

JOHN BEISNER: But there are three parts.

FRANCIS MCGOVERN: And the third is the Department of Energy. Let me back up a little bit. If you go to the history of managing complex litigation, in the '50s and '60s, the federal courts developed multidistrict litigation and there was a Manual on Multidistrict Litigation that had a series of very precise rules, very much like the Federal Rules of Civil Procedure.

Wave one of discovery, you do this. Wave two, you do that, and so on down the line. And then, in the late '70s and early '80s, judges reacted negatively to these precise rules and decided that there should be a manual for complex litigation which was basically a laundry list of things that judges could do to manage complex litigation. So, instead of precise guidance, it gave the general background you can use. This rule or that rule or you can do it this way or you can do it that way.

The current Manual,[5] which is in its fourth edition, has that same kind of "laundry list" approach. And so, judges who have been involved in complex litigation have been trying to develop some way of deciding, among those possible items on the menu, how to manage these cases. You can have bottom up reform. It's been talked up before or top down reform. The true value of the *Principles* is a conceptual format to assist you in deciding what pieces from the menu to choose in managing cases. And now, let me answer the question more specifically.

In the settlement context, the *Principles* both address class action settlements and non-class action aggregate settlements. We can talk some more about definitions of that and go in more detail. In the class action context, there is a tremendous amount of lore there, not in opinions but common practices that are used. These principles really crystallize the essence of those common practices. So, for example, in § 3.06, there's identification of the role of the court in class action settlements. It gives you a principle of what your role should be. And then in § 3.18, what the role of the court should be in a non-class aggregate settlement, not just for approval of the settlement, but also for continuing over the supervision of the implementation of the settlements.

I'm sure all of you have had problems where the settlements occur, the lawyers come in, it's great, thank you very much, goodbye, I don't need to deal with this, and then something goes wrong in the implementation. The *Principles* give you some guidance in that regard. Use of court ancillaries in § 3.09, there's a nice list of how you can use special masters or magistrates or adjuncts or court appointed experts to assist both in the approval and in the implementation process because, it turns out, in a large number of these cases, having your own state's rules for the appointment or the equivalent of Rule 53 of the Federal Rules of Civil Procedure. A special master might be a great aide, but how do you use it, how do you pay for it, issues such as that.

Another issue that's addressed specifically, that's helpful, is in § 3.10 on future cases. How do you cope with the problem, if you've got current injuries and in which you may have future injuries? As has been mentioned, the class action divide simply doesn't work very well anymore in the context of personal injury cases. You're going to have aggregate settlements. And typically you're going to have some problems as far as the future is concerned.

The fourth point I'll mention. Just in terms of how you create an aggregate settlement when you have multiple plaintiffs, and you'd like to bind everybody, but it can't be a class. Are there some vehicles to deal with this group of folks? In § 3.17, there is some real guidance. Later on, if you're interested we can talk about some specifics, where those principles come to apply to assist you in trying to understand how you can tailor the rules of civil procedure in the context of a complex settlement.

JOHN BEISNER: Let me add a few perspectives from a practitioner's viewpoint. One thing that has not been mentioned, which is a very pragmatic feature of this document, is that there's a wealth of just basic information about case law in this arena. Sam and the other reporters did a masterful job of compiling a lot of different judicial perspectives in this volume, particularly from the appellate court level. This will be maintained with updates over time, as the volume itself is referenced by courts along the way. But in terms of just going to find a place where the case law is all stacked up, categorized, and analyzed, the footnotes of the volume are a particularly marvelous resource. So, particularly for practitioners, but also for everyone else involved in litigation of these cases, particularly the courts, it's a marvelous resource in that regard.

The other practitioner's perspective I would bring—and this may reflect a little bit of my wearing my defense counsel hat—is that, as Carolyn was saying, it is a source of solutions. I think one of the more frustrating experiences one can have as a defense counsel walking into one of these mass litigation situations, a mass tort, 20,000 claims have been filed and you have your first appearance before the court. And the court is quite understandably throwing up its hands and says to the defendant, "The first thing we ought to do is call Francis and bring him to get this case settled because there's no other way to deal with this." I'll be 190 years old if I have to try all these cases *seriatim*.

So that's the only solution. Of course, as defense counsel, you want to say under your breath, "Well, your honor, the other thing, is they could voluntarily dismiss all these claims. That would also be a solution," but you can't say that. I think one of the comforting things about the book is it does lay out, and I think gives everyone involved some confidence, that there is a way to actually litigate these cases—to at least get the case far enough along to understand what's right and what's wrong about the allegations, what are strong contentions, what are weak contentions in the case, so that Francis can come along and meaningfully talk with the parties about whether there is a way to get the matter resolved.

FRANCIS MCGOVERN: One of the things that's coming across, and it's what we're going to turn to now, it's really the central point, I think, for you all, it is what differentiates this area of law from ordinary bi-party disputes, in that the courts have to play a completely different role. From the mo-

ment the case is filed, your role is managerial. And you have to start thinking about how to organize the litigation, something that normally is a simple, one-on-one contest you can entrust more or less to the parties to figure that part of it out or to present initially a proposal on how the case is going to proceed.

That fact takes courts away from the normal comfort zone of presiding over a predominantly adversarial process. It brings the American courts much closer to a European-style model, where you are the administrative body that is going to run the litigation. And it turns out, perhaps not surprisingly, that the formal rules of court organization do not lend themselves particularly well to that role. And that design, to address that, they don't provide meaningful guidance in that area. So, I think what all the speakers are stressing, is that from the court's perspective you are without the usual benchmarks for how to proceed in this area.

Just pushing on that point a little bit, one of the concepts of judging is that there's been an evolution from the judge as umpire, calling the balls and strikes, to managers, managing the litigation, telling the lawyers what to do. But then in some instance it involves the player. Soon the judge, if the judge is particularly activist, the judge can be the most important player on the field, tipping the scales. That balance of the role of the judge that Sam is talking about is absolutely critical in the context of these kinds of cases.

JOHN BEISNER: I turn at this point to talk about some of the specific sections that we haven't talked about already, to an extent, and look at some of the sections of the *Principles* book that we think might be quite influential going forward. First, is the subject of issue classes. Federal Rule of Civil Procedure 23(c)(4), of which similar versions can be found in many of the state procedural rules as well, is a one sentence provision that says, "When appropriate, an action may be brought or maintained as a class action with respect to particular issues." There are probably some competitors, but I always thought that was probably one of the least noted sentences in the Federal Rules of Civil Procedure. It has gone for many years without much usage, but it got a fair amount of attention in the *Principles* volume and in turn has gotten a lot of attention from the courts. What's the perspective that's being conveyed about issue classes? Examples?

FRANCIS MCGOVERN: Well, let me give you a concrete case that poses the question. There was a lot of litigation a few years back over contaminated blood products and HIV exposure. There were suits brought against the manufacturers of blood products for negligence in the treatment of the blood supply that led a class of hemophiliacs to be exposed to the HIV virus. There was a controlling legal issue at the time and the controlling legal issue was whether or not the blood manufacturers had been negligent.

They had not tested the blood supply. This was prior to the knowledge about HIV and the availability of specific HIV tests. They had not tested the blood supply for certain kinds of hepatitis exposure. Had they filtered out the hepatitis contaminated blood, it turns out there was a huge overlap with the blood donor population that was HIV positive. So it was something that Judge Posner of the Seventh Circuit would refer to as "the serendipity theory of negligence liability."

So a class action was proposed in which the central dominant issue in the case was "Is this a viable theory under negligence?" That was a problem because there were fifty state laws involved. I want to put that problem to the side for a second. Assume with me that the critical issue in the case was whether or not a negligence action would lie in the context of this kind of serendipitous exposure. The serendipity point makes it clear that courts thought it was unlikely. That's an action lying in negligence.

The problem in the case was that, even if you were to get a determination in some unified proceeding that, in fact, it was negligence, this would go all over the country to be appealed piecemeal once you found the determinations with regard to any individual as to whether or not his or her HIV positive status was caused by the negligent blood product or not. One of the problems was that you could not get any kind of unified determination. So that's an administrative point, from the vantage point of the courts. There had to be some way to get this resolved because maybe you could then settle these cases.

From the vantage point of the plaintiff, issue classes—this section of Rule 23(c)(4)—the different plaintiffs, this was a way of circumventing the Supreme Court cases expressing skepticism on class action for mass torts, because you can just say, "we just want to certify an issue, and by certifying an issue we would have a class." So it seemed to be a shortcut around the protections of Rule 23. From the defense perspective, this also looked like a terrible idea—the same reason it looked like a terrible idea, because it created this monster of a huge class action without the procedural protection of Rule 23.

So we looked at this problem and whether or not there was any utility to Rule 23(c)(4), and its state court equivalents. Our conclusion was that, under certain circumstances, it could actually be useful. Our approach was to look at it from the vantage point of whether or not you could generate issue preclusion. To generate issue preclusion means to take something off the table in a dispositive way that would be dispositive not just against the defendant who's a common party in all of the cases and therefore, under *Parklain Hosiery*[6] could be bound by issue preclusion, but also dispositive as to the entire group of plaintiffs.

Our proposal was that a trial court that certifies a class for issue class determination has to do two things. It has to identify the specific issue with precision, including the jury instructions that will follow from the trial, if it's a jury trial, from the trial of that specific issue, so that the issue preclu-

sion outcome is clear. Second, it has to be consistent with federal or state practice, certifying that class for immediate appeal. Now the beauty of this proposal was that the defense lawyers disliked it intensely because it seemed to bring some new life into issue preclusion.

The plaintiffs' lawyers disliked it intensely because it seemed to guarantee delay, because it would automatically be an appellate process before you can take this ruling to the bank, as it were. The trial judges disliked it intensely because of the noted irresponsibility of appellate judges and setting up things for too long and not doing their jobs. Who knows what they do? They don't manage the docket. They just sit there at conferences and stuff. And appellate judges disliked it intensely because it seemed to put too much power in the hands of the district court judges to determine the appellate docket and allow for further interlocutory appeals.

When every constituency dislikes something intensely you're probably on to something. It's probably a positive. So this went through unanimously, based upon the finding, this attempt to get something of value in a way that didn't give obvious, strategic advantage to either of the parties, the plaintiffs or the defendant, and also it seemed to be a rational use of court resources.

JOHN BEISNER: Let me ask whether this discussion in the book about the possible use of "issues classes" is going to increase the use, Francis, from your perspective. Do you think it's going to increase?

FRANCIS MCGOVERN: There's no question in my mind that the plaintiff's bar will try to push in that direction. Let me just mention, just on the side, there are other ways to accomplish the same goal as well, that is to say, one of the beauties of complex litigation is that it has complex solutions as well. In the silicone gel breast implant cases, for example, Judge Pointer used Federal Evidence Rule 706 and court-appointed experts to create a panel which addressed the issues related to an implant, a silicone gel based implant, capable of causing certain kinds of harm, which for all practical purposes, is the general causation issue in the case, because that was really the gravamen of all that litigation. No question, if the breast implant ruptures, it causes harm, but that's more specific. This was the general question and one could have done that in the context of a single issue trial or a 706 panel, which he did. And then de facto for all practical purposes resolved the issue as well.

So this concept of isolating an issue and trying to resolve it, I don't think is limited to just Rule 23. But I think you'll see more and more of this also from the defense perspective, because it's a free screening at home play, that is to say, if you win the general causation issue you've won the case. If you lose it, generally speaking, it still has specific causation that you can rely on.

JUDGE KUHL: One of the things I liked about the approach taken in the *Principles* project is that it's not as though a solution is defined. Now let's all go use that solution, a solution that's realistically presented in the context of alternatives, as Francis was saying. So in § 2.02, how should the court look at this? The court should authorize an issue class if doing so would materially advance resolution of multiple claims in a manner superior to other realistic procedural alternatives.

So you're asked to look at what the alternatives are, as Francis was just suggesting, and there's a handy little list right there in § 2.02(b), coordinated discovery. It might not work on this one, but for other issues coordinated discovery is going to bring you on the path. Pre-trial rulings, as on summary judgment or concerning admissibility of evidence, trial of an individual issue or fabricated trial or maybe another class action that's pending someplace else. So, I like the practicality of that which treats an issue class, not as some kind of a solution for all problems, but rather as one of a group of procedural alternatives that a court, managing mass litigation, ought to think about.

JOHN BEISNER: I think this is a good example of this notion of concepts that we talked about earlier. I don't think we've mentioned that last November, in the Third Circuit, a case came up on appeal where an issues class was proposed, a rare circumstance, that I think has actually bubbled up to the appellate level. This was in the context of environmental case and I won't go into a lot of details, but it had to do with the pollution of the water supply in a particular area. The key point is when the court came to the question of "Did the district court appropriately deny an issues class here?" the court pulled out the book and basically quoted the verse that Carolyn just mentioned and said, "This is the law now of the Third Circuit. These are the factors that our district courts should consider in addressing the issue."

I think the reason why, as Sam said, this is an extremely contentious issue among practitioners and others who have been in this area that have gotten involved in this very thoughtful list, is that there are lots of factors to be considered. As I said at the outset, if you are the judge dealing with this, it doesn't give you an answer by any stretch of the imagination, because both sides are going to have lots of things to say about the various factors. But it's a framework for finding a solution, as Carolyn put it earlier. I think that's the reason why the various people who were working, and the other reporters in drafting the document, ultimately got comfortable, because the reporters listened very carefully to the various voices of what was important to them.

It's not an issue—I want to come back to something. You said something earlier, Francis—it's not an issue that is plaintiff versus defendant. It's a controversy on both sides of the case. If I have a lawsuit that alleges

there's something in this water, that my client is told that maybe in some instance—

FRANCIS MCGOVERN: It would be in here, isn't it?

JOHN BEISNER: That's a little close to home. But anyway, if you're the defendant in the case and you're confident that whatever's alleged to be in here will not, in any circumstance, cause what plaintiffs allege, you may well, and in some cases people have, as defendants said, let's bring that on. Today it's normally been brought as a summary judgment motion with lots of experts in support of it, but it can also be brought as an issue struggle. And if you win, the case is over. If you lose as a defendant, you've lost general causation, but that might not be hard to prove in most cases anyway, so it gets cut both ways.

If you're the plaintiff, in a case like that especially, if it's a mass tort where there are 150 different law firms involved, the idea that your claims could be foreclosed by some other lawyers taking the case to trial and maybe you will or won't have much influence over how that trial goes into the jury, there's a reason why plaintiffs may not be very interested in going that direction either.

SAM ISSACHAROFF: It's controversial on both sides.

FRANCIS MCGOVERN: But keep in mind the kind of problem that this is intended for. The first time the U.S. Supreme Court confronted a mass tort case was in a very odd posture. It was an interpleader action but it's a case called *State Farm v. Tashire*[7] and this is an accident between a Greyhound bus and a pick-up truck in California.

Routine accident on the highway, nothing special except four people were killed, couple of dozen injured, there were forty people, forty plaintiffs, involved and the truck driver had no assets. The only question in the case that was significant was "Was Greyhound negligent or not?" Greyhound was desperate to figure out some mechanism to put that issue before a trier of fact and resolve it once and for all, because its claim was that it was not going to be negligent, it was not negligent, but it was facing the prospect of forty or more individual actions that could yield forty or more different resolutions of the question of "Was Greyhound negligent, and, if so, how much?"

The U.S. Supreme Court looked at this case and said interpleader is the wrong way to do this, but somehow there has to be a mechanism to get that issue resolved and we just don't know—this is back in the 1960s—we just don't know what it is. Well, fifty years later the Supreme Court has informed us that Rule 23 may not be the way to do it, but we still don't know what the way is yet.

Bankruptcy may not be the way to do it, but we don't know what the way is yet. So at some point, the genesis of this is, well, you know there has to be some other body that is capable of looking at this and coming up with proposals.

Because if you go back to the Greyhound accident case—when I teach this to some of my students I tell them it's like the movie *Speed*, if you recall the Keanu Reeves movie. One of the great things about the movie *Speed*, it's about a bus, out of control in L.A., driving very fast through the city. The great thing about the movie is that it is about Keanu Reeves and Sandra Bullock and there is about forty or so passengers on the bus and the movie never tells us anything about that and it does so because they don't really matter; it's all about the bus driving really fast and Dennis Hopper being a really bad guy.

These cases on the liability question, like on the liability of Greyhound, no individual passenger had anything to contribute to the resolution of the case of negligence or not, and so you needed some mechanism to get that resolved and then everything else would fall into place. What seemed irrational, systemically, was that we hoped that there would be private settlements, but we had no way of putting that question before a single court, in a single instance, and MDL now gives us the mechanism to do that on some of the issues, some other MDL practices do, but this is an attempt to give one more tool.

SAM ISSACHAROFF: Let me just mention one other, from the judicial perspective often times, as both of you suggested, there is an issue, if you get that issue resolved you can resolve all the rest of the cases—you could run the board in BP right now. One of the fundamental issues is how much liability does BP, as opposed to TransOcean, as opposed to Halliburton, as opposed to Cameron, and the vehicle the court is using under admiralty law is a limitation action, which you don't think of very much. Of course, I am not certain how many of you have admiralty cases, but that's yet another vehicle by which you can bring this gut-cutter issue to the fore and get it resolved, and then hopefully the rest of the cases will fall like dominoes.

FRANCIS MCGOVERN: In Kansas, right, you use the admiralty thing. [Laughter].

SAM ISSACHAROFF: Another area I thought we might touch on some months ago went off with one of the other attorneys in my office to look at on Lexis what section of the *Principles* document had been cited most frequently by courts, and somewhat to our surprise, by some distance, the most popular section was the discussion of *cy pres* settlements. Why? Why would this have been found to be perhaps the most useful section?

FRANCIS MCGOVERN: This was a complete shock to me. We had a little section on *cy pres* which said basically the money belongs—in *cy pres* you have a class action and the question is what to do with the funds and we wrote a principle that said, basically, the money belongs to the class, you should give it to the class. It's not money to be given to your favorite charity, your favorite golf event or what have you.

This seemed to us to be sort of inconsequential and obvious. This generated huge controversies. People would get up at these big membership meetings and say we used the money left over from our class action or we took money from the class action settlement, and only because the name brand was already taken would I not be recognized as the Mother Teresa of this particular jurisdiction. And my reaction was, that's great, that you want to set up a charitable foundation, you know you want to do these good works, that's wonderful. Just do it with your own money, not with other people's money.

It turns out this was hugely controversial and the people who gravitated toward this and this was also a shock to me because I had no idea this was going on with the judges. The judges said you have no idea that as soon as we have a big case assigned to our court, institutions, particularly charitable institutions in the area, will retain council to come and lobby us on behalf of the distribution of funds to their preferred charity.

I have to confess this was one where I just had no knowledge that this was going on and the judges needed some protection. Our basic principle was that the money belongs to the class, you should give it to them and you should not use it for your own purposes, no matter how admirable. If you can't give it to the class because of distributional matters give it to something that looks like a class.

Now the strangest case, where somebody decided to do something that looks like the class, and we discussed it, is a case out of New York where there was an antitrust action and it was against the modeling agency—the agency that pays models for commercial shoots. There was some money left over and the court decided that it had to do something proximate, so it gave it to a foundation for anorexic women. That was a little questionable.

JUDGE KUHL: Well, I think this is one where instinctively, as judges, we again feel sort of uncomfortable and I really think it's fundamentally a matter of the public's trust in the integrity of the judiciary. The *Principles* project, as Sam says, comes out in favor of, if there is a pot of money created, it should go to the class members, but only if you get down to the small pennies where you couldn't send out another notice, so you couldn't mail another check for the cost of the money, do you then have something that's left over that you might think about giving to charity and then the charity should attempt to mirror the interest of the class.

I think an important comment to § 3.07 is that the charity should not have a connection to the judge and it should not have a connection to either

side. In the early days of our complex litigation program, when we saw a lot of these settlements coming in at some point and a lot of them had *cy pres* at some point, I became very uncomfortable that I was going to end up approving a distribution to some charity and then six months later I'd find out that that charity was honoring the general counsel for the defendant corporation.

I mean, how do you know these things? So I think there's great wisdom in the recommendation that we kind of stick to business here and the idea of a class action is to better fit the class members and we stay as close to that as possible.

FRANCIS MCGOVERN: Two thoughts for those of us in toil in the vineyard of distributions. Number one, there's always money left over, which I think is one of the reasons why this has been cited so much. You will always have three to four percent un-cashed checks in every single one of these distributions, so this is a problem that's absolutely universal. The second thought, and my favorite one, is when a federal district judge created a new foundation and put his favorite chef as the head of the foundation.

The abuses have occurred over time, so this is not a one of a kind problem. You will always have some money and the reason folks haven't focused on it a whole lot is that usually the distribution phase of any settlement is kind of under everybody's radar screen; it kind of goes under the rug. Most of the fund administrators try their best to get down to the last hour and then they try to low-key any problems that come along and so shining a light on this tail end, the end game of the distribution, I think, Sam, really is the primary virtue of that section. Not so much *cy pres*, but putting the light of day on how that distribution is conducted at the end is really achieved.

SAM ISSACHAROFF: I think one other features of the *cy pres* discussion we've been talking about in terms of its impact on settlements—it's also—I've seen the principle cited for the fundamental proposition that, if you have a class action, the purpose ought to be to obtain money and get it to the persons who were allegedly injured.

There have been, I think, in recent years, some proposed classes where counsel has said "Well, we shouldn't worry about who was really injured, we shouldn't worry about identifying the class members, we should just figure out what the loss was in the aggregate and get that money out of the hands of the defendant" and sort of say, "we should do what an Attorney General action might do, but we should do that privately in a class action."

I think that, without directly addressing the issue, there is a notion here that a private class action may not be achievable in all instances, but first and foremost it's supposed to be, as with all civil litigation, somebody who claims they've been injured and needs recovery of some sort. The main purpose should be to get recovery to that individual and not be creating

anorexia foundations or whatever other things or maybe circumstance where —

FRANCIS MCGOVERN: There's also bulimia.

SAM ISSACHAROFF: Okay, well, you might have to divide between several important causes, but you know that may be necessary in some circumstances where you have residual out there, but it also serves as the other purpose.

JUDGE KUHL: There's another part of the settlement provisions of the *Principles* project that also goes in this same direction. That is the provision saying that an award of attorney fees made based on the percentage of recovery ought to be on the basis of the percentage of the benefit that actually goes to the class.

So frequently we see these settlements come in that are claims-made settlements and you may or may not want to prove those. I know Sam has some thoughts on that, but at a minimum the percentage of the attorneys' fees ought to be based on the percentage of what the class actually benefits from, not based on some theoretical amount that could be paid out, because nobody ever really believes that it's all going to be paid out.

SAM ISSACHAROFF: This is one of the areas; there's a handful where we recommend reversing a Supreme Court decision on this issue, and we say that not out of the arrogance of, you know, we can say anything we want, but I think that the Supreme Court, when it first addressed this issue thirty years ago had little practical experience with what we developed in this area of law. So, the Supreme Court authorized a percentage to be made available based upon what the class counsel in turn had made available to the class.

The problem as practices evolved, over thirty years, is that a lot of the work in class actions or mass cases takes place after the putative resolution of the case, and so, you have to incentivize the proper attention to be paid on the end stages that Francis was just talking about.

FRANCIS MCGOVERN: Sticking with the subject of settlements, there's a substantial section of the book that talks about non-class aggregate settlements and what we mean by that is you don't have a class action; you have a lot of, usually vast court claims that have been asserted individually. And it comes time for Francis to get involved, to get a settlement, and the plaintiffs will make clear what they would like to achieve with the settlement, which is compensation at certain levels for certain parties. Typically what the defendant will say is we want a global settlement. We don't want to just pay off the claims here that we would least like to get rid of. We are going to be spending a lot of money to resolve all of these claims. We

would like this to be over so we want everyone to participate if at all possible.

Well, in class action you've got opt-outs and so on that need to be used as a matter of due process, but in the mass tort arena it's a little fuzzier about what has to happen. What does this volume contribute to the approach that should be used in trying to achieve the interest of both sides in obtaining a settlement in this contest?

SAM ISSACHAROFF: If you imagine that in any settlement, in reality, that you have a fixed amount of money that's going to be spent on it, the defendant is always going to say this is, not publicly, but this is worth so much to me to get rid of and if we get rid of it entirely there is a premium available for that. That premium would be lost if it can't be harnessed into one proceeding. Now our legal system has two fundamental ways of creating that harnessing effect. One is through the class action, which, although there are opt-out rights available, has tremendous capacity to coerce participation against anybody who does not opt out, including over their objection. An objection does not kill a class action resolution and doesn't even kill settlement. The court can impose it.

The other mechanism we have is bankruptcy which has the clamp down mechanisms that just because you want to hold out doesn't mean you can. But increasingly we can't use bankruptcy before class actions for the mass harm cases, for the mass harm cases involving personal injury. But you need some kind of coordination mechanism nonetheless, that's what the MDL process does for the California Complex Litigation Project of the court system. That's a coordination mechanism. But what about the fact that there is a premium available to everybody for global peace? How can you realize that?

Well, the problem is that the ABA's Aggregate Settlement Rule says, in effect, that nobody can be crammed down. Nobody can be compelled to accept a settlement that he or she does not wish to accept. There is an individual entitlement to control of one's own legal claim.

So there's a case out of New Jersey that poses a problem. There were people who were franchisees of a tax service and as franchisee they had an identical dispute with the franchisor. The contract, the franchising agreement, prohibited class action. So they brought the mass action of several hundred of these franchisees and these are people who are professionals, who run a service, who handle tax returns, so they are competent to make economic decisions and they agreed among themselves that they would get a premium from the franchisor if they could all settle together, and that they would bring all their claims together. So they created, in fact, a de facto corporation, and the corporation was, that they all had an interest, and they all had an interest depending upon their economic state as franchisees. Three-quarters of them were to vote to approve a settlement, they could represent to the defendant that the settlement would go forward.

This was what happened and there was a settlement and more than three-quarters voted and there was a hold-out. The hold-out said I'm not going along. I have a right to say no even though I contracted into this. The New Jersey Supreme Court said, "We are uncomfortable about this because it violates the Aggregate Principal Rule of the ABA, but we are going to let it go through this time on the basis of the facts presented. We are not sure what to do about it prospectively."

We looked at this and we thought that this was the right outcome. The right outcome was that people should be able to create a limited partnership, a limited corporation, basically, and to commit themselves ex ante to a mechanism, not that the lawyer would decide, but that they would decide collectively and that they would effectively assign their rights into this common pool. So we are distancing ourselves from the ABA's approach to the Aggregate Settlement Rule. This is a very big issue in mass representation cases because of a case out of the Texas Supreme Court called *Burrow v. Arce*[8] in which the Texas Supreme Court said if you get the Aggregate Settlement Rule wrong, the remedy is not at law but the remedy is in restitution. The remedy is disgorgement of all legal fees, not how much you harmed the client as result of getting the Aggregate Settlement Rule wrong.

There are other courts that have looked at this and have said that a defendant who joins in an improper aggregate settlement is jointly liable for the wrongs committed there. So everybody is very skittish on this particular question, and we think that there is a communization necessary between these individual claims and the ability to contract into something meaningful. We chose as our model, Rule 524(g) of the Bankruptcy Code, which is the asbestos mass work out where all claimants have a vote and there is a certain threshold of three-quarters to participate.

JUDGE KUHL: I would answer that there is a statute drafted right in the back of the volume that would implement this. I mean, it's more than just a roadmap and you can take it to your local legislature and say pass this. We think it's a balanced approach. I thought that was pretty unique.

JOHN BEISNER: This was hugely controversial.

FRANCIS MCGOVERN: It is controversial. I will give you three concrete examples and one was a federal case, but it could have been a state case. The other two were state cases. We would love to have a statute, but sometimes you can't wait for the statute. The first involved, some of you may remember, a night club fire in Rhode Island. There were a hundred people who died by virtue of the fire and 200 others who had personal injuries, and the defendants were saying, "We are settling with you but we have to settle with everybody." How do you deal with that? And what we did in that circumstance was, we had a series of meetings with all of the 300 families, really, and we got them to agree on a formula before the settlement amount

was determined. So actually, they agreed in writing on the way in which the settlement would be divided, which is basically a point system that we have used in a number of different contexts. There was a positive vote for the formula and everybody agreed. One hundred percent agreement on the formula and then there had to be agreement on the various settlement amounts, which in the abstract was a little bit easier to obtain.

The second case involved a dam failure in Kauai where there was a dam up in the mountains of Kauai that broke and it went down into, of all places Bette Midler's pond, which was a beautiful place where you could go swimming in the Pacific and swim in Bette Midler's pond and get all the salt off your skin after swimming in the ocean. Eight people killed and a huge amount of property damage.

There, in draft form, we knew about the *Principles* and the lawyers decided to have a meeting and we did a 75% rule on the property damage cases. We were doing 75% on the personal injury and all of them agreed to it, so for all practical purposes everyone agreed ex ante to be bound by that particular kind of vote when the settlement came in. There was no appeal, so I don't know exactly how Hawaii would go on that if it were a controversy.

Third, was a case in Idaho involving a hundred and ten potato farmers and there had been some herbicide from the Bureau of Land Management land that had blown onto their land and destroyed a potato crop, to the tune of several hundred million dollars. The issue was that the defendants, the manufacturers of the herbicide, had said, "We will settle, but only with everybody." How do you deal with that one? With that, one of the lawyers was concerned about the ethical aspects of aggregate litigation and so we had a lump sum and ex post we got everybody's agreement to participate in it. The dynamic is a little bit different, because if all your neighbors are settling, and you are the only person who is not willing to settle, there is a tremendous amount of peer pressure that comes. That could be just as unfair, I would argue, as any other kind of pressure ex ante. So, the problem doesn't go away if you waive it for the end. But currently people are using all of those different techniques to try to resolve, in aggregate form, settlements that seem to maximize the value of money that the group as a whole would get.

JOHN BEISNER: We should turn to questions in a few moments, but before doing so, I had one closing question to pose to both of you and Sam. I will start with you. We've talked about a lot of different sections in the Volume today, but on this core issue of class certification, there's a substantial discussion of that subject here that we have not touched on a great deal. And I'm curious to get your thoughts, as this is a somewhat more traveled area in both federal and state courts, as to how you think the Volume may influence the courts going forward. Let's ask the question of whether class treatment should be afforded in certain circumstances.

SAM ISSACHAROFF: Well, I think this takes us to the *Wal-Mart* case.[9] The person who did the primary drafting in Chapter II, which deals was class actions, was my late colleague, Richard Alvarado, from Vanderbilt University. Where there is a unified injunction being sought, or there is only one pot of money that is going to be divided up in some fashion, the claims are divisible where individuals could bring their claims individually. But we want to bring them together for efficiency reasons, or we want to bring them together because they are small value claims or there is something of that sort and the rules have to be adjusted for that insight.

Our second concern was that the formalism of Rule 23 had given rise to quite artificial questions. Are their comments refused or not, and do they predominate? So what happens in practice is that the plaintiffs would have a list of common questions. And the questions would be very high levels of generalities, such as, "Are we not at the end of the day all God's children?" The defendants would counter with specific questions. "Yes, but is it not true that some of us were born on Tuesday and others were born on Wednesday?" So you could have endless lists of the common questions and the distinct questions and the real issue for us was, "Would common adjudication generate common answers?" We pushed this very hard and then Richard pushed it hard in some articles that he wrote and I pushed it in some pieces that I wrote in an academic capacity.

I think what you see in the *Wal-Mart* case is that all nine justices of the court are trying to grapple with this issue. And I think that *Wal-Mart Stores, Inc. v. Dukes* is actually flip sides of the same general problem of: How do you get reasonable and constitutional conclusion of common issues in these aggregated proceedings?

FRANCIS MCGOVERN: From the settlement perspective, one of the more notable challenges to the U.S. Supreme Court relates to Rule 23(a) prerequisites and predominance and Rule 23(b)(3) predominance, superiority, and commonality and all kinds of issues. In a settlement, it is common to relax those because you've got a settlement rather than a trial. In *Amchem*[10] and *Ortiz*[11] the U.S. Supreme Court indicated that for settlement you would have to have a class that would be certifiable for trial as well.

Judge A.D. Becker wrote the opinion and in *Amchem* in the Third Circuit[12] and at the conference at NYU he was asked, "Why didn't you allow the settlement to be certified, because it was really different and it was a settlement?" Judge Becker said that it just didn't rise. The elements of 23(a), one could argue, aren't really quite as important in the context of a settlement, and the *Principles* suggest that it is okay to relax those in the context of a settlement. I think it underscores a point that Sam has made earlier, and that is the U.S. Supreme Court, in my opinion, does not really understand mass cases. They have never had the experience with them, so now they are reacting against this bottom-up kind of push.

We know how to solve these kinds of cases at the trial level but they are saying no, no these are one-on-one cases. And the concept that Sam is talking about, and the issue they are grappling with, is going to go for a period of time. But to my mind this provision that allows relaxing 23(a) criteria in the context of class action settlements is a very positive move.

JOHN BEISNER: We have about ten minutes left in this segment and we would pause at this point to take any questions that any of you may have to pose on class actions, the book, or any other topics that we have covered this morning.

AUDIENCE MEMBER: If I can add, in your reading materials, there was a Table of Contents from this book that everybody is talking about, the section on objectors. You can see what it looks like. Paper copies are in the back on that, but I thought the Table of Contents would give you a sense of what's in there.

AUDIENCE MEMBER: Many jurisdictions have a statutory requirement that the courts agree to the settlement and approve the settlement. At the same time in many class actions you have known objectors sometimes sought out by an attorney who travels state-to-state you know, and they elicit someone to become an objector. Someone who maybe in discovery doesn't know much about the case at all, but was solicited to become an objector.

And then when there is a resolution at the trial level and it is approved sometimes that case is settled and there is an approved court settlement below. There are sometimes questions like: "What happened with regard to the settlement?" You have every party, say that you will have the objector, say I want to dismiss my appeal, which in most jurisdictions they have a right to do that unless there are some counter appeals or something like that, and you've got the other parties saying that we agree let them dismiss the case. You don't know what's behind all of that and are there guidelines in your settlements or proposals dealing with those kinds of situations. Because it appeals, like at the appellate level, if someone wants to dismiss the case and you did have a judicial approval of a settlement before it's dismissed.

FRANCES MCGOVERN: This is an artifact of what happened in 2003 in the amendment of Federal Rule 23. Before that, the settlement with the objectors—and there's different kinds of objectors—there are people like publicists and serious folks who come in and then there are various other people who go by various names—and we use the term extortion settlors for this as just a descriptive matter, not in a majority of it at all but just as a descriptive. And so they used to come in at the district court level and get bought out and that's what they are seeking to do.

In 2003, the Federal Rules were changed so you couldn't settle with anybody in a class action settlement without disclosing everything. Then the practice changed and you filed a notice and you file an objection. Some of these objections are great because they say, "I object because I believe that the settlement is not fair, adequate, and reasonable and that the fees are too high. And that's it. I do not intend to appear at the class level." They don't appear.

Then they file a notice of appeal and then it goes away. What happens, as somebody refers to in recent litigation, is as the hole in the rules gang because they appear where there is a vacuum in court supervision so now they can get out at that point.

We had a lot of discussion about this and our proposal is that the district courts have to set a better record—that the district courts actually start using sanction authority against these kinds of objectors. We also propose that the district courts tax the parties to reward objectors who successfully object on material grounds. So we go both ways. We want to recognize that judges are at a disadvantage of the settlement process precisely because everybody who is there is a friend of the deal and so you want people like Public Citizens or other such groups to scrutinize it and at the same time you want to stop this business model that has developed and I think it is dirty for everybody involved.

AUDIENCE MEMBER: When you talk about [inaudible], I can see maybe why with that record, why the settlement [inaudible] in appeal. But there's no way to monitor and they wanted to dismiss the lawsuit in most jurisdictions. They have a right to dismiss a lawsuit as long as there is nobody and no counter appeals or stuff like that.

FRANCIS MCGOVERN: But, there are some powers you have and you can impose some appellate bonds and if they are holding stuff up in some jurisdictions you can even use a supersedeas bond in this regard. You can create the record more clearly for appeal but this person did not appear. This person did not file a meaningful settlement proposal. This person did not engage in the merits. This person filed a document which talked about the objections to the antitrust settlement, but this is actually a securities case and this happens frequently and you can do that but you are right this is an ongoing problem.

AUDIENCE MEMBER: And in essence you are talking about the trial before it goes up.

FRANCIS MCGOVERN: Yes.

AUDIENCE MEMBER: I have a question and I'll start out with something a little bit humorous here. I have had a couple of class action cases

and a couple of years ago it was a silicone breast implant case and currently I have an asbestos case. Both cases are basically California cases that were filed in Nevada. As far as I am, kind of suspecting, it's because plaintiff's counsel figured out a way in which they could shelter income from the California income tax. I am hoping that Judge Vargas from San Diego won't bench slap me for making an expulsion against California taxes as he threatened last night.

STEPHANIE MIDDLETON: Also in Nevada juries have been more favorable to the silicone gel breast implant plaintiffs.

AUDIENCE MEMBER: Well, we did have one case in Reno where they won, but the basic question come down to asbestos. A couple of years ago I went to a—I think Henry Butler organized—class on toxic torts and at the end of the class we had a whole panel on asbestos. It seemed to be that they were in the federal court system and I asked the people about that when we had a pretrial conference with a whole room full of lawyers. "Whatever happened to that" and they indicated their case had been in the federal courts in Phoenix. Some kind of a processing but now it's out of the federal courts. So maybe you could comment about all of us and I think most of us are state court judges. Whatever happened to asbestos resolution in federal courts?

FRANCIS MCGOVERN: Six or seven times, various lawyers attempted to get the judicial panel on multi-district litigation to consolidate, for pretrial purposes, all the asbestos cases. Finally, a group of federal judges, about eight of them actually, wrote the letter—wrote a letter to the panel—to please use MDL treatment for all the asbestos cases in federal court and give them to Judge Weiner in Philadelphia. And, correct me on the time frame, this was probably mid-'80s or late-'80s, and they are still there. And the judge who has them is Judge Rubino and he is slowly sending the cases back.

So during that period of time the plaintiff's lawyers, if they could possibly file in state court, they would file in state court, because it went to Never-Never-Land in Philadelphia. Some of you may remember the *Amchem* case that came out of Philadelphia and went up to the Supreme Court was reversed. So there was a big attempt to have a national settlement that didn't work out. So Judge Rubino still has a huge number of federal cases.

They are slowly being sent back. Some of them, that had been removed, are now being remanded to state court. So you can anticipate the pleasure of getting more and more asbestos cases over time. There are a variety of approaches that states are using right now to deal with them, but that's sort of the history of the case in Phoenix that went to Philadelphia, that if it hasn't been resolved, will be coming back.

AUDIENCE MEMBER: As a matter of fact, in the early '80s there were certain key defendants in the asbestos cases. Of course, there is a common bar of clean-up defense and go around trying these cases. Now we should have that, because when these cases come up and we can't solve them. The target people have been bankrupt for a long time and there is no money there. So now you are going to people in the early '80s and so forth.

FRANCIS MCGOVERN: It's actually a little more interesting. There's about twenty billion dollars in asbestos trusts from those bankrupt images. Generally speaking, plaintiffs never heard of any of those manufacturers, but they have heard of solvent manufacturers and can identify the products quite readily.

AUDIENCE MEMBER: My turn?

JOHN BEISNER: Yes, your turn.

AUDIENCE MEMBER: I like the idea of a single issue class certification. And it leaks out when you tell the story of the Greyhound bus and the truck accident. I am wondering if you think it works as well in a constitutional context. So that you don't have to have all the plaintiffs that have been affected by a First Amendment claim or an Eighth Amendment claim or a Fourteenth Amendment claim, you can just extract the issue and create a class around that so that you can speak to whether or not it's a constitutional violation. Have you seen any cases like that?

SAM ISSACHAROFF: I have not, but I have seen the problems. So, there was a Supreme Court cases two years ago or three years ago called *Taylor v. Sturgill*[13] and it involved people who liked to reassemble World War II vintage airplanes. They didn't have the plans for them and so the President of the vintage air club of this particular kind of plane from World War II; F-45 I think it was, sued under the Freedom of Information Act to get this information out of a Federal Agency. The FAA, I guess, is the one who had the plans. It went up to the Eighth Circuit and the Eighth Circuit ruled that Fairchild and it's successors in interest could still claim that these were vital business secrets; how to build a small engine plane in World War II, which may say something about the state of business development in the United States if this is still critical to their fortunes.

His best friend then sues in D.C. for the same planes and they are working on the restoration of the same plane. And it goes all the way to the U.S. Supreme Court in a case called *Taylor v. Sturgill*. And the Supreme Court says there can be no virtual representation preclusion, because it's a new case and he wasn't bound by the prior case. It seems to me that a court handling a case like that should insist to the plaintiff, "Okay, you be class

representative on an issue class because otherwise you can't get the two-sided preclusion if it goes up." Because, if the government had lost, or Fairchild had lost, everybody would g the plans; on the other hand, because the claimant lost there was no preclusion at all. So I think courts have been grappling with this but they haven't started to try to use it intelligently.

JOHN BEISNER: Okay. We have time for one more question.

AUDIENCE MEMBER: It's an easy one. Some of us are at the point in life where we ponder life after the bench. I notice that there are only four pages dedicated to special appointees of the courts, special masters. My question is: Are there other areas in which special masters may be appointed? You have only in the settlement area and I would be personally and some of us would be interested in how masters come about and can they be utilized, let's say, in discovery?

FRANCIS MCGOVERN: Well, I've been a special master. I don't know eighty or a hundred times probably for fifty federal judges or maybe state judges. The roles have varied. I get a call about once a month from judges about to retire asking me how to do it. So this is not an unfamiliar question. Managing discovery, absolutely—e-discovery right now is the hot one; so managing e-discovery.

Ruling on privileged matters, we have huge volumes of discovery material. Settlement issues, as you have mentioned. One of the things I do is coordination between federal judges and state judges in silicone breast implant and now in BP where you have cases all over the country. How do you make sure the judges are all working together?

Implementation of a decree, if you've got a resolution and it needs to be implemented—overseeing the distribution of a settlement fund. I could go on and on and on. It's really based on the inventiveness of the judge and the felt need for assistance from a third party.

JOHN BEISNER: Yeah, and I would like to add to that the limits to the reference in this Volume shouldn't be viewed as any comment on the usefulness. I think, the thought was to address the special roles that special masters can play in the aggregate litigation context doesn't mean that the more traditional use of, just as Francis referenced, in part appropriate.

One note I would make though, is that in the federal MDA law proceedings that I am in that are relatively new, I have been surprised to notice that the use of special masters has become increasingly controversial among counsel. I have been in several cases where the judge took the matters aside that it has on the agenda to start with. So, let's get a special master. Both sides, with greater frequency, are objecting to that, saying we need a role. We need to define what this person is doing. Are they going to be in charge of e-discovery? They are going to be in charge of coordination

around all the proceedings. There are two or three special masters and each with a particular role.

But I think the concern has been, in some cases in which special masters have been appointed to be, sort of the assistant judge, dealing with everything. They have been paid in some instances two or three million dollars in fees over time.

AUDIENCE MEMBER: That's all?

JOHN BEISNER: No comment. But there is a concern on the part of parties of making sure there is a mission and mission creed that's involved. I think the role is safe and it's going to be there and I think as long as there are constraints on judicial budgets and so on and I think they are going to be important.

FRANCIS MCGOVERN: Rule number one, if you are going to do it, I think the best piece of advice you will ever get is make sure it is well defined, as to what you are supposed to do. Because otherwise you will be in trouble.

JOHN BEISNER: And to close, the name of the book once again is *Principles of Law: Aggregate Litigation.* Get it while you still can.

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1 131 S. Ct. 2368 (2011).
2 131 S. Ct. 2541 (2011).
3 Fed. R. Civ. P. 23(b).
4 131 S. Ct. 61 (2010).
5 Manual for Complex Litigation (Fourth) (2004).
6 Parklane Hosiery Co. v. Shore, 439 U.S. 322 (1979).
7 386 U.S. 523 (1967).
8 997 S.W.2d 229 (Tex. 1999).
9 Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541 (2011).
10 Amchem Prod., Inc. v. Windsor, 521 U.S. 591 (1997).
11 Ortiz v. Fibreboard Corp., 527 U.S. 815 (1999).
12 Georgine v. Amchem Prods., Inc., 83 F.3d 610 (3d Cir. 1996).
13 553 U.S. 880 (2008).

TECHNOLOGY IN THE LAW AND POSSIBLE SOLUTIONS FOR PROVIDING INCREASED ACCESS TO THE UNDERSERVICED MIDDLE CLASS

Charles Rampenthal
Moderator: Linda Kelly

LINDA KELLY: If I could have your attention up here on the podium, please, our luncheon speaker is ready to go.

We are pleased to have with us today Charles Rampenthal, who is the General Counsel with LegalZoom, an innovative legal services company that has grown from fifty people to 400 employees in the eight years since Charles has been with them. They are a provider of directed consumer legal services, and Charles is going to tell us about what they're up to. So please join me in welcoming Charles Rampenthal.

CHARLES RAMPENTHAL: Thank you very much, Linda. I'd also like to thank the George Mason University School of Law for having me out here in the symposium, the Law and Economics Center, Jeff, Henry, everyone, and everyone who's attending here. This is the type of stuff that's really important.

As Linda said, I was going to tell you a little bit about the company. I'm going to try and do a little less than just focus on what I do and what my company does, and try and do something a little bit more—talk about creating affordable access, affordable legal access. Now I think that's a pretty broad topic, and one that's been discussed at luncheons like this, and dinners like this all over the country, probably for decades now.

When I was preparing for the speech, I kept thinking about the number of directions I could go with a topic like legal access, or technology, or technology in excess, or what I do with the directed consumer model.

So, as an executive in a company, where we have married technology and legal documents together to try and increase access, I couldn't help but just see the effects of technology on our own customers, how the Internet has affected them, and what effect it has had on our profession. It's not just what I do as a living, but what everyone and the people who are in your courtrooms everyday do.

I also could not consider how much further the profession, I believe, has to go to actually take care of access, to come up with solutions that bring the law to more and more Americans every day.

I think that in the end, these new solutions are going to require technology, but they're going to require more than technology. They're also going to require maybe a new attitude toward the underserved and the legal needs that the underserved have.

Let's see how this little clicker thing works here. All right, so when it comes to the efficient use of technology and how we increase access to the law, I think that as a profession we have to face some facts. They might not be nice facts, but they're facts.

We've thrived for decades now as a profession that has largely been a pen and paper business model. And that's fine. I know that things are changing, but the model itself has really kind of been unchanged for those decades. The idea that now we use computers instead of tablets, and back in the day people used to tell me they used the carbon copies, and they'd leave a little—you know people who drafted contracts would leave a little space at the bottom.

That stuff has now changed with the advent of word processing. But the actual kind of fundamental embracing of technology, we've really kind of seen it creep into the legal profession. It hasn't been—there hasn't been a lot of open arms saying, "Oh, yeah, sure, we need to completely change the way we do things." No, and I don't think that this is for really lack of trying.

I think there's no shortage of legal technology shows. I go to Tech Show and Legal Tech and all the different stuff, and I think that there are consultants that are out there that are willing to do just about anything from setting up an email account to completely taking your firm and putting it into the cloud nowadays.

So I think we've reached the question, "Should I use technology?" I think that's not really the right question to ask anymore. I think everyone says, "Yeah. Yeah." I think most attorneys are going to say, "Sure, we should use technology. We should make things more efficient. I don't know why not? I mean it makes my life easier. It makes things a lot easier for everyone else, my assistants, the people that I work with."

This is especially true for the lawyers that have grown up using technology. I don't know if I'd count myself. In law school I was maybe one—maybe five or six years before everyone had a laptop computer. I still had the pen and paper. That's kind of the person I was. I was also a little older when I went to law school.

So like I said, lawyers want to embrace technology, at least the ones that I talk to on a day-to-day basis. However, it's not really super easy to just embrace technology.

I think that there are ethical rules out there, and we all know the ones without actually naming them, that have been written well before the advent of a lot of technology. And they're really not able to keep up with the way that the ever-changing commercial landscape is, and the break-neck pace of technology. So I'm going to talk a little bit more about this later.

Well, there's another obvious question when it comes to law and technology, that's the one that a lot of people ask. "Hey, what should I do? What should I use for my own law practice?" I think that a lot of lawyers might even talk to you as judges asking that.

Well, again, I think there's a ton of information out there, so I don't really want to talk about that question today. I think I should step back from that and leave it to the consultants, leave it to the technologists, the people who do this day-to-day.

So I'd like to focus on something that's a little more pressing when it comes to access—access to advice, access to legal services, access to help. We all know that developments in technology have opened up many other industries to new consumers. For instance, technology has given us, as consumers, better access to travel.

Think back, and you don't have to go too far back to the time when airlines were developing their own internal systems to do reservations. Then they took those systems and gave travel agents access to them. And remember we all used to use travel agents. You'd call them up and say, "I need to do this vacation," and they'd do it.

Now, it's funny, those exact same systems that were internal to the airlines became external to professionals and then external direct to the consumer. Places like Travelocity, Kayak, Orbits, and Priceline. They've supplanted the travel agent that was used in the seventies, and even up into the eighties.

Access to knowledge about airline pricing, it's made pricing more competitive. It's opened up the industry to people who weren't able to travel. My grandparents have never been on an airplane. My parents, until I probably left for college had never really been on an airline except once. And that was when my dad was flying back from—exiting the Marine Corp. to go back to his life. But now being able to book your vacation 24/7 just gives a different kind of click.

Technology also has given us access to entertainment. You think of the way it used to be. There was VHS, then there was DVD, and now there's streaming. New media companies are really leading the way in doing this—Netflix, Amazon, and Hulu. All of them have preempted what was once looked at as kind of a behemoth, Blockbuster. They're changing their entire business model based on pressures from people outside the industry.

Technology also gives us some interesting access to retail. It's not too far back in the day that there was no such thing as Amazon. You were buying stuff. You were going into a store. You were hitting up the Sears. You were hitting up the Penney's. Nowadays you can go online.

And it's funny, even when I find myself walking into a brick-and-mortar store nowadays, I'm a member of Costco, and my wife and I like shopping at places like T.J. Maxx. We like to get a good deal.

But even when we see something, I'll take my little scanner and I'll hit it and make sure that Amazon says it's still a good price. So even though I still shop at a brick-and-mortar store, the idea of Amazon being there has changed the way I think about it.

Now these businesses that I just talked about, they're just a small kind of spattering about of ones that have embraced technology, and really improved the way they work for consumers. And unfortunately, I think we all know the legal industry has been a little bit slower to do that to the same extent.

For all the people out there who are raising your eyebrows or maybe even rolling your eyes saying, "Who the heck is this guy? We're not DVDs." Right? "We're not airline tickets. And we're certainly not going out there and buying a book from Amazon. We're a legal profession. That's who we are. We're a noble profession. Who is this guy?"

Well, let me try another example. What about taxes and accounting? That was a primarily a 100% service industry twenty, thirty, fifty years ago, where if you wanted to get your taxes done, if you didn't know how to do it on your own—and that's what my grandfather gets every year, that big book, that big, thick booklet.

He doesn't go to Turbo Tax. Every year he flips that thing open and he does his 1040, painstakingly with a pencil. I use Turbo Tax. That's what I do. I enjoy it.

The fact is, is that there's a continuum of the way you can get your taxes done. From doing it yourself and learning, to having a little bit of information you can go right on the IRS website and complete stuff. You can go to Turbo Tax and get a little help. You can go to Turbo Tax and get an accountant to make sure things are happening. Or you can go to an accountant, a bookkeeper, or even a CPA. There's just this big kind of arc of doing it.

So I'd like to go back to the core of what my presentation's going to be, and ultimately I found that the real question that faces many of the people in our profession is this one, which is, "Yeah, okay, so technology's out there, and technology changes business, but how do I use it? What can I do? I'm a little concerned. I've got ethical standards. I've got quality standards. These people are counting on me."

The people who are walking into your courtrooms and delivering documents on behalf of their clients, they have a certain panache they have to keep up. They have to add value to it. So how can they use technology and still keep up and maintain their ethical standards and their quality standards?

So I'm going to postulate here that working kind of within the current system, it's really not always, and very rarely is the best way to bring innovation to an industry.

You think about it, Blockbuster didn't invent streaming. Someone else did. Blockbuster now uses streaming. As a matter of fact, there's a really great case study I think, some of the Harvard business people took a look at, where they looked at the fact that Blockbuster knew exactly what Netflix was doing.

They had a lot of information about Netflix. And they all kind of shook their head and said, "Oh, that place is about ready to go out of business." Then they got $200 million and really kicked their you-know-whats. The fact is Netflix has also made some blunders in recent days, as we all know. So Blockbuster's kind of back in the market.

So the interesting part is all these industries were disrupted by innovations, but they were all done with the right use of technology—and not just any old kind of use. It's not just technology for technology's sake.

So first up I want to be clear in the fact that I'm not saying that having ethical obligations is a bad thing. It's obviously one of the most tantamount things to our profession. We can't lapse on doing the right thing for our customers, or for the people that come into your courtrooms. We can't allow lawyers to all of a sudden just abandon everything they're doing. And to tell you the truth, we can't allow people who are non-lawyers to act unethically, or not in the interest of the consumer.

I think more than ever today, solo practitioners, small firm lawyers, and even the mega-firm partner, they're trying to do their best to really embrace technology, use technology, and serve their clients more and more. But as I said before, I think they're finding that the road is paved with some ethical landmines we need to kind of discuss. And many of those landmines are from a time that's a little bit far gone by.

So it should probably come as no surprise that the general counsel of a legal document company, that is not a lawyer, believes that innovation when it comes to this is probably going to come from outside of the legal profession first, in other words, outside the traditional legal profession. And then it will probably be adopted and adapted internally by the profession later.

So I'd like to take a few minutes to think about what it might look like, and how that might come about, and how technology is going to play a part.

So, over the next forty, well, now about thirty minutes, we're going to talk a little bit about the following things. We're going to talk a little bit about the middle class and the small business, and how the legal profession is really taking up new technologies. And taking a look at this pressure where change is going to come from, what the needs of the middle class are, and what a firm would look like if we could just take this kind of nirvana, or whatever's the avatar view of like perfection. And we can craft something that would actually work for the middle class consumer.

So let me get right into it. I'm going to start by saying what to some here, and many here is probably obvious, but I think it bears repeating. And that is that the true underserved, in my view, are the middle class and the small business.

So we all know that the wealthy have options. My corporation, if I went to hire a lawyer, there is no lawyer that we cannot afford. We have money. We have disposable income. Someone like Bill Gates can hire whatever lawyer he wants to.

But I can tell you right now, my grandfather, who is retired, and is on a fixed income, cannot. He cannot hire the biggest law firms. He cannot hire the David Boies of the world. He cannot hire as to what I've just noticed the most expensive lawyer, who is billing $1,200 an hour. That's where we're at right now, $1,200 an hour, some of the most expensive lawyers.

I think the system is badly designed. Our system has been designed, evolved to serve the wealthy more than it has others. The way it works is, we all know, someone who has money comes to us with an issue. They hand us a check that is blank, and we say, "Don't worry about it. I'm going to not only find out and tell you what the problem is, I'm also going to tell you how it's going to be fixed. And in the end I'll tell you how much it costs." And we all say "Okay" because that's the way it works for us.

You take a look at the poor, now I'm not trying to undermine the fact that the poor are underserved. They are. They definitely are. But the profession itself has done a lot, and needs to do more to help service the poor. We do have pro bono help for people. It's not enough.

In California, for every legal aid lawyer that does it as a full-time job, there are 8,000 people that are below the poverty line, 8,000 to one. Those aren't good odds. But it's better than zero to one. And it's getting better. And some of the things that we're trying to do internally with LegalZoom—we're trying to fund individuals that want to help some of these places, taking a look a Legal Aid, probono.net, etc.

We also have the court help—the self-help centers. I think a lot of what you've seen happen in your own courts in the past five to ten years, automating documents, automating processes. It's phenomenal. And I think it has given people a lot of access, and I think it's great.

When you take a look at the middle class, and this doesn't come from me. This comes from the American Bar Association. This came from a study that just happened last year. They've said it: "You're too rich." The middle class is too rich to afford legal aid, which just means they're not poor. They're also too poor to afford the traditional hourly rate that a lot of lawyers charge.

So I think when you take a look at the middle class, you can take a look at the small business. And when I say small business, I mean the unfunded one. They haven't gotten their $500,000 or $600,000 of friends and family funding, and their five million dollars of venture capital funding.

This is the mom and pop. This is someone who maybe lost their job, and is trying to open a consultancy right now to do something. This is someone who said, "Man, I do what I love. I bake cookies, and I think I want to start offering them on the Internet." These are people who don't have the same type of resources that larger companies have.

I think that the middle class individual also typically has problems that a lot of the poor don't have, which are they have higher home ownership. And we know with home ownership comes a lot of legal issues, also comes

probate thresholds, things that kick stuff into probate that otherwise wouldn't have gotten in too.

I think that small business owners, you take a look, most of them have zero startup capital—just what's in their wallet. So essentially they're their own start up.

I think that from all the people that I've talked to, and I've counseled a lot of small businesses. Being where I am, I'm constantly getting people asking me for help—asking me for things. Most of the time, I just have to turn them away. I don't want to have any conflict come up.

But as for my friends and family, my dad's owned a small business. My mom currently owns a small business. Some of my family members do. The one thing that they don't want to do is they don't want to take their hard-earned capital and invest it in legal fees. They want to invest it in growth. They want to invest it in marketing. They want to invest it in making money.

As a profession, I think it's time for us to really face the music here. How are we supposed to look at what I think are the biggest section of individuals who need our help with a straight face, and tell them that the plan as is, is the best plan for them? We don't need to change anything. Make more money, spend more money, or you get no access. I don't think we can do that. I don't think we can do that with a straight face. And I don't think anyone here really wants to.

I think most of the underserved I'm talking about are never going to be able to afford a lawyer, including what some people might call the discounted lawyer. I think there's this big disparity. There are stats out there. I think some of you have probably read them. I know I've read them—as to how much it costs to really get a lawyer, to really afford one.

You think of it from the average consumer in the average household here. Right here in the United States the average household makes about $5,000 a month. That's both people working. That's not a lot when you think about all the things that they have after taxes, after normal expenditures for things like housing, food, cars, and healthcare—stuff they can't do without. Most people have around $850 every month. That's to spend on things like clothes, entertainment, and guess what, legal stuff.

You take a look at an average price in 2010 of $295 an hour. Let's cut it in half. Let's call it $150 an hour. It's not hard to burn up a whole month's worth of disposable income just going to a lawyer for a pretty simple need. So I think there needs to be options out there for people.

So I'm going to move on a little bit to the pressures that the industry is facing when it comes to this stuff. And I think that there are more and more people who are saying we need more options for the underserved. And I think the profession is seeing it from a lot of different sides.

For instance, we're definitely seeing it from consumers in small business. There are lawyers out there—I'm an active participant in the e-

Lawyering Task Force for the ABA in the law practice management section.

I see the people who are out there, virtual law offices, the people who really want this to change. They want to have client interaction online. They want to take their small little practice and do it all over the entire state. Especially when it comes to transactional matters. Things like getting a will, or maybe preparing up a bankruptcy, things where you don't necessarily have to go into court, or drive for hundreds of miles to make that happen.

I think there are the lawyer aggregators and marketers. Some people might not like their methods, but what they're really doing is they're trying to get people together and volume priced, the total attorneys' model. And I've met Kevin Chern up in Chicago.[1] He's an okay guy. I like him. I like what he's trying to do.

He's trying to take things that are very repeatable businesses, things like uncontested divorces, things like bankruptcies, and he's trying to make them more affordable for more people. Instead of paying $2,500 or $1,500, some people can get that down to $750. That drop in price makes it much more affordable.

Talk about the virtual law offices—that's what VLO stands for. And alternative legal service providers, it's what many of you out here probably call non-lawyers. And I have to be really careful about that.

I don't like the word non-lawyer. It's funny, I don't know any non-doctors or non-accountants, but I certainly know a whole bunch of non-lawyers. It's always baffled me. So I like to call myself, and I like to call our company an alternative provider of legal services.

Well, what about these guys? Professors, legal writers, some of the people who are here, and you might be hearing from today. There have been books that have just come out. There have been op-ed pieces in the Wall Street Journal.

But Crandall and Winston have just written a book called *The First Thing We Do, Let's Deregulate All The Lawyers*.[2] And there was this outcry of like awfulness when people like "It's going to be the Wild West, and the lawyer with the most bullets in her gun is going to be the one that wins in court."

That's not what we're talking about. They're not talking about deregulation. I think what they're really talking about is the right regulation. The idea that the legal industry might actually, if we can just suspend our disbelief for a second, might be over regulated. It might be just a little too tight when the lawyers that are acting within the profession are not allowed to innovate because of the rules that are restricting them.

So, from inside the profession, even here in the U.S. and around the globe, we're feeling the pressure. There's the ABA Future of Law panel where the former State Bar President, Richard Pena said, "Hey, a tidal wave is going to hit our profession. The question is, are you ready?"[3]

And Frederic Ury, who was the Connecticut State Bar President, said, "If you think nostalgically about the practice of law and how it used to be, then you're on the train tracks and not the train."[4] These are interesting quotes from people who are the keepers of our profession—the state bar presidents.

From around the globe. How many people know what's going on in the United Kingdom right now? I talked with a couple of you about this last night. The Legal Services Act of 2007.[5] Well, it's 2011, and just like most good laws, it's finally coming into effect. It only took four years.

Starting in January of 2012, if the Solicitors Regulatory Authority gets it right, if I wanted to I could purchase a law firm. I'm not talking about partner with one; I'm talking about buy one. Companies right now are already formulating plots in the United Kingdom to make sure that that happens.

Places like WHSmith have partnered up with Quality Solicitors, which is a legal brand name over there. There's a lot of interesting stuff that's happening. And I'll tell you right now that if you don't think that that's going to have an effect on what happens here in the United States, well, I think you're all just dreaming. Because when these changes happen, I think they're going to have a profound effect.

So let's not forget about the very most important forces, and that's everyone here at this table, the judges. When it comes to litigation, how many of you think there are too many pro se litigants? Would you like to see them reduced to just a little bit? Not because you don't like them. We love the pro se litigants. We need them. They're a part of the backbone of our legal profession—the fact that you can do something on your own.

But we all know what happens when court calendars are clogged, when the number of court clerks is at an all-time low. My wife was a clerk in the criminal court. The entire criminal court system in the county of Los Angeles, her and two other people, three total lawyers, were all the clerks there were to review every single writ of habeas that came down. That's not a lot of staffing. That's not a lot of help. And we know it's getting tighter because when her term ended, they didn't replace her. So now there are only two.

We know that you guys are under a lot of pressure. And the way that the pro se parties act sometimes, and the access and the information they have can sometimes really kind of clog things up.

So last year a survey of 1,200 judges was conducted by the American Bar Association, the Coalition for Justice.[6] Has anyone here looked at that study, or read it, or been a part of it? All right. It's no shock. I have no idea who the 1,200 judges were that did this. But they said that in the weak economy there was an increase in the number of self-represented litigants—things like foreclosure, domestic relations, consumer issues, and other housing matters, ones other than foreclosure.

Then President Lamm, well, the then President Lamm of the American Bar Association, said, "This includes not only the poor, but it includes the middle class because it's not only failing in legal, the falling and legal services corporation funding, but it's also because the middle class are unable to spend on lawyers." I mean right there; the American Bar Association itself, the president said the middle class is not able to spend money on lawyers.

Some findings, where do pro se people hurt themselves? They hurt themselves in failure to present evidence, procedural errors, poor witness examination. How many here have a crystal ball and know what the ABA's conclusion was to that study? More lawyers. We need more lawyers, obviously. Court rules are hard. People don't know how to present evidence. The only answer is more lawyers.

Well, I'll tell you right now, we're minting lawyers by the pound. And most of them aren't getting good jobs. Most of them aren't doing the types of things that we say that they should do. The fact of the matter is, if we keep looking at the same problem the old way, we're going to continue to get the same results.

So let's talk a little bit about the reaction to the pressure. I think the ABA—how many are familiar with the 20/20 commission on ethics? They're actually re-looking at a lot of really interesting things. Things like whether or not non-lawyers should be allowed to be members of law firms, and have a profit share, whether or not rules on unbundling should be changed a little bit, whether or not things like outsourcing should be allowed more, cloud computing, all that type of stuff.

They're taking a look and saying, "Should we–if we knew today what we know today and didn't have any model rules, what would the model rules look like?" And they've been having some really open and interesting debates.

It's due to wrap up next year in 2012. It started in 2009, and it's a three-year commission. I've attended three or four of the public hearings on those, and I have to say that while I'm really excited about the fact that the American Bar Association is taking this up, based on what I've heard, and the questions and the comments from the people who are on the commission, my guess is that there's going to be a lot of talk and a lot of writing, but not a lot of change. Not yet. But I do think it's coming.

I think some change is going to happen, but I think it's going to be a little slower than maybe consumers want it to be.

There's a standing committee on the delivery of legal services. Their whole goal is to improve access, improve access mostly to the middle class because they've got one on pro bono services and services for the poor. This is solely something that focuses on the middle class. It's been around for a while. It contains a lot of help and resources, a lot of information.

I've had interactions with some of its members, people who are on that committee, and individuals inside the American Bar Association who are

on the staff. I've told them, "Hey, is there anything I can do to help out? Would you guys like information, data? Like I don't need to be on your commission, but I'd love to help. We've got millions of people who have used this company, and millions of middle class people who want legal services."

There answer to me was, "No. This is a commission for lawyers, and how we can get more people to use lawyers." So I bowed out and I said, "Thank you. If you ever want help and you change your mind you let me know."

The whole point is, they're doing the same thing. They tend to want to look at the problem the way that they looked at the problem ten years ago and twenty years ago, and not how they should be looking at it five years from now. This all sounds gloomy, but it's really not.

The Legal Technology Resource Center, I think they've got a lot of great stuff there. I think people should take a look at it. One thing that I do know is that when you take a look at this, and part of the reason why I'm saying this is that, when you look at the history of business and things that innovate, it has very rarely come from within the profession.

However, you take a look—I mean this Turbo Tax came along. Are there no more accountants? Are there no more CPAs? Absolutely not. They're doing the work that they've been trained to do. They've been giving advice. They're out there finding tax shelters for people. They're out there making things happen. And they're not out there completing 1040As, which is something that they probably didn't like doing anyway.

More pressure is coming from the individual lawyer. And in this case I talk about the individual lawyer, or what I call the one that gets it, the one that's embracing change. For example, Richard Granat, a friend of mine, runs MyLawyer.com and DirectLaw.com—tools that allow lawyers to do more things, like have a virtual office and have access to a system where they can gather information from clients. He tells me, and I agree that there are certain ethical rules that restrict innovation. Right now the American Bar Association is trying to come up with rules on cloud computing. Now I don't know about you, I'm not a technologist. I barely know what cloud computing is, other than the fact that it allows you to access data, access software, and access things that are not locally stored on your hard drive.

Right now the American Bar Association is taking a look at that saying, "Should we allow lawyers to use cloud computing?" Well, the fact is, is if you don't do that, I think it really inhibits a lawyer.

I'm not saying it should be willy-nilly and you should just let people take all their confidential client data and just throw it up on an unprotected website. But I think we have got to be really careful when it comes to interpreting rules that say lawyers should use their best judgment and they should do things to protect client confidentiality, and then enforcing the hard and fast rules on the technology that's probably going to change six months from now. You just have to be careful about that.

This one's an interesting one because it's one that I have found to be very relevant. How many people here have ever used Groupon? I know they've come under some SEC issues, but I've used Groupon before. My wife and I like it. You get a massage for half off, or you can go get yourself some clothes at The Gap. It's really interesting.

How many people here have heard of lawyers using Groupon? Yeah, there have been a couple of places. And it's funny, there's actually one state that says lawyers can't use Groupon because it's impermissible fee splitting, and there's another state that said, "Sure, go ahead." What's that telling the people? And there's still, guess what, forty-eight that haven't said anything about it.

So what do you think that that's going to make a lawyer do? Probably nothing. Either that or maybe they're going to write for an ethics opinion. Ask someone what they think about it. The whole point is they're taking—this is what happens when you take a very narrow look at the—I think it is Rule 5.4 that says you shouldn't split fees, Model Rule 5.4. Well, Model Rule 5.4 was enacted.

Why was it enacted? To keep non-lawyers from pressuring lawyers into doing things that they otherwise wouldn't do. Is that really what Groupon does? By telling someone that they get—

You had something there sir? Do you have a question?

AUDIENCE MEMBER: Yeah, why can't you use Groupon?

CHARLES RAMPENTHAL: Well because the way Groupon works—just so you know, let's say that you are a lawyer and you offer a will for $500. What you'll do is you'll say on Groupon I'm willing to give you that $500 will, but I'm going to give it to you for $250. I'm going to give it to you half off.

What happens is the $250 that the client pays, $125 goes to you and $125 goes to Groupon. That's how it works. So when you buy that restaurant thing that says $50 for $100 worth of food, the restaurant actually gets $25. Groupon gets $25.

That's how their business makes money. So the way it looks is that actually, that's fee splitting. When you look at it the way that the rules are supposed to be, it does.

Yes, sir?

AUDIENCE MEMBER: Which state was it that said you could, and which state was it that said you couldn't?

CHARLES RAMPENTHAL: You know what, I knew someone was going to ask that. I almost—oh, man, someone's going to have to correct me. I'm almost sure that North Carolina said, "No," and Missouri said, "Yes." I'm almost, like I'm right on the edge of being so sure about it that I

wouldn't have had to check, but I'm not 100%. But it's interesting when you think about it.

Oh, this is my favorite—the limited capital to invest. This is always a big one, and it's such a hot button item that even though the American Bar Association and the 20/20 committee, they said, "We're going to take a look at this issue. We're going to take a look at the idea of non-lawyers investing in law firms." And immediately the very first thing they said is, "We're totally not going to look at that."

The first thing they said is "Passive investment? No. Other? No. But what we will take a look at is whether things like doctors and engineers and other professionals, accountants, might be able to join a law firm in the same way that they do in the District of Columbia, where lobbyists right now can own up to a 25% stake in a law firm." It's the only place where that's really allowed.

The American Bar Association is looking at that. You need to take a look at that compared to the United Kingdom right now where in a few months 100% of a law firm can be owned by someone that actually has nothing to do with law—very interesting.

AUDIENCE MEMBER: I was just going to ask, was the U.K. law basically in response to this third item that you have here?

CHARLES RAMPENTHAL: Well, yeah, I mean the U.K. law, it came about over the course of about ten years. And I don't want to get into a huge history of it. My company, I've been over to the U.K. about four times in the last six months.

It's something that's really interesting to us, the way that the market's opening up there. And I think it is—I've got a couple colleagues that are there literally right now. I would have gone, but I'm here. My wife's very pleased that I'll be home tonight instead of home next week. I have to tell you that.

The U.K., so I guess around ten years ago something called the Clementi Report came out, and it talked about the underserved, the middle class. It talked about all these things. And they formed the—shockingly—guess who formed the Legal Services Act?

How many lawyers do you think were involved? None. Non-lawyers drafted up the Legal Services Act, and said, "Guess what lawyers, this is what you're going to do." And when I say that change is coming, what I prefer is for it to come within our profession. Because I'm afraid that in five or ten years from now when we see the results of what happens in the United Kingdom, people right here are going to say the same things to us.

I like the fact that we're a self-regulated profession. I think we could do a little better job regulating, but I still like the fact that we're self-regulated, and I certainly don't know if the Department of Justice or the FTC could do a better job of it. Lord, I don't know. But that's kind of

what's happening right now in the United Kingdom. People who are economists and professors are drafting up this law, and forcing lawyers to live with it. Now there are a lot of lawyers involved now, but it's a little too late.

The one thing that I find interesting about this, and I was at the Professional Responsibility Conference up in Seattle about a year and a half ago where they had two very powerful lawyers debate whether or not there should be capital from outside the law firm.

And well, one of the heads I think was a Mayer Brown was arguing the case; well, he's a Supreme Court litigator, brilliant. And he came up there and said why it should happen.

And his biggest argument was, "My firm can go out tomorrow and take a big bank loan for a few million dollars with a bunch of negative covenants on it, and that's okay. But a small firm that doesn't have access to the bank capital can't take a half a million dollars from someone with the exact same negative covenant. Why not? Equity. Debt. In the end when—as a corporate lawyer I know they're all the same thing. The only difference is who owns it at the end."

So he had some pretty persuasive arguments, and I'll tell you right now the one thing is that until small firms can get access to capital, they're really not going to be able to innovate. They can't go out and buy servers. They can't go out and buy systems like File Net. They can't do project management, and hire outside people to take care of it. They just don't have the resources.

All right, I want to keep moving on here because my time is getting short. So as lawyers, I think we have a habit of spending our time talking about change, thinking about change, and analyzing how change might affect us. We've all seen legal bloggers. Like who reads Larry Ribstein's *Truth on the Market*?[7] If you don't, you should. It's great stuff. He really lays it out there. And he's a phenomenally cool guy. Books on law are changing.

How many people have heard of Richard Susskind, *The End of Lawyers*?[8] He actually emphasizes the word "question mark" because he said otherwise he'd be kicked out of his own profession. How many people have heard of the book *First Thing We Do, Let's Deregulate All the Lawyers*?[9] It just came out maybe a month or two ago.

These are things that are happening right now and people are talking about it. The funny thing is, that book wasn't even written by a lawyer. It was written by an economist, someone from the Brookings Institut[ion].

The only problem is that I feel like all the stuff that we do, we don't really do a lot of changing. We do a lot of talking about change. We do a lot of analyzing how change might affect our profession. We don't sit and chitchat a lot about it.

So we know that it's coming. I think it's inevitable. People inside the profession think it's inevitable. I think a lot of you judges out there think

some change is inevitable. You might think it might not be now, or it might not be ten years from now, but it is coming.

I think the individual attorney, we've already talked about that, has limited power to enact change. I think the ABA is not really moving really fast enough, so the big question is, "Where? Where is change going to come from?"

So unsurprisingly, I think that in the beginning innovation, what some people might call disruption, will come the way that Netflix kind of disrupted Blockbuster, it's going to come from outside of the traditional hourly-rate legal market. Now that's not saying that everyone has only that business model, but for the ones that do.

So I can kind of back it up. At least I'd like to think I can back it up. There needs to be innovative thinking in the way that it's done. I think that companies need to get traction inside of the consumer market and not just traction inside their own market, the traditional market.

I think that we need different business models. Like I said, I'm watching the United Kingdom. I think everyone here should be watching what the United Kingdom does. I think the professors in George Mason, I think Larry Ribstein, I know he's watching it. Richard Susskind is watching it. Juliana Hatfield at USC is watching it.

They're trying to take a look at this because what a lot of people say is, "We've got to continue to have this level of licensing. We have to limit what the authorized practice of law is. We have to be able to have—we can't have this non-lawyer ownership, and why? Because it's going to hurt the client. The client will be harmed."

The problem is, four years from now when this is enacted and there's no evidence of client harm, what do you think is going to happen here in the United States? The argument that we have is going to be empirical proof to say that it doesn't exist.

I can tell you right now, it's not like in England it's just going to be willy-nilly. There's still regulation. They're going to make sure to prevent client harm. They want this to actually happen.

Most importantly, and this is the thing that I stress to every lawyer that I talk to when they say, "How did your company become so successful?" And that's because we don't have clients. We have consumers. We have customers. I think that for all the lawyers that everyone here knows, or when you treat people and you see individuals that want it, we have to start treating what we used to look at as a client like a customer.

Well, what's the difference? Who's a client? A client is someone that needs something from you. Who is a customer? A customer is someone you need something from. That might sound really simple, and it's probably an oversimplification if there are enough economists here.

But the way I look at it is, if you take a look at how we have looked at our profession, we hold the keys. Come to us and we'll bless you with the solution. Customers are like, "We hold the keys. They're in our wallets,

and they're dollar bills. And you're going to give us the solution that we want." We have to really—and in the legal profession we really need to marry that and give them the solution they want, but still make it ethical. Still make it high quality. Still make the consumer first.

So I think if we're really going to shake things up, I'm going to stop calling them clients. I don't think lawyers—the lawyers that I know, they don't want clients. They want customers. They want to be treated like that. Now that we know that there's this legal consumer, we have to ask ourselves kind of service they actually want. Well, we know that they're fed up with the limited choice that they have in legal services.

I know this. I've polled them. I've polled hundreds of thousands of them. I know exactly what they want. They would like—they say to me, "Why can't you give me some advice on this, LegalZoom? Why can't you just have a lawyer that answers the phone and can tell me the difference between these two things? The difference between an LLC and a corporation. The difference between a will and a trust."

And we say, "Well, I'll tell you why we can't do it because we're not a law firm. We don't give legal advice." It says it right on our website. And up until a few months ago, when we had partnered with a legal plan and started a legal plan, we now can actually do that by having them join a legal plan at a monthly rate where they can now talk to a lawyer in their state, bar certified, malpractice, and all that stuff.

But up until then, for the first ten years that we operated, people would call and ask me a simple question, a question that people who had just graduated college and have worked at our company for three months know the answer to. And it's the right answer, people. We all know. I mean when I practiced law, my paralegal knew a lot more about Blue Sky laws then I ever would know. I always went to her and asked her questions because she taught me what was going on.

The fact is a lot of the people that are processing documents and taking care of these things, they know more about the intricacies of a will than some probate judges do. It's shocking to me.

That being said, they're not allowed to do it. And I make sure that they don't. That's partly my job. I have to make sure that they don't cross the line.

So what is it that they want? I think that what they really want is the solution. And we've polled them. We've used things like, "What would you like? Do you need advice? Do you want assistance? Do you want a lawyer? Do you want legal help? Do you want a consultant?" And they actually say, "No."

I'm going to kind of click through this right now because I want to get to the answer. That's what they say. Everyone chooses this answer. "I just want help. That's all I want. I want help." The funny thing about help is that help takes many forms. Help can be advice. Help can be information.

Help can be a fact. Help can be a price. Help can be a lot of different things.

Help isn't always the practice of law. But sometimes what people want is the practice law, and sometimes what they want is not. But we do know the one thing is that people out there, the middle class especially, just want a little bit of help when it comes to their legal problems.

What kind of help do they want? They want help that is simple. They don't want it overcomplicated. They don't want it in legalese. They don't want it in a language they can't understand. They want it quick. This is the Internet age. They want it yesterday. They want it ten minutes ago. They don't want it in six weeks. They don't want it in six hours. They want it economical. They want to be able to afford it. No shock there, right?

And they want it from someone they can trust, which is very interesting when you think about the legal profession. The legal profession is really kind of fostered itself on the idea that the license equals trust. If you have a license, you have ethics. If you have ethics, clients can trust you.

Well, we all know, present company excepted, there are some people who have passed the test, some people who have signed to the code of ethics who don't actually follow them. We know there are businesses out there, some of whom do things that are anti-consumer protection, and doing things against the protection law. We know that they can be held accountable for it. We know lawyers can be held accountable for it.

So we know that this is what's going on. How do we provide them? This is my favorite slide. This is what, when we asked consumers what they really want, they said, "Why can't the law firm be like Costco? Why can't a law firm be like Target?"

I go to Target and I can get a designer quality sweater from Missoni, who I understand is a very good designer. Some places design sweaters that cost ten times that much for very big stores, and I can get it for $30 at Target. It's the same quality. It's the same design. It's the same fashion. But I can get it at a price that I can afford.

I can go to Costco and their volume lets me afford things. How many people here actually are members of Costco? I'm a member of Costco. How many people here have actually told someone else when you found out they weren't a member of Costco, that they were nuts? "You should be a member of Costco." I talk about it all the time. I love it. I mean as a parent of a newborn, Costco is one of my favorite places. I bulk up there.

So I'm going to keep it, kind of cruising on and talk a little bit about what's going on. So I'm going to talk about what happens if Costco ran a law firm? And I'm going to kind of whip through this real quickly.

Now let me get this straight. I am not advocating that Costco run a law firm. But what I'm trying to say is, what if someone who used to run Costco came in and ran law firms that we all know about, a middle class law firm? Well, things that face the consumer, here's what they want, and here's what they'd have. They have a brand name that they could recog-

nize. Because just saying I went to this law school, and just saying I've been practicing for ten years doesn't make people trust you. It just doesn't.

It's a relationship that makes people trust you. And when you're online, you don't get that face-to-face relationship that you do with a big law firm. An online interactive customer relationship, that's what they really want. They want to be able to do something online, which you can go to Costco and buy stuff online, or you can go into a store. Affordable pricing, flat fee pricing, that's a really big one. And I know we can't flat fee everything in the world when it comes to legal services, but I think we can do a lot more than we already are.

Top-notch customer service. Wow. Customer service. This is my favorite one. When we first started our legal plan—now how many people have heard something called "willingness to refer survey," or what's called "net promoter score?" It's something that gathers data on how people are doing in customer service, and they ask one question.

The question is, "Hey, how likely are you to refer my business to someone else?" And you answer on a scale of zero all the way to ten. Some of the best companies in the world, Apple, Southwest Airlines, USAA, they get scores in the seventies, seventy-one, seventy-two typically. That's about as high as it gets. LegalZoom is at about a sixty-five. When we first polled the lawyers in our legal plan, they got a ten. Within three months they were at a fifty-two.

You know why? They started answering phone calls. They started calling people back. When some—you know what one of the comments were? "Hey, this lawyer said he was going to call me at 12:00 and he called me at 12:08. What a jerk." That lawyer calls him back at 12:01 now. And instead of getting a four, he gets a nine. That is what customer service is.

Research that used to take hours takes seconds. That's what makes things faster. That's what brings legal costs down. There'll be a high standard for all legal services. Things like the checklist. I've read the checklist manifesto. It's interesting how doctors use checklists. And as a former pilot, I used to be a pilot; I'm all about the checklist. It's very important to make sure that people constantly get that high quality service.

The last one is volume. Volume is what's going to really create the economies of scale. If you represent one restaurant in a year, you're going to do okay. But if you represent one every three days, you're going to get really good at doing restaurants. That's the way that the crowd sourcing can really take management.

So I'm going to conclude and say what's the takeaway? The takeaway is not all bad. I know I said a lot of things, and I don't want to really bash our profession because I'm a part of it. I mean I'm still a lawyer regardless of what I do for a living, which is still being a lawyer. And I think our profession is noble and I think it's amazing, but the one thing that I think it hasn't been is very nimble. I'd like to see us be more nimble.

I think the people here in this crowd who are now judges and are watching the profession from a vantage point that very few get, are able to really take advantage of seeing this. I think when you talk to your colleagues, when you talk to people at the state bar, the lawyers in your courtroom, you can tell them not to be afraid of technology. You can tell them not to be afraid of change. You can tell them that it's okay as long as we're careful, as long as we're cautious about it.

The lawyers I talk to often, the ones that want to see real change and innovation in our profession, they're the ones that look at the vantage point–they're looking at the underserved from one vantage point.

I say this to people, "We're on two separate mountaintops looking at the same valley. You've got lawyers on one side saying, 'I wish I had more innovation. I wish I had more technology. I wish I could lower my prices." And they're doing that and filling that valley. And you got the alternative legal services providers, like LegalZooms, the Rocket Lawyers, the Total Attorneys of the world on the other side of the mountain saying, "We're going to fill it from this way."

I think the most important thing is that if we work hard and we work smart, that we're going to be able to meet somewhere in the middle and show the underserved that we really haven't forgotten about them. So I'm willing to take questions.

The first thing I do want to comment on is the fact that this really sweet mustache that you see here is not a fashion statement, it's the month of November, and it's all about prostate cancer. That's my little shameless plug for that. And the reason why I'm growing it is in honor of my dad who is a prostate cancer survivor.

But if—I know we're running a little bit later. We got a few minutes for questions, or? Nope.

LINDA KELLY: If you don't mind just—

CHARLES RAMPENTHAL: And you can come talk to me. I'm around here. And even at the reception later tonight I'll be around. I'd love to talk with you. I've got cards and stuff, whatever. Thank you all. Thank you very much.

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[1] Kevin Chern is President of Total Attorneys, Inc.

[2] CLIFFORD WINSTON ET AL., FIRST THING WE DO, LET'S DEREGULATE ALL THE LAWYERS (2011).

[3] Mark Curriden, *Future of Law Panel: Change with the Time or Find Another Line of Business*, ABA JOURNAL, *available at* http://www.abajournal.com/news/article/future_of_law_panel_change_with_the _times_or_find_another _line _of_business.

[4] *Id.*

[5] Legal Services Act, 2007, c. 29 (Gr. Brit.).

[6] Terry Carter, *Judges Say Litigants Are Increasingly Going Pro Se—at Their Own Peril*, ABA JOURNAL (July 12 2010), *available at* http://www.abajournal.com/news/article/judges_say_litigants_increasingly_going_pro_se_at_their_own.

[7] Larry Ribstein, TRUTH ON THE MARKET, http://truthonthemarket.com (last visited Apr. 2, 2012).

[8] RICHARD SUSSKIND, THE END OF LAWYERS?: RETHINKING THE NATURE OF LEGAL SERVICES (2009).

[9] WINSTON ET AL., *supra* note 2.

THE FUTURE OF CLIMATE CHANGE LITIGATION AFTER *AEP V. CONNECTICUT*

Rick Faulk, Eric Lasker, Amanda Leiter, Mike Myers
Moderator: Henry N. Butler

HENRY N. BUTLER: Okay, good afternoon. We're ready to continue with the next panel, which is titled "The Future of Climate Change Litigation after *AEP v. Connecticut*."[1] I think we're going to actually talk about a little bit more than climate change; but, it's a big picture discussion related to public nuisance, and how that can be used, and whether there have been any changes on the ability to use public nuisance litigation as a result of the Supreme Court decision.

We have a great panel here for us, Eric Lasker from Hollingsworth, it's the firm that was here earlier, will lead us off; Mike Myers from State of New York Attorney General's office will go next; Rick Faulk from the Gardere firm in Houston; and then, Amanda Leiter from Catholic University here in the Washington area will close out the panel.

Each speaker has ten to twelve minutes, and then we'll have some discussion on the panel, then it will be thrown open for questions. Please welcome the panel.

ERIC LASKER: Thank you all. I'm going to start our presentation today by giving you an overview of the public nuisance doctrine. And, in particular, how that doctrine has developed or efforts to expand that doctrine over the past ten to fifteen years, to the point where we are today where a climate change case involving global warming for the entire country, or even the entire world, could be brought in one lawsuit against individual defendants.

Now traditionally, public nuisance dealt with an interference with a public right and has existed for over 400 years. The remedy generally was an abatement action. You had a single source that was causing harm to the public at large and you wanted to stop that. That's the way many of us think about public nuisance and many of you may have dealt with public nuisance, a single source that's polluting a stream, a strip club perhaps that's polluting a neighborhood; and, that has been what public nuisance traditionally has been.

But, what happened, starting about fifteen years ago, was that public nuisance expanded to start covering issues that were societal issues, societal wrongs where the idea was that if something is bad for society by some definition, then that is a public nuisance. And, all of these images that are popping up on your screen are industries and areas of our economy that have been tagged by either public officials or private payer attorneys as

public nuisances. And, litigation has been brought against those industries arguing that they should pay for their impacts against society.

So, the first of these, sort of the granddaddy of the new public nuisance is the tobacco litigation, which many of you are familiar with. These lawsuits were filed by the federal government and by forty different state governments. And, the argument there was that the tobacco industry, by providing this product, had imposed Medicaid costs on various states. These public expenditures on public health were a public nuisance that had an impact on the public at large and should be remedied as a public nuisance liability.

That did two things. First of all, it funded what has now been ten or fifteen years of attempts to create the next tobacco model of a public nuisance lawsuit. Secondly, it created this new model of what a public nuisance lawsuit could be.

So, the next area of society that was targeted was handguns. In the '80s and '90s, and some still today, the cost of handgun violence in inner cities became a burden on the public, one could argue, by increasing costs for the police force, and increasing costs for healthcare. And again, the industry, under this argument, has created this public nuisance, this societal bad, and they should be required to pay for that. And municipalities and states across the country brought lawsuits against gun manufacturers arguing public nuisance theory.

Again, the litigation was not going particularly well for the plaintiffs, as far as courts accepting that theory. And then, Congress got involved with gun rights advocates. They passed a statute saying that this litigation was unlawful; you couldn't even bring these lawsuits. So, that put an end to that avenue.

The next industry that was targeted was the lead paint industry, or the former lead paint industry, manufacturers that had sold lead paint in the early part of the 1900s. The argument here is that by manufacturing this product and selling this product, although it was perfectly lawful at the time, the industry had put lead paint on walls. That lead paint had deteriorated, was now turning into chips, started being eaten by children, and causing all sorts of public health problems. So, the lead paint industry had created this public health crisis again, thus creating a public nuisance theory.

What you also had here, and you had this to a certain extent as well in the tobacco industry, is this marriage between public government officials and the plaintiff's bar, that is, the private plaintiff's bar. Ronald Motley is a plaintiff's attorney, and he sort of famously announced at the beginning of this litigation that he was going to bring the industry to its knees. And, the goal here now was to get a lot of money for the private plaintiff attorneys. And, that was driving this litigation, it was actually marketed by private plaintiff firms and they went out to the municipalities and sort of sold this business model.

There was one relatively short lived success for the plaintiffs in Rhode Island where they won in front of a jury; and, they moved to the damages phase, which would've been about $2.5 billion judgment before that case was reversed by the Rhode Island Supreme Court. All the other courts have rejected this theory except for one; in the California court system litigation is still ongoing.

Prescription drug manufacturers have been targeted in a fairly narrow area for prescription drugs that could be misused as holistic drugs. We're talking about Oxycodone and methamphetamines; but, the theory is the same. By manufacturing this product, you have contributed to a societal problem of illegal drug use, and therefore, you've created a public nuisance and you should be held liable for that public nuisance.

Again, there were some small, relatively small, if you count $10 million as small, settlements; but, the litigation otherwise has not been successful. Once the courts were faced with ruling on the issue, they rejected the theory.

Poultry litter, for those of you in farming communities, is a little bit closer to the traditional model, but the argument here was that large farming companies, by not manufacturing the chicken litter but rather, marketing the chicken litter for its many marketable uses, is causing a public health crisis. And, there's a regulatory scheme that's set up for this chicken litter and the legislatures and the regulators have said, "Yes, this is a product, it's a useful product, and this is how it should be done."

But, other public officials decided that they didn't like the regulatory scheme and they decided to bring the industry to court and there was a very long lawsuit, a bench trial that was finished about a year and a half ago. The Court is still noodling over the public nuisance aspect of that case, and deciding whether they will allow that to continue.

If you've been following along, over the last three or four or five years, what's caused the most problem in our society, what's caused a societal impact? Well, the subprime mortgage crisis brought our economy to its knees. That is a societal bad under this new public nuisance theory. That is now a lawsuit. The City of Cleveland brought a lawsuit saying that the mortgage companies, by creating these subprime mortgages, have caused the city's economy to crumble, and therefore, they should be held responsible for that in the courtroom, in a single court, under a public nuisance theory. That argument was also rejected.

That brings us to climate change and global warming. The first lawsuits were brought against an automobile manufacturer, like General Motors. The case was dismissed on political question grounds at the district court; and then the EPA regulated specifically in that area, which sort of ended that litigation.

And then, the target went to the power companies and the electrical utilities. And, there's a series of cases that I know my co-panelists will be talking about in more detail, including the *Kivalina*[2] case, which is pending

before the Ninth Circuit and oral arguments are going to be in a couple of weeks, and of course, *AEP v. Connecticut*. In the Supreme Court, the Court ruled that the federal common law claims, at least, were displaced by the EPA's regulatory authority.

So, that's sort of a very quick journey through public nuisance over the past ten to fifteen years. The question I think that's particularly important for this audience to consider is what's going on? Why are we facing this expansive theory in our courts, and should we be worried about this, is this something that's appropriate for me to be resolving as a court, and why am I facing cases that bring these sort of societal problems into my courthouse?

Well, I think the initial impetus of the new public nuisance doctrine is what Robert Reich coined as a phrase, "regulation through litigation,"[3] which is descriptive of how public officials had tried to get their views enacted through law or through regulation and who were unsuccessful, and decided "look, there's a third branch of government that if I can't get it passed in law, I'm going to try and sue my way to get the societal change that I think is appropriate." There are lots of issues of separation of powers and balance of powers there that give concern, I think it's not only to me, and I think it should give concern to judges who are protecting the constitutional framework. And, that's part of the responsibility that I would submit that the judiciary has.

The second issue, which I talked about briefly before, is the marriage between the private plaintiff's bar and state attorneys general. And, the argument there is that the states don't have the funding to be able to bring these lawsuits because of all the state budget deficits and the limited funds that they have. Now, I'd argue that states still have a lot of money if the lawsuit is worthwhile; but, private plaintiff's attorneys who made huge amounts of money in the tobacco litigation are trying to get that one more silver bullet. They only need one, if they win one, they could bring twenty-five or thirty cases, it's been a successful business model for them.

They've joined together and the problem, from my perspective, is a due process one because private plaintiff's attorneys, appropriately for them, have their own monetary interest in mind. But, that's not what a public government official should be driven by in making a decision to bring a public nuisance lawsuit. That sort of distortion of the decision making is a problem.

There is one case I would commend to your attention in this area, which is *New Mexico v. General Electric*.[4] It arose in a somewhat unique context of a CERCLA[5] action and a natural resource damages claim under CERCLA. But, in that case, the Tenth Circuit held that having a private plaintiff's attorney help fund the state attorney general's claim under natural resource damages was inappropriate because the money that would be recovered wouldn't go to restore the natural resources, it would go to the plaintiff's attorney. And that's not the purpose of this type of litigation.

The final thing I'd point to is this issue of standardless liability because what is really happening in these cases is that plaintiff's attorneys and public officials are saying, "If we're suing over societal harm, then we don't have to show individualized fault, individualized liability, or proximate causation." You don't have to have an individual defendant who took an individual action that hurt an individual plaintiff. You now just have to have an industry that in some way contributed to something that seems to be a societal harm. And, if you frame the question that way, your burden of proof all of a sudden becomes much easier to meet. The stakes are a lot higher, financial stakes are a lot higher, and your burden of proof is a lot lower.

The fact that you have this disconnect, I think also highlights one of the problems with the new public nuisance doctrine. So, with that I'm going to hand the microphone over to Mike, who I think is going to have some different views on some of the issues.

MIKE MYERS: I think it's fair to say we'll have some slightly different views on—Good afternoon everybody. I'm Mike Myers from the New York Attorney General's office. I was one of the attorneys who wrote the brief on behalf of the state plaintiff respondents in the *AEP* case before the Supreme Court.

Very quickly, in terms of background, to give you a sense of what we were concerned about. We're looking at a range of different injuries that are either occurring or that we think are likely to occur as a result of global warming and focused on some of the New York specific injuries that we were concerned about. They included a mix of public health impacts: more heat related deaths and illnesses due to the elevated temperatures we expect to see, more respiratory illness because the conditions for the formation of smog are going to be enhanced under global warming, and also, threats to infrastructure, low lying areas, coastal areas (New York City in particular), the subway system, as you can imagine, could be vulnerable to those types of effects.

I was actually interested to see a news report a couple of months ago, where the City of Norfolk in Virginia is confronting these problems now, given how close they are to sea level in terms of planning for what the future of that city is going to be.

So, I think the regulatory context was quite important and, just reading from Justice Ginsburg's opinion in the *AEP* case she said, "The lawsuits we consider here began well before the EPA initiated the efforts to regulate greenhouse gases."[6] When we filed the lawsuit, which was back in 2004, it was a much different time. It was still the first term of the Bush Administration.

At that point, the EPA was taking the position that they didn't have the authority under the Clean Air Act to regulate greenhouse gas emissions from power plants and automobiles. And, the alternative, if they had the

authority to do so, they were going to use their discretion at that point not to do so.

A lot of people try and make the *AEP* case out to be some crazy case that had no basis in law. But, really, I think it was fairly simple in terms of our theory and that is, if there's no available statutory remedy, but you have harm, common law nuisance has often filled the void to enable the government, and in some instances, private parties, to abate that pollution. There is a long line of Supreme Court cases that support that.

So, the lawsuit itself, as I mentioned, was filed in 2004 by eight states, three land trusts in the Southern District alleging public nuisance. And, we asserted a federal common law nuisance and the alternative state common law nuisance, from harms caused by climate change. We sued the five largest power plant companies in the country, in terms of their contribution to global warming. They own collectively about 200 fossil fuel burning plants, which emit on the order of about 10% of all the U.S. emissions, or 2.5% of worldwide emissions.

I think, importantly for the discussion today, the remedy that we sought there was a strictly injunctive remedy. It wasn't a damages remedy. It was trying to get a court order to require these defendants to abate their contribution to the public nuisance and specifically, we sought an order requiring them to cap and then reduce their emissions each year for at least a decade.

The defendants moved to dismiss under 12(b)(6), that resulted in a district court decision in 2005 which dismissed the case on grounds that it presented a non-judiciable political question.[7] We appealed to the Second Circuit and in a ruling that was issued three years later, or three years after the oral argument, in 2009, the Court found by a 2–0 ruling, issued by Judges McLaughlin and Hall, that the district court had erred in applying the political question doctrine and finding that our case was not fit for review by the courts.[8]

The Court went on to also consider three other issues that the parties had briefed that also had touched on the issue of subject matter jurisdiction. And those included, standing, whether or not we had stated a claim of federal common law nuisance, and also, the issue of displacement; in other words, whether or not either the statute or EPA actions had displaced what our common law remedy would have been. I'm not going to spend the time to go through each of these slides due to the time we have.

But, I will stop at standing just to make the point that this was a tort case, so some of the judges in the audience may be saying, "Why were they talking about standing in a tort case?" This is a good question. Typically, tort cases you don't think of a type of case where a court would have to deal with arguments that the plaintiff lacks standing.

I mean, you think of the standing law jurisprudence in this country that was developed in response to public law cases that were filed concerning government laws or government actions. The idea with standing was to

make sure that the plaintiff bringing the case had a direct stake in the outcome. Whereas, in tort cases and other similar common law types of cases, proving injury is part of your case. You don't need that separate analysis of standing. But, because it was an argument that was raised by the defendants, we briefed it and the Court addressed it. So, I think one of the interesting things about this case is thinking about whether or not standing principles have any place in a case at all, with respect to a tort case. Maybe they do in some cases, maybe they don't at all; but, that was one interesting feature.

So, of the four legal issues that I was referring to, all four were granted cert.[9] The private party defendants petitioned for cert, TVA was a federal defendant that filed a brief in support of the cert petition, and cert was granted. In addition to the four issues that I mentioned, the Solicitor General also invited the Court to take up the issue of prudential standing; arguing that because global warming harms are so far ranging, they present generalized grievances that the courts cannot handle. So, that was essentially another issue that got folded in.

After oral argument, the Court issued its opinion in June 2011, ruling 8–0, with Justice Sotomayor recused.[10] Justice Sotomayor was on our panel before the Second Circuit. She participated in the oral arguments. She was actually the presiding justice at the oral argument. But, by the time the Second Circuit's decision came out, she had been elevated to the Supreme Court. So, she, for obvious reasons, decided to recuse herself.

Most of the decision, Justice Ginsburg's decision, focuses on the issue of displacement. But, I think, one of the important pieces of the decision that could get overlooked because it's such a small part, is some of these threshold issues. With respect to standing, the Court, by an evenly divided court, upheld the Second Circuit's ruling that at least some of the plaintiffs have standing specifically under the *Massachusetts v. EPA*[11] case, which was a 2007 Supreme Court case that was brought by Massachusetts, New York, and some other plaintiffs under the Clean Air Act alleging that the EPA was required under the Clean Air Act to regulate greenhouse gas emissions from cars. So, the Supreme Court, four of the justices, found that, that decision applied here as well, and that had the effect of affirming the Second Circuit's ruling on standing.

The other thing to mention is that the Court said that "No other threshold obstacle bars our review here," and they dropped the footnote then, which is footnote six of the decision where they specifically identified what they were talking about in terms of threshold obstacles.[12] And, in that footnote, you'll see a reference to the prudential standing issue that the Solicitor General raised and also the political question argument that had been raised and that the district court relied upon; so again, affirming the Second Circuit's ruling. So, we were two for two so far, which was a good start, but unfortunately didn't last.

With respect to the third issue, and that was whether or not the plaintiff's had stated a claim for public nuisance, Justice Ginsburg set out the issue, I think, in terms of framing what the two sides' arguments were, emphasizing obviously, that the Court does not like to get into the development of federal common law, but at the same time, recognizing that there had been a tradition of common law suits in the area where one state is trying to abate pollution coming from another state. While acknowledging the two sides of the argument, she then went on to say, "We don't have to address that in this case because we hold that even if the plaintiffs had met the requirements for pleading a federal common law nuisance claim, we would find that they were displaced."[13]

In terms of the displacement analysis, I think the most important language is in the third bullet there where the Court says, "The Clean Air Act and the EPA actions it authorizes displace any federal common law right to seek abatement of carbon dioxide emissions from [defendants'] plants."[14] The Court pointed to a couple of provisions, the one that it found most relevant was Section 111(d) of the Act,[15] which is the new source performance standards which require the EPA to set emissions standards for categories of sources; in this case, we're talking about power plants in the category.

Once the EPA sets standards for new and modified sources, they then have to issue emission guidelines that states then use to apply to existing sources. The Court pointed out that EPA had committed to go forward with rule making under the Section 111(d) provision of the Act next year and that, frankly, was an event that overtook us during the seven years that this case took to get to the Supreme Court.

There was an issue of preemption because I did mention we did bring a state common law nuisance claiming the alternative that the Court did not address because the parties had not briefed it below. So, that was something that was mentioned in the opinion, but the Court did not deal with.

One of the cases that Eric mentioned was the *Kivalina* case, which will be argued later this month before the Ninth Circuit.[16] That's a damages case. It's not a case where they're seeking injunctive relief. Kivalina is a village in Alaska that is being threatened by the rising seas and by increasing severity of storms. They believe, they've alleged in their complaint, that they can trace that harm back to the results of climate change. So, they're seeking damages for relocation of their village.

I think, obviously, the Court's going to confront whether or not *AEP* controls that case. And, I think the plaintiffs have a good argument that it does not. If you look at some of the language that the Court used in its decision, highlighted in these bullets, for example, the Second bullet, the Second Circuit erred in ruling that federal judges may set limits on greenhouse gas emissions in the face of a law empowering the EPA to set the same limits.

Well, you don't have that with a damages action. The EPA has no authority to assess damages from alleged harms from global warming. So, I

think the plaintiffs have a pretty good argument that *AEP* does not control in that case.

I have one other thing just to quickly wrap up before I turn it over to Rick. One of the things that the Court's decision stands for, certainly emphasized, I think, is the ball is now in the EPA's court when it comes to dealing with emissions from the largest sources of emissions for greenhouse gases in the country, and that's power plants. So, we'll be watching closely to see what the role is potentially in the future for federal or state common law nuisance based on what the Agency does with respect to those sources. And, I'm happy to take your questions later.

HENRY N. BUTLER: Thank you Mike. Rick Faulk.

RICK FAULK: I represent a number of organizations, and have been involved in all three of the major cases including the case that arose out of Hurricane Katrina in the Fifth Circuit,[17] the case that was before the Supreme Court, the *American Electric Power*[18] case, and the *Kivalina* case in the Ninth Circuit.[19]

There's been some mention by Michael that the thought in these cases is that where the government has not specifically addressed certain issues by way of statute or regulation, the common law is free to create and invent, and that judges have the unbridled creativity to look at situations and creatively design remedies and procedures by which they can address what they believe to be unreasonable types of conduct.

Well, the Supreme Court laid that to rest in the *AEP v. Connecticut* case because they explicitly found that there was no void to fill.[20] They found that the courts had no business dealing with the regulation of how much emissions of greenhouse gas is going into the environment, and whether the amount was unreasonable or reasonable. Those were not things that courts were prescribed to do. As a matter of fact, Justice Ginsburg was very explicit about it in saying that judges simply don't have the resources. They don't have the skills available to them. They cannot commission studies and send people out to do their bidding to report back to them on facts. They do not have the ability to sit through days, and months, and years of hearings while warring parties decide and report back to them. And then, decide what is reasonable on a national basis, indeed a global basis, for any particular emitters to emit into the environment from certain types of facilities.

Let's face it. Do judges have that time, first of all? Because let's look at it. Every district judge, every trial judge that has faced this particular issue, whether it be in California, Mississippi, New York, has said, "Kings X, not in my courtroom." It has said "Kings X" not because it's hard, but because it is impossible to set these standards in a coherent way to determine whether any particular person at any particular time has contributed sufficient amounts of emissions into the environment, and to actually trace

any cause of a particular injury to any particular person. And, that is what the real problem has been.

Now, it may be, as Michael said, that that issue of standing, because that's what we're talking about is standing, that issue of whether anyone has suffered an injury caused by any particular defendant's conduct has not been decided by the Supreme Court. The truth is that four judges of the Supreme Court thought there was a serious problem there and four justices decided that perhaps the case could go forward with respect to other parties. What's that? That's a tie vote.

Do we know what Justice Sotomayor is going to decide when that issue comes from the *Kivalina* case in the Ninth Circuit? I would suggest not. Do we know what's going to happen when the re-filed *Comer*[21] case comes up from the district court in Mississippi in the Fifth Circuit? Do we know what the facts of those cases are going to hold with respect to those cases? I suggest to you that the issue of tracing an injury to any person's conduct, whether it be Exxon Mobil's, whether it be from my lawn mower, whether it be from the cows that emit methane gas at my ranch every day, whether I'm responsible for that and to what degree is not a judicial decision.

It is not a judiciable decision, and believe me I'm mindful of the fact that I'm standing here in front of America on record saying, "You can't do that." Because most of the time when I tell judges that they can't do that, I usually get a lot of push back. But, I'm telling you, in these situations, when you're dealing with a global phenomenon, how can you determine whether the livestock in China are contributing to this event such that they were the cause of the injury as opposed to the emissions from the American Electric Power Plant in Texas?

These are matters that are best decided by the political branches of government. That's why we have these particular devices available to us. That's why we have Bismarck, back in the old days saying, "You really don't want to know how sausage is made, do you?" You really don't want to know how the legislative process goes because there are compromises that are made in that process that are impossible within a court of law.

You, as judges, have to set down your reasons for why you're making these decisions and they have to be based upon facts in the record that are examined and reviewed all the way up to the United States Supreme Court. These sorts of decisions, the setting of standards by which people are to be judged on a global basis is not something that's appropriate for a district court sitting in any particular community in the United States. And, I'm not the only one that said that, every single trial judge that has faced this issue has said exactly that and four justices of the Supreme Court of the United States have said exactly that.

So, before we rush ahead into a new brand of litigation and try to solve the problems of the world in our local courthouses, maybe we should think and maybe we should sit back, chew on it a little bit longer and say to the

Congress of the United States, "This is your job." To say to the American Environmental Protection Agency, "This is your job. You have the resources to do this because this is something that in my courtroom where I have to deal with individual problems, that preoccupy my time from individual people and individual businesses. This is not the scope of a controversy that I want to address."

That sets the stage for what is coming and we'll talk about that amongst ourselves. What's coming? What's the future of this litigation? What's going to happen in *Kivalina*? I have some ideas about it and we'll talk about it in a minute; but, that is the stage setting I wanted to give you from the defense side as to where we look at these sorts of cases, with all due respect to you guys. Thanks.

HENRY N. BUTLER: Thank you Rick.

AMANDA LEITER: Hi, so I'm Amanda Leiter. I'm actually at American University's Washington College of Law where I teach administrative law, environment law, and torts. I filed an amicus brief in the *AEP v. Connecticut* case on the side of the states.[22] So, it's no accident that I'm on the left of your panel.

I wanted to start by reemphasizing that these injuries that the states alleged in *AEP v. Connecticut* are real. You hear regularly about sea levels rising, about loss of coastline, about increasing severity of heat waves, and other extreme weather events. I wanted to personalize it a little bit by telling you what New York is facing and is concerned about. I wanted to tell you a little bit about what the City of Chicago is doing just to make this concrete.

The City of Chicago expects that by the end of this century, its climate will be akin to that of Baton Rouge. They expect 35% more precipitation in winter and spring, 20% less in summer and fall; they expect a drastic increase in heat related deaths, increased storm intensity as I talked about. Also, in a concrete sense, no pun intended, they expect a higher cost of road and building construction and maintenance because of increased freeze-thaw cycles as climate change heats up, so to speak.

One striking fact is that city planners in Chicago no longer plant the state tree, the white oak. They have replaced it with Deep South species, like the swamp oak because that is the Chicago that they expect by the end of this century. So, these are real problems and the plaintiffs are looking for real solutions.

Now, that said, I think the plaintiffs in the case, one of whom is here, so he can speak for himself, but my guess is that they would be the first to say that pursuing these cases through the courts is not their first choice avenue. They have been pushing the EPA to act under the Clean Air Act. They have been pushing Congress to act to give us a better, broader, more

comprehensive, more balanced statutory approach to regulating these kinds of problems.

But, in the absence of those solutions, I think it is historically very much the court's role to give solutions, to give remedies to private parties that are injured by other private parties' actions in situations in which the legislature has not acted. And, that is the situation in which *AEP v. Connecticut* was first filed. The Clean Air Act was on the books, but the EPA, at that point, not only hadn't acted under the Clean Air Act, but in fact took the position, prior to *Massachusetts v. EPA*, that it lacked authority to act under the Clean Air Act.[23] So, that was the position in which New York found itself and Connecticut found itself when this case was first filed.

All right, with that as my personal take on these cases, I want to give you a background on where climate litigation stands in the U.S. and I'm going to step back and take a slightly broader lens than the other panelists. There are some 430 climate cases pending in the United States at this time, of which only the three or four that you've heard about actually pose these climate nuisance arguments. One hundred and nineteen of the lawsuits are industry-filed challenges to federal action regulating greenhouse gases. So, the very same industry defendants that are defending climate litigation on the ground, saying that really this is the EPA's job and the EPA should be doing its job, are suing the EPA right and left every time that the EPA tries to act in this area.

The first of those rules was a light duty vehicle rule that went into effect January of this year. That rule and several other EPA actions in this regard have been challenged in the D.C. Circuit and the court will hear all of those cases in a combined two day ordeal, for lack of a better word, at the end of February. So, for those of you who are in the area February 28th and 29th of next year, they will hear two days' worth of argument challenging all of the EPA's actions under the Clean Air Act; actions to date under the Clean Air Act to regulate greenhouse gases.[24]

In addition to those 119 cases, there are about thirty challenges, again by the industry to progressive state regulations in this area, principally to the various actions California has taken to try to regulate greenhouse gases in California. There are close to 100 challenges, now mostly on the other side of the aisle, filed against coal-fired power plants in the country. So, the development of new coal-fired power plants has been brought virtually to a standstill by some combination of those lawsuits, the low price of natural gas right now, and the economy.

There are eighty pending lawsuits over the degree to which state and federal environmental impact statements must consider climate change effects of a federal or state project. And then, finally of course, there are these pending common law nuisance suits and I wanted to say a little bit about where I think those will go in the aftermath of *AEP v. Connecticut*.

The Supreme Court, as you heard, only resolved the federal common law nuisance suits and they did that specifically by saying that the Clean

Air Act and the EPA's action under the Clean Air Act displaces federal public nuisance law in this area. Those are two important points because first, it's a political bargaining chip now in Congress, which is working hard to overturn the EPA's authority under the Clean Air Act.

It is fairly clear from the narrow drafting of the *AEP v. Connecticut* decision that if the EPA's authority under the Clean Air Act is withdrawn, the federal nuisance suits could be reinstated. Now, of course, that only raises a bunch of additional issues about whether federal nuisance can be proven, etc., but that's at least one potential bargaining chip that's out there.

A second point though, is that the state common law nuisance claims are still potentially viable. And, I have no inside information about what's going to happen with those claims, but my best guess is that the plaintiffs are going to wait and see what the EPA does with respect to regulating greenhouse gases and potentially re-file state common law nuisance claims. There's a precedent on point, *International Paper Company v. Ouellette*[25] that suggests that there is state common law in these kinds of cases under the common law of the source state, so AEP's home state, etc. And so, there's a possibility that these same claims could be pursued under state common law of nuisance.

The second case you've already heard a little bit about is *Native Village of Kivalina v. Exxon Mobil*.[26] That was dismissed by the district court as raising a political question, but the Ninth Circuit is going to hear oral argument in that case later this month, November 28th. And the Ninth Circuit asked for briefing by the parties in that case as to whether *AEP v. Connecticut* resolves all of the issues in that case or not. You've already heard from Mike Myers, his view that because that suit raises a damages claim, the native village has a reasonably good argument that their lawsuit is not squarely addressed by the *AEP v. Connecticut* decision.

In particular, the Clean Air Act does regulate the emissions of the defendant power plants, but it does nothing to remedy the injury to the village of Kivalina, which is that the village will soon be underwater. They have been told by the Army Corps of Engineers that they have to relocate to the tune of something like $90 to $400 million and they are seeking relocation costs from the fifteen largest emitters of greenhouse gases in the country.

One other interesting point that hasn't been made yet about *Kivalina*, the Virginia Supreme Court resolved a case just this September in which the American Electric Power Company sued its insurer, Steadfast Insurance Company, claiming that Steadfast has a responsibility under their corporate general liability policy to protect AEP. This protection is to defend AEP, first of all, and then pay any liability that AEP found itself confronted with. The Virginia Supreme Court said no, that climate change is not an occurrence within the meaning of the corporate general liability policy that AEP purchased from Steadfast.[27]

I actually think that development is the most interesting one in this area because the insurance companies nationwide and globally are becoming

increasingly concerned about the exposure they have to climate injuries. I think we may see policy driven in this area principally by changes in insurance company policies and rates, etc., even ahead of whatever Congress and the EPA do.

The last case that remains out there in the climate nuisance area is this *Comer* case, which you've already heard a little bit about.[28] This was a case filed by some victims of the Katrina Hurricane against Murphy Oil and a set of other energy companies that they said contributed to climate change, which in turn contributed to the increased intensity of Hurricane Katrina. Obviously, some tricky causation issues were involved in that case, but the court didn't even get there.

The district court in Texas dismissed that case again on political question grounds.[29] That ground for dismissing the case now probably no longer stands under *AEP v. Connecticut*. It has a sort of complicated history in the Fifth Circuit; a bizarre history in the Fifth Circuit, frankly. As a result of which there is no appellate decision and the case has now been re-filed in the district court and is pending in the district court.

So, I think the short answer for the future of climate change litigation is watch this space. There's a lot going on, a lot of more issues to be resolved, and I particularly think that the insurance angle on all of this is likely to be where there's a lot of activity over the next couple of years.

HENRY N. BUTLER: Thank you very much. Well, I think we've got a lot to talk about here. We'll start off and just work our way down the, down the line here. And each person will have two minutes to comment and we'll then see where we go from there.

ERIC LASKER: Thank you Henry. The issue in the *Kivalina* case is interesting. The argument that because in *Kivalina* the plaintiffs are seeking damages, as opposed to the injunctive relief, is the argument that makes *Kivalina* a more suitable case for public nuisance theory. Think back to my opening slide. Traditionally when, at least a public plaintiff brings a public nuisance action, the only remedy was abatement; there wasn't a damages action aspect of that. And the argument now is being made that because there's no damages remedy available under the EPA regulations; therefore, there must be a damages remedy available under common law. But, that has not been the traditional view of the public nuisance doctrine, at least as brought by a public official. So, I think that's one argument against that theory.

The second argument goes back to one of the other issues I mentioned, which is the marriage of the plaintiffs' bar and the public officials, which is an issue in *Kivalina*. The Supreme Court's ruling in the *Cipollone*[30] case, which is that damages remedies can drive public policy, and, in this area—particularly with the magnitude of the damages that could be sought—the particular interest of the plaintiffs' bar has sort of pushed those theories. A

damages remedy has an equal legislative or regulatory policy effect potentially as injunctive action. So, I don't think that argument works for that reason as well.

MIKE MYERS: One of the things I didn't get a chance to focus on Rick reminded me of it based on his remarks. The real theme before the Supreme Court, both at the cert stage and then at the merit stage, is that if you allow this case to go forward, life as we know it will end. I'm exaggerating slightly, but I mean, it really was a "sky is falling" type of an attitude that really cannot be squared with the cases that have been filed so far.

I mean, there've been three or four cases filed and, public nuisance cases are typically brought by the government, by states. And, states neither have the resources nor the interest to bring a lot of public nuisance cases. I think the sort of theme that if the plaintiffs are allowed to go forward and try and prove their case, it's going to bring down the whole U.S. economy, just isn't believable.

I just pulled out a quote here from Justice Easterbrook from the Seventh Circuit during a case, where he said "Skepticism about a plaintiff's ability to prove its claims is not a reason to dismiss a pleading, however, at most, [it's] a reason to hold a hearing and require the plaintiff to pony up the proof."[31] So, I mean, I think that was our attitude in terms of this area of cases. Courts have dealt with these issues in the past. This one is more complex than others that have come before it, but it's not beyond the ability of the judiciary in terms of deciding whether or not these largest sources of greenhouse gas emissions in the country are contributing to global warming.

HENRY N. BUTLER: Mike, I just want to follow up with a quick question about your point about the states and not having the resources to bring these cases–one of the points that Eric had made earlier was about the use of the private contingency fee attorneys. Does that at all change your thinking about whether the states have the resources to bring these things or not? I know a number of the states have been relying on the private attorneys to carry the weight.

MIKE MYERS: Well, I mean, it's not something obviously we did in this case. So, I really, I mean, my experience in bringing public nuisance cases has really been limited to this case and also, bringing them within my state, so I can't really comment beyond that.

HENRY N. BUTLER: Okay, and I think Rick can help us out on this as we transition over to him because I know that in the *Kivalina* case Susman Godfrey has been taking the lead. But, they're not owned by half of the state I guess.

RICK FAULK: I can talk a little bit about that; the idea that the sky is falling and that this is a looming, impending terrible catastrophe. I can only go back to the fact that several years ago I was sitting in a CLA meeting at lunch in Houston, at the Houston Bar Association Environment Group. And, one of the lead counsel for the City of Kivalina was speaking and the comment was, "I missed out on tobacco litigation. I'm not going to miss out on climate change."

So, when you think about it, what's the old saying, "You're not paranoid if they're really out to get you?" That's what is going on here, there is an immense interest here, obviously, and there's nothing wrong with contingency fee lawyers. I'm not going to get into that, but there is an intense interest here and the interest is certainly in the interest of justice, but there are also huge sums of money involved in these situations. So, we can't, whatever that means to anyone who hears that should make their own judgment.

I would want to, I do want to challenge one thing that Amanda brought up, the fact that these injuries are real and that global warming and climate change are real phenomena. It is one thing to say that here, it is one thing to say that anywhere; but, when you walk into a court of law, whether those injuries are real, whether global warming and climate change are real and whether mankind has anything to do with it, has yet to be determined. And, that will not be determined until, if ever, we have the mother of all *Daubert* hearings, which will unquestionably consume innumerable days, months, perhaps years in courtrooms. And then, who knows how long in the appellate courts to determine whether, in fact, all of this is really true from a legal point of view.

As a matter of fact, where we are right now, there are about five steps of where we are right now. Right now, we're just trying to decide who's going to make that determination. That issue has not even been decided. We're also trying to decide, after that, who's responsible for global climate change? And, after that, we then have to decide who's responsible for the particular injury that the person who's claiming damages in the lawsuit; who's going to pay for that? I guess after that, we then have to decide what in the world are we going to do to determine the degree to which any particular person is responsible for this situation?

In other words, in a comparative responsibility world, that's exactly where the law is, who in the world is going to decide what percentage is going to be assigned to whom? And, what about all these people out there who are contributing to this situation who aren't before the court? What are we going to do about those sorts of situations? And, I guess finally, once all that comes down, some jury, perhaps many juries somewhere, perhaps 100s of juries, 1,000s of juries, are going to have to decide whether, in fact, someone gets damages in this situation. And then, appellate courts are going to have to weigh in.

And then, somehow, does anyone believe that that patchwork quilt of jurisprudence is going to really answer the question? Is it really going to solve the question? Or, is it simply an exercise in financial enterprise translated into jurisprudence? Is that really what we're talking about?

And, we're talking about here, in the final analysis, people's lives certainly, businesses certainly, and is this something that we want to transform our judicial system into? I won't make that decision. I'm an advocate folks. You will make that decision. And, believe me, I understand that that's going to be a very difficult thing for you folks to decide. I don't minimize it. I thank you for hiring on to do it.

HENRY N. BUTLER: Amanda?

AMANDA LEITER: So, I have a couple of thoughts. One is that I do sense, and this is, this is my close reading of *AEP v. Connecticut* rather than my personal view. I sense some reluctance on the part of Justice Kennedy, at the very least, perhaps the whole Court, to recognize standing in anyone other than a state. So, my guess is that, after a period of years when some more cases make their way back up there, this is a cause of action that will be more clearly limited to state plaintiffs; in part because the state, of course, is representing the interests of their citizens, as opposed to individualized interest.

I think the "sky is falling" rhetoric is overblown. Courts are very capable of dealing with this. They have very handily thrown out all of the cases that have been filed thus far. If one makes it through and makes it all the way it will be because probably, it's a state plaintiff, it's a narrow set of injuries that are easily proven, and the range of defendants that is sued will be a range that sort of adequately represents a high enough percentage of the greenhouse gas emitters in this country; that we do have some sense that you've sued the right defendants, the folks who are substantially contributing to the harm. Courts have been resolving these issues in other contexts for centuries and this is just another case in a slightly different context.

Now, that said, I don't like the notion of a patchwork solution to climate change. I don't think that that's the best way to get to any sort of comprehensive, reasonable, and well balanced solution here. We all contribute. I drove here to this meeting today and that's one of the concerns that I know the courts have, that everyone is a potential victim and everyone is also a potential perpetrator. We need a legislative solution.

The last point I would make is that the states, I think we're very aware that one thing they were doing in filing this suit is creating a few more poker chips for use in the legislative bargaining, right? That is, that the defendants on the other side of this lawsuit probably would also rather have a legislative solution than face endless and endless series' of lawsuits.

HENRY N. BUTLER: Does anyone else want to comment on any of these comments on this panel? I'm ready to go for some questions now.

AUDIENCE MEMBER: This is a question for the defense bar. Is this a problem because of public plaintiffs? Or, is this a problem because of the litigation is over climate change? Because for years, I've heard folks from the defense side say that this whole regulatory state is really illegitimate because it displaced the public nuisance litigation approach that had been in place and adequately resolving the allegation that smoke stacks cause injury to my health and my property. That was considered adequate for a long time.

RICK FAULK: Let me try to answer your question this way, and Eric touched on it in his opening slides. Professional James Henderson, who is the drafter of the third Restatement of Torts, has written a series of comments, and it's pretty interesting. His concern is that when we get into a situation that involves a cause of action, which has no standards to govern its resolution, other than those that are ad hoc, creatively designed, and administered by the courts; then, you have a form of standardless liability. And, that is really not even a lawful situation. He calls that, "A lawless situation" because you're retrospectively imposing liability on the basis of standards that didn't even exist at the time the party was engaging in the conduct. And that is a serious problem.

One of the problems is raised by the political question doctrine. In other words, there have to be standards and rules by which liability is going to be determined. And, it's one thing to say, "Oh, public nuisance is an ancient tort." But, the specific standards that would be applied in this sort of a case would be creatively designed and administered ad hoc by judges throughout the country. I just don't see that that is a judiciable situation. That's where I come from in this situation.

It is one thing to have a set of regulations, and you violated a set of regulations. It is one thing to have a whole set of standards out there that you can be judged by. But, to have it sprung on you in retrospect is simply not fair.

ERIC LASKER: Let me just add to another aspect of what your question was, which is the concerns certainly that I have with the new public nuisance doctrine; it's not that there was a factory that polluted the groundwater underneath a particular property and caused damage. Depending on the facts of the case, that's a perfectly appropriate lawsuit.

What's happened in the sort of the new public nuisance doctrine is you have a problem with society at large and there are certainly people you could point to who may have contributed to that, but, you can't say that they caused the problem at large, they're just in the chain somewhere. And you can't say that what they did linked up to the individual damage of the

individual plaintiff. That's where we get to this sort of standardless liability where you don't have sort of that traditional model that all of you are much more comfortable with.

Maybe, I'm not, as we're going through quoting on the private plaintiff attorneys, saying "You don't need a regulatory state," but, that, the distinction between that individual factory, individual property owner situation, and this sort of global public nuisance theory is where I have my biggest problem and where the standardless liability issues come to the fore.

MIKE MYERS: If I could just take that up for a minute or two?

HENRY N. BUTLER: Is this a defense perspective?

MIKE MYERS: No, no, you wouldn't want to leave the panel unbalanced. I think, first of all, I come at this from a totally different perspective from Eric. I mean, I come at this from a perspective of, states beginning in the 1800s were using public nuisance to deal with pollution, not just from one factory, but from multiple factories. So, the question, the problem of multiple defendants who contribute to a single harm is not anything new.

There have been references to standardless liability, but we have, over time, developed things such as the Restatement of Torts, which is based on cases that have evolved over the last several hundred years where the courts have come up with principles. And, things such as, how do you deal with a situation where you have multiple defendants who are contributing to a harm? So, those are the types of things that we would have pointed the court to if we had gone forward with the case under federal public common law nuisance. I guess I'll leave it there for now.

AMANDA LEITER: I want to say one more thing too, which is, you can't lump all of these cases together; even just putting on my torts professor hat for a minute. There's a very big difference between the *Comer* case, where the plaintiffs are alleging that the particular circumstances of Hurricane Katrina were caused by particular emissions from the defendant power plants.

That's obviously a much harder causation argument to make than New York's argument or Connecticut's argument in *AEP v. Connecticut* that we face an increased risk of a series of climate injuries as a result of, what I think is a well proven causation link. You may need a *Daubert* hearing, but just about every expert willing to testify would say there was causation between the emissions of the defendants in *AEP v. Connecticut* and the future harms that New York anticipates.

HENRY N. BUTLER: Okay, next?

AUDIENCE MEMBER: My question is more mundane, but it goes to the point that Professor Leiter finished her presentation with, and that is the role of the insurance companies. And, perhaps especially, Mr. Myers, I know this isn't going to interest you that much, but in terms of, pardon the expression, seeing which way the wind is blowing, are the carriers picking up now, and especially the excess carriers in saying, "We're with you on products liability guys, but forget this public nuisance. We're not going to cover you on that." Because that seems to me would foreclose a great deal of this.

HENRY N. BUTLER: Amanda, you want to talk about it?

AMANDA LEITER: Foreclose?

AUDIENCE MEMBER: If there's no insurance there—I'm leaving aside the self-insured obviously and the large deductible companies, I'm not talking about that, I'm just talking about the deep pocket, which is obviously the insurance carrier in many cases—are they stepping in now to try to tighten their policies?

AMANDA LEITER: Well, they're certainly stepping in. I mean, this Virginia case was the first climate insurance case to be resolved. So, we don't know which way the wind is blowing, but it very squarely held that—and it's the Virginia Supreme Court, so it's the end of the case—under the comprehensive general liability policy that that AEP held, Steadfast was not obligated either to defend or to cover any climate liability that AEP may have.

I question whether that forecloses the lawsuits frankly because I question the premise that a lot of this is being driven by the plaintiffs' bar. I think if you look at where the economic incentives lie with respect to climate change, they are very much on the other side.

ERIC LASKER: I guess, the one thing I'd say is about foreclosing the litigation also is I don't think the fact that Exxon may not have insurance coverage is going to really discourage a plaintiffs' attorney, who has a financial interest.

RICK FAULK: One of the problems though, I mean, let's just be honest about this, there is a sense, and maybe people disagree with this, there is a sense that when it comes to a situation where physical harm has been sustained, when a problem can be solved by money and there's money available to solve it, then there's not a problem. And, that's just not true. That, to me, is personally nonsensical. Just because someone can create a mass controversy doesn't mean that people should pay millions, and millions,

and millions of dollars just to get rid of it so they can go on and do their business.

Surely, there has to be some rational, realizable, standard, governed procedure by which all of us can come to an intellectual resolution and to home and feel comfortable that justice has been done. Justice is not just a transfer of wealth between insurance company and insured to injured party. It's a lot more complicated than that and I know all of you guys know that.

But, for those of us who have been raised in this system and have practiced in it and done all this for all these years, there's got to be more to this situation than a transfer of wealth. To me, there is an underlying current somewhere going and I don't know who's pushing it. I don't want to put blame on anybody, but that current is wrong. And, that is what I stand against here. I want a rational reason for making a decision to give relief or to deny relief, not one that is simply expedient. And, I think that's it.

AMANDA LEITER: I want to jump in and say I filed my amicus brief pro bono, just—

RICK FAULK: Good for you.

AMANDA LEITER: One sort of interesting intellectual point on the insurance question is one that the *Comer* case now raises, as a complaint, the fact that the plaintiffs in Louisiana are finding it very difficult to obtain personal homeowner insurance, flood insurance, etc., because of the risk of climate change. Insurance companies are making it far more expensive to obtain insurance against events, weather events like Katrina, because of climate change. And so, that actually now is increasing the requests on the plaintiffs side, as opposed to the reverse.

RICK FAULK: Well, I guess, to one extent that it points out there's no such thing as a free lunch here, right?

AMANDA LEITER: Right.

RICK FAULK: And this litigation is going to have tremendous consequences. And, the wealth transfer story is one that we need to really think through as well. We're taking money, I mean the simple story, we're taking money from large utilities and we're going to pay the money to states or are we going to pay it to individual claimants? And, I imagine the first people in line as individual claimants could be, "Hey, I own this nice island in the Florida Keys, personally. I'm a billionaire and I'm—that's going to become worthless. Now, I'm first in line. That's the first one under water."

So, it's not like when you start taking wealth distribution into account, you got to really start identifying who the parties are, who's been harmed, as opposed to a real aggregation, a big chunk of wealth from one group to

another group. As you pointed out, a lot of people are on both sides of this equation. So, it's got a lot of misallocated effects of this. And, I don't know of any economists who could figure it out, but maybe our judges can. Next question?

AUDIENCE MEMBER: This may be a question from reality T.V. If the power companies are polluting and we're breathing that air, power companies are allowed to have a certain return on their investments and operations. We, as consumers, pay rates that provide a profit for those companies. So, we basically will be paying so that we can breathe cleaner air.

RICK FAULK: That's a part of the economic analysis. I mean, when someone fixes rates, they get a rate of return that's decided by the citizens themselves typically in a public utility commission situation. But, whether in fact, the air you're breathing is actually polluted as a result of your local power company or by the one in China when the wind is blowing around the earth at hundreds of miles an hour, who knows?

ERIC LASKER: Just another thing I'd throw in here because I think it bears repeating; the fact that there are harms in society doesn't mean that the judiciary is the branch that's supposed to address those harms. There are certainly harms that, if the state legislature was to come in, in a slip and fall case and pass a statute saying the plaintiff wins, I think you'd all have problems with that. That's the role of the judges. There're roles of the legislature, and the regulatory, and the executive to help society. Now, people may argue that lately they haven't been doing a great job at that, but that's their role and that's the way our system is set up; to have different branches of government addressing different types of problems. And so, it may be that, you want to have a carbon tax, you want to have some sort of extra fee to address a societal issue. But, that doesn't mean that a court is going to impose that tax or is the proper body to impose that tax.

MIKE MYERS: Well, and I think one of the interesting things that came out of the Supreme Court's opinion was you didn't have the majority of justices who took that view. If you're going to get rid of the case on a threshold basis, be it standing, political question doctrine, there were certainly plenty of very well written briefs on the defense side articulating why that should happen. Yet, that only commanded the view of four of the justices in the case. It was the actual merits—I mean, merits in the motion to dismiss context, but, nonetheless, the merits in terms of whether or not the federal common law claim had been displaced—which was the one that got eight votes.

HENRY N. **BUTLER**: Please join me in thanking the panelists—thank you very much**.**

RICK FAULK: The flogging will continue after a twenty minute break.

HENRY N. BUTLER: Thanks.

AMANDA LEITER: Thank you.

ERIC LASKER: Thank you, all right.

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1 Am. Elec. Power Co., Inc. v. Connecticut, 131 S. Ct. 2527 (2011).

2 Native Vill. of Kivalina v. ExxonMobil Corp., 663 F. Supp. 2d 863 (N.D. Cal. 2009), *appeal docketed*, No. 09-17490 (9th Cir. 2011).

3 Robert Reich, *Regulation Is Out, Litigation Is In*, USA TODAY. Feb. 11, 1999, at 15A, *available at* http://legacy.library.ucsf.edu/tid/xiy82c00/pdf.

4 New Mexico v. Gen. Elec. Co., 467 F.3d 1223 (10th Cir. 2006).

5 Comprehensive Environmental Response, Compensation, and Liability Act of 1980, 42 U.S.C. §§ 9601-9675 (2006)

6 *Am. Elec. Power Co.*, 131 S. Ct. at 2533.

7 Connecticut v. Am. Elec. Power Co., Inc., 406 F. Supp. 2d 265, 267 (S.D.N.Y. 2005), *vacated and remanded*, 582 F.3d 309 (2d Cir. 2009) *rev'd*, 131 S. Ct. 2527 (2011).

8 Connecticut v. Am. Elec. Power Co., Inc., 582 F.3d 309, 325 (2d Cir. 2009), *rev'd*, 131 S. Ct. 2527 (2011).

9 *Am. Elec. Power Co., Inc. v. Connecticut*, 131 S. Ct. 813 (2010).

10 *Id.*

11 549 U.S. 497 (2007).

12 Am. Elec. Power Co., Inc. v. Connecticut, 131 S. Ct. 2527, 2535 n.6 *(2011).*

13 The speaker is paraphrasing Justice Ginsburg. *See id.* at 2537.

14 *Id.*

15 42 U.S.C. § 7411 (2006).

16 Native Vill. of Kivalina v. ExxonMobil Corp., 663 F. Supp. 2d 863 (N.D. Cal. 2009), *appeal docketed*, No. 09-17490 (9th Cir. Nov. 28, 2011).

17 Comer v. Murphy Oil USA, 585 F.3d 855 (5th Cir. 2009).

18 *Am. Elec. Power Co.*, 131 S. Ct. at 2535.

19 *Kivalina*, 663 F. Supp. 2d 863, *appeal docketed*, No. 09-17490 (9th Cir. Nov. 28, 2011).

20 131 S. Ct. at 2537.

21 585 F.3d 855.

22 Brief of Environmental Law Professors as Amici Curiae in Support of the Respondents, Am. Elec. Power Co. v. Connecticut, 131 S. Ct. 2527 (2011).

23 549 U.S. 497 (2007).

24 Coalition for Responsible Reg v. EPA 75 Fed. Reg. 25 (May 7, 2010), *appeal docketed*, No. 10-1092 (9th Cir. June 3, 2011).

25 Int'l Paper Co. v. Ouellette, 479 U.S. 481 (1987).

26 Native Village of Kivalina v. ExxonMobil Corp., 663 F. Supp. 2d 863 (2009).

27 AES Corp. v. Steadfast Ins. Co., 282 Va. 252, 262 (2011).

28 Comer v. Murphy Oil USA, 585 F.3d 855 (5th Cir. 2009).

29 Comer v. Murphy Oil USA, Inc., 2007 WL 6942285 (S.D. Miss. Aug. 30, 2007).

30 Cipollone v. Liggett Group, Inc., 505 U.S. 504 (1992).

[31] Alliant Energy Corp. v. Bie, 277 F.3d 916, 920 (7th Cir. 2002).

THIRD-PARTY LITIGATION FINANCING

Joanna Shepherd Bailey, Michelle Boardman, Jeremy Kidd, Eric Schuller, Paul Sullivan
Moderator: Geoffrey J. Lysaught

LINDA KELLY: With that, let me turn over to substance here and I want to just briefly introduce my colleague Geoff Lysaught, who is the Deputy Executive Director of the Law and Economics Center who is going to moderate our next panel for us. Welcome Geoff and panelists.

GEOFFREY LYSAUGHT: Good afternoon. Well, I want to just take a two quick minutes to briefly introduce you to this panel and our panelists. The first thing I wanted to mention is that we have had an effort underway under the Law and Economics Center, as part of our Searle Civil Justice Institute, which is one of our research divisions, which I'm sure you've heard a little bit about, addressing this issue of third-party financing of litigation.

We started this initiative a little over a year ago now, and as part of that effort we have commissioned research by ten scholars—five of whom are based in the United States, five of whom are international scholars—to better understand the legal and economic implications of the introduction of outside capital into the civil justice system.

So, you are going to hear today from three of the scholars who have been involved in that process. Each of the scholars has written an original law review style paper for our effort. All of those papers will appear in a symposium issue of the *Journal of Law, Economics & Policy*. So, that is a little bit about how the broader organization, the Law and Economic Center, works. We have a unique opportunity to take some of our own research and policy efforts, through the Searle Civil Justice Institute, and share some of that information with you.

Now, the panel is not comprised solely of people who have been working with us on our initiative. We have two participants from the industry who can share their unique perspectives and experiences as it relates to the financing and the role of financiers as it relates to litigation in the United States. So, that is a little bit of the background about why we pulled this panel together for this symposium.

The other thing that I will list for you, as by way of introduction, is to talk a little bit about third-party financing of litigation and what that means. Many of you may be familiar with the concept—or have at least been exposed to the concept already—but I think it is a little bit of a misleading term or set of terms. The notion that there are outside financiers behind litigation probably should not be a shock to any of you, and it can take on a variety of forms, some of which have been around for a very long time.

At a simple level, you can think about third-party financing as a small plaintiff's law firm who has received a bank loan, or some other line of credit, secured by the business assets or the individual attorney's home, in order to fund the ongoing businesses expenses, which is essentially a small business. That is a financing arrangement that has been around for quite some time. So, you could, in some sense, talk about the economic, legal, and ethical implications of that kind of financial arrangement under the umbrella of third-party financing of litigation.

The two things that have actually received more attention than that category of financing are, first, loans that are made to plaintiffs in litigation that are more of a payday style loan, a consumer style loan. The loan is not used to finance the litigation in any meaningful sense; but, is used to finance living expenses—rent, car payments, etc. That consumer loan concept also falls under this sort of rubric of third-party financing of litigation. Eric Schuller, who is on our panel, will give you some insights and perspectives around the legal, ethical, and economic implications associated with that business.

The other piece that has really been a hot topic over the last twenty-four to thirty-six months, has been the introduction of a private equity or hedge fund style investor making an investment directly into litigation in exchange for a share of any settlement or award at trial. In that sense, the investors are partnering with the plaintiff to help facilitate their litigation in the U.S. civil justice system. This is a phenomenon that exists not just here, but on a global basis, in some countries for the better part of a decade or more now.

So, when we talk about third-party financing of litigation, I think the key takeaway I'm trying to get across is this can quickly develop into a very complex set of concepts and a very nuanced set of analysis. In some sense, every financial arrangement is going to depend on the facts and circumstances behind that particular contractual arrangement.

But, at a big picture level, you can think about the traditional business financing that a plaintiff's law firm—or any small law firm—might take on that looks more like a business loan, or look more like a consumer loan, which we will spend a little bit of time talking about today. Then, there are those things that look more like a private equity or investment-funded sort of litigation, which we will talk a lot about today. This is really where the focus of our policy and research initiative was. So, that is just to give you a little bit of a grounding in the terms and concepts you will hear about today on our panel discussion.

Joining me today are several scholars and two industry experts. We have Joanna Shepherd Bailey from Emory University, Jeremy Kidd from George Mason University, Eric Schuller from Oasis Legal Finance, Paul Sullivan from Juridica Capital Management, and Michelle Boardman, also from George Mason University. So, we are going to mix it up a little bit

between our scholars and go back and forth between the scholars and the industry experts. To get things kicked off we will have Paul Sullivan.

PAUL SULLIVAN: Thanks, Geoff. Good afternoon. I appreciate the opportunity to speak to you today. I am Senior Vice President at Juridica Capital Management, U.S. Incorporated. My firm manages a publicly traded fund, Juridica Investments Limited. It is traded on the AIM, which is an alternative to the London Stock Exchange. We provide a form of financing that is sometimes referred to as third-party litigation financing or alternative litigation financing, or what I will call "ALF" for short.

This financing provides companies with an alternative to how they have traditionally financed their litigation. Generally, companies finance their litigation through their own capital as opposed to a third party's capital, or by retaining an attorney on some form of a contingency fee or alternative fee arrangement.

Well, there are different ALF markets, including those for personal injury claims, law firm loans, and corporate claims. Juridica only participates in the market for corporate claims, which would include claims for antitrust violations, breach of contract, securities violations, environment issues, and those same issues in arbitrations. The market also includes intellectual property claims, and particularly, patent infringement claims, which have developed into a very robust market all of its own.

Juridica's investments involve mainly claims in the U.S. and the U.K. We do not invest in class actions, product liability, mass tort, or personal injury claims. Our clients include eighteen Fortune 500 companies, thirteen smaller mid-range businesses, and two major universities. These clients are represented by numerous international law firms, including fifteen Am Law 200 firms.

Our typical investment size in a particular claim is $3 to $10 million with a current average commitment per case of approximately $5.5 million. The typical claim size—in other words, the amount at stake for recovery—is $25 million to over $100 million, and in some cases perhaps over $1 billion.

So, why does a market for financing corporate claims exist and why does Juridica participate in it? Well, litigation, as we all know, can be a blunt instrument for resolving disputes. It can cost too much. It can take too long. It can be economically inefficient. There are times when cases are brought where, from a litigation standpoint, the merits of the case are strong; but, in terms of the overall business strategy of the company, the case does not make a whole lot of sense.

There are also cases where the economic incentives between the lawyer and the client become misaligned during the course of the case. Just one example of how this can happen is a case in which the legal fees are disproportionately high compared to the potential recoveries. For instance, this would be the case where, in a hotly contested commercial litigation, the

lawyers end up billing $10 million in fees when the reasonable value of the case to the company is only $9 million.

In today's legal market, numerous approaches are used to improve the economic efficiency in litigation outside of third-party financing. These include, for example, early assessment of the case's value and cost—which is something a lot of companies are focusing more on and is an approach that might have been able to prevent the misalignment of interest in the example I just mentioned—and alternative fee arrangements with counsel, which involve the lawyers sharing risk in the case through a contingency fee, a fixed fee, a reduced fee, or some other risk-sharing mechanism.

In many ways, the demand for alternative fee arrangements from general counsel, in our experience, coupled with the inability of many law firms, even large ones, to take on the kind of risk necessary to make an alternative fee arrangement work, opens the door for ALF, which can serve as a kind of bridge between general counsels who want a particular firm to work on a case and a firm that wants to take the case, but is unwilling or unable to share the risk to the degree required.

One place we see this scenario come up is with cases with large e-discovery budgets, where the client is asking the firm to front the expenses of the e-discovery; but, the firm does not have the capital up front to do so, even if they are willing to take on the attorney's fees as a full contingency. In those cases, the clients can seek an investment from us that covers the expenses.

Another approach being employed is the use of legal outsourcing firms, which, as you probably know, attempt to provide a lower cost alternative to law firms for certain types of litigation support services, including document review and e-discovery.

So, all of these different approaches in trying to drive down the costs of litigation and making it more efficient, are motivated by the fact that our litigation system for corporate claims is currently not that efficient. Where there is inefficiency there is not only room for improvement, but also often a financial opportunity. And that potential opportunity is largely why there is a market for alternative litigation financing.

Third-party capital tries to identify good cases in which make an investment—similar to a portfolio manager identifying a good stock, or a contingency fee lawyer deciding on which cases to invest his or her time. ALF, therefore, looks for efficiency, predictability, transparency, and timely returns to drive results. We look for cases that can be completed efficiently and in a timely manner, and for cases where the lawyers and the clients are trying to drive cost out of the process and reduce risk because we are usually being asked to finance those costs.

As someone who spends a lot of time evaluating opportunities to invest in litigation—and most often rejecting these opportunities—I believe that ALF is unlikely to invest in cases with, for example, an absence of up front serious economic analysis by both outside and in-house counsel. In

fact, I see cases where the failure to conduct such an analysis is why ALF is being sought in the first place, because the costs have gotten out of control. These are the kinds of cases in which we do not invest.

Also, we are unlikely to invest in cases with a misalignment of interests between the client and counsel, or where there is a disproportionate cost-to-value ratio, as in the example I mentioned earlier of a case with fees of $10 million and a risk-adjusted value of $9 million. We are not likely to invest in cases with unfavorable merits or in cases where the lawyers are not experienced in the subject matter. Actually, we spend a lot of time vetting the lawyers and evaluating the lawyers as part of our due diligence process.

We are also not likely to invest in cases where the investment sought would essentially take the risk off the plaintiff, which raises issues of moral hazard, or in cases where there is a positive correlation between the company's demand for financing and a high risk of loss in the case. In other words, we need to very carefully screen the cases that come to us to make sure that this correlation does not exist. Because of that, I believe that ALF incentivizes improvements in the efficiency of litigation, rather than incentivizes greater inefficiency.

So how does Juridica make its investments? Well, there is no model form of agreement; but there are two broad approaches to how we make investments in cases. Our preferred approach is basically to make an investment directly with the client. This investment usually involves providing cash to the client that can be used to pay attorney's fees or case expenses and, in some cases, can be used by the company for other purposes. In return, Juridica receives an assignment of some percentage of the proceeds of the litigation, similar to a contingency fee.

The businesses seeking this sort of investment are generally either companies with liquidity restraints that want to retain sophisticated commercial counsel that are otherwise unwilling to take such a risk in the degree required by the company; or, they are businesses that can finance the litigation, but choose not to do so for budget capital allocation or other reasons.

Juridica's investments directly with clients are generally constrained by the usual rules governing contracts, and also by any applicable rules of champerty, barratry, and maintenance. Juridica does not make an investment without having received a favorable opinion on these issues from an outside expert.

Juridica, as the second form of investment, can also make a loan directly to a law firm in certain circumstances. To the extent Juridica does make a law firm loan, the loan is non-recourse, secured only by the firm's recoveries in a particular case, or more preferably by a portfolio of cases. Juridica's ability to make loans directly to law firms is constrained by the ethical rules prohibiting lawyers sharing fees with non-lawyers. And again,

Juridica does not make an investment without a favorable outside opinion on these issues.

Either approach, however, can have a beneficial effect, not only for the client, but for the law firm as well. Even where Juridica's investment is with the client, the law firm can benefit from being able to take on a meritorious case without having to take an undesirable degree of contingency fee risk. We, as the funders, spend a lot of time thinking about deals through these sorts of deal structures to ensure that our incentives and returns are properly aligned with the plaintiff and litigation counsel, so that if we are happy with how the case works out, they are as well.

We really need to focus on this issue because we are a passive investor in litigation; we do not have control over litigation strategy or settlement decisions. Because litigation strategy and settlement decisions remain in the control of the plaintiff or defendant, Juridica needs to make sure that the plaintiff or defendant is incentivized to make decisions that, although they are self-interested, benefit us as well because of our alignment.

In terms of ALF's impact on the overall litigation system, as I said before, I think that ALF can improve the efficiency of the litigation system, at least for resolving corporate claims, which is my field, and even reduce the amount of litigation. But, it should only be employed in a manner that does not compromise the administration of justice or interfere with the independent, professional judgment of counsel.

ALF should not be used in a manner that incentivizes the filing of frivolous claims that clog our court system and create greater injustice, or where the attorneys are not beholden to their client's interests, but to the interests of a third party who may not have the same interests as their clients. I also think that the existing laws and rules that apply to ALF need to be considered in the current context of commercial litigation and updated or reconsidered where necessary. Many states have not updated their laws on champerty, barratry, and maintenance in the commercial context in many years, in some cases even a century or more. Those laws should be updated in light of current economic principles and realities.

Overall, I think that ALF can improve the efficiency of the litigation system, at least for resolving business claims, and even reduce the amount of litigation. But, as I said before, it should only be used in a manner that does not compromise the administration of justice or interfere with the independent, professional judgment of counsel. Thank you.

JOANNA SHEPHERD BAILEY: Okay, well I would like to thank George Mason and the Law and Economics Center for inviting me to speak with you today. I am going to brief you a little bit on the academic thinking on third-party litigation financing and how that fits with what is going on in reality.

When academics first began thinking several years ago about third-party financing—especially the kind that Geoff was talking about, the pri-

vate equity funded sort of investment—they began to think about barriers to justice and how third-party financing could improve access to justice by eliminating some of these barriers.

Specifically, the ideal situation they were thinking of were these situations where we have: the poor little individual plaintiffs, like the one here, pitted against the more risk-neutral defendant. The barriers to justice that could arise in this situation may arise from the cost of litigation, where a plaintiff could not afford litigation on its own, or it could also result from the plaintiff's relatively stronger risk aversion. So, given that they were injured, they may not be insured, would have more to lose, and would not be able to ride out a long litigation, they may be willing to settle for a lower amount than they could expect in trial.

Contingency fee attorneys can help this situation somewhat, obviously by bearing some of the risk themselves, but they cannot completely eliminate all of these barriers to justice. For certain cases with very low economic value, it does not make economic sense for a contingency fee attorney to take that case. They say the average med-mal case costs about $100,000 to litigate, and if we are talking about a relatively low economic value case, it would not make sense for a contingency fee attorney to take that case. Similarly, there are some cases that are so big, but they are still too costly and risky for a single attorney or a law firm operating on contingency to bear.

The idea was that third-party financing could alleviate some of these problems by diversifying the risk against an even greater pool of cases, and also, they could afford a lot more. The two big companies I will be talking about today specifically are Juridica, which Paul represents, and Burford. Their portfolios are in excess of $100 million, so they can obviously fund pretty significant cases, as Paul just expressed.

The claim addressed by academic theory is that there are situations where there are these barriers to justice; justice is not being achieved on the part of the plaintiff. But, third-party financiers can remedy this; they can balance the scales to make these cases fairer, and end up with a fairer outcome.

The problem with this theory is that third-party financiers are businesses. They are not in it to improve access to justice; that is not their goal, nor should it be. They are in it to make money. Their duty is to the shareholders as public companies. Their duty is not to the plaintiffs. They are earning significant returns—over 70% on their investments. Last time I checked my poor little stock portfolio, it was earning somewhere around 5%, and I have not looked in a long time because I am too depressed to do so. So, obviously they are making a lot of money, and they are paying attention to what they should be from a business perspective.

But, again, the problem with the academic theory is that the kinds of cases with the most profit potential are not these kinds of cases. They are not the cases where the plaintiff is already in a weak bargaining position.

Those cases are not going to be as profitable, from an investment perspective, as cases where the plaintiff is already in a stronger bargaining position, and, therefore, the financiers can expect a higher return on their investment.

So, for certain kinds of cases, I am going to posit that the substantive law creates imbalances that already favor the plaintiff, or puts the plaintiff in a stronger bargaining position. These imbalances can be caused by creating more risk aversion on the part of the defendant, an asymmetry in costs, costs being born unequally by the defendant, or just a general kind of asymmetry in bargaining position.

Juridica makes a lot of information available on their website, which is very nice. This is their most recent announcement of what their current portfolio consists of: primarily price fixing cases and patent infringement cases; others include breach of contract, and the cases that Paul just suggested.

Burford is the other big, hedge fund type of investor. And although they do not make the same kind of information public that Juridica does, we do have quotes from some of their shareholder documents claiming that their focus is going to be on very similar kinds of cases. Whether or not that is actually occurring is unknown because there is no data. But, we can assume that at least this is somewhat what their interests are.

My argument is that, at least in some of these kinds of cases, the substantive law creates existing imbalances. Specifically with patent infringement litigation, there are disproportionate litigation costs. The average patent infringement case costs about $2 million to litigate. The research shows the defendants bear the vast majority of these litigation costs, in contrast to the plaintiff, for various reasons. For example, because the patent is presumed valid, the defendant has the burden of proving that it is not. The defendant also risks preliminary injunctions against the allegedly infringing product. And, if this is a significant product line, obviously there is going to be a substantial economic cost to the defendant.

In addition, if there is a finding of willful infringement, both treble damages and attorney's fees are awarded against the defendant. Again, these results increase the potential costs that the defendants risk if they go to trial. And finally, they risk a permanent injunction against the infringing product if the court finds infringement.

All of these combine to make the defendant more risk averse than the plaintiff. It weakens the defendant's bargaining position and a lot of these reasons are the exact same reasons why we see the development over the last few decades of this idea of a patent troll. Defendants are in a weak bargaining position and these patent trolls can take advantage of that. Whatever you might think about patent trolls, we know that they are very profitable and so it can make these particularly good investments for a third-party financier.

Price fixing cases have some of the same characteristics. We have the potential for exorbitant damages: the damages of the entire cartel's over-

charge, and they typically exceed $1 billion. I do not know if that was the kind of case that Paul was talking about there, but they involve huge damage awards. The Sherman Act automatically trebles damages and attorneys fees in price fixing cases. [1]

Similarly, in contrast to most areas of tort law, joint and several liability has not been reformed in patent infringement case—one individual defendant could be liable for the entire cartel's overcharge and there is no right of contribution against the other defendants. So, there is the risk of one defendant having an exorbitant damage award at the end of the day. Also, there are often early settlements, and, as a result, the remaining defendants end up paying the vast majority of the settling defendants' share of damages.

Finally, the statute of limitations often will toll if there is a finding of fraudulent concealment. So, the damages often go back much farther than what the four year statute of limitations would suggest.

All these things combined, it is the underlying substance of law that creates this balance that already favors plaintiffs to begin with. Third-party financing takes advantage of this imbalance, which, obviously, from a business perspective makes that a good investment. But perhaps it also further exacerbates this kind of imbalance that favors the plaintiff.

So, in contrast to the previous picture, in reality I would say that in these kinds of cases the field is already relatively level between the plaintiff and the defendant, if not favoring the plaintiff to begin with. Then, when you have a third-party financier, it would tilt the scales toward the plaintiff's side, away from the defendant's side.

While Juridica has explicitly stated that they will not invest in class action litigation, Burford has recently invested a significant amount of money in a big group litigation case. You have probably read about it in the paper—the case in Ecuador where Chevron did some environmental damage. They have also stated in some of their public documents that risk imbalances in the class action context are markedly different from those in the personal injury suit, often working in this context to the disadvantage of defendants, recognizing that these are again, relatively profitable kinds of cases for an investor on the plaintiff's side.

The problem with class action, as we all know, is that the aggregation of even small claims can sum to a massive potential damage award for the defendant. Similarly, the litigation is often endless, lasting decades, and is very costly, typically costing in excess of $10 million annually to litigate. So, once again, we have an imbalance in risk preferences and a huge asymmetry in the costs of litigating these firms. All of these combine to put defendants in a weaker bargaining position.

In conclusion, the idea that academics originally had in mind when they were writing on this early on in the process was that litigation finance would take this legal balance of equity that was favoring the defendants and balance it to make it more equal between plaintiffs and defendants. But, in

reality, those just are not the good kinds of cases to invest in from a business perspective. The best investments would be cases where the plaintiff is not already in this weaker bargaining position, perhaps equal or perhaps actually favored by the underlying substantive law.

The exact features that make these cases attractive from an investment perspective also make these cases the opposite of the kinds of cases that academics originally had in mind. So, instead of third-party financing improving access to justice, it presumably is creating greater inefficiencies. We have over-deterrence of some defendants; wasteful, inefficient, defensive actions by potential defendants; and overcompensation of certain plaintiffs. So, it is very different from the ideal world that the academics originally pictured. I will stop there, thank you.

ERIC SCHULLER: Thank you. My name is Eric Schuller and I am with Oasis Legal Finance. I just want to give you a quick synopsis of our average consumer: Somebody that typically works paycheck to paycheck, gets in a car accident or has some sort of personal injury situation, is out of work, misses two or three paychecks, is back at work; but all of a sudden bills start piling up. They cannot pay their bills, they cannot pay their mortgage or their car payments, and so they come to us.

We typically look at their case and say it should settle for *X* and then, based upon that, we will typically fund no more than about 10% of that up front; and then we recover on the back end. But, if their case is not successful, or if there are not enough funds to pay us back—in other words, the case settles for a lot less—we receive nothing on that case.

What I want to do here is go through some of the legislation that we have proposed to regulate the industry and answer some of the questions it has raised.

The last place we had, it was in Nebraska and so it is the most current here. At that time we used the term "non-recourse civil litigation funding." We have changed that to "consumer legal funding" because no one could say that in one breath. Once a funding company purchases a consumer's rights case contingent on receiving an amount of the potential proceeds of a consumer's legal action, and all of the proceeds are realized in the settlement of the award, the verdict may be received in legal claim.

The definition of the legal funded company is important here, especially the last couple lines here: "[W]ho has a pending legal claim and is represented by an attorney."[2] Some of the opponents of our industry say we stir up litigation, we stir up lawsuits, and we encourage people to file them. Yet, in order for them to even come talk to us, they already have to have a claim and they already have to have an attorney. Our average funding is $1,600. That is not a lot of money, but it is enough for a lot of people to save their house or save their car.

There was a study done this past May that said over 50% of American households could not come up with $2,000 in 30 days if they had to. It

went on to say that 25% of American households making $100,000 to $150,000 a year could not come up with $2,000 in 30 days if they had to. Money is tight out there for everybody.

Eighty percent of consumer legal funding is used for immediate household needs—putting food on the table or making a car payment. For over 57% of the cases that we fund, the time between the date of accident and when they come talk to us is six months or more. Our clients are not getting in an accident on Monday and calling us up on Wednesday requesting some legal funding.

This is a synopsis we did a few years ago. We had a marketing firm figure out what the average demographic of our consumer is. As you can see here, these are people who often have nowhere else to go. This is the last line of defense to keep them in their homes, to keep their cars viable, to even put food on the table.

RAND put out a paper a couple years ago and one of the conclusions that it came up was this: that legal funding does not increase litigation costs, so it does not increase litigation. It does not make sense for us to fund a case which is frivolous, in which we do not think there should be at least some matter of recovery. It does not make sense for us from a business standpoint.

Again, the person must already have a legal claim and they must already have an attorney before they can even contact us. These are the first two questions we ask when people call us. If the answer to either one of these questions is no, the conversation stops.

Some of the issues that have come into focus are champerty and maintenance. If you look at their definitions, you can see that especially maintenance encourages others to bring actions. We do not encourage anything. The actions are already there, they are already pending, they are already in place. We just make sure the person is still viable and that we can see total resolution in their case.

One of the other important things is that the funds that we provide consumers do not go toward financing the litigation—they go to their household needs. They do not go to the attorney, they do not go for legal experts, they do not go to make sure the attorney can file some paperwork—they go to the consumer. So, the funds we provide apply to the consumer needs, and consumer needs only.

The American Bar Association, as some of you have seen from the Ethics 20/20, has come out with some recommendations. This is in draft form now and is currently out for comment. The idea is to have an alternative litigation financing portion that will be published the first week of December. But, I want to highlight some of the points they bring up and how it compares to the legislation we have already passed.

In the statute in Nebraska, we have no right and will not make any decisions with respect to the outlying claim. We cannot get involved in the settlement process. We cannot call the consumer up and say, "Hey, what's

your case settling for? $25,000. No, no. The minimum you can settle for is $50,000." We cannot do that. In Nebraska and a couple of other states, if we do that we are breaking the law.

In the statute, there can be no remuneration between the consumer legal funding company and their attorneys. There can be no quid pro quo back and forth. We also have it in there too that the attorney cannot have a financial interest in the legal funding company that funds their clients. What we were trying to prevent was four or five attorneys getting together, each kicking in some money, setting up "ABC Funding Company," hiring somebody for $35,000 a year to manage it, and getting one of their clients to come and say, "Oh, I need legal funding." And then have their attorney say, "Oh, you know what, I heard of this new company, ABC Funding. Why don't you go give them a call?" Well, in reality, the attorney owns ABC Funding Company. So, we wanted to make sure it was in the statute that that cannot happen.

The other thing that was brought up here is privilege. We do not ask for privileged documents, but there have been situations in which we may call an attorney up and say, "Hey, can you send us a copy of the police report?" and they have a temporary paralegal there who faxes over the entire case file. Now we have privileged documents in our possession. So, the Nebraska Bar recommended protecting the consumer on those cases in which we accidentally get privileged documents, to ensure that the consumer is not being harmed.

It is becoming a trend now for defense attorneys to ask in a deposition, "Are you getting legal funding?" I know about a half-dozen funding companies who have received subpoenas from defense attorneys requesting all the documentation regarding those cases. It is becoming a trend, and this right here—this protects the consumer.

The lawyer must fully explain the terms and conditions of the transaction. Again, this is in the statute—in twelve-point, boldface font—that they have gone through the contract, and did not sign it until they have retained legal advice from their attorney. The client may want to even consult someone other than his attorney to make sure it is right and proper. We want to make sure that the consumer knows exactly what they are getting into and that there are no hidden agendas.

The other thing is having whoever is representing the consumer review the contract. The attorneys must sign off on the transactions. It is the only financial product out there that I know of that, just to receive $500, you have to have an attorney sign off on it. If the attorney will not sign off on a transaction, we will not fund the case, and we have that in the statute as well.

In May of this year, the National Association of Mutual Insurance Companies published a white paper on third-party litigation financing, *Tipping the Scales of Justice for Profit*.[3] Of course, right away, the first thing it said was we should be burned in effigy; but other than that, they made

some recommendations. First, this should not be allowed in class action lawsuits. That was not really brought up when we drafted the Nebraska statute, but in the current legislation we have pending right now in Tennessee, we address that issue. As you can see here, "'Legal claim' does not mean a commercial tort claim . . ., medical malpractice claims, employment discrimination claims, class action claims, or product liability claims."[4]

Next, the notes and disclosures. They wanted it to be capped at a percentage of the case. We do not think that is right because what if you fund a case and you think it is going to settle at $50,000 but in reality it settles for $500,000. All of a sudden, that funding company can receive ten times more money. This way they only get what they contracted for.

Third, attorneys should not be paid or offered commission. And finally, we do not have financial interest in the case and no input on the decision-making process.

One of the things that they wanted is for everything to be divulged to the courts and the person who got this. We do not agree with this because that is telling the defense, "Hey, I'm weak." Why should they be notified that the plaintiff in this situation has a weak stance?

JEREMY KIDD: All right, so a couple of introductory points to make before I get started. I am presently agnostic on the question of litigation financing in the commercial context. In general, the incentives of the parties seem to be completely different in commercial litigation versus personal injury tort litigation. So, everything I talk about today, all the risks that I point out are limited exclusively to personal injury. I do not have anything against Paul and his funding of litigation financing in a corporate context, yet. I may sometime in the future; as of now, I do not.

The second thing to point out before I get started is that, for the most part, I am going to contrast two extremes, neither of which really describes the world we live in. So, I will be looking at the comparison of a zero financing world, which I realize is not the world we live in. We do have a number of forms of litigation financing, even before Juridica, Burford, Oasis and all the rest came into the market. We still had contingency fee arrangements. We had various ways of financing lawsuits.

So, when I talk about a zero financing world, I realize that is not the world we live in. Now contrast that with a world in which litigation financing is allowed to exist pretty much without restriction. So, those are the two extremes. I will bring in reality as we go.

Alright, so everything that Eric pointed out, those are real costs, those are real people who are kept from justice because they cannot quite afford the costs of bringing a lawsuit, the costs of recuperation, the opportunity costs of missing work, of missing other life activities. Litigation is very expensive and it keeps people from getting into court.

And, the courts, as you know, regularly employ a variety of screening mechanisms that keep some people out of court; but, the idea is to keep out

frivolous claims while keeping legitimate claims. Frivolous claims do not help us with tort law's goals of deterrence and justice. By definition they are not based on legitimate, valid claims. So, the courts have tried to screen those out, but allow legitimate claims to come forward.

The problem is that people are kept from the courts because they cannot feed their kids or pay their mortgage, which is not correlated with the merits of their claims. The barriers to justice that arise because people are poor are not even in the same category of our traditional screening mechanisms. They are far more likely, over time, to get in the way of us achieving tort law's goals of justice and fairness and providing deterrents.

There are significant benefits, or at least potential benefits, to litigation financing. Now the problem is that litigation financing, if allowed to exist without any kind of restriction, also poses a number of risks. It presents the possibility of a significant increase in the amount of litigation generally. Scholars are pretty evenly divided on whether or not that is the case.

There are scholars who argue that litigation financing increases deterrents; so you would see less tortious activity, and you might see a reduction in litigation because of that. If you have litigation financing, plaintiffs are better able to weather the initial stages of litigation, and there might be a greater likelihood of early and better settlement. So, it is a bit of an empirical question to which I do not have the answer.

But, countering those somewhat convincing arguments is the simple fact—the simple economic logic—that when you increase the amount of capital to finance litigation, the cost of litigation goes down. When the cost of litigation goes down, the amount of litigation should go up. The law of demand, right? We should see that there should be that pressure toward increasing litigation as well.

Whether or not it actually would increase litigation, again, is an empirical question, but there is reason to be cautious. There is a reason we should be at least concerned about the possibility of increasing litigation; not just for its own sake. I think the fact that there is additional litigation may be a perfectly desirable thing for society. Tort law imposes costs, that is true, but they may be the costs of making society safer.

So, as long as the claims were legitimate, we would not necessarily have any concerns with having an increase in litigation. But, it is possible that this increase in litigation will lead to a greater increase in frivolous lawsuits as well. It does not have to be litigation financing generally that does this. It is simply a fact that if we increase the total amount of litigation, it puts increased pressure on the screening mechanisms that we use to filter out frivolous litigation from legitimate litigation.

All of you know that you operate on relatively fixed budgets. Similarly, no matter how good our judiciaries are, there is only so much they can do with the fixed resources that they have; you push them too far, they begin to break down. They begin to break down, and we would expect to

see more frivolous lawsuits making it through, and more legitimate lawsuits being rejected, simply because of the pressure on the system.

We could see an increase in frivolous litigation there; but there is one more reason we could see an increase—this is the main concern that I have with regard to litigation financing—that is, the potential for what is called path manipulation. Path manipulation is the idea that arises from the acknowledgment that law evolves, and the evolution of law is subject to conscious prodding and nudging by individuals and groups who can marshal the right cases in the right order in order to move law in a desired direction.

Now, some scholars have pointed out that path manipulation is not inherently bad. Path manipulation is what allowed groups like the NAACP and the civil rights movement to achieve much needed and long awaited changes in the law with regard to minority and women's rights. The danger of litigation financing is that these same tools could be used in pursuit of profit, rather than in pursuit of justice because they expect a stream of future income to be generated from that factory. Litigation financiers could pursue litigation in order to generate that new liability.

Once that new liability comes, a whole bunch of new cases suddenly become legitimate; they become viable. And, if you were the firm who was able to push through that boundary, you become the go-to firm for that type of case. Add onto that the fact that the process of pushing through that boundary generates firm-specific infrastructure so you can process those claims rapidly, and you stand to gain a large percentage of the damages awards from those new cases.

So, what does that do? It creates an incentive in litigation financiers not to just invest tactically in individual cases. If that is all we have, then I would not be that concerned. But, what we have with the possibility of some future expansion in liability is that litigation financiers would begin to invest strategically in precedence. Lining up currently frivolous cases, cases that have no current legitimate legal basis, and placing them in the right order and in the right court and pushing through to create new precedent, new liability.

Not every litigation-financing firm would engage in that; but the existence of those incentives creates the possibility that at some time in the future, we could see the pursuit of precedent rather than the pursuit of justice. That precedent would be pursued in the interest of firm profits. There is no way to know ex ante whether that would be good for society, bad for society, in favor of justice, or opposed to justice. But, let me give you one example of why there is at least a plausible reason why we might be concerned about this.

Let us take a look at two victims, one wealthy, one poor. The wealthy victim of a tort is more likely to have a high loss of wages, and, especially in states where there are damages caps on non-compensatory damages, lost wages are going to be a big part of the damages award. That is going to be attractive to a litigation financier because of the higher back end award.

Plus, that wealthy plaintiff is far more likely to have insurance, disposable income, and some amount of savings. So, they are less likely to need up front maintenance. The combination of lower up front costs and higher back end damages awards is going to be very attractive to some litigation financiers.

What does that mean? That means the possibility of path manipulation in favor of wealthy plaintiffs. Now, that seems fundamentally wrong from a moral perspective that we would skew our justice system in favor of the wealthy; but it also betrays the basic promise of litigation financing, which is helping the poor and the middle class who need access to justice.

What is my conclusion? My conclusion is not that we should not have litigation financing. My conclusion is that we need to look for some way to change, to fix the structural problems in our society. All of this arises from certain structural problems. We have imperfect screening mechanisms, no offense to anyone in the room. You are all doing the best you can, but you are faced with insignificant, insufficient resources.

One way we might achieve some improvement in reducing the risk of litigation, the risks posed by litigation financing, would be to increase funding to the judiciaries. We could implement things like the "loser pays" rule. That is not particularly popular in a lot of areas. But, a loser pays rule and something similar to France's penalty for abuse of process, which is somewhat similar to the Federal Rule 11 sanctions, would begin to deter filing frivolous lawsuits strategically in pursuit of that new precedent out into the future by making the costs of filing frivolous lawsuits higher.

Damages caps are another way. Some people have argued that we can curb this expansion of liability, but I do not know about the damages caps. They do deter frivolous lawsuits, but they also generally reduce deterrence of torts generally, and I am not a big fan of that.

In addition to fixing these structural problems, we can find pathway solutions. There is a theory in economics called the Theory of the Second Best. It acknowledges that the ideal solution sometimes is not available to us. More than that, in a world with serious structural problems, not only is achievement of the ideal impossible, but even pursuit of the ideal can be dangerous. A GMU colleague points out: imagine you want to get to the top of Mount Everest; you want to reach the highest point on earth. So, you begin your ascent, you get half way up and you realize you are actually on the slopes of Mount McKinley. At that point, trying to get to the top of Mount Everest is dangerous. If you simply start walking there, you will, in fact, drown in the ocean.

So, we are half way up the slopes of Mount McKinley. We can make some progress towards litigation financing, but until we find a way to change the structural problems that exist in our system, trying to achieve full, unbridled, unregulated litigation financing could be dangerous. The current litigation financiers seem to be conscious of these problems and seem to be countering them, but that will not be the case indefinitely. Until

we can find a way to make the incentives align, pursuit of unbridled litigation financing could be dangerous to us. We ought to go slowly. Thanks.

MICHELLE BOARDMAN: Okay, so it is an honor to be addressing you. I am going to be discussing the lessons we may or may not be able to learn from comparing the widespread liability insurance structure we have in the U.S. with third-party litigation funding. This might seem like an odd comparison to make initially, so let me explain why I am addressing it.

There are a number of concerns that academics, lawyers, state legislatures, and, one assumes, the judiciary, and others have about the growing market of third-party litigation funding in the U.S. I will list just a couple concerns we might have and then think about how we might consider dealing with those concerns.

The main concerns that I have heard about and read are concerns about champerty and maintenance, limits on claim transfer, ethical prohibitions on lawyer fee splitting, and ethical concerns about fidelity to the clients. The concern is that the lawyer serves multiple masters and the client may be the one who is harmed. Another concern is the idea that third-party litigation funding might lead to an increase in litigation. The final concern is the setup, as Paul discussed, where we do not have an increase in litigation, or perhaps we have an increase and it is positive.

I am agnostic on the extent to which any of these concerns end up being a problem for third-party litigation funding; but, a number of these concerns have at least historically arisen also in the insurance context. There are a couple of reasons, in addition to that, why academics and others, including policymakers, have drawn some analogies with the fact that liability insurers in the U.S. fund huge sums of litigation. They are liability defendants, the fact that their liability policyholders are defendants, and the fact that insurers fund much of the litigation that is brought against those defendants.

The first argument that has been made is that we already have third-party litigation funding widespread in the U.S. You can see it in the structure of liability insurers. Let us look at that and see if there are problems there or if it is a good structure and, therefore, we should not be concerned about third-party litigation funding.

Another analogy that has been made is that insurance companies are much more involved in litigation funding in Europe than they are here. I am only going to talk a little bit about Europe, but, as you may or may not know, there is something called "litigation expenses insurance," which is, as it turns out, much less prevalent in Europe than is sometimes claimed. It is a kind of insurance you can buy either before you have an incident that leads to litigation or after the litigation has occurred, and it helps the parties with their own litigation expenses and also with fee shifting. The American rule where third parties in most circumstances bear their own costs is not the dominant rule in Europe.

So, it is possible to have insurance in Europe issued by an insurance company that deals with both your own litigation fees and the litigation fees of your opponent in the event that you lose and fees are shifted to you. We do not have that in the U.S. Nonetheless, the analogy has been made, to some extent, that we should think of insurers generally as a large part of third-party funders.

Another argument that has been made is if insurer control of litigation is acceptable, then investor involvement in litigation should be fine. This is one of the main arguments I want to discuss, and then briefly at the end, I will talk about a third argument that Joanna has already talked about a little bit.

The argument here is this: When it comes to defense and liability insurers, the insurer often pays for the entire litigation, controls most, if not all, of the litigation in many circumstances, and we are fine with that. Obviously there are problems that can come up with the misalignment of incentives between the policyholder and the insurer; and there are times when of course, the rules are such that the insurer has to step out and continue to pay for the litigation but cannot actually be involved in the defendant's litigation. But, the argument goes, that if we have such heavy investment from a third party—the insurer—into litigation, then we should not be concerned about what happens when we have third-party litigation funding. I am an insurance scholar by the way, so that is where I am coming from.

My conclusion, and I will share with you how I get there in a second, about this analogy is that there are concerns. There are some ethical concerns about serving two masters in insurance. There are other concerns about the heavy influence of an outside party that may have other incentives than the sheer ones between the parties. But whatever the problems might be in insurance—most of which I believe have been dealt with properly through contracts, the common law, and the requirements of ethical behavior—they just do not map onto the concerns you might have about third-party litigation funders.

So, this is an analogy that has been made in some of the academic literature and has been made by public policy experts. I think it is going to continue to be made and my suggestion is that we should really step back and be cautious about accepting the analogy between insurance defense funding and third-party plaintiff litigation funding. They really are two different animals.

First, I will go through key aspects of the insurance defense relationship that I think are just fundamentally different from what we see in a third-party litigation context. Now, I have written a paper about this, as Geoff said, and the paper in part applies to both the kind of civil, smaller plaintiff funding that you have heard about, and also to the corporate. I am mostly going to talk about corporate today, although some of these analogies work across the board.

The first aspect of the insurance defense relationship that is obvious is that the contractual relationship precedes the litigation. Thus, the second part, the insurers' involvement in the litigation, is automatic; it is not an investment choice. This speaks, in part, to whether or not you think third-party litigation funding is going to increase litigation. The relationship between the insurer and its policyholder, who becomes a defendant in the context that we are thinking of, precedes litigation and the involvement of the third party in the litigation is automatic.

Now, this is something that is so obvious that it is kind of painful to say—funding the defense also probably has a much lower impact on the amount of litigation than funding the plaintiff. This should be obvious, but to the extent you may or may not have concerns about whether or not third-party litigation funding will increase litigation—and you might think it is a positive increase that will increase access to justice, or you might think it is not—we do not have that concern when it comes to funding defendants.

Now, having insurance by itself does increase litigation because you take people who otherwise might be judgment proof and you make them worthy of suit. But, that is about the existence of insurance proceeds, it is not about funding the defense.

Third, litigation funding is not the primary purpose of the contract between the defendant and its liability insurer. Now, there are places where this might not be true. When it comes to professional liability insurance, for those who believe themselves to be ethical and to behave responsibly, they often will say 50% of the value of the insurance policy is litigation—that is, the cost of the defense that the insurer provides. For the most part, litigation funding is not the primary purpose of the contract. Why might we care about that?

Well, I think it matters in two ways. First, to the extent that third-party litigation funding might have negative externalities, it might make litigation more expensive and it might lead to an increase in litigation. It may also potentially raise other concerns. We might be more inclined to restrict contracts that have litigation funding as their goal and less inclined to restrict things like insurance, which has other goals, many of which we think are socially laudable and important to the working of the economy.

Second, the purpose of each contract affects the potential alignment of incentives for the funder. One of my key beliefs here is that the insurer is much more fully invested in the litigation than the third-party litigation funder. Often the insurer may be more invested in the litigation from a monetary perspective than the defendant because in a lot of suits, both for personal liability and for corporate liability, the insurer pays for the suit and the insurance proceeds may be, in settlement, all of the money that is on the chopping block. Not always, but it may in fact be that the insurer's money is the one almost exclusively affected by the outcome of the settlement.

In a way, the insurer, in many circumstances, has a greater stake in the outcome of the litigation than the defendant; and yet we think their incen-

tives are primarily aligned. Now, of course, there is an important subset of cases where they are not, and we have ethical rules for dealing with that. But, in general, their incentives are aligned, and that does not seem to be true when you think about third-party litigation funding. In this circumstance, I agree with what others have said—there is a big difference between civil litigation funding, especially funders who really have nothing to do with the litigation other than if the litigation is successful they receive a percentage of the proceeds. They are not in control of the litigation; they are not investing in the litigation; they are investing in the potential outcome of the litigation.

Then, if you think of third-party litigation funders like Juridica, what is the alignment of incentives? Here we actually have a black box because at Juridica, as Paul has said, they are passive investors. They invest and then they do not sit at the settlement table. That is not true, from what we can tell, of a lot of other third-party litigation funders. They are heavily involved in what is happening in the litigation and in the settlement process. But the incentives are potentially misaligned because the third-party litigation funders are getting maybe 10 to 40% of the outcome of the case, as opposed to almost all of the benefit of winning the insurer gets, despite the fact that the third-party litigation funders are investing less money in the case.

So, if we are concerned about there being two masters, there may be two masters on the third-party litigation side more often than on the insurers' side. Now again, this is not to say that the incentives that we have in third-party litigation funding are necessarily bad. As Paul said, if you choose only to invest in cases where the incentives line up, and you are passive, I do not think we have a problem. But, there are a lot of circumstances where that does not seem to be the outcome.

In fact, we recently had a conference in Brussels and I believe a French judge for an arbitration court in France said she had asked third-party litigation funders in Europe—and mind you this is Europe—and they said that this was a condition of their investment, that they get the right to control what happens in settlement. This sounds actually a lot more like what happens on the insurer's side because insurers have, in so many ways, power over settlement there. So, we potentially have a completely different structure between the two.

Then, finally there are two ways in which the insurance relationship differs from the third-party litigation relationship. Contractually, the policyholder has a duty to cooperate with the insurer, which is very different from what at least Juridica does. Also, the policyholder and the insurer are co-clients of the lawyer.

Some of you may be looking at me like I am crazy. This is true in most jurisdictions and if it is not true in your jurisdiction, you may think it is interesting to look at. The ABA has a 1996 ethics opinion that says, "We

have been fighting about this for a long time, but for the most part, the insurer and the defendant are co-clients of the lawyer."

Part of my conclusion is that there is a way in which the insurer is actually not a third party. Now, they are not the party to the underlying fight between the plaintiff and the defendant, but they are not outsiders. It is not a choice to bring them into the litigation; they are already part of it because the insurance proceeds are on the hook. So, the insurers are already an integral part of what is happening in court. That raises some concerns, but again, I think it suggests that the analogy between the two is not particularly profitable.

Let me just say something very briefly about the third claim that is sometimes made, which is that the insurance defense payment for the defendant creates an imbalance for the plaintiff, which is part of what Joanna has discussed. There is a related claim that is made, which is that the insurer providing the defense is like an imperator, it is like a signal to the other party and to the court that the defendant has a good case. And, if you allow a third-party litigation funder to come in, that is a counter-billing signal, that the funder thinks that the plaintiff has a good case.

Now, I admit, if I was a defendant and Juridica funded the plaintiff, I would settle. I am afraid Juridica always wins, and for a lot of money, because they choose good cases. But, one thing that we have learned by talking to industry experts is that, for the most part, third-party funders do not want the fact that they have funded known in court. They say it just becomes a sideshow; it becomes a waste of time. To them, it is not necessary for the parties to have this discussion in court. It leads to a side part of discovery that is expensive. It is not clear that it would affect any judgment if that happens, but it does not seem valuable, at least to the funders that we have talked to, to have their imperator there in court.

I would say just briefly before concluding, I also am skeptical of the idea that the insurer funding the defense means the insurer is saying they believe the defendant's claim is strong. As you know, the insurer does not say, "Oh, well yes, we will fund the defense if we think you have a good claim." Most of these claims of course end up settling; but the insurer's involvement is contractually based on the policy, it is not based on the strength of the claim.

So, in short, this is an analogy I think you will come across, if you have not already, and I suggest skepticism. Thanks.

GEOFFREY LYSAUGHT: Thank you, Michelle. Well, before we open it up to the floor for a little Q&A, I would like to give each of our panelists a quick thirty seconds to add on any observations you have that came to you while listening to your co-panelists, starting with Joanna.

JOANNA SHEPHERD BAILEY: Wow, I did not know that was going to happen. I have already actually heard all of these people speak so many times; I do not think I have anything to add.

GEOFFREY LYSAUGHT: You should have a good one then.

JOANNA SHEPHERD BAILEY: No, I do not. Okay, so I have a question for Eric. When people call on the phone and you ask them if they have legal counsel or not, if they do not, do you give them a list of attorneys?

ERIC SCHULLER: We give them the local bar association.

JOANNA SHEPHERD BAILEY: The local bar association. Okay, that is all.

GEOFFREY LYSAUGHT: Paul?

PAUL SULLIVAN: Just one general comment. We have made investments in cases with plaintiffs because that is where the demand has been. We would make investments in cases with defendants or in defense cases as well. Just like a lawyer can do a reverse contingency fee on the defense side, we can do a similar arrangement. We are agnostic on plaintiffs or defendants. It is a question of the demand, and right now we are seeing a lot of demand by large companies that are often on both sides of the "v"—on the defense's side and on the plaintiff's side.

These companies have recognized that litigation has grown too expensive for both plaintiffs and defendants. The courts, for various reasons, including budget shortfalls, are taking longer than they had expected for the cases to resolve and the billable hour model that has been traditionally in place on both sides of the ledger is not functioning properly. And, there is a misalignment of interests occurring between plaintiffs' attorneys on the billable hour and plaintiffs.

So, the clients are coming to us and to their attorneys asking to share risk through alternative fee arrangements and contingency fees. Which, generally speaking, for large law firms is not something that they have been willing to do, but they have been forced to do it recently by, or at least to a much greater degree, by their clients. Also, these clients are coming to us saying, "Our attorney will not take all of the risk in this." If you are talking about a large price fixing case, the expense budget just for e-discovery and experts alone, taking out the attorneys, can be in the tens of millions of dollars. So, clients have these huge potential losses they could incur if the case does not go well and they are looking to hedge some of that risk.

I think that a lot of the reason why we exist today is because there is a demand in the current economic realities. These companies are coming to us for alternatives to the usual model, or for the traditional model just like they finance any other capital project. They have to look around and ask,

"Can we do it with our own capital? Do we want to engage, or do we want to look for third-party financing?" More and more, they have realized that it makes sense to try to hedge some of the risk a little bit, given the increasing costs, and the length of time, and the uncertainty that litigation on a large commercial scale has become.

GEOFFREY LYSAUGHT: Thank you. Eric, anything?

ERIC SCHULLER: One thing. What we have been able to do with the legislation we have passed, which has been the biggest help, is that we have been able to standardize the contracts. The problem that we run into when we hear complaints from consumers is that they did not know what they were signing; they could not understand it. I have seen some of these contracts—and I consider myself a fairly intelligent individual—and I have no idea what they say.

What we have been able to do—at least in those three states and also with the New York Attorney General's Agreement—is to standardize the contracts so that they can compare Company A to B to C and know exactly what they are getting into. Also, we went even further in Nebraska; the consumer and their attorney will know when they sign that contract the maximum amount that they are going to have to pay back if the litigation is successful, the worst case scenario. I think that is the biggest advantage that this has had.

The other thing too is that it forces the funding companies to make sure that the attorneys acknowledge these contracts. There was a famous case that some of our opponents like to bring up in North Carolina in which a woman was involved in a sexual harassment suit that went to court. She received funding of $200,000 from a funding company and never told her attorney. They had a million dollar offer on the table, she turned it down, went to court and lost.

Her attorney finally grabbed her in the parking lot and said, "Why did you turn down the million dollar offer?" She finally confessed to him that she had taken out the $200,000 in funding and owed the funding company over $600,000. If she accepted the million dollars, she wouldn't have any money left over. Well, the attorney rightfully sued the funding company and won. But, in cases like this when you have a statute in place, in which the funding company has to notify the attorney, you would never have those situations come up.

GEOFFREY LYSAUGHT: Jeremy, anything?

JEREMY KIDD: No, I was at the end.

GEOFFREY LYSAUGHT: Okay, Michelle?

MICHELLE BOARDMAN: Yeah, I just have one question for Paul. Speaking of the alignments of incentives, which almost everyone has talked about, in general, are you committing a set amount or are you committing to pay a certain percentage of what it costs to get a settlement? How are you coming up with the figure? Does it change every time?

PAUL SULLIVAN: That is a good question. As anyone here who has dealt with attorneys trying to figure out budgets probably knows, it is always a moving target. But, that is actually something that we pay a lot of attention to. We are budgeting a certain amount of an investment up front and it is for a specific purpose. Either for expenses in the case, out of pockets, experts and so forth—

MICHELLE BOARDMAN: Discovery?

PAUL SULLIVAN: —discovery, or it is going to be for some percentage of the attorney's fees. We prefer the attorneys to be on a full contingency fee to the extent that they can handle that kind of risk, just simply because it makes our lives a lot easier to align incentives. So, it is for a set amount and there is a clear understanding contractually as to what is going to happen if the budget caps are exceeded in any given case. Who is going to take the risk at that point? We don't like, to speak in an analogy, to get into a car with the plaintiff and the plaintiff's attorneys to go for a drive where no one has put enough gas in the tank. We want to make sure there is enough gas in the tank to get wherever we are going at the outset.

MICHELLE BOARDMAN: That must mean that at some point down the road you, the lawyer, and the client have a discussion, potentially, about where fees are going, right? The lawyer is aware of the cap that you are willing to find, right? You must be putting them under pressure since you are not foolish. So, does that mean you have a discussion with all three of you down the road?

PAUL SULLIVAN: It actually is usually the client's responsibility to—

MICHELLE BOARDMAN: To raise it?

PAUL SULLIVAN: —approve or to not approve bills.

MICHELLE BOARDMAN: Yeah.

PAUL SULLIVAN: We are paying up to a cap. To a certain degree, how quickly the money is spent by the attorneys is less important to us than perhaps that there is a cap and how much of the ultimate amount is spent. But, that is really a question of the attorney and client relationship. We really

try to make sure that we are outside of it. We are dealing with sophisticated clients in all of our cases, so they can usually handle that negotiation.

GEOFFREY LYSAUGHT: Questions from the floor?

AUDIENCE MEMBER: I would like to direct this question to Mr. Sullivan. Which states have updated their laws to allow your type of claims?

PAUL SULLIVAN: Well, the good ones, Massachusetts—I think *Saladini v. Righellis*[5] is the Supreme Court case—has basically abolished champerty, maintenance, and barratry in the common law and there are no statutes on the books. New Jersey is a favorable state. New York has also had very active case law recently in the past year or so.

It is mainly a common law principle on the books in eastern and western states; it is not in statutory form there at all. There might be a statue in some states, but because the western states did not adopt the English common law the way the eastern states did, there is a difference there. Mainly the states where there is a lot of litigation going on, generally speaking, and sophisticated commercial litigation, the issue of champerty has come up in various contexts. Some southern states have addressed it.

Actually, it is an interesting point one of the other speakers made, addressing champerty during the civil rights era, because there was legislation put on the books by some southern states trying to ban the NAACP from coming in and supporting cases, calling it champerty. There were lines of cases in some of those states that basically said that this legislation was unconstitutional. I think there is a U.S. Supreme Court case on that. Somebody who is a scholar can probably say better than me. But, states that have not addressed it are generally states where there just is not as much litigation or certainly not as much commercial litigation.

JEREMY KIDD: Well, and also, earlier this year, the Ninth Circuit in the *Del Webb* case addressed the issue of champerty.[6] The court basically said, "If it wasn't codified after July 3, 1776, it doesn't count," because before that we were part of England.

GEOFFREY LYSAUGHT: Back of the room?

AUDIENCE MEMBER: I suppose this is a question for Eric and Paul, but anybody who wants to answer it is welcome to as far as I am concerned. If things break down in the relationships that these contracts cover, obviously there would be a breach of contract action. My question is: Are state attorney disciplinary commissions engaged in this as well so that disciplinary complaints are also prosecuted if the lawyers miss the mark?

PAUL SULLIVAN: Miss the mark? Miss the mark in what way?

AUDIENCE MEMBER: In failing to abide by the things that you were just talking about.

PAUL SULLIVAN: Okay, no, I understand, okay. There have been some, in fact, there was a recent case, in which an attorney refused to pay a funding company under the contract and he was held in ethics violation because of that. We have the attorneys acknowledge the contracts to make sure that everybody knows what the obligations are all the way across the board, that there is nothing hidden, that there is no surprise at the last minute, and that the attorneys are aware of this. It is the attorneys that disperse the funds to us; it is not the consumers. The attorneys are cutting the checks out of the settlement agreements; one of the checks they cut is to us.

GEOFFREY LYSAUGHT: Okay, well unfortunately, we have reached our time limit. It is time for break. I want to thank my panelists for participating.

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[1] Sherman Act § 1, 15 U.S.C. § 1 (2006).

[2] NEB. REV. STAT. § 25-3302 (2011).

[3] NAT'L ASS'N OF MUT. INS. CO., THIRD-PARTY LITIGATION FUNDING: TIPPING THE SCALES OF JUSTICE FOR PROFIT (2011), *available at* http://www.namic.org/pdf/publicpolicy/1106_thirdPartyLitigation.pdf.

[4] S.B. 2432 § 29-40-102(5)(B), 107th Gen. Assemb., Reg. Sess. (Tenn. 2012).

[5] 426 Mass. 231, 687 N.E.2d 1224 (2004).

[6] Del Webb Communities, Inc. v. Partington, 652 F.3d 1145 (9th Cir. 2011).

THE EXPANDING ROLE OF STATE ATTORNEYS GENERAL IN ENFORCING FEDERAL STATUTES

Jennifer Epperson, Jim McPherson, Anthony Troy, Greg Zoeller
Moderator: Linda Kelly

LINDA KELLY: I get the pleasure of introducing and moderating our last panel of the day. Before I turn to that duty, I would like to let you know that the announcement I made about the signup sheets, that I told you would be out there, which were then put behind a locked door, those signup sheets are now in the back of the room. So, when we finish up here, again, if you're interested in continuing judicial education credits, you can sign up there. If you need a ride to the airport after the sessions end tomorrow, you can sign up there on another sheet. So let's turn now to the topic of our last panel, which involves the federal and state partnership in enforcing federal statutes.

There are a number of federal statutes, and I think some would argue there's a growing trend to help enhance the reach of some federal statutes by granting enforcement authority through the State Attorneys General. There are a number of statutes on the books: The Child Online Privacy Protection Act,[1] HIPAA,[2] the Consumer Product Safety Improvements Act,[3] and most recently, and perhaps most comprehensively, Dodd–Frank.[4] So to discuss this phenomenon and the federal–state partnership overall, I'm going to briefly introduce each of our panelists, and then we'll have them speak in turn, and then have a little bit of back and forth, and hopefully, take some questions from you.

We're going to start off with the Honorable Greg Zoeller, who is the Attorney General of Indiana. We're very pleased that you were able to be here with us, General Zeller. He has a distinguished career as a public servant in the State of Indiana, as well as here in Washington, having served in the White House with Dan Quayle. He also has the distinction of being a member of our board of advisors of our Attorneys General Education Program.

I will then turn it over to Jennifer Epperson, who is here from the North Carolina Department of Justice, where she serves as legislative and policy counsel, working closely with Attorney General Roy Cooper. Jennifer probably knows as much as anyone about the State Attorneys General authority, including the new authorities under the Dodd–Frank law. So Jennifer thanks for coming up to be with us.

Then I'm going to introduce you to Jim McPherson, who is the Executive Director of the National Association of Attorneys General. He jokes that he was chosen for that job because a bunch of people who go by the title General wanted to be able to boss around a former Admiral. He's a

retired two-star Rear Admiral and a terrific leader for the National Association of Attorneys General. So Jim, thanks for being with us.

And then finally, we'll hear from Tony Troy. Tony is Senior Counsel in the Richmond office of Troutman Sanders, where he practices in the Regulatory Compliance and Government Litigation Practice Group, focusing a lot of his attention on Attorney General matters. Tony is also the former Attorney General of the great State of Virginia, having served in that position from 1977 to 1978. Please join me in welcoming our panel.

HON. GREG ZOELLER: Well, thank you, Linda, and thanks for the invitation. You know, I've just recently, in fact, the last couple of hours, come from a meeting with a whole group of Attorneys General, and this subject of the relationship between our federal partners and state enforcement is one that's always brought up in that company. You know, anyone who's been around over the years, whenever the federal government talks of federalism, states usually guard their budget. So it's with some skepticism when we hear the federal government talk of federalism, and this new way, which I agree, there's a growing trend, the term of art now is "collaborative federalism."

So, just to set the stage a little bit from the perspective of the Attorney General who has to manage, I've got 150 lawyers. It's a very large law firm. I've had an increase in caseload with a bad economy. We have a lot of work in our consumer protection, a lot of litigation that goes on. We had a 19% increase at the same time my general revenues appropriations were cut by 15%. And Indiana is doing a lot better than most states.

So I think you recognize the reduction in our resources from state enforcement. So among the State Attorneys General, we often partner on our own. You'll see more multi-state activity. A lot of the investigations are taken out among groups of states. Enforcement is now being shared among the states where we have actors—defendants that we bring action against, that are in a multi-state capacity. Some of that is really just based on the economics, the reality of our fiscal situation.

With the federal government's involvement, I'll add to the list that Linda gave you, in terms of other—let's say similar areas, where the federal government has provided authority for state enforcement. We've had a long history with the Medicaid Fraud Control Units. Almost every Attorney General enforces Medicaid fraud activity, using some federal monies and some state monies as part of the program for Medicaid, the state–federal relationship. That has been an area that has raised considerable concern among Attorneys General, who like the autonomy of managing their own staff.

Sixty-nine percent of the monies that come from Washington fund my Medicaid fraud unit. With that money comes a lot of requirements, including filling out the forms. Anyone in business can tell you what it's like. But even in a sovereign state, the Attorney General that represents the sov-

ereign is required to fulfill all the responsibilities and requirements that come with that federal money.

So it's with that sense of, let's say—I've been labeled a skeptic of these programs that have federal–state relationships—the whole focus now with Dodd–Frank, and the Consumer Financial Protection Bureau (CFPB). I'd been such a vocal skeptic of being careful with this partnership that was being crafted in Washington. But I'd said just about enough that Roy Cooper asked me to join. There's a group of five Attorneys General that work with the CFPB in helping work through some of the collaboration between the state and federal partnership.

I was the only Attorney General, I think, that had written to each of the members of the Indiana delegation, asking them to vote against the Dodd–Frank bill for a number of reasons, but apart from the fact that I had some concerns that it would constrict and throw doubt into the credit markets at the very time when credit is not readily available. The next four or five years of doubt, while we develop rules and regulations in the enforcement program, I really do think there will be some economic impacts that are the unintended consequences of well-intended acts.

But the point of today's program, that was another part that I'd focused on, is this idea of the federal government providing regulatory authority to be enforced by a state sovereign Attorney General. Our focus is to maintain and defend the sovereignty of our state. So you always see the Attorneys General join together when it's an issue of preemption, which really triggers that same thought that we're meant to defend the state's autonomy and sovereignty.

But in these cases where the federal government is going to partner in a consumer protection area, most of the Attorneys General saw it as a plus. So I was somewhat the lone skeptic. And I do think that a lot of collaborative work that we do with the federal government, the FTC particularly, has been very productive.

Going back to my original point that with the reduction in resources at the state level we are joining together between states, I think that joining with our federal partners is going to become an economic reality. So it's not something that I'm suspicious of, in terms of the voluntary joining of the state's sovereign with the federal sovereign and other states, but it's this forced marriage through an act of Congress that ends up being part of a regulatory scheme yet to be developed that makes me suspicious. Even among my colleagues, who know I spent ten years in the Senate and in the White House with Dan Quayle, there's a little bit of room for skepticism. I didn't trust the federal government that much when I worked in it. So now that I'm the Attorney General, I think it's part of my mission to be at least a little bit skeptical.

I think this idea of having the federal authority enforced by the sovereign states has some issues. I'll give you an example from my own state. I'll give you at least a little flavor for it. I'm a legislative officer. There are

sixteen states where the Attorney General's Office is created solely by statute. The rest are constitutional. Within the sixteen states that are statutory, some of us have statutory authority that specifically says you are able to enforce federal rules and regulations. In Indiana, there's blanket authority. So I won't have to go back to my legislators to seek additional authority to provide the enforcement efforts on the CFPB rules. But in other states, that's not the case. When you get to a constitutional officer, there's very little authority that's granted specifically by the legislature, other than in the general creation of the office and the funding of it.

So I think the issues regarding federalism that are kind of easy to think through when you look at federal grant of authority, if it's permissive. I think, such as in Indiana, where the General Assembly has specifically said that the Office of the Attorney General can and *may* enforce federal rules and regulations, there's a question in my mind about whether, if it costs too much, that "may" can turn into "thanks, but you can do it yourself."

But there is this issue in the other states where the Attorneys General are constitutional officers. I'll leave it to others to think through those problematic issues when it comes to the federal government's exercise of using the tools and resources of the state. And again, it gets back to that—I've seen a half a billion dollars, I think is what the current estimate, the federal government will produce for the CFPB, in terms of the creation of the CFPB and the management.

But there's no additional funds, at least that I've seen to date, that are going to help build out the enforcement arm in my office with a 19% increase already, and a 15% cut. So it's yet to be determined how practical this federal collaboration of our new collaborative federalism becomes. So with that very small amount of skepticism, I'll stop with that.

JENNIFER EPPERSON: Well, thanks again for the opportunity to be here. And I hope to maybe provide a slightly different perspective on state Attorney General enforcement of federal law. First, just a little bit more context. According to a study that I read, there are twenty-four federal statutes that have an explicit grant of authority for state regulators to enforce federal law.

So this is a little bit different than different schemes and programs that you may be aware of, particularly in the environmental context, where the Federal Government may create a program like the Clean Air Act, and say, "States, we're going to let you have the opportunity to enforce this within your own state, but if you don't want to do it, we'll step in, or if you're not doing it to our standards, we'll step in." These twenty-four federal statutes are a little different. This is an explicit grant of authority to state regulators to enforce federal law and/or regulations.

I think we're going to focus on State Attorneys General, but it may also be a grant of authority to a State Insurance Commissioner, or to a banking regulator or other state regulators.

A lot of these statutes seem to have come in little groups. Some of them were enacted in the late '70s and early '80s, others came in the early-to-mid '90s, and then we've seen some, I think, significant pieces of legislation that have been enacted most recently. Almost all of them fall into the consumer protection area, some in antitrust, but most of these are in the category of consumer protection.

I don't want to run through all of the twenty-four statutes that I'm aware of, but the three that you may have heard of that are the most recent enactments are HIPAA,[5] the Consumer Product Safety Improvement Act,[6] and Dodd–Frank.[7] And at least these last two, Dodd–Frank and the Consumer Product Safety Improvement Act, were enacted perhaps in response to some headlines and some issues that came from what some people perceived to be a lack of federal enforcement.

So obviously, Dodd–Frank was an enacted response to financial crisis, and the Consumer Product Safety Improvement Act in response to lead in toys from China. Generally, I think they went beyond those issues, but it's important to just note that they were enacted on some level in response to a perceived lack of regulation or tough enforcement by federal agencies.

The language granting the authority in all of these statutes is not uniform by any means. Sometimes, different remedies are available to state enforcers. It may be that they can just get an injunction, or it may be that they can or cannot seek recovery of the fees they expend to pursue those actions. But, it varies.

So as Linda mentioned, I work for Attorney General Cooper. He was President of the National Association of Attorneys General. He began his term June 2010, and maybe fortuitously, Dodd–Frank was enacted just weeks later. I think we sort of saw those two events coming together and decided this is going to be a really important issue to Attorneys General, to really understand, first of all, what the enforcement authority was, and also how it was going to affect all of us.

But we can see if we can work to build a relationship with the new consumer agency, if it's productive and helps consumers. So immediately we put together a task force or a working group of Attorneys General with a broad range of perspectives on these issues, so that we could begin to understand where the concerns were of all the officers. We spent some time reading the statute—I think it's over 2,500 pages—and tried to understand all the little pieces that affect Attorneys General. Very often, we find a new section that applies to us that maybe we didn't notice from the start. So there are a lot of little things hidden in the statute.

We also met with several representatives from the financial services industry, to understand from their perspective what their concerns were with this dual enforcement jurisdiction. The financial industry is really important in North Carolina; Charlotte's a big banking center. We thought that it would be most productive to say, "Obviously, this was a long battle to get this legislation enacted. But let's think about how we can make it

productive as we meet with the new Consumer Financial Protection Bureau authorities, and with the other Attorneys General. Let's think about the way we can all work together and understand each other's concerns, to make this productive for consumers."

So we met with a number of representatives from the financial services industry, and we routinely heard two concerns. First, there was a fear of inconsistent interpretation in our application of federal law. When you have potentially fifty-plus independent sovereign Attorneys General that have the ability to bring these actions, in addition to the federal government, there is the potential for a wide variety of applications of the law and what may be a violation in one state is not a violation in another. Not to mention the fact that what the federal government or the federal regulator thinks is important, may or may not be important to other states. So they're really concerned about how to anticipate compliance when it could vary so much.

The second main issue we heard about was the use of private counsel, working on behalf of Attorneys General, that work on a contingency-fee basis, with the recognition that these sort of private litigants may not have the same concept of public interest as the Attorneys General. Those are the concerns we heard over and over again. Those are the many things that we brought up in our meetings with CFPB, just to sort of talk about those issues. Although, there are a couple of potential safeguards in many of the pieces of legislation that kind of address those things.

First of all, many of the statutes require that before enforcing a federal statute, a state Attorney General or regulator has to provide notice to the appropriate federal agency that they are going to take a certain action, pursuant to the federal law. The statutes then usually give that regulator the ability to intervene in the action and become a party. Some even give the regulator the opportunity to shut it down. So that may help a little bit with the consistency argument.

Another thing that would help provide more consistency is that some of the statutes require that all enforcement actions be filed in federal court so you don't have differing authorities. For example, if a state court says we interpret this this way, and then a federal court doesn't feel like that's precedent, there can be different interpretations leading to inconsistency. So, some of the statutes require that all actions must be filed in federal court. The Clayton Act,[8] which is an antitrust regulation, excludes attorneys working on contingency fee from the definition of state regulators. So, that addresses that contingency private counsel argument.

From the perspective of General Cooper, there are certainly budgetary concerns with these kinds of things. If consumers are aware that you have this ability and this authority to enforce federal law, then of course, that puts the pressure on your office to bring these cases. But by far, we see this as a greater protection for consumers. State Attorneys General have very close proximity to consumers. We receive thousands of complaints every

year about people in really sympathetic situations. And it's not very satisfying when we have to say, "Sorry, we really can't help you; call the federal agency in DC." In North Carolina, that doesn't make people very happy when we say that. They don't understand why we wouldn't be able to help them. So we see this as just giving us another tool in the toolbox when we're approaching a problem or a trend that we see in our state.

I think another advantage is accountability. And by that, I mean that there's been a recent trend, or at least in the past ten or twenty years, of two things happening at the same time—federal statutes are delegating more and more authority, decision-making and policy-making authority to federal agencies, and, at the same time, preempting many state laws in a number of different areas. So you have these agencies with a lot of authority, and they're further and further removed from consumers. And so we think that having a healthy competition with different regulators, including federal and state regulators, helps to level that a little bit more.

Particularly, we've seen statutes where, again, kind of going back to Dodd–Frank, and the consumer product safety statutes that were enacted in a response to a perceived lack of action by federal agencies. I think having states with the ability to step in and enforce federal law might get things moving and help consumers where there are regulators that don't seem interested in perhaps pursuing enforcement actions vigorously. Related, I think it also provides a deterrent for companies that feel like, "We have a good relationship with an agency, or we're doing this little thing over here. A state can't get me. The federal regulator is never going to really realize what I'm doing. I'll sort of play my odds. I'll change the name of my company before anybody can catch me." We see the potential to have fifty cops on the beat, in addition to federal regulators, as really extending the reach of law enforcement and protection of consumers.

I recently came across a law review article that was published just this year that looked at the use of Attorneys General to enforce federal law.[9] And they found that the authority isn't being used very often. They did a number of FOIA requests and reached out to Attorneys General's offices. They looked through some court filings to just see how often these things are being filed. They looked at sixteen of the twenty-four statutes that I mentioned in the beginning, a real core of the consumer protection statutes. So they looked particularly at the actions of state regulators that derived their authority from those statutes and they found that claims over however long that statute had been in place were made in only nine of the sixteen statutes.

So, seven statutes had never been utilized for state AG enforcement. One of those is Dodd–Frank. So, I think everybody's just now trying to understand what the Act means, so it's not all that surprising. But still, only nine of the sixteen statutes had ever been used in that way. There were a total of 104 cases and 120 claims coming from those cases, so some of them had more than one claim. Ninety-one of those 120 cases were brought

under two telemarketing claims. So, the vast majority of these claims were just under these two telemarketing acts. Most of the cases were brought by a single Attorney General, rather than multi-state. But federal agencies were far more likely to be involved in multi-state action than joining one state in pursuing the claim.

So, I think there are a lot of reasons why this authority is being under-utilized. One is because all of our state Attorneys General offices are dealing with budgetary issues, and perhaps dealing with what they know right now, and not expanding to understand these new statutes and things like that. So that's why we're working to try to understand the Dodd–Frank Act, and think how we can be creative to protect consumers.

LINDA KELLY: All right. Jim, can you talk to us about how NAAG works to—

JAMES MCPHERSON: I'll take a shot, thanks. Congratulations to Henry Butler in the Law and Economics Center here at GMU for an outstanding conference. And thank you, Linda, for inviting us to be on this panel, and then agreeing to moderate it as well. We all understand, and we're very sensitive to the fact that this is the final panel of the day. We stand between you and the meeting reception. I must begin by a shout out to Judges Hayes and Vargas, from the Superior Court in San Diego County. I left your jurisdiction over thirty years ago, but I remain a loyal Chargers fan, which is almost as hard as being a loyal Colts fan.

You know, traditionally, conferences that include attorneys in attendance, usually schedule the last panel of the day as the qualified continuing legal education panel, thereby ensuring audience attendance. I'm not sure I should reveal this, but I'm really not certain that this panel qualifies for CLE. Now, before any of you bolt for the doors, that's good news because it means that the panel should be interesting, informative and entertaining.

I must confess, I never had the opportunity nor privilege to address such a large group of jurists. I'm a little surprised that by now, no one's interrupted me to ask a question, which I would have to bluff my way through. I guess this won't be as painful as I thought.

Linda asked me to begin by providing a very brief introduction to the National Association of Attorneys General or NAAG, and we actually flipped a coin on who would have the opportunity to say that and make a joke about a dead horse. We're working on that acronym, trust me. NAAG is a professional association of the fifty-six Attorneys General; states, territories and the District of Columbia are all included in our membership.

So I work for fifty-six politicians, ranging from very liberal Democrats, to very conservative Republicans and all flavors in between. Allow me to note for the record—you should be used to that phrase—by stating the obvious. One of my fifty-six bosses is with me on this panel, and I might add that the Attorney General of Indiana is my absolute favorite.

I work for a large group of politicians who hold a wide variety of views. How do I work that magic? By ensuring that NAAG is completely non-partisan. Let me stress that point. The strength of the Attorney General community in this country is non-partisanship. Yes, there are Republicans and Democrats, but they do come together in their common role as the chief law enforcement officers of their jurisdiction. And that really is the touchstone for what we're talking about here today. In that role, they are distinct from all other statewide politically elected vote-appointed officials. They're different than the Governors, than the Lieutenant Governors, than the Secretaries of State, ad nauseum, because they have that role as the chief law enforcement officers of their respective states.

NAAG's day-to-day role is to provide a forum for the exchange of ideas, experiences and solutions to common issues of the Attorney General community, to assist in cooperation between the Attorney Generals, to provide research and training to their staffs, and to facilitate communication between and among the Attorney Generals. In addition to our role as facilitator and coordinator of communication, and joint or multi-state action by AGs, we are involved in a certain number of substantive areas of practice. For example, NAAG provides subject matter expertise in areas like bankruptcy, antitrust, tobacco-related matters, consumer protection, and appellate practice.

Let me begin by just putting an exclamation point behind what Attorney General Zoeller mentioned, and that's the Medicaid Control Units in each of your states. In all of the states except one, the Medicaid Control Units work for the Attorney General. There's one state out there in which they work for a different agency, but we won't even talk about them. What's very curious about the Medicaid Control Fraud Units is the federal agency that supervises them is not Department of Justice (DOJ). It is the Department of Health and Human Services. As a matter of fact, it's the Inspector General of Health and Human Services, an individual that I've met with several times in my role as providing help in that area as well.

There are no attorneys that work in that office. They're all green-eye-shade kind of people. And as a result, you can see the problem that that engenders. They're after the bottom line. And so all of the reporting requirements that General Zoeller mentioned is very typical coming from an audit type of agency, which is what they do. So when we go to them with issues that involve the law, it's a deaf ear, not because they want it to be a deaf ear, but because that's not what they do. They're not DOJ, they're not attorneys; they're the green-eye-shade group.

And that's one of the problems, and probably the one area of state enforcement of federal regulations that you see most prevalent. There are many areas we've talked about so far, some statutory areas, in which the Attorneys General actually enforce federal law. But there are many non-statutory, informal areas in which they come together with the Department

of Justice, usually, in the area of enforcement; in this administration more so than in previous administrations.

This administration created a financial fraud enforcement task force. Within that task force, they included mortgage fraud, Recovery Act fraud, oil and gas gouging, and have partnered with the state Attorneys General on a voluntary basis, to enforce various state laws, but federal laws involving those substantive areas as well. It's interesting because it was completely informal. There was no coercion involved whatsoever. And not every AG responded favorably that they wanted to partner with the federal government in those particular areas. Some did, some didn't. No two AGs are created equal. That's obvious.

The one interesting part that I did see is that what DOJ did is it went through its US Attorney's Office, Executive Office, and directed every US Attorney Office to designate a financial fraud attorney, and then task them to reach out to the Attorneys General in their state, at least their consumer protection chiefs, and begin talking to them. For many states, they've been doing that for a number of years. We have a number of Attorney Generals who used to be US Attorneys in their jurisdictions. And of course, they have a relationship with the US Attorney.

But in some jurisdictions, that's the first time the US Attorney's office and Attorney General's office ever spoke. And now they are speaking, and doing things jointly, or in partnership with each other. But again, it's informal in nature. There's no legislation that required that. You find that in the consumer protection area, particularly the Federal Trade Commission (FTC), which we've mentioned recently, too. A new commissioner in the FTC is a former Assistant Attorney General. And so she brought that viewpoint to the FTC, and the FTC has reached out to us quite a bit wanting to do joint things, again, in an informal nature.

One of the things that is in the news a lot now, just celebrated its one-year anniversary, was the multi-state effort that all fifty Attorneys General agreed to with regard to mortgage servicers and the fraud that was going on there. Now, we've seen some of that falling apart at the edges in a couple of the larger jurisdictions who are no longer a part of that effort for a variety of reasons. But that was probably one of the very first efforts that we have seen, in which all fifty Attorney Generals in the states, and one or two of the territories, came together to address a common problem. DOJ partnered as well, I think.

And again, there was no legislation that required that. There was no Memorandum of Understanding that was signed. It was all very informal in nature, and it was the Attorney Generals again, in their chief law enforcement role, protecting their consumers, that came together and did that. As I said, some had disagreements from the start on how the negotiations would take place. And now that they're a year into them, some of them have decided no longer to be part of that. But again, there's no requirement that they be a part of it or they don't be a part of it. So I think that in many cas-

es you will see brought in your courts it is a partnership that has taken place more informally than formally.

ANTHONY TROY: As I started this, good news for you, I told Henry I had three things I wanted to mention, but I could only remember two. Consequently, you will get to the cocktail earlier than normal. I was interested, as a slight aside, in the lack of an acronym for NAAG. I always thought it was obviously the National Association of Aspiring Governors. I can't remember. It's one that's ingrained. But to take a look and you know, it's my role, as I mentioned to Linda, to throw a question of constitutionality into what is transpiring lately.

And if you go back and look at some of the evolution, as Jennifer indicated, it started at one time with not only Clean Air Act,[10] Clean Water Act,[11] Fair Housing Acts,[12] where if the state wanted its own laws, it could not implement those laws unless, for example, when Fair Housing first enacted laws, they were sent to HUD. HUD would say that the laws were equivalent to, and had the same remedies as federal law, and consequently, those state laws could be enforced. In each instance, that happens with the Clean Water Act, the Clean Air Act.

In Medicaid for example, where you are having a lot of federal money to help support, nonetheless, you are enforcing Medicaid fraud laws enacted by the states. What you now see is a trend, that I recognized starting in '08 with the Consumer Protection Safety Improvement Act[13] that specifically authorized each Attorney General to enforce consumer product safety requirements. It limited it to enforcing only, and not allowing the Attorneys General to have the ability to enforce with penalties, civil penalties, or fines. They can bring an injunction only.

Now you have the Dodd–Frank Act that came into being, and it's very clear. It says the Attorney General of any state may bring a civil action in the name of such state, as *parens patriae* on behalf of natural persons residing in the state. And the purpose is to enforce provisions of the title, or any regulations issued thereunder. So you're talking not only about statutes that Congress has enacted, but allowing the Attorney General to enforce regulations that an executive branch agency will eventually evolve and develop.

So suddenly, you have that power in the hands of the Attorney General, or do you? Now, again, before initiating any action, the state Attorney General, which I always thought was a pretty independent constitutional officer, must first provide a copy of his complaint and written notice describing the action to the Director of the Bureau of the Consumer Protection Bureau, under the Dodd–Frank Act. Then certain contents of the notice are required.

Once that happens, the Bureau, if it wants, may intervene as a party, remove the action to the United States District Court, if it was brought in a state court, and appeal any order or judgment, even if the Attorney General apparently does not want to. The one issue, and talking to General Zoeller,

this does not exist in Indiana, but when you go back to the beginning, as I guess we all should, we all know from civics, that there are three branches of government.

We somewhat forget sometimes that we have what, in the words of Madison anyway, was a compound republic of America. You have the three branches of government at one level, the three branches of government at the state level, and the compounding being that states are separate sovereigns, and they control the federal government and vice versa. So you have those protections back and forth. In my opinion, they're suddenly forgetting that structure when suddenly Congress believes that it can somehow authorize and empower a state constitutional officer to enforce federal law.

Now, in Virginia and every other state in the country, most every constitution has what they call the suspension clause. It came from the kings, I think back in 1689, with the English Bill of Rights. But it says emphatically that no laws may be suspended without the authorization of the legislative branch of their respective states.

In Virginia, and in North Carolina, and a number of other states, there is a slight difference. Virginia has not only a suspension clause, but an execution clause. And it says that the execution of laws by any authority, without consent of the representatives of the people, is injurious to the rights and ought not to be exercised. That means that the execution of law is by the Attorney General without the consent of the General Assembly of Virginia, the representatives of the people, and is injurious to the citizens' rights, and cannot be exercised.

So a key question here in these states, where you have not only the suspension clause, but the execution clause is, can in fact an Attorney General have standing in the state court to enforce a federal law when its own legislature has not given him that authority? Now if I'm representing a bank, and I have an Attorney General suing my bank in a court, I think zealous advocacy requires me to raise that issue, and I think it's an interesting issue.

We do have, in 1997, Justice Scalia in the *Printz* case striking down Congress' attempt under the Brady Act to require sheriffs throughout the nation, on an interim basis, to enforce the gun registration laws as unconstitutional.[14] One of the reasons Congress' action was unconstitutional is because of the guarantee clause located in Article IV, Section 4 of the Constitution of the United States, which presupposes the continued existence of states and those means and instrumentalities that are the creation of their own sovereigns.[15]

I suggest that when you have these powers in states where you have both the suspension and execution clearly saying that I'm not going to have any authority in this state executing any laws that the legislature of the respective state has not authorized, now you have an interesting question. If any of you know of a bank that needs an attorney to raise that question, I'd

be happy to respond. But it's not clear. There are always ways of looking at things, and I think this is an interesting point that is yet to be resolved, but I presume we may see some arguments on that front in the near future.

HON. GREG ZOELLER: The notion that we all work collaboratively as say, the managers of law firms inside of our state governance, is the common point of reference. But, the idea of the federal government authorizing me raises those same questions—the constitutionality and the sense of sovereignty. But when I look at my statute in Title IV, Indiana's General Assembly has already granted this complete blanket authority.

Now, whether they knew it at the time when they passed that statute, they may take a second look at it if I suddenly—or let's say an Attorney General today or in the future might—exercise grants of federal authority that the state chooses to exercise. So I think it's a constitutional question whether it's today, or in the future when Indiana's General Assembly might remove authority from the Attorney General.

So it is something that, again, is in the federal government's regulatory scheme. The fear of the unknown is what I hear today, because no one knows how the rules will be written, or how the rules will be enforced. That's the only focus I hear from a community that's been focused on Dodd–Frank. When we get into the real exercise of this new grant of authority, when we see how well it's implemented in a new regime that really regulates all of the credit world, there will be some serious questions that I think you're right, will loom large over the whole creation of it. But at least currently I'm working under the premise that the Indiana General Assembly has authorized my office to enforce Dodd–Frank, to the full extent of the law in federal courts.

LINDA KELLY: Did you have anything to add?

JAMES MCPHERSON: Not really. Just knowing you've all been captured here for the day, my public affairs person just sent me a note saying the Supreme Court's announced that it's granted certiorari in the healthcare legislation cases, and has set a date in March for argument. As you know, several of our Attorneys General across the nation have joined in that lawsuit, and it'll be interesting now as the sides line up and file their briefs, and the Supreme Court will rule upon it. Five and a half hours of argument.

JENNIFER EPPERSON: I think a similar difference, in low presence in the cases that have delegated authority to enforce federal law, is whether state legislatures have authorized the state Attorney General to utilize that authority. But I think allowing state Attorneys General to enforce these federal statutes and regulations, gives Attorneys General, at least nine, another tool to help consumers and to vigorously enforce the laws that exist.

HON. GREG ZOELLER: I mean even under my theory, if the legislature granted the Attorney General certain power is fine, but that's the legislative way of giving the powers, or in Indiana, perhaps taking powers away. I have some problems with the federal government simply thinking that it can empower Attorneys General, separate constitutional offices of states, period. And they don't have to go any further. I think they do, and I think there are some key questions out there that will eventually be argued and answered.

LINDA KELLY: Do you have any questions out there?

AUDIENCE MEMBER: Question about the scope of the disclosure required by these federal statutes. Does the state actor have to disclose the theory of the case in addition to just the complaint?

MALE SPEAKER: Some of these things can be real exotic.

JENNIFER EPPERSON: Well, in particular to Dodd–Frank, the new CFPB has issued an interim final rule that discusses the contents. You may have the exact list, but it's fairly brief. I'll just read them right here. The rules don't go much further than this: identity of parties, alleged facts underlying proceeding, and whether there may be a need to coordinate the prosecution of the proceeding, so not as to interfere with any action, including rule making by the Bureau or other federal agency.

So it is fairly limited, but we've been working with the Bureau and sort of coordinating informally about the channels of communication, and how we're going to approach many of these things, with the idea in mind that right now we have a good relationship, but who knows where that might be some time in the future.

JAMES MCPHERSON: Let me just put an exclamation point on that. You offered an interesting observation regarding disclosure. Oftentimes, I've discovered that our federal partners are very surprised when they begin working with a state, only to discover that the state information laws, FOIA if you will, go way beyond what the feds do. And suddenly the correspondence they have been having through emails with their state partners are a matter of public record. Many are very chagrinned to discover that.

AUDIENCE MEMBER: I have a question for you. I'm one of those state federal crossover people, and twenty years ago we had cross-designation, so that we were prosecuting cases in federal court, and we've been doing it for years. How is this going to change anything?

As state court judges, what we see now is a fairly shocking admission in the course of cases mostly involving foreclosures, of the fact that there was no enforcement of 18 U.S.C. § 1014,[16] which you know is the full

statement on a loan app. We have people coming into court and freely admitting they've "straw manned," they made false statements. I've heard expert witness testimony about how this was prevalent in the industry and it was perfectly all right. I mean do you really think this is going to pick things up, or how's it going to differ?

HON. GREG ZOELLER: Nobody wants that one. I guess I'm the Attorney General. Well, I can give you the example from at least my state of Indiana. In Indiana, we're blessed with a very strong judiciary, so they step up to the challenge of being an equal branch of government. When they saw the massive problems dealing with the so-called robo-signing and everything throughout the foreclosure process, since it's a judicial foreclosure in Indiana, they've promulgated a set of best practices rules that would help correct the problem going forward. We then submitted that to the legislature and most of the best practices now have been codified.

But you're correct. Some of the early decisions—like in the *Wachovia*[17] case—preempted the states from enforcing some of the regulations and the statutes that we wanted to enforce. So it's like this—you first shut down the people, the fifty states' enforcement mechanisms, where we were left seeing these problems with very little to do to enforce. So again, in retrospect, everybody now sees the massive nature of the problem.

Currently, we're trying to deal with this on a going-forwards basis. So I will say the courts in Indiana have done a remarkable job of showing some leadership to step up and do some correction of the process. But in each state, they've got their own problems to deal with, and I'm not sure they're all going to be able to step up to the plate quite as well.

ANTHONY TROY: Additionally, if I heard your question correctly, even when I was Attorney General eons ago, you had assistance being consigned over to the US Attorney's office, for example. But they took an oath there as well, and had an enforcement power to enforce, usually federal laws that had a direct impact on the state where the state needed the assistance. That's not the point I was trying to make here, where you have federal law directly authorizing and empowering an Attorney General to enforce a federal law.

FEMALE SPEAKER: I think [inaudible] just listed the practical aspects, but it's the same thing. We want to process federal prosecutors; we want the state court [inaudible] state prosecutors [inaudible]**.** It all worked out just fine. It seems like it's just eliminating procedural—

MALE SPEAKER: Well, you know, I have a good friend in the legislature who, when you would suggest to him that something was unconstitutional, his key response was, "What's the Constitution among friends?" But it's there.

LINDA KELLY: I guess I would ask you to comment on, beyond the issue of potentially interfering with state sovereignty and imposing some requirements like the data keeping requirements in the Dodd–Frank Act, if these grants of authority are permissive, really what's the harm?

ANTHONY TROY: You're asking—

LINDA KELLY: Anyone.

ANTHONY TROY: Anyone? Well, the harm, to me, is that if it's permissive, and you somehow are authorizing an Attorney General to enforce a federal law, when the state legislature of a sovereign state has not granted them that power, whether it's mandatory or permissive is irrelevant to me. You are undermining the compound republic that this nation was founded on. And I want to emphasize, I held office as a Democrat, so—

MALE SPEAKER: You know, I do think that within the range of Attorneys General, we are each unique, and you will find some that will exercise, let's say, whatever grant of authority and then some. So there are likely to be people that take great latitude with the early days of Dodd–Frank and the CFPB. And I think you'll see some challenges, as to whether they either have the authority directly, even if it's permissive, and whether they've extended the authority into areas in the early days. So when you have these massive new programs, you're likely to have years and years of work for all the judges to sort through what it all means, which is why we're here today.

LINDA KELLY: If there are no other questions, then please join me in thanking the panel.

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[1] Child Online Privacy Protection Act of 1998, 15 U.S.C. § 6501-06 (2006).

[2] Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, 110 Stat. 1936 (codified as amended in scattered sections of 18 U.S.C., 26 U.S.C., 29 U.S.C., and 42 U.S.C.).

[3] Consumer Product Safety Improvements Act of 2008, Pub. L. No. 110-314, 122 Stat. 3016 (codified as amended in scattered sections of 15 U.S.C.).

[4] Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (codified as amended in scattered sections of 7 U.S.C., 12 U.S.C., 15 U.S.C., and 31 U.S.C.) (2010).

[5] Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, 110 Stat. 1936 (codified as amended in scattered sections of 18 U.S.C., 26 U.S.C., 29 U.S.C., and 42 U.S.C.).

[6] Consumer Product Safety Improvements Act of 2008, Pub. L. No. 110-314, 122 Stat. 3016 (codified as amended in scattered sections of 15 U.S.C.).

[7] Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (codified as amended in scattered sections of 7 U.S.C., 12 U.S.C., 15 U.S.C., and 31 U.S.C.) (2010).

[8] Clayton Act, 38 Stat. 730 (codified as amended in scattered sections of 15 U.S.C. and 29 U.S.C.) (1914).

[9] Amy Wildman & Prentiss Cox, *State Attorneys General's Use of Concurrent Public Enforcement Authority in Federal Consumer Protection Laws*, 33 CARDOZO L. REV. 53 (2011).

[10] Clean Air Act, 69 Stat. 322 (codified as amended in scattered sections of 42 U.S.C.) (1955).

[11] Federal Water Polution Control Act (Clean Water Act), 62 Stat. 1155 (codified as amended in scattered sections of 33 U.S.C.) (1948).

[12] Fair Housing Act, Pub. L. No. 90-284, 82 Stat. 81 (codified as amended in scattered sections of 42 U.S.C.) (1968).

[13] Consumer Product Safety Improvements Act of 2008, Pub. L. No. 110-314, 122 Stat. 3016 (codified as amended in scattered sections of 15 U.S.C.).

[14] Printz v. United States, 521 U.S. 898 (1997).

[15] U.S. CONST. art. IV, § 4.

[16] 18 U.S.C. § 1014 (2006).

[17] Watters v. Wachovia Bank, N.A., 550 U.S. 1 (2007).

PRIVACY ENFORCEMENT UNDER STATE CONSUMER PROTECTION ACTS

Justin Brookman, Shannon Choy-Seymour, David Lieber, Michael Martone
Moderator: James Cooper

LINDA KELLY: I am going to introduce my colleague, James, who is going to introduce the panel. We are very pleased to have James Cooper with us this morning, who recently joined us at the Law & Economics Center as the Director of Research and Policy, following a few years over at the FTC. So James, welcome, please take it away with the panel.

JAMES COOPER: Thanks, Linda. I am very pleased today to have such a distinguished panel. Hopefully, we are going to have a vibrant discussion today on privacy. We have David Lieber, the Chief Policy Counsel for Google; Justin Brookman, Director of the Project on Consumer Privacy for the Center of Democracy and Technology; Shannon Choy-Seymour is the Assistant Attorney General for the Massachusetts Attorney General's Office; and finally Michael Martone is the Executive Policy Advisor and Counsel to the Connecticut Attorney General.

The format for today is: Each presenter is going to talk for about ten to fifteen minutes, and then hopefully we are going to have a really lively discussion on privacy. I encourage all of you to ask questions when we get to the question-and-answer section. So without any further ado, let me turn it over to Justin.

JUSTIN BROOKMAN: Thanks. I am Justin Brookman. I am the Director of the Project on Consumer Privacy at the Center for Democracy and Technology. We are a non-profit simple society group here in Washington, D.C. that works on a lot of technology issues. I work on privacy vis-à-vis businesses, like Google and Facebook and a lot of internet companies. We also do a lot on government privacy, so we recently filed an amicus brief[1] in the, in the GPS *Jones*[2] case that was heard at the Supreme Court last week.

The way we try to find our space in Washington, is we try to find a middle ground between companies and advocates and regulators and find consensus solutions to emerging technological issues. Privacy is increasingly one of those issues. There is a lot of information out there. We are increasingly putting stuff about ourselves online. We are increasingly sharing information. It is increasingly easy to collect information about people.

It can be often put to really good uses. So the example that we often hear in D.C. is Googling flu trends. When people search on Google for "the flu," Google can chart out where people are searching for that, and can get real-time information about where diseases are spreading a lot faster

than the Centers for Disease Control and Prevention can. So there are a lot of really beneficial uses to personal information.

Then again, maybe you do not want the fact that you are searching for a disease being shared around the world. Maybe you do not want the marketing information getting to you. Maybe you do not want your insurance rates going up. People increasingly put information out there about themselves and they do not really know what is happening with it.

Prior to joining the Center for Democracy and Technology I was at the New York Attorney General's Office where I ran the Internet Bureau. I brought some privacy enforcement cases, but not a whole lot, because there is not a whole lot of law out there to enforce.

Let me start out from an advocate's point of view. What are advocates looking for? What privacy protections do we want? The framework that we usually use is called the "fair information practice principles." The Nixon Administration put out these ideas in the early '70s as the basis for privacy law around the world. They have since been exported to the OECD[3] and they are the basis for the European Data Protection Directive, which is a very stringent rule. This is what we are looking for as far as how privacy should be protected in the United States.

So there should be transparency, companies should be up front about what they are doing and what they are collecting about folks. Purpose specification: Tell them what you are going to do with it and then do not use it for anything else beyond that unless you have fairly described what you're doing.

Data minimization is the practice of not collecting information about people that you do not need and getting rid of old information that is not really useful. Think about the Sony data breach recently. Sony got in trouble for keeping around credit cards from 2007 that they did not need. They were accessed and breached and it ended up being a very expensive event for Sony.

Choice: Letting people have some control about how their information is being shared with other parties.

Security: Put reasonable security protections in place for people's information when they give it to you.

Then, accountability: Make sure the organization has a structure to ensure that privacy is protected, and that if they run afoul of these principles someone is held accountable for it; that there are ramifications for misusing personal data.

Look at the United States; which of these do we really have today under the current legal framework? It is not really that good. We have some transparency, especially online. Companies have privacy policies that you can open up and dig down into, but they do not really say a whole lot. The policies are written by lawyers whose job it is to just make sure the company does not get sued, not so much to make sure that the company fairly discloses what is going on.

So there is a little bit of transparency, and there is a fair amount of security. These are pretty strong security protections under the law right now, but for the rest of it, not so much. It is really hard to figure out what is happening with your data.

Lack of data minimization is certainly observed in the breach. Companies do not do a great job of tracking data and old information and getting rid of it. If you ask "Why?" the answer is that there is not really a lot of law out there to enforce. The rest of the world has pretty strong privacy protections. Europe arguably has too strong privacy protections. South America, Latin America, Asia—every other developed country in the world—has a comprehensive privacy protection framework which says if you have personal information, let people know what you are doing with it. Give them some control over it.

Here in the United States, we do not have that. We have some sector-specific laws. For certain areas of law that are deemed sensitive Congress has passed a narrow law. In finance, we have seen Gramm–Leach–Bliley[4] and a couple other laws out there that give people control over that information. The Children's Online Privacy Protection Act[5] is a very strong law governing what companies can collect about kids. There are some pretty strong protections around health information. Cable and telecomm companies, these companies have always been regulated entities.

Video records are the area where there is probably the strongest protection today under the law. This came out of the 1988 board hearings, when Judge Bork was being nominated for the Supreme Court and someone went to the Watergate Blockbuster and said, "Give me all of Bork's video records." The Washington City Paper published everything he had ever watched, which was terribly boring. He was watching *North by Northwest*, a lot of James Bond movies.

Members of the Judiciary Committee who were hearing this were outraged that someone could go to Blockbuster and find out everything that they had watched, so they immediately passed the Video Privacy Protection Act, which says you cannot disclose that without someone's permission.

Other than that, the only real law governing personal data protection in this country is Section Five of the Federal Trade Commission Act,[6] which says, "Do not commit deceptive or unfair business practices."

What does "unfair business practices" mean in this space? No one really knows. They have not been aggressive in this area.

"Deception" means not to lie about what you are doing with user data. Do not make any representation you cannot live up to. You do not have to make any representations; you probably have to have a privacy policy under some states' law. You do not have to say a whole lot in it, you can reserve all the rights to do whatever you want, and that is where we are today. That is how privacy policies have evolved. They have evolved into these long, legalistic documents that reserve a lot of rights.

So even if I am trying to make a business decision, and I go to NewYorkTimes.com or WallStreetJournal.com to try to see which one protects my privacy more, it would be very hard to say because the job of the lawyers writing those privacy policies are making sure that whatever the company does, the privacy policy—which no one is really reading anyway—does not get us into trouble.

As a state regulator, when I came into the New York Attorney General's Office, we got a lot of complaints from people about privacy online. "I do not know what is happening to my data, companies are misusing it, what do I do?" And our response was, "There is not a lot we can really do here. There is not a lot of law to enforce." We have to wait for a company to mess up. We have to bring "gotcha" type cases. Whenever someone happened to make a representation in a privacy policy that they could not in fact live up to, then maybe we could bring a case.

A lot of the early cases that the New York AG's Office and some of the other AG offices brought were security cases where companies had said, "We do not want to misuse your data. We are not going to share it with any other third parties," and then they screwed up. It was a security breach.

In some of the early cases—BarnesandNoble.com is a good example—they said "We are not going to share your information with any third parties." But when you logged onto BarnesandNoble.com and bought something on a shared computer, it was very easy for someone to go back after the fact and find out what exactly you had done. They were keeping all the data in the URL address at the top of the screen.

Other cases, like VictoriasSecret.com, they were accidentally sharing information. It was easy for someone to see on a shared computer when someone had been shopping at VictoriasSecret.com and what the person had bought. Victoria's Secret had promised they were not going to do that, so Victoria's Secret got in trouble for those sorts of things.

Those are some of the easy cases that AGs brought from the beginning. Then they started moving on to some other cases where companies intentionally violated the privacy policy. So one of the biggest privacy cases brought by an Attorney General's office was New York versus a company called Gratis Internet. This was back around five years ago.

There were a lot of these companies that were offering free iPods. If you go to this company, freeipods.com, and enter your personal information, you are going to get three messages a day for random offers you do not want. If you do this enough times then maybe you will enter a drawing for a free iPod.

There were a lot of companies doing this. It ended up that they realized they were not making as much money as they thought they would. They had said in their privacy policy, "We are not going to share your information with other marketers; we are just going to spam you ourselves." But then they had a clause at the bottom of their privacy policy saying, "By

the way, we can change this policy whenever we want to. These terms of use, we can change them whenever we want."

And then one of these companies said, "We are not making enough money, we are going to sell the information to another data broker, another data marketer."

We brought an action against that company saying it violated the consumer's reasonable expectations. The company said it was not going to sell personal information; it had this clause at the bottom saying it could change the terms whenever it wanted to, and that is not a contract. A contract cannot say, "I am going to give you $10 and then another party can change the terms whenever they want." That clause is illusory. The consumer could reasonably rely upon the statement that the company was not going to do anything with the data beyond what it had clearly stated that it was going to do.

That is one of the few, very few, privacy cases in this country that have ever been litigated. We won that case. There have been a few other cases holding the same concept; if you are going to make a material change to your privacy policy after the fact, and you have previously collected information, then you need to go back and get new permission from the user in order to do that, whether or not you have reserved the right to change your privacy policy after the fact. So we made some progress on that. There are some controls there, but still, there are not a whole lot.

We tried to get a little more aggressive in some of our spyware cases, where a lot of the AGs, and the FTC as well, started cutting their teeth in the privacy space. You may remember back in the mid-2000s there were a lot of adware companies and pop-up software companies. They would offer you a free screensaver. "Hey, here is a free screensaver." You say, "Yeah, I like it. I would like a free screensaver. I like to see butterflies going across my screen." And then attached to that was another software program that would bombard you with pop-up ads all the time. And there were a lot of these companies and back around six years ago it was literally a multi-billion-dollar business, these pop-up software companies who would sneak onto your computer with other free software programs.

We got a lot of complaints about that in the New York AG's office and we brought some enforcement actions. We brought actions against the advertisers that used them, saying it violated consumers' reasonable expectation of privacy, even though in the terms of service, the long contract, the advertiser said "in addition to this free screensaver program, we are also going to install eighteen different spyware companies."

Even though that term is on paragraph sixty of the terms of service, that is deceptive. The advertiser is marketing this as screensaver software. It is not putting up front the costs of what the person is effectively paying for it. The advertiser could have put in paragraph sixty of the terms of service, "Oh, by the way, you owe us $90 a month for this 'free' software."

Those enforcement actions by us and by the FTC effectively killed that industry. You do not see that business model happening anymore. However, after that business model was dead, we finally got to litigate the case.

In *People v. Direct Revenue*[7] the judge said, "What they did was okay, even though consumers probably did not know what was going on, but they had it in their terms of service, 'by the way, we can do this.' It is a contract. You can do whatever you want in a contract. People could have read it and therefore you should have lost New York Attorney General's office."

And we did lose. The company we had sued was out of business and the industry was dead, but the concept was that as long as you say something in your privacy policy or your terms of service about what you are going to do with the data, maybe you are okay.

The FTC has since pushed back on this concept and has continued to bring enforcement actions, however none of them have been litigated. I mean, the FTC does not litigate cases, especially privacy cases. They have against Sears,[8] for example, which is the leading bellwether privacy enforcement action that I'm aware of.

In the Matter of Sears Holdings Management Corporation was a couple years ago. They installed some software on your computer that would publish to the world, effectively, whatever you shopped for at Sears.com, and they put it, again, in paragraph sixty of the terms of service. The FTC brought a complaint and eventually settled the case, saying, "If you are going to be doing that sort of very public disclosure of personal information, you really need to put it up front."

The FTC has provided a lot of guidance on very material terms to a contract. There needs to be clear and conspicuous notice about what is going on. You cannot bury it in the terms of service—you need to be up front about what is happening.

That is all of the case law we have right now. One settlement from the FTC saying if a company is going to be sharing data in an unexpected way then it must put a notice somewhere the customer is likely to expect it. That is a fuzzy standard for companies to try to figure out what is going on. There has been a lot of discussion about whether it is deceptive to not say up front what you are doing.

There is also this concept of unfairness under FTC law, which the FTC was very aggressive about in the '70s but since then, authority has been curtailed. There is a three-part test for what constitutes an unfair business practice. There has to be substantial harm to a consumer, the harm must be unavoidable by a consumer, and it cannot be offset by any other gains.

The FTC has aggressively used this authority in security cases. When companies accidentally lose data—for example, if a company like T.J. Maxx loses information for eight million credit cards because they had really poor security—the FTC says that is substantial harm. Consumers cannot really get around it, and there are no gains by anybody except for the hackers who stole the information.

Unfairness does not really map over that well to privacy because privacy harms are relatively minor. It is personal information, I am revealing it by myself, I do not want to share it with the world necessarily, but is it really substantial harm? The FTC has been leery about extending it over to that area.

In the privacy area there is not gains. There are marketers who want the information, who are collecting it, who are using it, and then they are making more relevant offers to you because they collected a lot of personal information about you. So there are gains there.

A lot of consumer advocates in this space first argued for an overall privacy law saying, "Make companies tell you what they are doing." But they also said, "Absent that, can we at least use the FTC's unfairness authority to be a little more aggressive toward companies who are not telling us what is going on?" By and large, we have not seen the Federal Trade Commission go there.

About half the states have unfairness laws under their state consumer protection statutes; however, I am not aware of any state which has brought an action against privacy under the basis of unfairness.

The one trend we have seen here is that we have pretty weak privacy law. The FTC had a report come out last year saying, "Privacy really is not working in this country. We relied on self-regulation for twenty years. People now have less control over their data. Something needs to change." They do not really say what, exactly, but they say something needs to change.

The Department of Commerce similarly says "From a business point of view, we probably should have some sort of basic privacy protections." Because people have their computers, they share information online, but they are increasingly getting skittish about it, especially in the mobile space. There have been a lot of surveys showing that people are really reluctant to do certain things on their mobile devices. They do not know what is going to happen to their personal data. So the Department of Commerce said there really should be some sort of basic protections in law out there for consumers.

Because we are in an election year, obviously nothing is going to happen in Congress, certainly not on this issue. The Department of Commerce has said, "Maybe we can get industry together all at once and make actionable promises to give people some assurance that they are not going to misuse data."

A lot of the privacy debate in Washington has centered on online collection and sharing by advertising companies. There are advertising companies who can see what I do on NewYorkTimes.com and ESPN.com and WallStreetJournal.com and whatever.com. Then, there are companies who can collect dossiers about you across the Internet. Maybe they can make those companies make promises in their privacy policies or agree to an industry-wide code of conduct, "We are going to behave in a certain way."

The self-regulatory groups who operate in those areas have been pushed by the FTC and the Department of Commerce to say as an industry they will treat data pursuant to the Fair Information Practice Principles. The question is: To what extent are those statements enforceable by state AGs? If they say in the privacy policy, "We are compliant with this code," then that is probably enforceable. If the company is a member of a trade group that says, "You should be doing this," is that actionable? Maybe, I would say yes, but it is definitely up in the air.

If a company is in an industry that, as a whole, follows these principles but the company does not, does the company have an obligation to say so up front? As regulators try to be more aggressive with the relatively limited authority that they have, I think these are the questions that you are going to see litigated or at least pushed in the next several years. And I think that is where the privacy debate is going to be.

JAMES COOPER: Thanks a lot, Justin. Shannon?

SHANNON CHOY-SEYMOUR: Hello, everyone. I work in the Consumer Protection Division of the Massachusetts Attorney General's office, so we focus on the civil side. We bring our actions primarily under Chapter 93A, which is our Unfair and Deceptive Trade Practices Act.[9]

We have recently been focusing on our data security law and data security regulations as well. A violation of those laws is also considered a violation of our Unfair and Deceptive Trade Practices Act.

So in ten to twelve minutes what I am planning on doing is just give you a little bit of background on the Massachusetts Data Security Law, both our statute, which talks about notification, as well as our regulations, which have been somewhat controversial in the data security world. I will tell you about some of the enforcement that we have done and then some of the trends that we have seen as one of the state enforcement entities.

In Massachusetts, although now we are considered one of the strictest states in terms of data security, we were pretty late to the game. It was not until August 2007 that we implemented a data notification law, and we only did this because of the TJX breach. After that, our legislature said, "Consumers should know when there is a data breach and know what they can do to protect themselves."

Right now forty-seven states have data breach notification laws, and Massachusetts, in March of 2010, implemented data security regulations, as well. I will talk a little bit more about the regulations. Essentially, any entity that owns, licenses, stores—basically has anything to do with Massachusetts residents' personal information—has to follow these regulations.

There are two main elements to our regulations. First, a company has to have what is called a "written information security program" in place. It is often referred to as a WISP, and that is basically to make sure that companies are examining their data security policies, know where that infor-

mation is, know how it is being used, are making some effort to protect it, and also that they have certain computer safety security requirements.

When an entity in Massachusetts experiences a data breach and it affects Massachusetts's residents, they have to notify our Office of Consumer Affairs and Business Regulation and they also need to notify the residents. Part of my job is to make sure that when we receive these notifications they comply with Massachusetts law and to dig a little bit more into some of the bigger breaches or the breaches that really raise concerns for us.

Companies that experience a breach not only need to notify us when they think there is a substantial risk of harm to consumer information but also if somebody acquired or accessed personal information of a Massachusetts resident and they were not authorized to do so. Whether or not they think there is a risk of harm, they still need to notify us about that breach.

As I had mentioned, we had regulations put into place in March 2010, and there was a lot of back-and-forth with the business community on this. In the first iteration of it, the business community said, "Hey, this is too expensive, we cannot do this; it is too burdensome." So the ultimate regulations that came out really do take into account the size of the business, the scope of the business, how much personal information they have, and what they are really capable of doing.

There are essentially two things they have to do. They have to implement this written information security program. And by doing so, our hope—and we are starting to see that companies are doing this—is that companies feel a need to examine what type of personal information they have and how much they need. It is surprising how many companies maintain information from back in 1996. They do not need this information anymore, and they are really putting themselves in harm's way by not getting rid of the information they do not need.

So one goal of this security program is to make sure that companies assess what information they have, if they need the information, and if they do not, it encourages them to get rid of it. It helps the company and it helps the consumer.

Other elements of the WISP, the security program that companies need to have in place, is they need to develop security policies for employees and really take into account how employees should be using the information. They need to examine if an employee is even allowed to take information off premises, and if employees are allowed to do so, then how are you going to protect that information?

For example, hospitals. We have had breaches in Massachusetts, a lot of hospitals in Massachusetts, and one of the more notorious breaches occurred with Massachusetts General Hospital. The Office of Civil Rights ended up settling that case, but in that case, an employee took work home with her, took it on the red line on the subway, and left it on the train. Unfortunately this was information about HIV positive patients, and the information was never found. So one goal of the security program is to make

companies aware of what employees are taking off premises and decide whether this is information you should be allowed to take off premises?

The security program also requires that disciplinary measures be imposed if there has been a breach that employees are responsible for. It does not tell the company what the measures have to be, but that there does have to be some kind of discipline in place.

It has to incorporate employee training and also require that third-party service providers maintain security measures as well. A lot of the time companies rely on third parties to do payroll, to do retirement, and so they are passing on this information. So one of the goals of the security program is to make sure if a company is hiring a third party, they also need to have a security program in place and they need to protect the personal information as well.

In addition to training, disciplinary measures, and third-party oversight, there are certain computer security requirements as well. For example—this is basic but some companies have not done so—making sure that there are unique user IDs and passwords for every single employee, and making sure that the company is controlling those passwords so that if an employee is terminated, then that password no longer works.

Encryption is also important. Under our regulations, if personal information is stored on a portable device such as a laptop, USB device, or a backup computer tape, it needs to be encrypted if technically feasible. There also needs to be encryption of emails containing personal information that travel across public networks.

If we receive a data breach notification where it is clear that a laptop was lost and it was not encrypted, or an email that was sent to the wrong address was not encrypted, we will dig in further and ask for the company's security policy to see what they have in place, what they are doing in the future, and depending on the nature of the breach, we may do more, taking into account a lot of other factors as well.

So in terms of enforcement, how do we decide what we are going to enforce and what are we going to do? We receive data breach notifications every single day, at least five a day. And a lot of these are petty—an employee sent a fax to the wrong address or an address was mislabeled—so we want to make sure that the notification is compliant and that they are doing something in the future to prevent the breach, but those are not going to be triggering the investigations, the enforcement actions.

Some of the things that might trigger an investigation or enforcement action Justin brought up too, in terms of what we examine. We look at whether the data was compromised because it was being collected for a purpose other than what was stated in the privacy policy. For example, if the privacy policy says "We are only going to be using this information for internal purposes," but then they start up with a third-party marketer and in that process the information is lost, then they might be in trouble there.

You have to notify. If you fail to notify us and fail to notify the residents, as well, then that is going to also be a red flag for us. Quite often we receive tips on our consumer hotline, either from a whistleblower employee or from a consumer who has heard something. If we find out about the breach but not through the company, then that is also more likely to trigger an investigation.

We look at the representations the owner of the data made about security. For example, if they say "We have the most up-to-date antivirus software," but they haven't updated anything since 2000, that is also going to be a problem.

We look at how the data was stored. Was it maintained in a reasonable manner? For example, if you have personal information on a USB device, well, number one, should it be there? And number two, is the company encrypting data like it is supposed to?

Of course, we also look at the nature of the personal information that was breached. We have always been looking at credit card data, financial data. We are also really looking at healthcare data, as well now, because there are too many breaches that happen in that realm. We also look at the breaches that focus on the most consumers.

In terms of the penalty, there is no unique penalty structure under our data breach notification law. But because a data breach is a violation of our unfair and deceptive trade practices, the penalty laid out in that act is $5,000 per violation. So we often start out with $5,000 times the number of people who were affected. The numbers can go up pretty fast on that, but that is generally our starting point.

We do have several ongoing investigations, but I am just going to touch on two of the cases that we have settled in the past year. One we settled by consent judgment. It was against a company that runs several bars and restaurants in the Boston area. If you have ever been to the Boston area, it is very likely that you have been to a restaurant or a bar that was owned by this company.

It was a hacking incident that exposed tens-of-thousands of national residents' information, not just Massachusetts's residents. This investigation led to an action because, upon looking further into this, we realized that this company failed to implement very, very basic data security. They were taking credit card data every single day, debit card data every single day, but they did not change user names and passwords on their point-of-sale system, and these default passwords are very well known in the hacker community. You can go online and type in this point-of-sale system, just Google that, and the passwords would come up.

Employees were allowed to share user names and passwords. They were not modifying passwords after employee termination; they were not securing their wireless network and remote access utilities like PC Anywhere. One thing that did not make us happy was that they did not properly

alert consumers to the breach and continued to take credit cards after they knew of the breach but before the malware was removed.

All these factors led us to decide that this is one we needed to pursue further. We ended up obtaining penalties of $110,000 on this breach as well as injunctive relief, and requiring that the company implement and follow its own security program.

One other smaller breach I want to mention that we did follow up with was a local Massachusetts bank. They did have a security program in place, but they failed to follow that program. Over 10,000 Massachusetts consumers were affected by this breach, which is relatively small, but for the size of the bank it was pretty big. What happened in this breach was that they were storing unencrypted data, names, Social Security numbers, and account numbers on unencrypted backup tape. They had a great policy in place where an employee had to sign out the tape, had to go in a safe to view the tape, but rather than following the policy, the employee just left the tape on a desk and a custodian threw it out.

We decided to follow up this breach because, although a policy was in place, they were not following it. This was also a case where we ended up getting penalties and injunctive relief.

One final issue I just want to touch on here is that because we see so many breaches, we are starting to get a sense of what breaches occur most, and they really do affect all manners of institutions: financial, colleges, hospitals, everybody is affected by data breaches.

However, a quarter of the data breaches that have been reported to us since January 2010 did involve some intentional hacking. While a lot of them did occur because of external threats, 23% of the breaches that were reported to my office were because of human error, where an employee sent personal information to the wrong person via fax or mail or unencrypted email. This emphasizes for us how important that employee training really is.

Another common breach we have seen is the loss of laptops, thumb drives, and portable devices that are either lost or stolen. Again, this is highlighting the importance of following our regulations and encrypting that data if it is going to be on a portable device.

And with that, I will turn it over to the next speaker.

JAMES COOPER: Okay. Well thanks a lot, Shannon. Dave?

DAVID LIEBER: Great. Thank you. I can probably just say at the outset as a standard disclaimer that I am speaking today in my individual capacity and not on behalf of Google. So if I say anything egregious or outlandish, which is pretty likely, do not impugn my shortcomings to my employer.

The title of our panel is "Privacy Enforcement under State Consumer Protection Acts," and I'll just quibble slightly with the title because we are lawyers and that is what we do, we quibble. I would argue that an exclu-

sive or even primary focus on state consumer protection acts might be a little bit too narrow in understanding how privacy principles and laws are being enforced today.

In the past ten years, and I think particularly at the state level, we have seen fairly robust enforcement regimes developed that are oriented toward specific privacy and data security issues, including security breach notification protocols, data security regulations, and rules governing protection of Social Security numbers. I imagine ten years from now we will have a new set of privacy principles around emerging issues.

For example, in the past two years we have seen state legislation that would require default privacy settings for social networking websites. We have seen that in California and Puerto Rico. We have also seen bills that would create notice and consent rules for online behavioral advertising to some degree in California, Massachusetts, New York, and a couple of other states.

Many of the new privacy and data security laws that we have seen give state AGs, and at times individual plaintiffs, enforcement tools that might be questioned if they were raised under the auspices of state unfairness and trade practices laws.

What I want to focus on a little bit today is the private enforcement of state privacy and data security laws. First—and I will discuss this a little bit more—many privacy and data security laws are not readily susceptible to redress by individual plaintiffs and private litigation. Second, not all privacy and data security laws, including state unfair and deceptive trade practices laws, authorize private rights of action. Among those that do, there is often a requirement to show that there has been actual harm or actual damages that have been sustained.

So, plaintiffs do face challenges when seeking monetary relief for a violation of state privacy and data security laws. While nobody would excuse a company's failure to notify individuals in a timely manner of a security breach or excuse a company's shortcomings in terms of the data security protocols that they deploy, privacy injuries are not readily redressable because there is often no legally cognizable harm.

Without going into too much detail here, there have been a number of cases where claims based on violations of state privacy and data security laws, unfairness act and trade practices statutes, and even common-law claims under state law, have been dismissed because the plaintiffs failed to plead or articulate any legally cognizable harm.

Now, that is due probably to a variety of reasons, one of which, at least in part, is due to the zero liability rules that exists for credit and debit cards. If you report or contest charges as a result of fraudulent activity, you do not suffer any actual financial harm, provided that you report it in a timely fashion. But in many cases there is no identity theft or fraud that is attributable to security breaches or even poor data security practices, and so it is diffi-

cult in those situations for plaintiffs to articulate actual harm in a way that satisfies the strictures of either constitutional or prudential standing.

The problems associated with bringing private causes of action under state privacy and data security laws in some cases have led plaintiffs to seek relief under friendly or statutory regimes, and in many cases we will see plaintiffs that cannot avail themselves of remedies under state laws are going to federal laws that do provide for statutory damages.

So the Electronic Communications Privacy Act,[10] the Computer Fraud and Abuse Act,[11] the Cable Communications Privacy Act,[12] among others, are sometimes invoked as ways to circumvent the limitations that might be imposed on private litigants under state law.

I want to talk very briefly about an interesting case that came up in the First Circuit last month[13] that may have the effect of swinging the pendulum a little bit in the opposite direction here for private litigants. In that case the First Circuit held that individuals who were adversely affected by the Hannaford Brothers grocery chain security breach did articulate actual harm and had compensable damages as a result of prophylactic measures that they took to prevent themselves from financial harm.

In that case over 4 million records were compromised. It was an intentional hacking incident and there were, I think, almost 2,000 cases of fraudulent activity reported.

In that case, at least some of the plaintiffs paid card replacement fees when their financial institutions decided that they would not replace those cards, because they felt that the risk was too remote. Also, some plaintiffs proactively purchased credit-monitoring services, in some cases for a period of two years. The court held in that instance, too, that they had compensable damages that would meet the actual harm standard.

The court called these "mitigation damages." This is the First Circuit Federal Court of Appeals. They said that this was compensable under negligence and breach of implied contract claims. The court in this case was ultimately looking to determine under Maine law whether plaintiffs in similarly situated circumstances had the right to incur costs for the purpose of avoiding harm.

What the court said here, was that there was actual fraudulent activity, almost 2,000 cases. In other cases, where there were security breaches, there was no actual fraudulent activity that was associated with the security breach. What the court was saying here is that plaintiffs had the right to sort of take prophylactic measures here to prevent reasonably foreseeable harm. Also working in the plaintiff's favor in this case before the First Circuit was the fact that other financial institutions had replaced some of the customers' credit cards at no cost.

So let me just return to the point that I initially underscored here because I think, broadly speaking, there are real barriers to private litigants that are looking to vindicate their rights under state privacy and data security laws. So there really is an important role, a vital role for state attorneys

general to play in this regard. State AGs have the ability to encourage or compel systemic changes among companies in ways that private litigants and their attorneys are not incentivized to do.

I think what we will see going forward, to the extent that there are new specific privacy and data security laws that are enacted at the state level, they will be provisions for strong attorney general enforcement. In many ways the state attorneys general can do things with companies that force them to make changes to prevent certain privacy violations from occurring again that private litigation just is not as well attuned to, if you will.

Thank you very much.

JAMES COOPER: Thanks, David. Michael?

MICHAEL MARTONE: Thank you. Good morning, everyone. I just want to talk a little bit today about data breaches and privacy. Some of what I will discuss has already been shared by my esteemed colleagues on the panel, but just to give you an overview of the conversation, I will talk a little bit about breaches in policy and about Connecticut-specific law, as well as some of the specific enforcement that Connecticut has undertaken. Finally we will just take a look into our little crystal ball in terms of some of the issues that are coming up on the horizon.

So just by show of hands, those of you who have ever received a data breach notification or have otherwise had their information compromised—can you just raise your hands?

Take a look around the room. It is pretty much everybody, for the most part. I wish I could stand here today and tell you that you will never receive another data breach notification or have your privacy implicated, but the unfortunate reality is that we live in a constantly changing world of technology. We have more and more information being aggregated about us, and the likelihood is that this will converge to create the perfect storm where we are going to see more and more data breaches.

Of those 478 instances, approximately 22 million sensitive records were compromised, and that's a conservative number. In these types of incidents where we have data breaches, many times we do not find out the exact number of records that were compromised, we may only have an estimate of the time period by which the actual breaches took place.

This sensitive personal information includes Social Security numbers, financial account information, medical information, driver's license information, and a whole host of other data.

Now by a show of hands in the room, how many folks have a smart phone? Either a Droid or a Blackberry of some sort or an iPhone? Okay. How many of you folks have a Twitter or a Facebook account or some other social networking website or your children do or grandchildren? Okay. And how many of you folks use grocery cards or shopping cards for re-

wards or discounts or anything along that lines when you go to the grocery store? Okay.

So essentially, personal information is much more than just your Social Security numbers and your financial records. It includes information about your shopping habits, it includes information about your cell phone use and the locations and your whereabouts on cell phones. It includes your driving record, your medical diagnoses, your work history, your credit scores, movies that you rent at video stores, and so much more.

Companies in general are very hungry to market more effectively and to mine your data. Essentially, the information about you is powerful and it equates to them being able to market to you more effectively, sell you more products and increase their revenues.

Online information brokers are making information more accessible than ever before. In years past, in order to get information like marriage certificates, housing or mortgage information, or court records, you had to go to that particular town or city and the town hall or the relevant courthouse and get those records and that information from that specific place. Today, you can be sitting anywhere in the world and as long as you have access to the Internet, you will have an enormous amount of access to a whole host of that information and type of data.

The aggregation of this personal information, it increases more and more, and essentially it puts you more at risk of the information being compromised. Obviously that has an impact, and that's why we are here today.

We heard a little bit earlier today about the question whether the law defends privacy? The right to privacy is something that many of us take for granted. We do not find it in the Constitution or the Bill of Rights.

In fact, as we have heard previously, in looking at the United States, unlike most developed nations, there is no overarching or comprehensive federal level law protecting against information being stored or collected. The U.S. has a patchwork of different laws covering different types of data, with separate laws for medical privacy records, financial privacy, telemarketing, credit reporting, video records and such like that.

Now California was the first state to enact a data breach notification law in 2002. When California set the stage and enacted this particular law, it did a couple of things. First of all, some companies through good faith decided to notify their customers who were located in other states, and in that situation, folks were notified.

In other situations, you had neighbors who were across different state lines or heard from friends or from the news media that information had been breached, and they started asking questions themselves as to whether or not their information was compromised.

Over time that led to what we have today, which is, I believe, forty-seven states having some type of data breach notification law. I am going to talk a little bit about Connecticut's security laws, three in particular. The first being section 36a-701b, this is our Computer Data Breach Notification

law.[14] Essentially, under this particular statute, a breach of security has to be disclosed to any Connecticut resident whose personal information was compromised or reasonably believed to have been compromised or accessed by an unauthorized person.

A breach of security is defined as an unauthorized access to or acquisition of data containing personal information. If the information is encrypted or otherwise protected by some type of technology that makes it unreadable, then that is not considered to be a data breach under this particular law.

Personal information, how is that defined? Under this particular law, it is defined as your first name or your first initial plus your last name, and a combination of one of the following things: your Social Security number, your driver's license information number, an account number, a credit card number or debit card number (plus on that end it has to also include a security code, some type of access code or password that would allow a person to permit access to that particular debit or credit card number).

Notice has to be made without an unreasonable delay—and that can sometimes be a sticking point in terms of what is unreasonable delay—but it does allow for the completion of an investigation to determine exactly the extent of the breach, the folks who were impacted by this. It allows the company to determine the nature of the people and to obtain a list of the people who were impacted and affected by the breach. It also gives the company a period of time to restore the integrity of the data system so that it is no longer essentially putting consumers at risk.

Now, technically under the statute, notification is not required if, after an appropriate investigation and consultation with relevant law enforcement authorities, it is reasonably determined that the breach will not likely result in harm to the individuals whose personal information has been acquired or accessed.

In practical terms, in our office we encourage, whenever possible, companies to provide notice to consumers. Companies are in a special position when they are safeguarding this information and when consumers are entrusting them with their private, personal information. And when companies breach that, whether it is inadvertent, whether it is willful, whether it is just by happenstance, it is important that consumers are then put in the best position to be able to protect themselves.

By having notice, consumers can then place fraud alerts on their accounts, they can be especially vigilant in watching their credit card information and other financial account data, they can place credit freezes on their consumer credit report information, and otherwise they can just stay particularly vigilant in terms of the information that is out there.

At the very least, it empowers consumers, and we encourage companies whenever possible to make notice as quickly and effectively and swiftly as possible.

Section 42-470[15] deals with how businesses and individuals can use Social Security numbers. Essentially, it prohibits any person from publicly posting an individual's Social Security number. It also prohibits an individual from printing a person's Social Security number on any card to access services and things like that. And it also prohibits any individual from requiring an individual to transmit his or her Social Security number over the Internet. Unless, of course, the Internet connection is secure and the information is otherwise encrypted.

Penalties for this particular violation in this particular statute include both non-civil and civil penalties. The non-civil penalties include for the first offense up to a $100 fine per willful violation, for the second up to a $500 fine per willful violation, and for the third and subsequent offenses it includes up to a $1,000 fine per willful violation as well as possibly criminal time of up to six months.

The civil penalty includes a $500 fine per willful violation and maximum fine of $500,000 for a single event.

Moving right along, our sister companion to § 42-470 is § 42-471.[16] This deals with the safeguarding of personal information. In this particular statute, personal information is defined much more broadly than in the breach statute that we talked about previously.

Under this statute, an individual must safeguard data. Data can be computer-generated data or it could be data that is stored in hard copy in an office. Essentially, they must secure that data and ensure that it is not made available and that it is protected from third-party disclosure.

They also have an obligation to destroy or erase information and data that has personal information on it. You might have heard over the years, we experienced it in Connecticut, of instances where companies, or pharmacies for that matter, were routinely throwing away documents in their local dumpster. All of a sudden dumpster divers and other folks who were trolling for treasures were finding great information about all kinds of individuals, about their medical information and their Social Security numbers and such like that. So this particular prong of this statute encourages, and ensures that information is destroyed—effectively destroyed—once the individual or business is done with it.

This statute also requires that any person who collects Social Security numbers to also have a policy in place to protect that information. We heard a little bit about what Massachusetts does, which really is a model in many respects. This essentially encourages companies to think about what information they collect, how they collect it, and how long they keep it. Those are all the things that have really gotten a lot of companies into trouble. They have collected information that they did not need, they have held onto it for a period of time that is too long, and this particular prong of the statute deals with that.

Civil penalties for this particular statute include a $500 fine per willful violation and up to a $500,000 fine in the aggregate for any single event. This particular statute also requires intent.

Last, I would just like to talk a little bit about a few key Connecticut settlements, the first being TJX. You heard about TJX in the panel before. TJX for many of you is better known as T.J.Maxx, Marshall's, Bob Stores, and Homegoods. They operate and do business here in the United States, Canada, and the U.K. as well. They had a multi-year breach that took place over a couple of years.

What happened is that the hacker parked his car outside of a local TJX store and broke into the wireless network. As part of our investigation, in which Massachusetts was the lead and Connecticut was on the executive committee, we discovered that there were a whole host of inadequacies in terms of the security measure taken by TJX.

They kept information for a period of time that was considerably longer than we believed that they needed to, and ultimately there were issues in terms of the delay of notifying consumers as to whether or not TJX knew or should have known that the breach was taking place as long as it had been.

This ended up in an assurance of voluntary compliance with the state of Connecticut, and we had a multi-state settlement of $9.75 million. As part of that settlement there was a $2.5 million settlement fund that was directed toward data security issues.

Just to give you a little bit of background on that, what we found, and what we find in general in these types of cases, is that they are very expensive. Because technology is changing as quickly as it is and is as complex as it is, we find that folks like myself who are lawyers and not computer engineers or computer software programmers or computer scientists are not necessarily in the best position to be able to be analyzing actual systems and security systems. So what happens is that in these cases, particularly in TJX, we had to hire an outside consulting company to go through the specific technology details and requirements and such like that, which is very expensive. This particular fund is dedicated to being available for state attorneys general who are looking to tap into monies for consultants and things of that sort when they are prosecuting and investigating these types of privacy and data breach cases.

Next we have Countrywide, which is now better known as Bank of America. In that particular case an employee downloaded sensitive loan information onto a personal thumb drive and he later sold that information for profit on the open market.

To give you a little bit of background, prior to him obtaining that information, Countrywide rolled out a feature which basically disabled the ability to download information to removable devices, like a thumb drive. What happened is that that employee found a way around that. He found at least one computer that was not protected and he stole and sold that information over the course of a two-year period. There were issues in terms of

whether or not Countrywide should have known of that particular breach prior to the period of time that it did, since it was such a long period of time.

Ultimately we resolved the issue with an AVC[17] with Countrywide, and the respondent recognized that they had to take additional steps to protect information, to eliminate unauthorized downloading and the transfer of this type of information to removable storage devices. There was a monetary payment of approximately $350,000 to the state, as well as $25,000 in a fund set up to reimburse consumers who wanted to place a security freeze on their account.

Just as a backdrop, as a consumer, you cannot place a security freeze on your account. There is a cost to place it on your account and there is a cost to lift it, and that is levied against each of the three major credit bureaus. So that money would be available for consumers to tap into.

Lastly, we have Express Scripts. In October of 2008, the CEO of Express received a letter from an individual trying to extort money from the company. The threat was to expose millions of Express's members' records over the Internet. The letter had the information of some of the members, including Social Security numbers.

A short time after that, about a month later, Express received letters from the same person yet again. In August of 2009 the FBI was informed that a law firm received another letter indicating that the sender had even more information on the Express members' data.

Ultimately there were issues in terms of the ability of someone to take this type of information, and this much information, without being detected. It seemed that the only way this could have happened was by somehow downloading this type of information to a removable media source, despite the fact that there were no logging of downloads or forced encryption of downloaded data. We were concerned about the delayed notification due to inadequate internal procedures in this particular company.

We resolved this also with an AVC which included $55,000 and a fund set-up to reimburse consumers for security freezes; two years of credit monitoring for consumers, which included $25,000 in insurance; and Express agreed to take additional steps to protect their information and eliminate the unauthorized download and transfer of personally identifying information. They also had to make other enhancements to their data security systems.

Finally, looking forward into our crystal ball, this is by no means a science and certainly more of an art, there are a whole host of different issues that are really on the horizon. From my perspective, we are going to see enhanced privacy impact assessments from companies. Companies taking a closer look at the type of information that they collect, how long they keep it, largely because of the efforts that we have seen on the part of law enforcement authorities to enforce these particular data breaches and

such like that. It costs them money and certainly there is an impetus to address it as a result of that.

There is an enormous amount of effort at the state and federal level to create a national data breach and privacy law. As we talked about, we have got forty-seven different data breach notification laws throughout the land.

In Connecticut, the Attorney General recently created a task force to deal with privacy issues, and we have been meeting with businesses and individual stakeholders who are particularly local to Connecticut and many of them have national footprints. We are hearing from folks, particularly with national and global footprints, concerned about the myriad of laws and regulations that are coming or that are across the different states.

We are also likely to see companies engaging in enhanced consumer notice about their data collection policies and increased opportunities to potentially opt-out, particularly if that is tied into federal legislation.

There are questions as to whether or not we will see a "do not track" list. Just to give you a little bit of background, when you visit some websites, the website itself may collect information about you, not only on that particular visit but also on subsequent visits. They may issue what are called "cookies" or other types of technological devices that allow them to track your information long after you have passed.

In some cases, it is not even the site itself that is tracking you. It is one of their third-party marketers that have purchased a marketing ad of some sort on the site that issues these types of cookies. In places like Europe and elsewhere, a "do not track" list is something that is particularly popular, and we may see more and more of that here in the States.

We heard a little bit about it earlier as well as affirmative consent for changes to privacy policies. Obviously it is very important that companies are transparent with how they are using your information, what they are doing with it, and how long they are holding onto it.

If you make one purchase at one particular time, does that allow them to hold onto that information for years later and to sell it then to third-party folks, or to share it or to pass it along to the company that purchases them after they have gone bankrupt or otherwise sold their assets? There are real questions in terms of that as well.

Ultimately, when we are looking forward, there is increased uncertainty and risk. I do not mean to sound the alarms, but with technology increasing as quickly as it is, you have got folks who are using the information for legitimate purposes and folks who are trying to obtain the information, data hackers and thieves, who are trying to hack into systems and find creative ways of using information.

Looking forward, smart phone privacy issues are huge. When you look at your phones, there are question marks. I was just reading an article a couple days ago about a cell phone company that is about to embark, or is considering efforts to sell your locational data to marketers so businesses

can have a better idea of where you go and how you behave in order to more effectively set up locations. Data mining is all connected to this.

Lastly, I just wanted to talk briefly about re-identification of personal information. Re-identification of personal information is the process by which anonymous data is matched with its true owner. What happens is that to protect the privacy of consumers, personal identifiers like name and Social Security number are removed from databases containing sensitive information. This anonymous data safeguards consumer privacy while making the consumer information available to marketers or data mining companies.

Recently, however, computer scientists have revealed that this data can easily be re-identified so that the sensitive information can be linked back to you as an individual or to somebody else as an individual. These are real issues going forward that we are going to have to look at, examine, and be particularly aware of.

Again, not to sound the alarm, I think what we need to be especially vigilant in terms of how we participate, how we review our information, keep track of our credit reports and our financial information, what information we choose to give to people, and when we give it to them. We are really in a day and age where Social Security numbers and traditional identifying information are not the only threat.

So thanks very much. I appreciate it.

JAMES COOPER: Thanks a lot, Michael. Thanks to all of you. I think we will start off this discussion. I think it will be a bit provocative, I hope. It is early in the morning.

We have heard from Michael and Shannon—the state enforcers—that the trend is toward an increased regulatory environment and increased regulation in privacy. I guess my provocative question is: do we have good evidence that the market is not working here? That there is a problem that needs to be addressed by increased state involvement?

At the end of the day, privacy policies and data security policies are the product of private contracts between consumers and the firms they visit. We have seen in the past Google Buzz and Facebook have made some missteps and then they have quickly corrected those, not with government prodding but because their consumers were upset. We see private browsers coming out with "do not track" options on their own, again, without government regulation.

So, I guess it is a two-part question here. One, what is the predicate for the increased need for government intervention here, as opposed to letting the market continue to work? To the extent we thought that there was a consistently unmet consumer demand for privacy, we have seen a rapid explosion of social networking, where people share all manner of information. It does not seem to deter them there. We have also seen a rapid explosion of e-commerce.

My two-part question is: (1) what is the predicate for the increased ramping up of government involvement? And, (2) are consumers aware of the benefits they may forego with increased government regulation?

We heard from Michael that third-party ad networks collect data. They track you, but that tracking also allows for better monetizing of content providers, which then again allows for richer free content. You can visit most places on the web and get free content because it can be monetized. The marketing data almost consistently shows that targeted advertising yields a lot more revenue than non-targeted advertising.

In the health information technology area—this is an area where I have done some research—there is some good empirical research that suggests states that have privacy or consent requirements above and beyond HIPAA's[18] current requirements have lower adoptions of health information technology, which leads to poorer health outcomes.

Health information technology is something that has been a priority for good reason. Increasing the flow of health information to physicians can increase health outcomes. But ramping up privacy protections in that area might not just make it so your advertising is not as targeted or you do not get as much free content. You also may end up with lower health outcomes. As I said, there have been a couple empirical papers published in top-ranked journals that seem to suggest that that is the case in states that have high privacy protection.

So I would just throw this out, again to be the provocateur here, to any of the panelists if they would like to jump in.

JUSTIN BROOKMAN: It is like a twenty-part question. I am not really sure which part to respond to.

JAMES COOPER: Two parts with like seven subparts.

JUSTIN BROOKMAN: Really, back to school. I have one question and twenty-seven parts.

First, I guess I am going to push back on the idea that we are seeing an environment of increased regulation. The title for this panel was "Protecting Privacy through State and Consumer Protection Laws." We did not really hit anything about privacy. You heard a lot about security, which is arguably a small subset of privacy and arguably something else entirely. Security is when a company just screws up and loses your data. Privacy is what the company wants to do with the data themselves.

If Google were to lose all the information that I give to them, then you might see Shannon or Michael bringing an enforcement action against them. If they were to sell that same exact information, they are probably fine. There is no prohibitions on that whatsoever unless they had said, "We are not going to do that." That is where we have started to see some pushback from the government.

You said that Facebook and Google have fixed things themselves. But the FTC had actions against them, right?

JAMES COOPER: They had lawsuits against them. Not to interrupt, but those lawsuits were settled. In fact, in the *Wall Street Journal*, Facebook said they may be settling now. This is two-plus years after the action, almost two years after they did something. Then the FTC corrected the same thing with Google Buzz, they settled an action.

JUSTIN BROOKMAN: But there are also private enforcement actions. With the very limited rules that we have, they had made representations that they were not going to do this. Both Facebook and Google had to pay upwards of $9 million because of that. I want to say that is the market correcting.

I mean, I agree with you, people like to share a lot these days. I have a Twitter account, I have a Facebook account, and I share a fair amount. I strongly reject the notion that because you choose to share some information online, then you are willing to forego all privacy whatsoever.

I would say that the market does not work because there are strong incentives under existing law to not disclose what you are doing. The privacy policies are the only way you can get in trouble, you have to have a privacy policy. For example, Google Buzz was a settlement where Google effectively tried to take your Gmail accounts and push you through this process where you ended up turning your Gmail account into a social network. It was a bad idea—I think the program is dead now. Only because they had said when you signed up for Gmail they were not going to share your content information could they get in trouble. Now I think the takeaway from that, from a lot of companies' perspective is, "Well, I am not going to make any representations because going down the road, I might find a cool use for this data."

I think if we lived in an environment where companies just had to say what they are doing with the data and if they are going to change their mind later then they have to tell me they are changing their mind, then I can make an informed market decision about which company to go to. As it is today, all the data sharing goes on in the background and you are right, there is data sharing online that does monetize content. But that is not transparent to people. I understand when I go to NewYorkTimes.com that there are ads. The advertising is the value proposition I get; I am going to watch ads in exchange for content.

I do not get the fact that Google is going to them, or Microsoft, or dozens of other companies that I have never heard of are creating dossiers about me across multiple sites. That is what the efforts to do better notice and choice around are for.

DAVID LIEBER: I would agree with Justin on the point that there certainly are disincentives in terms of providing transparency. Once you do formu-

late a privacy policy—and there is no affirmative obligation to do that that I know of other than in California—once you do make those promises, they are enforceable. So there are disincentives to make the promises in the first place.

I think what I want to underscore, though, is that the issue of transparency here is not new. It has certainly gotten a lot more attention, but in the past, when you went to a mall and you filled out a card and provided a whole bunch of very rich personally identifiable information, you put that card in a slot. There were no disclosures about what the company would do with it, no disclosures about to whom that would be disclosed. No ability for you to access the data, no ability for you to correct it, no ability for you to exercise any choice about how that data would be used in the future.

I think with the advent of the Internet, and I think a lot of what we are doing at Google, we are enabling people to make choices. We do provide more transparency and we are constantly striving to get better in that realm. I agree with Justin in the sense that just because you provide information does not mean that you want all of it exposed.

I think people in their daily lives, when they access the Internet and they go on the Internet, in a lot of cases it takes a lot of time to learn about exactly how these things work. People feel comfortable that with most brand-name companies, their information is going to be protected and people are not going to misuse it.

I think we have pretty powerful incentives as an Internet company to do that. Our philosophy is we are just one click away from competition. If you look at a company like Google, the vast majority of our revenue comes from a website and, frankly, it is not that great of a website. It just has a box. If you think about it in that regard, if somebody comes up with a better search engine, we are in a lot of trouble, and I am not going to be on a panel like this in the future.

JAMES COOPER: We will invite you back.

SHANNON CHOY-SEYMOUR: One issue that you had brought up, do we need regulation? Is the private market really the one who causes change to happen? Maybe in some circumstances. We have Google and Facebook who are under the microscope, but there are so many companies out there who are not under that same microscope, and I think you need a baseline for those companies where the consumer might not be aware that their information is being used.

I am one of those weird people who gets a privacy policy and reads it through and highlights it, but I realize that I am rare. I think you do need that regulation where government entities are saying, "Yes, this is a baseline and even though you are a small mom and pop shop, you still need to protect information like Google would."

JAMES COOPER: Michael?

MICHAEL MARTONE: I think overall we are going to see increased protections for privacy. I think it is just a matter of time before the federal government really weighs in. I think there is going to be an enormous amount of pushback by a lot of the folks, by the powers that be, but ultimately I think we are going to see some type of privacy protection. What that action looks like I think is yet to be determined, but I do think that we will see increased protections. I would like to see them as protections, not regulations.

In many cases, as Shannon alluded to, when you have got a lot of small businesses and medium-sized businesses, those folks do not necessarily know where that bright line is in terms of what they need to do and how they need to do it. When they are operating on a limited budget and they are not the TJXs or the Bank of Americas of the world, it makes it much more challenging and difficult.

JAMES COOPER: Go ahead, Justin.

JUSTIN BROOKMAN: I think I would say that I was probably a lot more sanguine about the prospects of national legislation on this issue six months ago. I think you might see some national legislation around data breach notification just because there are already statutes in forty-seven different states, so it is something you already see a lot of push for from the industry. Can we just have one standard instead of forty-seven different states?

For me, as a consumer advocate, there is not a lot of value added for us. You are making it slightly cheaper for companies to lose my data. As far as national legislation about saying companies can do this—disclose what is going on and give consumers some rights around their information—in the last just couple of months there were some really important pieces of legislation that were worked on a lot in D.C. However I think the impetus behind them has died down until after the 2012 election.

Interestingly, I think one of the reasons for that is the *IMS Health v. Sorrell*[19] Supreme Court decision. Vermont had passed a law a couple years ago saying that pharmacies cannot sell information about doctors' prescribing habits to the pharmaceutical companies just because pharmaceutical companies want to know if Dr. Jones prescribes a lot of Xanax in order to try to sell him a lot of Allevia and Prozac too. Vermont passed a law, a badly written law, saying that awful, evil marketing companies cannot be accessing this data because doctors have privacy rights.

The Supreme Court said that law is unconstitutional, that it violated the marketing companies' First Amendment rights, and the law had no provision on what they could or could not say, but rather it flatly deprived them of information about doctors' prescribing habits. It was a 6–3 deci-

sion. The Kennedy opinion said pretty clearly that depriving the marketing companies of that information violated their speech rights.

So we look at legislation. Google has a lot of information about me. My Gmail account, all my Google searches, do they then have a First Amendment right to use that information however they want?

We do have some narrow sector-specific laws, like the Video Privacy Protection Act. Does Netflix have a First Amendment right to tell the world whatever I watch on Netflix? Is that what the First Amendment was designed to do? That is what the law is these days. So maybe it is a fact that the only efforts we can really do are self-regulatory or co-regulatory, industry-wide efforts.

JAMES COOPER: Oh, go ahead, Michael.

MICHAEL MARTONE: I think also, as part of the backdrop of this discussion, we have to recognize that privacy is constantly changing from generation-to-generation. There are things that my parents would not do. For instance, online banking my parents do not do, they do not feel comfortable as far as safety and privacy goes. There are things that my eleven-year-old niece does online with her social networking sites and such that I would never even think to do.

I think we really have to recognize that privacy is changing, it does change from generation-to-generation, and there has to be some type of baseline in terms of protections, transparency, and openness.

JAMES COOPER: To shift gears a little bit, we heard a lot of talk today about the patchwork of forty-seven different states having data security laws. Really, in no state, and certainly not at the federal level, do we have privacy laws. And I think Justin has made an important distinction between privacy, which is the collection of data, versus the data security once you have it, what you do with it.

At the federal level and state level, are the current consumer protection laws sufficiently flexible to deal with the problems, and if not, do you think we need national data security and privacy law?

Finally I will raise—which hopefully will not send Michael and Shannon screaming—the dreaded P word. Preemption. If we do end up going with a national privacy and data security law, one or the other or both, do you think it makes sense to have preemption to avoid patchwork? And if there were preemption, would it be setting a floor or setting an actual level?

That was like a twelve-part question. I will throw it out to Shannon and Michael.

SHANNON CHOY-SEYMOUR: There has been a lot of talk among the states about what legislation is out there, what is going to move forward, and what is not. I am mildly sympathetic to industry concerns about the

patchwork. I see where they are coming from, but I have not yet seen any federal legislation that protects consumers sufficiently. If I did see that legislation, maybe I would be more in favor of it. What I have seen so far has too many safe harbors, I think, for companies. The ones I have seen do not inform the state attorneys general offices about data breaches.

I think that we are very cautious, of course, about preemption. I think it is important that states still maintain that right to enforce because it is too much for just one federal agency to do. I think that states need to have that ability to bring cases. If there is preemption, I hope it is as limited as possible.

MICHAEL MARTONE: Yeah, I would have to agree with Shannon. I think the states have really been the leaders in terms of privacy issues, data breach enforcement in particular. The bottom line is that the FTC and other authorities just do not have the resources to be able to effectively enforce on their own. If there is some type of preemption, then certainly that would have to be taken into consideration and allow for state attorneys general to enforce notwithstanding.

JUSTIN BROOKMAN: I agree that most of the bills we have seen proposed, as far as on the federal level really are not quite strong enough to justify a strong preemption. There are some very strong states out there and they have probably stronger standards. We have asked for some sort of value added for consumers, saying "Okay, you are getting one standard, what more can you give us to make it stronger?"

One of the things you are seeing in some of the bills is data broker access. If you are a third party who collects information and sells reports about people who are not covered by the Fair Credit Reporting Act, which is most of the information brokers, maybe you make the information available to people just so they can see what is being sold about them.

The information broker industry is very powerful, and so we have seen this legislation introduced over and over again, and then that clause gets stripped out before it gets to committee.

One other idea that we like that should go into legislation and is not in most of the bills right now is having some sort of written security program. At first we were skeptical about it. There must be market incentives. When a company undergoes something like Sony's undergoing right now, what Epsilon is undergoing right now, like T.J. Maxx went through; it is an incredibly awful and terrible process.

But I think we have seen that this is just human nature, people underestimate a very low risk of a very terrible thing happening. That is what a data breach is—it is a really terrible thing happening.

So I testified on this topic a few months ago with Dr. Spafford from Purdue. He said data breach costs upwards of $200 per consumer when it happens. So under the law there really should be a very strong incentive to

do something, to put even just the most basic security in place. We have seen over and over and over again, laptops left in cars, Apache servers not even patched. If the company just had to sit down, think about it, and have a program, maybe that would help. So that is one of the things we would like to see in a bill.

As far as preemption, for a data breach bill, if it was strong enough, we could be behind preemption for baseline privacy law. In general, we like the idea of the states being an incubator of new ideas. Data breach notification was a new idea that states did, and we would like to see a federal law set a strong baseline.

If other states want to set extra protections on top of that, then that should be their right. If Texas wants to pass a strong healthcare bill, let Texas do that. If California wants to pass a law giving stronger protections over what books you read, then let them do that. There should be extra ability for states to do that when they make the decision, that is what their consumers want.

DAVID LIEBER: I guess I will make the argument for preemption. Here is a good example. We have Connecticut and Massachusetts, which have been at the forefront in terms of leading the charge on data security issues in particular. Michael had talked about Connecticut's breach notification statute, which has an access standard, and that is different than acquisition.

Michael also had mentioned that the data security rules in Connecticut deal with a broader universe of personal information than the data breach notification statute.

Massachusetts has a whole set of data security regulations that other states do not have. There is an encryption requirement, although I think it is somewhat flexible. That is different from Nevada, which has a hard encryption requirement, which also requires affirmatively that companies comply with the Payment Card Industry Data Security Standard (PCIDSS), which deals with how you protect credit card data. And there are many specifications and sub-specifications under the PCIDSS.

I would also say that Massachusetts has rules about what type of content you have to include in a breach notification that differs from other states. I have seen this in my previous job when I was dealing with security breach notification protocols and response programs. Sometimes you are notifying some state regulatory authorities and the content of your notice is going to differ depending on the residency of the affected individual.

So there are ways, I think, that you can get a national law that makes the rules simpler, particularly for smaller businesses that might have a breach that spans a number of different states. But I think what we are seeing in Congress—at least with the data breach and data security issue—is that Congress is looking for a way to get to a national standard to preempt the states on these issues and then to preserve a role for the state attorneys general to enforce those laws.

I will say that at least with some of the laws, in terms of the way that the preemption provisions are written, they would preserve the right of residents to sue under common law claims: misrepresentation, negligence, and breach of contract. There still would be remedies available to individuals as long as they were not suing under the state-specific data security laws or security breach notification laws.

I think that preemption, if it is properly crafted, can preserve the traditional role of the state attorneys general here in enforcing privacy and data security laws.

AUDIENCE MEMBER: Have there been studies on how they have handled these new problems that have come up because of the Internet and all of the other electronics that we have available for us that touch on the privacy concerns that you have just talked about?

Secondly, so many of these issues are not just issues in the United States. They are international issues. A lot of the breaches of things you are talking about are coming out of Eastern Europe or Asia or China, all kinds of places. How can we handle that with just doing a patchwork methodology we are left with, as you have discussed? Thank you.

JUSTIN BROOKMAN: I will take that. You are right. Europe for at least twenty years has had a data protection directive, which is a Europe-wide directive to the twenty-seven member countries, to a pass around privacy law, each of which is a little bit different. It is a really hard question about how you take what these very high-level information, fair information principles, like transparency, choice, data minimization, and translate that to a company like Google, which has like 8,000 business lines and is inventing two new ones every minute. How do you translate the high-level principles to on the ground?

It is hard, and people have had to try to think about how to do it. You can write very prescriptive law, like the tax code, and revisit it every year. I do not think anyone thinks our legislatures are really capable of doing that. You could do it through more regulations. Someone like the FTC could pass rules as industries emerge about how that industry should treat data. You can do it through sporadic enforcement, and that is how it has been done in Europe. Every once in a while the German data protection authority will sue Facebook or will arrest someone from Google for something that happened, which is not giving a great deal of firm guidance to companies who are trying to figure out what to do.

One model that we are seeing pushed in the U.S. and in Europe now is this idea of co-regulation. You have these principles, maybe the first half say, "Okay, we are the data broker industry, we are the online advertising industry, here is how we think maybe that the law applies to us." Then the regulator or the data protection commissioner or the FTC checks it and says "Okay, that is a safe harbor. You guys do that with these improvements,

that will be fine," because no regulator can really keep up with all these things.

When cookies came out, the European commission passed a cookie law that says cookies are illegal, which does not make any sense. When they try to be very technology prescriptive, it is not a good privacy result for anybody. So a company trying to deal in Europe is thinking, "I have no idea what I am supposed to be doing right now."

You are definitely seeing a lot of companies and industry and consumer advocates trying to think of a flexible way to protect privacy in an increasingly borderless world where different jurisdictions have different laws and no one is really sure what they mean as far as new technologies come out.

MICHAEL MARTONE: Just to touch upon the second part of your question. Not all breaches arise from outside hacking incidents. Obviously there have been instances, many instances of lost laptops, improper disposal, the list really goes on and on and on. Just in terms of addressing third-party hacking incidents in places like China and Eastern Europe—which you are absolutely right, that is where the front of the attack is coming from in many cases—I think that companies in general, while they will not always be able to prevent breaches, what they will be able to do essentially is ask themselves, "How long am I keeping this information for? What am I keeping? How robust is my security system and my security measures in terms of protecting information? Do I have a plan in place to respond?"

On many of those fronts, since we have been in this business of enforcement over the last five, six, seven years or so, we have found that a significant number of those companies have failed in each of those areas and others. Those are areas where they should be top-of-the-line and they should have plans in place. They should know what they have in terms of the information that they are collecting, they should have a plan in place to remove information that they no longer need for any business purposes as soon as they are done with it.

I think if they at least do that—I am not saying that's the only thing they have to do—but if they at least hit those measures, they will be head and shoulders ahead of where many companies are today.

AUDIENCE MEMBER: Thanks.

AUDIENCE MEMBER: I want to pick up on something you said, Mr. Lieber. It is a judge's question. Assuming that there are some private causes of action that still are available to people and that individuals choose to assert their own rights without going through a regulatory scheme—I do not know whether state statutes have a private cause of action, but let us assume for purposes of my question that they have an individual right to assert their own individual injuries.

I believe that a lot of the law in this area that is protective of consumers is going to be developed by the individuals, by litigation rather than legislation because we know how the legislature has to work in this ponderous fashion.

So tell a room full of judges what potential remedies there might be. How proactive can a court be in structuring a remedy that basically attempts to put the genie back in the bottle and does not just create an economic loss or offset in money damages? Because that is what the regulatory system is doing. It is saying, "If you disclose this information improperly, you have to pay a fine. You have to somehow offset the society's loss by an economic loss." But for the individual, the real injury is having the information out there that cannot be retrieved and revoked in anyway.

So give judges some idea of what kinds of remedies might be available for a personal cause of action.

DAVID LIEBER: Tough question. I would argue because there are limitations in terms of when private litigants are seeking monetary relief, there are inherent limitations in terms of what judges can do if there has not been any actual harm. If there is no identity theft, fraud, or anything where you can attach a dollar figure, it is difficult in that situation to come up with a remedy.

In some instances, there is probably some room for creativity when plaintiffs are seeking injunctive relief. There will be questions in terms of an individual judge's authority to order a defendant to do something that is not otherwise required by law.

In a way, that could raise a number of different issues. Let me give you an example. At the state level, let us assume there is a suit that has merit and is litigated, that injunctive relief is sought. In a lot of situations, and this is not talked about a lot, but there are Dormant Commerce Clause considerations.

When a state remedy is put forth, or a state chooses to enact a piece of legislation, how does that state confine an Internet law to the state's borders? The Internet is borderless. So there has been a lot of litigation when states have tried to regulate the Internet and courts have struck it down because it essentially regulated interstate commerce in contravention of the Commerce Clause.

There are probably ways for judges to fashion remedies because there are broad unfair and deceptive trade practices statutes. There are laws in a number of states that require companies to implement reasonable security. The security breach statutes are pretty broad in terms of saying you have to notify people without unreasonable delay.

So in those situations, I think there is some room for discretion for judges just to say if a company notified its consumers ninety days out, and that notification is being litigated, there are remedies that can be fashioned to require companies to notify sooner or to implement data security proto-

cols going forward that may reduce the likelihood of this sort of harm in the future.

JAMES COOPER: Well thanks, David. I think that is going to have to be our last word, since we are over. But please help me in thanking our panelists for this great discussion.

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[1] Brief of Center for Democracy & Technology et al. as Amici Curiae Supporting Respondents, United States v. Jones, 132 S. Ct. 945 (2012).

[2] United States v. Jones, 132 S. Ct. 945 (2012).

[3] Organization of Economic Cooperation and Development. For more information *see OECD Guidelines on the Protection of Privacy and Transborder Flows of Personal Data*, http://www.oecd.org/document/18/0,3343,en_2649_34255_1815186_1_1_1_1,00.html (last visited June 3, 2012).

[4] Gramm–Leach–Bliley Act), 15 U.S.C. §§ 6801-09,106 Pub. L. No. 102, 113 Stat. 1338 (Nov. 12, 1999).

[5] Children's Online Privacy Protection Act of 1998 (COPPA), 15 U.S.C. §§ 6501-06, 105 Pub. L. No. 277, 112 Stat. 2581-728 (Oct. 21, 1998).

[6] Unfair Methods of Competition Unlawful; Prevention by Commission, 15 U.S.C. § 45 (2006).

[7] People v. Direct Revenue, LLC, 19 Misc. 3d 1124(A) (N.Y. Sup. Ct. 2008).

[8] *See In the Matter of Sears Holdings Mgmt. Corp.* (Sep. 9, 2009), *available at* http://www.ftc.gov/os/caselist/0823099/index.shtm.

[9] Regulation of Business Practices for Consumers Protection, MASS. GEN. LAWS ANN ch. 93A (2011).

[10] Electronic Communications Privacy Act of 1986 (ECPA), 18 U.S.C. § 2510-22, 99 Pub. L. No. 508, 100 Stat. 1848.

[11] Computer Fraud and Abuse Act, 18 U.S.C. § 1030 (1984).

[12] Cable Communications Act of 1984, 98 Pub. L. No. 549, 98 Stat. 2780.

[13] Anderson v. Hannaford Bros. Co., 659 F.3d 151 (1st Cir. 2011).

[14] Conn. Gen. Stat. Ann. § 36a-701b (West 2012).

[15] Conn. Gen. Stat. Ann. § 42-470 (West 2012).

[16] Conn. Gen. Stat. Ann. § 42-471 (West 2012).

[17] Assurance of Voluntary Compliance.

[18] Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, 110 Stat. 1936.

[19] Sorrell v. IMS Health Inc., 131 S. Ct. 2653 (2011).

MEDICAL LIABILITY REFORM: AN ISSUE FOR THE STATES, THE FEDS, OR NEITHER?

David Kendall, Jonathan Klick, Paul Taylor
Moderator: Scott Hazelgrove

LINDA KELLY: I am pleased to introduce my colleague, Scott Hazelgrove who is a Policy and Research Associate with us at the Law and Economics Center who will be the moderator for the next panel. He's going to introduce our distinguished panelists. Thanks, Scott.

SCOTT HAZELGROVE: Welcome back. And thanks for joining us for our second morning session. Here on this medical liability reform panel, we have Paul Taylor who is the Chief Counsel on the Subcommittee on the Constitution of the U.S. House Judiciary Committee. We have David Kendall who is the Senior Fellow for Health and Fiscal Policy at Third Way. And then we have Jonathan Klick, Professor of Law at the University of Pennsylvania School of Law. So Paul is going to get us started here.

PAUL TAYLOR: Thanks everybody. It's an honor to be here today with such distinguished jurists, and thanks to George Mason University School of Law for inviting me. I want to give a short presentation on how James Madison and Alexander Hamilton articulated the purpose and the intended effect of the federal commerce laws and how that relates to federal tort reform today. I have a more elaborate discussion on these points that's going to be published in the *Suffolk Law Review*, but that's not until next year. First, I want to highlight some interesting correspondence that James Madison entered into with Thomas Jefferson back in 1825.

Jefferson asked Madison what source materials should be used in a class on American political principles at Jefferson's new University of Virginia. Madison replied, and Jefferson agreed, that next to the Declaration of Independence and the Constitution, the most important documents were the *Federalist Papers*. The *Federalist Papers* were pamphlets written principally by James Madison and Alexander Hamilton during the New York debates on the ratification of the Constitution. They were distributed nationwide to some extent, but they were also sort of handed out to proponents of the Constitution at various state conventions so that the opponents could use them sort of as "crib notes" during their debates. James Madison called the *Federalist Papers* "the most authentic exposition of the text of the Federal Constitution as understood by the body which prepared & the authority which accepted it."[1]

So I'm going to focus on the *Federalist Papers* today. Everybody is familiar with, I'm sure, the simple text of the Commerce Clause, that "Con-

gress shall have the Power . . . To regulate commerce . . . among the several States[.]"[2] What did Hamilton and Madison have to say about the Commerce Clause? Well, first, the Commerce Clause was recognized as being the most important change to the prior Articles of Confederation. Hamilton writes in *Federalist Paper* 11, "[t]he importance of the union in a commercial light is one of those points about which there is least room to entertain a difference of opinion and which has, in fact, commanded the most general sense of men who have any acquaintance with the subject."[3] Creating a Commerce Clause was actually the sole genesis of what was called the Annapolis Convention, which was the very first official call to revise the Articles of Confederation.

The Commerce Clause, according to Madison and Hamilton, was also necessary to allow Congress the ability to provide for the free flow of goods and services nationwide so America could become a dominant economic power. Forgive me for this one extended quote, but it's a fairly important passage. Again, Hamilton in *Federalist* No. 11 says, "[a]n unrestrained intercourse between the states themselves will advance the trade of each by an interchange of their respective productions, not only for the supply of reciprocal wants at home, but for exportation to foreign markets. The veins of commerce in every part will be replenished, and will acquire additional motion and vigor from a free circulation of the commodities of every part. Commercial enterprise will have much greater scope, from the diversity in the productions of different States. When the staple of one fails from a bad harvest or unproductive crop, it can call to its aid the staple of another."[4]

The Commerce Clause was also necessary to allow Congress to counter not only the source of state imposed trade barriers that increased prices at the time, but also future trade barriers, the nature of which would change with time. Here's Madison on this point. He said in *Federalist* No. 42, "[t]he very immaterial object of this power of Congress, the Commerce Clause, was the relief of the states which import and export through other states from the improper contributions levied on them by the latter. Were these states at liberty to regulate the trade between state and state, it must be foreseen that ways would be found out to load the articles of import and export during the passage through their jurisdiction with duties, which would fall on the makers of the latter and the consumers of the former. We may be assured by past experience that such a practice would be introduced by future contrivances. And both by that and the common knowledge of human affairs that it would nourish unceasing animosities and not improbably terminate the serious interruptions of the public tranquility."[5]

So the point of the Commerce Clause was not just directed at the trade barriers they saw at the time but also future, as yet unseen, barriers. And here's Hamilton on the same coin. Without the Commerce Clause "this intercourse between states would be unfettered, interrupted, and narrowed by a multiplicity of causes. A unity of commercial as well as political interests can only result from the unity of government."[6]

The Commerce Clause was also necessary, according to Madison and Hamilton, not just to protect the free flow of products between the states, but also to protect the free flow of skilled professionals and laborers between states.

Here's what Hamilton had to say in *Federalist* No. 12: "When multiplying the means of gratification, commerce serves to vivify and invigorate the channels of industry and to make them flow with greater activity and copiousness, the assiduous merchant, the laborious husband, and the active mechanic, and the industrious manufacturer, all orders of men look forward with eager expectation and growing alacrity to this pleasing reward of their toils."[7] Now, with that understanding and purpose of the Commerce Clause in mind, Madison and Hamilton then moved on in the *Federalist Papers* to discuss the dividing line between state and federal authority under the Commerce Clause.

They made clear the line would be drawn by the people themselves. Hamilton writes in *Federalist* No. 17 that the general rule should be that Congress would leave to the states those "authorities judged proper to leave with the states for local purposes."[8] However, he made clear that such a general rule could be deviated from by Congress when the states did not administer such authorities "with uprightness and prudence, especially when it came to the administration of authorities related to Federal issues such as commerce, finance, international negotiation, and more."[9]

Here's Madison on the same point: "If the people should in future become more partial to the Federal than to the state governments, the change can only result from such manifested irresistible proofs of a better administration."[10] And Hamilton elaborating on this point further in *Federalist* No. 27 states, "I believe it may be laid down as a general rule that the people's confidence in an obedience to a government will commonly be proportioned to the goodness and badness of its administration."[11] And he was referring to the federal versus the state governments.

Political scientist David Epstein highlights the importance of this point. He says, "[t]hus the relative spheres of the central and state governments will depend on the relative attachment of the people, which may be expected to change in the future. The central government will have to prove itself by good administration. While the Constitution does enumerate the objects of the central government, the partition between states and nation will not be as much of a legal issue as a political one."[12] Hamilton often used the metaphor of scales when making this point. He wrote that the people will hold the scales in their own hands. It is to be hoped they will always take care to preserve the constitutional equilibrium between the general and state governments. [13]

Of course, state governments were well known at the time to be capable of administration. In fact, Madison wrote that abuses by state governments contributed more than anything else to the need for a new Constitution. So how does all this relate to modern tort laws? Well, remember that

in *Federalist* No. 42, Madison wrote that the Commerce Clause was necessary to allow the Congress to counter future contrivances in the states that limit the free flow of goods and services nationwide. One such future contrivance, it could be argued, is the vast expansion of tort liability in the states and the adverse effects of such an expansion. Legal historian Lawrence Friedman described the situations as follows. "The dramatic extension of the tort system of the 20th century is unquestionably real. People brought law suits, which would have been unthinkable in the 19th century or even in the earlier part of the 20th."[14] Here's a familiar chart showing the rising tort cost per person in America. The annual direct cost of tort litigation is reported to have seen $250 billion a year, almost 2% of the gross national product. And regarding products and liability, Madison wrote in *Federalist* No. 42 that the Commerce Clause was necessary to allow Congress to remove state barriers to trade that involved the loading of goods that entered into their jurisdictions with taxes and duties, which increased prices to consumers.[15]

A modern manifestation of the problem Madison first saw is that today, some states' tort laws allow virtually unlimited lawsuits, which increase the costs of selling products or services that cross into their jurisdictions. The modern term applied to that phenomenon is the "tort tax," and when it's applied to national industries, it is passed on to consumers everywhere. The result is higher prices and lost jobs across multiple states or nationwide. When that happens, Congress can, and often should, pass Federal tort reform.

Some might argue that businesses can avoid tort liability by simply avoiding states that have oppressive tort laws. Madison rejected that argument against congressional action, arguing instead that Congress should have the power to enact rules that allow products and services to enter into a state jurisdiction without having to worry that doing so would dramatically increase the price of their products and services elsewhere. Not surprisingly, state tort law can also have dramatic effects on the interstate movement of individuals with valuable skills. Let us look at one study from the Mercatus Center, which is located here at George Mason University School of Law.

The study ranked states based in part on how onerous their liability systems were on business. Using a survey of business owners and managers, the study sought to determine whether free states tend to attract more people than less free states that tend to repel them. The researchers concluded that substantively, the results showed an increase of 0.5 points on the freedom scale increases net migration to a whopping 5.9 percentage points. One profession that has been particularly hard hit by the dramatic expansion of tort liability is the medical profession. Before the 1960s, only one physician in seven was sued in their lifetime.

Today, about one in seven physicians are sued per year. I am not going to steal much of Jonathon's thunder, but studies show that medical lia-

bility laws can have a significant effect on the movement of certain medical professionals from state to state. Studies also showed that Mississippi and Texas, two states that enacted medical tort reforms recently, have experienced a significant rise in the number of doctors practicing there. To cite a quote from the Texas study, "[p]ost tort reform physician practice in the state of Texas grew at double the rate of the Texas population."

It is also worth noting that during his later service in the first Congress as a member of the House of Representatives, Madison spearheaded the legislation that made clear he understood the Commerce Clause gave Congress the power to enact legislation that had the purpose and effect of bolstering its domestic manufacturing economy against foreign competition. On the House floor, Madison quoted the Domestic Commerce Clause saying, "While the states retain the power of making regulations of trade, they have the power to protect and cherish such institutions. By adopting the present constitution, they have thrown the exercise of this power into other hands that is Congress. They must have done this with an expectation that those interests would not be neglected here."[16]

By the same logic, Congress could act under the Commerce Clause to enact tort reform legislation allowing domestic commercial entities to better compete with foreign commercial entities. As this chart shows, tort costs to businesses in the United States are the highest as a percentage of gross domestic product as compared to all others reported in other industrialized countries. They more than double the estimates for countries such as the United Kingdom, France, and Japan. So the statistics outlined above indicate a need for tort reform that can be enacted at the state level.

But in the absence of such state action, the *Federalist Papers* understanding of the Commerce Clause allows ample room for federal action. As Hamilton wrote, federal solutions may often be preferable to the people because federal representatives can be "less apt to be tainted by the spirit of faction"[17] than state officials who can sometimes "beget injustice and oppression on the part of the community and engender schemes, which though they gratify a momentary inclination or desire, terminate in general the stress, dissatisfaction, and disgust."[18] Stark measures of such disgust regarding the state regulation of lawsuits can be found in public opinion polls.

One prominent poll taken right after the 2008 elections found that 83% of voters believed the number of frivolous lawsuits is a serious problem, including 77% of Democrats, 80% of Independents, and 92% of Republicans. So in conclusion, the authors of the *Federalist Papers*, which are considered to be the most authoritative exposition on the Constitution, advocated for a Commerce Clause Congress could use to remove state barriers to trade which weakened the national economy.

The examples they gave illustrating the need for the Commerce Clause, encompassed by their logic, some federal tort reforms regarding both state products and personal liability law insofar as such reforms are required to counteract significant negative impacts on America's free enter-

prise system. Today, in new ways, the authors of the *Federalist Papers* foresaw, but not in detail, state tort law regimes have resulted in sometimes dysfunctional incentive structures that have limited economic innovation and productivity on the national scale. Under such circumstances, I think it might be prudent for Congress to enact uniform rules to better administer free commerce among the states. Thanks.

DAVID KENDALL: A friend of mine nearly died on the operating table a couple of years ago. Something went gravely wrong during his surgery. As a physician, we were able to stitch together what had happened. He nearly died from a medical error. Fortunately, he did not suffer any long-term permanent damage, but he was alarmed about the care that he had received. So he decided to seek out this trial lawyer to take his case. It was a big step for a doctor, as you can imagine. However, the trial lawyer said that there was nothing he could do for him. Without substantial damages, it would not make any economic sense to take the case. And besides, "Why bother?" Those are the exact words.

That statement, "Why bother?" reflects one of the many obstacles that patients face when seeking justice for a medical injury. The sad truth is that patients injured by medical errors, including those with serious injuries, rarely get justice. The medical malpractice system is failing to compensate victims of medical errors and should prevent those errors from happening. I have been working on this issue for about twenty years on and off. My current organization, Third Way, is a think tank that creates and advances moderate policy and political ideas. And if there was ever an idea that there was a policy that needed a moderate alternative to the periodic fight between doctors and trial lawyers, this would be it.

So, in my remarks, I would like to cover three aspects of the medical malpractice system. First, I would like to look at the problems facing patients and use those problems to describe the scope of what medical malpractice reform should be. It is usually defined much too narrowly. Next, I want to look at the current limits on federal and state responsibilities for reform. That is, sort of the assignment of the panel here, to look at that issue, but we really cannot sort out the responsibilities for federal and state reform until you first define the problem. And lastly, I want to offer some ways to overcome the limits of federal and state responsibilities, a solution that would ideally involve many of you here in this room.

In 1999, the Institute of Medicine released its landmark report, *To Err is Human: Building a Safer Health System*.[19] It estimated that between 40,000 and 98,000 patients die each year in the hospital from preventable errors. These numbers were based on the *Harvard Medical Malpractice Study*, which was first published in 1991. The effect of the study was to find a relationship between medical errors and patient compensation. They did not find much. Most people injured by medical error never receive compensation. Only 2% of injured patients even file a claim. My friend

never even made 2%. For every valid claim, there are four unfounded claims.

The chance of success for patients who file a claim is about one-third. The few so-called "winners" in this system will have waited years to see any money, and more than half of that settlement will go to cover court costs and lawyer's fees. If you take two doctors practicing the same medicine, treating the same person, the court system is likely to treat the doctors two different ways. Similarly, two patients who have the same injuries, and exact same circumstances, will often get dramatically different awards. These are not the usual characteristics of the problem you hear about in the malpractice debate.

What happens is that about every five to ten years the malpractice insurance liability crisis rears its ugly head. Malpractice insurance goes belly up. The premiums increase. Pregnant women and other patients have trouble finding a doctor. Employers and consumers pay more in healthcare to cover the costs. Maybe a few things happen, but pretty much everything settles down into a calmer albeit more expensive state of affairs after the crisis is over. Sometimes in the middle of these crises, things do change. States like Texas and California have enacted caps on damages and other reforms that end up reducing malpractice liability costs for doctors. There is no doubt that they have accomplished that.

The doctors in these states pay lower medical malpractice insurance premiums. But do the patients in those states get better care or better justice? That is not so clear. That typically has not been the focus of those reforms and there are no results. There is no consensus of what we have achieved on any goals like that. What we do know is that you can achieve lower malpractice insurance premiums. But when so few patients receive compensation, and so many medical errors persist, we really have not solved the underlying problem. What I would suggest, is that we need a court system, and an ideal one, which has three characteristics.

First, it has better access to justice. It gives patients the opportunity to find out if they are victims of bad luck or bad care. Second, they need to have a consistent performance so that doctors can find out whether or not the court system is going to treat them right if they treat their patients' right. And the last characteristic is fairness. The court system needs to address equally patients who have injuries. And no one should give too much.

Right now, what the states face—and what we face with the federal and state system—is a system where the states write the laws, and the federal government foots much of the bill for the consequences of those laws. In particular, the federal government pays for defensive medicine. To further make this point, about half of the nation's healthcare bill is paid for by the federal government, either through Medicare, Medicaid, or the tax code. And so what we know about defensive medicine is also limited. But we do know that there is some number, probably between 0.5% and 9% of the total healthcare system, which is wasted on care that is intended to avoid

lawsuits. In order to capture and reduce those costs, I would suggest a new model for exchanging this system rather than one that sort of fights between the trial lawyers and the doctors, or one that fights between the federal and state responsibilities.

Let me turn to a model for that—welfare reform. Like the medical malpractice debate, the story of welfare reform began in the states. In the 1980s and the 1990s, states like Wisconsin and Governor Tommy Thompson made progress at welfare reform, but it clearly was not enough. They could not do it by themselves. The welfare debate in 1988 did very little. As a young staffer for the House of Representatives, I remember President Reagan calling for his idea of welfare reform. His version was less welfare. The Democrats offered their version, which was more welfare. It was a tug-of-war between more or less access to welfare, just as today's malpractice debate is a fight over more or less access to justice.

The old welfare system was bad for people who were trapped and for the taxpayers who were funding them. The only folks who were really benefiting from it were the program administrators and caseworkers who were in charge of the system. The federal entitlement under the welfare benefits was a major obstacle to ending the cycle of poverty and welfare dependence. But that policy also gave the federal government leverage to make national policy. That is not unlike the huge leverage that the federal government has today with its own healthcare spending. In 1995, President Clinton desperately needed a victory to show how he got from the [inaudible].

We probably can see the same result after they went too far in shutting down the government. Finally, all the pieces were in place for a major change, and the rest is history. So there are a lot of parallels between the welfare debate and the medical malpractice debates. States haven't gone far enough in solving the problem. There is a tug-of-war between having more or less access to welfare or, in this case, to medical justice, and no one is happy with the current system—except those who are in charge of it—mainly through the trial lawyer. So federal policy is both an obstacle as well as an opportunity to change, and we need to find a way so we can give both parties an idea of how to do it.

Now, you all in this room can probably design—would be the best qualified to design—the best legal ways in which we could improve the medical malpractice system. I personally would like to see a health court, which has certain characteristics. But that is something that we need to find out. There is no certainty about how we need to change this system, but we do need to try. So let me just offer three ways in which we could start a series of experiments and create safe opportunities for adaptation of the current system to get at the knowledge about how we can really design a system that prevents injuries and delivers to patients, who are injured, compensation.

First, why don't we share the savings from malpractice with our test states. The federal government is paying all this money, the states are making the laws. Let us say the states make more efficient laws, they can share some of those costs. What we would do is have the Department of Health and Human Services measure the baseline that the states are spending to see what the changes were, if the states enacted these laws, and then share part of the savings with the states if they lower costs in certain areas. This would help ensure that there is an upfront investment in those test models through various grants and so forth.

As has already happened in the Affordable Care Act, we have already enacted this notion of experimentation. Unfortunately, it was too tied to the current system, which doesn't allow you to establish a new system that goes outside the current court system. Another idea would be to apply the Federal Arbitration Act to test new models of justice. The current law allows each of those doctors and hospitals to present any malpractice claim to an alternative arbitration process. So we can do this under current law, but the problem is that there is enough ambiguity in the law that would likely draw a legal challenge and make the cost of defending that legal challenge from the trial lawyer extremely costly.

So all we need is a simple clarification of the Arbitration Act that states that it could actually apply to providing a regulated system of alternative assistance in justice. The third way would be to use the U.S. Court of Federal Claims to test new models of justice. Malpractice cases against healthcare facilities and public health clinics provided by the government do not go through the traditional court system. Instead, they go through the Federal Claims Court. This federal court lacks expertise in malpractice cases and often treats them as mediation instead of adjudication.

In this case, a health court would lower the costs for the plaintiffs and increase access to justice. Congress can establish health courts or other options within the Federal Claims Court process just by simply enacting the revision without having the debate over federal versus state responsibilities. All this is going to require some leadership both by elected officials and policy leaders, but also by you. What this debate has been missing is a sense that the judges themselves, who are responsible for the system, are going to take some ownership for the problems that are out there and find ways to innovate and move the debate forward.

So my friend, he didn't have a major injury. He would have been fine—he is fine. But even $1,000 compensation for him would have allowed his injury to be plugged into a database and treated as a way in which you measure the errors that doctors make. That would in turn encourage doctors to prevent those errors and have more rational reactions to those judgments when they are made by the court system. And it can also lead to safer care. Thank you.

JONATHAN KLICK: Okay. So I am going to cheat a little bit. I am not going to speak directly to the federal versus state issue, although we could probably get to that based on what I am going to talk about. Although I do teach torts at Penn Law, and I am a lawyer, I also make comments and do a lot of statistical work. I am going to spend my time talking about a lot of the underlying empirical claims that we hear in this debate, in fact, that we heard from both Paul and David, because tort reform is an area where almost everybody thinks they know what is going on and what the effects are. But when you actually look at the data, things are really very surprising.

It turns out nobody really quite knows what is going on. What do I mean by that? I am not saying that I am against tort reform either at the federal or state level. To my mind, at least as a conceptual matter, the best evidence that suggests the tort system is kind of screwy is that medical malpractice liability insurance is the only line of insurance that I am aware of in the entire world and in all of history that is not risk rated. That is, the insurers do not take into account past liability history when they determine premiums. That seems really odd, right?

When we are driving around in our cars, one of the things we worry about in terms of getting in an accident is to say, "Oh my goodness, my insurance rates are going to go up." Or when you get pulled over by a cop, you beg and plead so that he reduces the charge so you do not get points on your license. But doctors, if they get sued or they get dragged into court, or they get a judgment against them, that does not directly factor into the calculation of their premiums. Now, you might wonder why is this, and a lot of economists have sort of puzzled over this. Insurers are in the game to make money.

It would seem that if this provided information content, insurers would exploit it. But if you talk to the insurers, they basically say, "Look, the tort system is a random draw." That is, something bad happens, you might as well flip a coin to figure out whether or not you are going to have to pay for it or that you will even get brought into court or what have you. So to my mind, conceptually, there are plenty of reasons to be suspicious of the tort system. But when you start drilling down and trying to figure out what it is that is problematic about the tort system or, maybe for this audience, what are the right solutions, you find out that the simple solutions that various sides offer are not borne out by the data.

Okay, so what do I mean by that? Well, Paul had a nice slide up there where he said, "Look, there is literature looking at how tort reform effects where doctors are willing to practice." And he is right. He presented our research accurately, and even had a quote from us. It was a valid quote from the article. But the research that others and I have done has been misinterpreted slightly. This research is about ten years old. There is a big boon in this area and probably about half a dozen articles have been written.

But what guys like me and other folks like Dan Kessler and William Sage did, was published in the *Journal of Legal Studies*. They were pub-

lishing in the *Journal of the American Medical Association*. What they said is: "Well, you have these debates about tort reform, when in fact, in some states these debates have gotten so heated that you have actually had doctors marching on the state capitol saying 'Look, if you do not engage in tort reform, we're all leaving.'" For example, this happened in West Virginia.

The lore in Philadelphia is, unless you are lucky enough to go to the University of Pennsylvania Hospital, you cannot have a baby delivered in the city of Philadelphia. That seems odd. I know lots of people who have had babies delivered in the city of Philadelphia. So there is a lot of heated rhetoric on this issue. So what a lot of us did is we actually looked at the data. This was about 2000/2001. We all got together the best data that we could find on where doctors practiced, what specialty they specialized in, and things of that nature.

We compared what happened in the states before and after tort reform was enacted with what is happening in other states that are not enacting tort reform. The basic idea is that although we cannot run experiments the way science guys do, in social science we try to exploit these natural experiments. That is, you have a legislative change or a court change, and you try to see what outcomes change as a response to that, and you look at what is going on in other jurisdictions as a control, so to speak, because there may be other things going on in the economy, etc.

What we found—and pretty much what everyone else found—is that the state enacts damage caps, which the most asked-for tort reform. When the state enacts damage caps, you do see a little bit of an increase in the supply of doctors in the state. This is the kind of result that Paul noted and that a lot of the tort reformers noted. "Pass tort reform, get more doctors." Yes, but, and what is the "but?" Well, in our research, and what other people have found, is that the effect is very, very concentrated.

What do I mean by that? Well, if you are a podiatrist, you do not care about tort reform. You are never going to get sued. There is no way in which this effects your decisions at the margin. If you look at the data, this effect runs all the way up to doctors who were in specialties we generally associate with having somewhat of a risk. If I am an emergency room doctor, it turns out, I do not change my behavior in terms of where I practice or what I practice based on tort reform. So then, where are we getting the results? What we are finding is the results are concentrated among three or four specialties: the three or four specialties that get sued the most often.

This includes various surgeons: thoracic surgeons, neurosurgeons, obstetricians, and folks like that. You have a concentrated effect. It is not as though doctors generally care about tort reform or at least care enough so that they change their behaviors. A handful of doctors in some very high-risk specialties care, but then the question we need to ask is: "how big is the effect?"

Now, Paul and the other folks who quote our results, they quote what we say in the paper, which is to say, there is a statistically significant effect.

That is different from saying there is a *big* effect. So what we were finding is on a per capita basis, a state that enacted tort reform saw an increase in their number of high-risk specialty doctors—again, these three or four specialists—of about 3%. Is 3% big? Is it little? I do not know. Different people can have different opinions on this, but I know it is not absolutely huge. And so to think of tort reform as some sort of panacea to assess the "care" kinds of questions is probably wrong.

Again, we were finding results that were consistent with what everybody else was finding. Tort reform does seem to have an effect, but it is very concentrated, and it is relatively modest. To my mind, a natural policy implication of that is if you want these kinds of effects, tort reform may be a fairly blunt instrument to use to go after them. One could imagine many more targeted policy interventions—subsidies—or something along those lines. The second question that we might ask is, "Why do we care about the market for doctors?" We do not really care where doctors practice; we care about public health.

And so you might say, "Well, we must obviously know what the effect of all this is on public health for people that care about these issues. What about these other issues?" David mentioned the defensive medicine problem and the defensive medicine idea. It has been around for doctors for a long time, and they have talked about it for years. But it really got a lot of attention back in the 1990s when Mark McClellan and Dan Kessler published a very famous paper in the *Quarterly Journal of Economics* called *Do Doctors Practice Defensive Medicine*?[20] What they did is employ a natural experiment research design.

They had a Medicare database where they looked at all the people who presented in hospitals who were Medicare patients with signs of a heart attack. What they looked for was whether or not these folks were treated differently in states that had enacted tort reform. They looked at patient treatment before and after the enactment of the tort reform to make sure they were not inflating the problem by not taking into consider that, for example, California doctors treat heart attack patients differently than Florida doctors who treat it differently from Pennsylvania doctors.

What they found was the defensive medicine result that you all are familiar with. For example, if I am a doctor who is treating an elderly heart attack patient in a state that doesn't have tort reform, then I end up ordering every test in the book. The idea being that even if this is not clinically valuable, I do not want something to go wrong that would cause me to get dragged into court.

They had evidence that doctors were ordering more tests and procedures when they were not protected by tort reform, which is not necessarily defensive medicine, because it could be that these tests are actually generating some value. The whole economic theory behind tort liability is that it actually induces doctors, or people in general, to engage in proper care levels. So in this case, it may be that these extra tests were actually useful, but

the evidence suggested that they were really ordered as a result of defensive medicine.

In light of this finding, Kessler and McClellan then looked to what was the eventual outcome for these heart attack patients, and found absolutely no difference. That is, you could have 50% more tests ordered for you, and yet you were no more or less likely to die. This is what they used to call the defensive medicine result. They came up with a back-of-the-envelope number, which suggested that this could account for many billions of dollars. Their number is the 5% number that fell in the higher end of the range that David noted, and this number has become part of our consciousness. Everybody knows that defensive medicine is important; but it turns out that everyone who has tried to duplicate and replicate the Kessler and McClellan result has failed.

CBO has attempted to replicate this result; they have not been able to do it. What is even more shocking is that Kessler and McClellan themselves have not been able to replicate the result. In a subsequent paper, they tried to look for the same result in a later period, and they did not find it. So it may well be that even this defensive medicine that we worry about is maybe as much folklore as anything. Where does that leave us? Quite frankly, we do not know a ton about what the effects of tort reform would be in this particular area. We actually do not even know what the effects of tort reform would be beyond medical liability.

This is a pretty hard empirical problem to get to the bottom of. Now, you might be saying, you read in the *New York Times* that ever since Texas enacted tort reform everybody can get a doctor. There is a doctor on every street corner so to speak, and if you look at the data, it does seem so. Some metrics of medical liability have declined in Texas post-tort reform. There does seem to be more people practicing in that state. Here is the problem: how do you know it is not being generated by other factors? It turns out if you look in other states, the exact same things are happening.

I have gotten a number of calls from friends of mine who were insurance brokers in this particular area and they say, "Klick, what's going on? Our business has all dried up." These are not guys who are trying to sell insurance in Texas. These are guys who are selling insurance in New Jersey and Pennsylvania. What happened? It turns out that medical malpractice as a field of law, as a field that interests people, is not very interesting in any state. It turns out that Texas is probably not so different, and so to attribute what has happened in Texas to their tort reform is problematic.

You may say, "Well, Klick, then why does the *New York Times* keep running these stories?" Quite frankly I do not know. In fact, every time they run the story, they call me and they say "Hey, can you tell us about this?" And I say, "Well, it is not at all clear that it is anything specific to Texas." And they say, "Okay, thank you very much," and then they call someone else. So this is actually a big problem. It is a problem in many areas of public policy, but it is a particularly acute problem in the area of

medical malpractice because all of us have these deep intuitions and these beliefs about what is actually going on, what the empirical truths are. But it turns out that the data has not revealed any of these things.

You may ask about some other ancillary issues. Are there any other metrics? Can we show any indication about what is the effect of our liability system in general? Maybe not even the effect of tort reform, but maybe about our liability system and the costs of medicine in this country in general. We all know that medicine and healthcare in this country costs a lot more in both absolute terms and in percentage terms. Even if you take the most generous possible estimates of the effect on our liability system, you are talking about nothing more than 2% of our entire costs. That is, again, making every assumption on the high end of the estimates. Quite frankly, this is not what is driving our healthcare costs.

If you want to look for what is driving our healthcare costs, there are lots of other areas. Liability probably does not even show up in the top ten. So where does that leave us? Am I in favor of tort reform? Well, like I said at the beginning, it does not seem as though the system is doing anything good. I am not sure if we "fix it" that it is going to solve any of the problems we care about. I guess I would not be against the low cost fix, but I would not expect very much either. That is our best guess right now.

In terms of some of the suggestions that ask more specifically about what is the benefit of going federal versus allowing the states to operate, one of the great worries that we have when we federalize any area of law is the effect that it has on the experimentation. As an empiricist, one of the reasons why I love the system that we have in the U.S. is it allows for some empirical testing. You can compare changes seen in some locations and a continuation of the status quo in others and hopefully learn from that. As we learn from that maybe we can move toward better policies. In a federal system, you lose that, but I am still sympathetic to Paul's claims. I think Paul is absolutely right as a legal and a historical matter. If we think that tort reform is causing these economy-wide externalities, or these drags on productivity, that's absolutely the kind of thing that the Founders were worried about. And even Federalists like me would say that this is an area where the feds should probably step in. That being said, I worry about losing the experimentation. So perhaps a compromise solution would be best—we could have something that I view as a more targeted solution. One could allow the states to still have their own laws, but the feds, the Congress, could re-examine the *Erie* Doctrine.

There is not a strong legal reason why, if we end up in federal court under diversity jurisdiction, state law should govern here—other than the fact that the Supreme Court said so in *Erie*. I think there would be a very strong Federalist case to say, if we have got two parties from different states, let us apply a federal law. But if everything is within a state, we will apply the state law. That would maybe solve some of the worries that Paul has while maintaining the ability to experiment.

And we can argue as a legal matter whether reversing *Erie* or tort reform is the easier legal and policy argument to make. But I think it would have lots of virtues rather than just saying, "Let us have federal tort law."

SCOTT HAZELGROVE: Thanks. Thank you very much, Jonathan. Before we turn to the floor for any questions, I would like to give the panelists an opportunity to respond to the remarks of any of their co-panelists.

PAUL TAYLOR: Just a couple of things. I really enjoyed Jonathon's work, but I was surprised that your pessimism for tort reform was lost on the *New York Times*. You have got some work to do. But on the federalist governmental issue, I agree with a policy project of federalism. Allowing the different states to enact different reforms, measure them, balance them, and see what works. I guess in a sense though, if you think of the crisis as actually real or that there is a problem, at some point the federal government has to pick a program. Now, the federal legislation that is most often talked about is actually directly modeled on California's reforms, which have been around for over thirty years.

California's reforms include limits on pain and suffering damages and a collateral source rule, which are pretty significant tort reforms. They were actually signed into the law, believe it or not, by Governor Jerry Brown. Henry Waxman, who was on the California legislative subcommittee in charge of analyzing this at the time, proposed them. So we do have thirty years of data on what is happening in California. It is the most popular state. It is a diverse state. The premiums in California tend to be 300% lower than they are in the rest of the country. At this point in California, you have just about every group supporting the maintenance of those reforms.

So trial lawyers have given up even trying to defeat those reforms, because now there is so much evidence of their keeping down the medical liability costs and expanding the number of doctors in the state, at least according to the medical professionals in the state. The evidence has gotten so visible over thirty years that even the CBO, which is very conservative in its modeling estimates, has finally, for the first time last year, concluded that the federal reforms that have been proposed, if enacted, would save $57 billion in the medical system over ten years. So even in the conservative estimates of the CBO, they have actually taken the step of saying there is enough evidence to actually score this as a cost saving.

And there are other areas of possible research. A lot of people are predicting a giant doctor shortage in the future in certain specialties. You see surveys of medical students and fewer and fewer wanting to become OB/GYN's or neurosurgeons—the same specialties Jonathan was focusing on. In the future, the prediction is you are going to have a lot fewer specialists in these areas and there is going to be a greater demand for doctors. As pessimistic as Jonathan might be, that there might be all these compounding

factors, I think we are getting to a point where we are going to have to look down the road and look at the state experiments.

The federal government may actually have to decide, based on the evidence we have now, what is the proper way to go to avoid a massive doctor shortage in certain specialties in the future.

JONATHAN KLICK: I think, in principle, it is a reasonable point. At some point, you do need to make a decision, even though an academic like me would love to just keep studying stuff forever. That being said, when the CBO comes up with these cost savings, some of the literature they rely on is written by my friends and me, and we are not confident that those numbers are supportable at all. I am not so sure what magic CBO has in order to be able to come up with a conclusion. So I am still skeptical. In terms of the doctor shortage, this is the big problem empirically. Everybody sees one thing happen and then sees what happens after that and says, "Well, the two must be related."

But look, there are 10,000 reasons why there is going to be a doctor shortage. And tort reform or liability, although it may be the one doctors' talk most about, because they've been kind of prompted to talk about it, we can come up with very plausible reasons why there are other factors involved. If you were a young kid figuring out what to do now, and you say: "Well, medical school is going to put me hundreds of thousands of dollars in debt, and everybody wants to overhaul the healthcare system. But if I look at worldwide comparisons, I see the biggest cost driver differential between us and the rest of the developed world is doctor pay."

And you are going to draw some expectations on what is going to happen if you make a decision now. Fifteen years from now, if there is some kind of reforms, I would short the doctor field. I think rationally, a lot of people are doing it. So to say this is because of liability primarily, or even substantially, I think is unsupportable at this point. If you are worried about the doctor shortages, there are lots of reforms that we could make that seemingly have a much more direct effect on doctor supply. As it is now, if I were a doctor trained in another country, in order to get licensed in this country, the rigmarole that I need to go through is just enormous.

You could enact changes to that pretty quickly. And you can have sort of as many specialists as you want in various specialties just through immigration. And that is just one solution. There is absolutely no evidence that these limitations we have on the licensing of doctors trained in other countries have any beneficial effects. So if I want to give you one parting point in all of this, it is just because liability gets a lot of attention does not mean that what people claim as being the driver really is.

I wrote my first paper on this area when I was working for the American Enterprise Institute running a tort reform program. If anything, the conclusions and results that I came up with were against my interest. But after looking, I decided this is not the main driver in any of these areas.

DAVID KENDALL: So this is a great example of what I am talking about. We have a debate here, more or less between access to care and access to justice, but we are not really looking at the fundamental purpose of the tort system, which is to compensate people who are injured by medical errors and to prevent those injuries from occurring in the future. So I wanted to clarify to make sure that everyone understood that the excellent work that Jonathan has done based on those tort reforms that California has done, which are caps on pain and suffering damages, as well as a host of other attempts to limit the risk that a liability insurance company takes when they insure doctors.

That is different from the question of whether the courts do a good job giving doctors a signal about what they are doing wrong. That is what we are missing right now. We are missing the clear signals from the courts to doctors practicing modern medicine. Medicine is no longer just an art but rather a science-based approach. It is unclear whether the courts are supporting those doctors who practice that kind of medicine and make the judgments that they need to in order to do right by their patients. That is where I think the breakdown is in this research.

Clearly, even if you had chosen between these two sides, you might think that you had to get something from this. This is a huge political problem that has been stalemated for decades at the federal level. It is a perennial issue. To overcome this problem, you have to really move a lot of levers and policy circles. The reward is going to have to be greater than the current level of choice that we are talking about here. That is why I think you have to lower your targets a little bit. Try to figure out where you can do experimentation with alternatives that really address what the courts are telling doctors in terms of how to practice medicine and actually giving compensation to patients who for the most part are not getting it.

But to keep the conversation going, you did not hit the Harvard malpractice study, and I was just hoping that meant you agree.

JONATHAN KLICK: Oh, yeah. That was the point in saying that the insurers themselves do not take your liability history into account when they set your premiums. I think it is because the insurers knew even before the Harvard medical study what those results were. This is a completely uninformative signal of whether you have gotten sued or whether you get a judgment against you or not. So yeah, I do completely agree with that. I am not saying that the system works, that is not my message at all. There are lots of reasons to think the system is screwy. I would like to take issue with your claim that the tort system is primarily about compensation.

I am not so sure that is true. One of the reasons I believe that is because every study that has ever been done suggests that the tort system, whether in medical malpractice areas, products, automobile cases, etc., is a ridiculously expensive way to move money from one person to another.

The most conservative estimates say that the tort system is three times more expensive than regular first party insurance, and some of the more in the middle estimates suggest that it may be as much as ten times more expensive.

So the 18th century conceptions of torts—that tort are primarily about compensation—if that is true, it has not worked effectively in any area for probably 100 years.

PAUL TAYLOR: If I can just say something about the Harvard practice study, which we all seem to be agreeing on. It is a pretty dramatic study. Just to give you a little more flavor of what it did, it had a bunch of medical experts look at the files in the hospitals of a county in New York. They asked the doctors and professionals to determine whether or not an injury that occurred in the hospital was the result of medical error or a pre-existing health condition. They said, "If you find medical error, put it in this pile. If you do not find any medical error related to the injury, put it in this pile." It turns out that the pile in which they concluded there was no medical negligence, over half of those files resulted in lawsuits.

The common denominator in those cases was how sympathetic the plaintiff would appear to the jury—if the injuries were visible, or if the plaintiff would somehow resonate in another way with the jurors. And the pile where they did not conclude there was medical negligence, a much smaller percentage of those cases were wrong. And that just shows you that there is something dysfunctional about the incentive structure right now related to which cases become paired with lawyers that go to court.

Some people argue that the attorneys get a third of the cut of pain and suffering damages, which gravitates them towards certain plaintiffs rather than others. People can debate that, but it is really a dramatic study that everyone should be aware of. Now, on the health court proposal, I do not want to mischaracterize. My understanding is that the health court proposal has medical experts deciding whether or not injury did or did not occur under a relatively low threshold, bearing on the side of compensation with the compensation being sort of limited by a rough workers' compensation model of payment with certain types of injuries.

Now, the concerns I have heard expressed is that you would end up with a system where there are more payouts—lower payouts per claim—but there would be more payouts. And that would not reduce the amount of money going out the door to compensate injuries. That is just my impression of how that proposal has been discussed.

DAVID KENDALL: Thank you. Just to respond to that: I think the idea is that you reduce the average payment, but you have more of them. You do not change the overall payout factor, but what you do is reduce the risk of calculations so that if you had a more systematic way of assessing errors and figuring out whether a doctor has actually made mistakes consistent

with medical judgments, then you would reduce the uncertainty liability insurance companies face when they underwrite insurance. In fact, you could facilitate risk rating by data of doctors because you would, first, have a pool database, which would be believable and second, would be statistically valid for the physician.

Then the bonus, you are not saving any money that way, but you would potentially save money on this issue of defensive medicine. Defensive medicine is a phenomenon out there in the minds of doctors, if no one else. They say they do this. Let us take them at their word. Let us remove their excuse for doing so-called defensive medicine. Let us also change the way we are paying them so that we are not just paying them to do more and more and more. Let us pay them for outcomes, and maybe the combination of those two would actually make a dent in lowering healthcare costs.

PAUL TAYLOR: Just one more thing on that point though. I am very open-minded on any reasonable reform. The problem in terms of the political dynamics is we already face a situation where it is hard at the federal level to limit the category of damages. Pain and suffering damages are, let us face it, inherently unquantifiable. They do not actually reduce anyone's pain and suffering because if it were a drug or a rehabilitation program that could be awarded, that would be economic damages. That would not be covered by the cap. It is already so difficult to even get any limit on pain and suffering at the federal level.

I am just predicting it would prove very difficult to get a worker's compensation model on the injuries if we cannot even get a limit on one particular category of damages.

JONATHAN KLICK: President Obama is the first democratic President ever to come out for tort reform of some kind. That is huge, and we need to exploit that.

SCOTT HAZELGROVE: All right. Well, I would like to give the audience the opportunity to ask any questions from the floor.

AUDIENCE MEMBER: Mr. Klick, until your last comment, I was thinking that you were a spokesman for the plaintiff's lawyer. You talk about the tort "deform," not tort reform. I mean, what was the way to improve the method of getting compensation to people who are truly harmed? Because I think that is what we want to do. We want to provide the compensation to the people who are truly harmed and not provide compensation for people who have not been harmed. So how do we do that?

JONATHAN KLICK: Luckily, I am an empiricist, so I am not saying I do not have any views on things, but I do tend to follow the data. They are suggesting tort reform is not a panacea. It may not cause harm, but it is not

a panacea. To your specific policy question, yeah, I do not know. I think we probably need more experimentation. There have been some focused and targeted applications of victims' funds, specifically no-fault victims. Virginia, where we are now, has a bad baby victims' fund that is no-fault. It is not mandatory.

You can opt out of it if your baby is born with some kind of defect or something like that. It seems as though it is actually doing a relatively good job of moving money from the collective whole to these people who are bearing sort of a significant cost. I do not know that there is enough evidence yet for me to endorse that whole-heartedly or with a great degree of confidence, but I think more experimentation with these kinds of no-fault systems may sort of prove.

AUDIENCE MEMBER: Thank you. Good morning. You have all done a good job. Two questions. First, I hear a lot about the problems of doctors and the problems that we are going to have a doctor shortage. What I never hear is whether or not there has been any increase in the efforts to reign in medical errors through self-policing of the profession. Is there any effort to increase the policing of the medical profession?

Second, I do a lot of medical malpractice. The fact of the matter is that the medical profession wins an overwhelming number of these cases. Why do the rates not go down?

PAUL TAYLOR: Well, I do not know. You may have more data than I do, but I am not sure that the doctors are winning all the cases in the sense that the insurance company just settles a lot of these things.

AUDIENCE MEMBER: But why do the rates not go down?

PAUL TAYLOR: I thought Jonathan may have touched on that in terms of how he explained how risk does not enter as much into the equation.

JONATHAN KLICK: Every casualty insurer in the country hires dozens of guys like me to crunch data every which way you can imagine. If they can sort of exploit a margin, they do it. The fact that they do not risk rate at all suggests that there is no correspondence between what happens in terms of the liability side and actually what is predictive of future costs. This is something close to a random system. And I think that is the best claim that we can make with any confidence. And that is surely a screwy system. Now, what the solution is, I do not know. You also asked the question of what's being done to reign in doctors.

AUDIENCE MEMBER: To police the profession.

JONATHAN KLICK: Yeah. I think the profession has done a poor job of it. There is at least some evidence in the data that some of the managed care organizations do a better job in selecting doctors and disciplining doctors. But the evidence is great enough to say that theirs is not the right model either. So, like you, I am pretty pessimistic.

PAUL TAYLOR: Well, on that front, I think there is also a separate problem, which is that part of the problem with hospital policing and the lack thereof is that people are worried when they are at a conference room in the hospital discussing things that may have gone wrong with a certain operation. They are reluctant to say too much about whether a doctor did something wrong because they are worried about that being revealed in court and this being used in evidence. So there is this sort of perverse stifling effect of what you would prefer, which would be a more robust discussion within hospitals about what went wrong and what did not go wrong.

People are worried for liability reasons about saying too much. In fact, it is so bad you now have legislative proposals that would give doctors some sort of liability protection if they simply said to their patient "I am sorry." Doctors are worried about saying "I am sorry" to their patient for fear that it would be used in court, and they will get some judgment or large settlement against them. That is just one aspect of it, but I think that is relevant to your point.

DAVID KENDALL: Let me just comment on that. We are missing the change that has happened in the medical profession. Medical practice is no longer a single doctor practicing like Marcus Welby, M.D., it is a team effort. If you look at the kind of errors that were discovered in the Harvard malpractice study, there were a lot of things like infections. Now, infections in a hospital are a matter of washing hands, a matter of keeping IV lines clean. It requires team effort. Part of the way the profession is taking responsibility is by expressing itself in a national movement to reduce health consequences from these kinds of systematic errors.

Don Berwick, who is the head of the Centers for Medicare and Medicaid Services, has gotten a bad rap for some of his views on healthcare. He started off with the goal of saving 100,000 lives by just reducing some of these known things. He increased his campaign to a million lives. The guy single handedly has saved more people's lives than probably anybody that is alive today. Now, the way we do the standard for care in terms of evaluating the court system has to adapt to that. It cannot be just about a liability for an individual practitioner. It has to be about avoiding the error to begin with, which requires a systematic effort.

The other problem with the self-policing by the professional society is a few of them have tried, Massachusetts being one. What they found is they could not really do much because they did not have the data. There is not good data about how doctors are actually practicing bad medicine, and

so therefore, they cannot use that against the doctors. So we need to create a greater supply of data to solve that problem.

AUDIENCE MEMBER: Just touching briefly on the same topic, there has been some discussion in the literature, but it has not seemed to gain much traction, about the idea of hospital enterprise liability, which would change existing law in order to make hospitals vicariously liable for the torts of the physicians practicing within the hospitals. Today, non-hospital based physicians are essentially choosing the contractors, and this proposal would essentially remove that status and make physicians essentially agents or employees of the hospital. This might align incentives better than the way most other professions are aligned, where the company rendering the services is vicariously liable for the errors of their workforce.

DAVID KENDALL: Briefly, that idea actually was part of the original Clinton proposal in 1993 and got knocked down due to the trial lawyers again. But actually, that was an idea that appealed to a lot of democrats and had a little life but it was short. But note that it only works if the liability system is working. If we had enterprise liability, and it still effectively [inaudible], that is not going to do anybody any good. So yeah, it may be a great idea, but it is probably a third order issue. It could have made the problem worse. The problem is the liability; even if you expand the liability and make the people vicariously liable, you extenuate all the current topics.

Like this example where that provision requires CEOs to sign off on all of the financial records of the entire company. I think you will find a lot of companies reluctant to try new things or be experimental or too bold because the guy at the top who really does not know what is going on and cannot really be expected to know everything that is going on is reluctant to sign his name to something.

SCOTT HAZELGROVE: Yes, ma'am.

JUDGE BERNICE DONALD: Good morning. I have a comment and a question. I'm Bernice Donald. I'm now a Federal Appellate Court judge, but I served as a trial judge for about sixteen years in the federal court. I am in western Tennessee, and we have a rich medical community. We are the hub of St. Jude and Le Bonheur, and other great places.

Unlike my colleague who spoke before, I do not get, and have never gotten, what I would consider a huge number of medical malpractice cases. I have tried a number of them, and in those, a couple of them were against obstetricians, but I had never presided over one where there was a plaintiff's verdict. I think that where information is presented, jurors try to do a great job in assessing the information and following the rules and in coming to a decision that is suggested by the evidence. The point I wanted to make, and the question I have, is I think that in a lot of senses, judges become

scapegoats. We are sort of easy targets. I view us as keepers of the process. We are in the fairness business. We want to make sure that both sides have a venue to try the matter, which granted is an expensive process, but the rules that are applied vary so that the people who were the ultimate decision makers can make the decision.

And one of the speakers this morning made a comment about judges needing to signal to doctors how they practice. And that is not really our business. We do not set and develop the standard of care—others do that. We get the rules and the law and we apply that. If I did get that correct—that we judges need to signal to the medical profession how they practice—I want to know, how do you propose that we do that, and what is it that either gives us the right or the obligation to signal to the profession about how it does its business?

While we are keepers of the process, and we do conduct the hearings, and we do have the competing experts come in, we are in the business of ensuring the process. If I heard you wrong before about judges signaling to the profession about how they practice, accept my apology in advance. Thank you.

DAVID KENDALL: That was my point, and thank you for your question. I would love the opportunity to expand upon the relationships between what the courts' decisions are and how doctors practice medicine. I probably was speaking a little too abbreviated. I do not want judges to tell doctors how to practice medicine. But what I do want is for the decisions by the courts to make it clear what the standards are that doctors would be held to. For instance, when a jury gets a case for murder, the standards for the murder decisions are clear to the jury. They are given clear instructions about what those standards are.

What I want is something similar to that, for a judge to say what the standards of care are that the doctor should be held to. Now, this is kind of murky because it involves a lot of things, but one of the problems we have today is that the only way for the judge and jury to get that standard is from two expert witnesses. You bring two experts together, and they duel over what the standard of care should be. And as good as juries are, it is impossible for anybody to figure that out.

I think in the master situation, perhaps the judge needs to have access to that information so that they can parse the complicated issue of what the centers of care should be so that the jury can have some clear criteria for deciding rather than just having to weigh the scientific evidence. This kind of goes to the heart of what we need to do in terms of reform. It is not entirely clear to me how to do that. And I am maybe a little confused; I hope I am, because I want that confusion to be out there because I do not know how to solve this problem.

We do need to have experiments to figure out how to set precedents the way that doctors can get better signals from the court decisions so that

there is more of a relationship between the suits that are brought and the ultimate culpability and liability for those decisions.

JONATHAN KLICK: One experiment that I think we should re-examine that could probably shed some light on ways that we could fix some of these issues would be to allow people that contract away their litigation rights access to arbitration. If we re-examine this and add some jurisdictions to allow doctors to write contracts that say, look, if you come to me, any disputes are going to go to arbitration. We know from other areas, arbitrators have been much more willing to bring in independent experts than federal judges have, for example, and certainly than state judges have.

Arbitration is a cheaper mechanism just to get money to go from one place to another. I do not actually know of any arbitration area where you would have win rates for one side as high as 80%.

Now the judge says she never saw a plaintiff win at all in the medical malpractice case—

AUDIENCE MEMBER: In my court.

JONATHAN KLICK: In your court, right, in your particular court. So I am wondering if on a lot of these issues, it may not be worth re-examining, at least in some jurisdictions, allowing some of these cases to go to an arbitration model.

PAUL TAYLOR: I just wanted to say one thing. I do not blame any of the judges, but there are some categories in damages, and I am talking now about pain and suffering damages, which have no objective basis. It is really impossible for any juror or judge or anyone else to come up with a rational number to attribute to the pain and suffering damages since there is a separate category of damages, economic damages, which is literally anything that you can attach a receipt to, to put someone as close to the position they would have been in were it not an injury.

So pain and suffering damages are really pie in the sky damages, which cause mass chaos everywhere. The insurers cannot figure it out. There is no way for an insurer to predict—in a rational way—what the pain and suffering damage is, given your pain. The interesting thing about my understanding of the history of pain and suffering of damages, and this is not blaming anyone here, but judges in the early 1900s created this category of damages in order to give the plaintiff a little extra money to pay for their attorneys. The judges were seeing that a chunk of their award was going to pay for their attorneys, so they were not getting full compensation for their injuries. So they created this kind of loosey-goosey category of damages that would fill that gap, and it mushroomed into whatever it is today, which is, like I said, a main driver of chaos in the system.

DAVID KENDALL: Okay. Just to comment. A cap on pain and suffering damages does not do much. It just says $250,000 and that is it. What we really need is a schedule of benefits that that would apply to a specific injury. Other countries have these schedules. They have decided that a person whose injuries result in their being quadriplegic for the rest of their life is going to get X amount of money. It could be arranged, there could be some flexibility there, but it is not like pain and suffering are not economic damages, they are just not something we can distribute a number to. That does not mean we cannot as a society figure something out that is more rational than we have today.

SCOTT HAZELGROVE: Yes, sir.

AUDIENCE MEMBER: I cannot resist the number of comments simply because I feel like I have stepped into an alternate reality hearing some of the things that are stated here. Just the statement that pain and suffering damages were invented in the 1900s by a bunch of judges, when in 1851, the United States Supreme Court in a case called *Day v. Woodworth*[21] said that they had been so well established as within the province of the jury that it is beyond question now.

We have a very attenuated connection between the *Federalist Papers* comments on the Commerce Clause and medical malpractice, which completely ignores the Supreme Court's discussion of the Commerce Clause in the *Morrison* case, where the Court struck down as unconstitutional the Violence Against Women Act because the act of sexual assault was not an economic act just as a tort is not an economic act. There is no market for it. There is no way to do that. The fact is that acting on the damages is just as indeterminate as noneconomic damages because we are projecting lost wages. We are projecting all sorts of things.

In fact, if we are talking about medical malpractice, the largest portion of it, and the growing portion of it, is economic damages because the rate of medical inflation, which is several times what the consumer price index is. It is interesting to hear that California is such a success story. Of course, the California statute was passed in 1975 for twelve years. The insurance premiums for doctors continued to skyrocket until California by initiative passed insurance reform, and then it stabilized. It is interesting that it worked also when five years ago, the California Medical Association put out a report called *And Then There Were None* about the fact that California was losing doctors at a higher rate than any other state in the nation. And why was it?

Because of the penetration of managed care made it less profitable particularly in California to continue to practice medicine. We hear about the increase in Texas, but of course, the *New York Times* and *Washington Post* recently ran stories about how the increase in doctors in Texas, which of course is no different than the increase of doctors anywhere else. It was all

concentrated in the highest population areas where there was no availability problem. That is one of the major problems with federal tort reform. It violates the Seventh Amendment, and it does so in an area where, of course, not only are doctors licensed by the state, but insurance companies are regulated by the state.

We are stepping into that merely because I think it is more religion than anything else. We believe in tort reform not because it has any constitutional basis. And the same problem with health courts. We're taking away from your right to trial by jury, something without an adequate quid pro quo. For example, workers' compensation makes sure that there is an absolute guarantee. You do not have to prove liability, you are guaranteed compensation on a scale, and that is the quid pro quo of the offsetting benefit that you get that justifies that system. If we did that with health courts, we would have compensation for every medical injury, and as a result, the costs would be astounding.

SCOTT HAZELGROVE: Thanks. I'd like to give everyone a chance to respond.

DAVID KENDALL: I will go first. There is something for everybody in that one. I'm not a religious person about tort reform. I come at it from a practical point of view. I do not want to put them in the same category as what is an ideological battlefield. I am trying to get away from that and get to the real purpose. What I did not hear in your response was any ownership of the problems that the tort system has in terms of compensating victims and preventing injuries. Clearly, the people who are advocates of the current system never deny that. They are just "Well, there are other problems, and you cannot solve it because there are always other problems."

So yes, you are right. There would be more people compensated, but that is what we want under the health court system. If we did want to tradeoff between the no-fault system where you lose your right to a jury trial that could be fair if a lot of the injuries were adjudicated, or not even adjudicated but just awarded. But that is because they fit a certain preset set of categories. If you cut off the wrong way, there should not be any argument about what the facts are and whether this person should get compensated.

So we could have a set of categories, which are basically no-fault where if the circumstances fit a set of preset conditions, then you get the award. But health systems, health problem liability, are more complicated, and you cannot always just have a simple formula. You have to allow for both formulas, answers that would be like workmen's comp, but also have some adjudication going on. It is more complicated, but in the end, yes, it would have more cases that would be adjudicated and more people getting compensated.

That has some benefit, which means the medical system would have more incentive to avoid the injuries in the first place and have clearer signals about what it needs to do in order to avoid getting dinged with suits. The economics of this are tough, that is why we still need some experimentation. The liability insurance companies are not going to go for this new liability system without some data. They have to figure out how to price their product. So we can sit back and say, "That the system may not be the best one, but it is the best we can do," or we can say, "Can we do it better?" And I think we can do it better.

SCOTT HAZELGROVE: Paul.

PAUL TAYLOR: Yeah. On the Seventh Amendment point, the jury system is absolutely a wonderful fit. They have great innovation, and everyone supports it. But like every other aspect of government, no point in the system should have absolute power. Presidents should not have absolute power, the Congress should not, the state legislature should not, and neither should a handful of jurors be immune from rules that limit their ability to hand out certain types of awards, especially if the ramifications are going to be dramatic enough to put certain companies out of business if the award is large enough.

In terms of the Supreme Court case law, you have *Morrison* and *Lopez* recently. If you think my analysis of what the Founders said was a little off track, you must think the current precedents of the Supreme Court related to the Commerce Clause are way off track because basically anything goes in terms of congress. *Morrison* and *Lopez* involved non-commercial activity. With the system we are dealing with, money is exchanged all over the place. I cannot see the Supreme Court saying federal tort reform, at least certain types of reform we are describing, would be unconstitutional.

If you think that is the case, bring it. I think a lot of people are hesitant to bring those sorts of cases to the Supreme Court for fear of what they are going to say. You have the cases related to asbestos; some of the local justices begged Congress to get involved and limit damages in the asbestos area because of what they saw in terms of transpiring in the litigation being very dysfunctional.

JONATHAN KLICK: And look, my religion is I am an agnostic, and I think more of us should be on these fronts. People on the tort reform side and people who are on the plaintiff's side really are much too confident in what they believe given what the data actually say. I think Paul is right on the federalism point. Here is another area that comes down to as much religion as anything. I write in the area of preemption, and if you asked me to come up with a principled explanation in the way the judges vote, say, in the marijuana case versus the violence against women case, you cannot do

it. Believe me. I have not found anyone who has been able to do it. So I do not think making that legal claim is dispositive in these debates.

AUDIENCE MEMBER: Thank you. I must say that having been a member of the Hawaii judiciary for the last eighteen years, seventeen years as a trial judge, I agree whole-heartedly with the last speaker. But I have presided over numerous medical malpractice cases, and I do not think I ever saw a runaway jury. I am here to ask questions based on some of the comments made. In Hawaii, we have statutes that prohibit admissibility of apologies and peer reviews by medical doctors of their own studies. Also, we have a statute that requires all medical claims to first go through a medical claims conciliation panel, an administrative hearing with a doctor, a lawyer, and a layperson, which is just a short hearing on liability with the experts.

It is just like a screening tool, which a lot of the time, the plaintiff's lawyers will use to see if they really want to go forward. But I am just wondering are statutes like these uncommon in the rest of the United States?

DAVID KENDALL: They are uncommon, but they are in-between. Indiana has a good system similar to that. They have a system where the pre-screening is a doctor, a lawyer, and a person. There is some evidence that suggests that it does help, primarily by lowering the costs of the investigation. The upfront costs are huge. That is why we have an expensive contingency fee system, which the trial lawyer risks a lot of money to point out if the case is valid or not. So if you have some ability for there to be a pre-screening to back up what the costs are of doing that that is a good thing.

Overall, all the evidence on screening panels is not going to play out. They generally tend to validate what is going to happen anyway. So it is not effective. I am not sure if I know much about the question about the peer review.

DAVID KENDALL: I'm drawing a blank on that one.

PAUL TAYLOR: Yeah. I am not an expert on Hawaii's law, and those both sound like they are really good reforms. Just look at the way arbitration works, is that not where each side picks their own expert, and those two experts pick a third expert, which you would expect to be somewhat neutral in a sense that they have to be agreed to on both sides. I think a system like that preserves the essence of the adversarial system but also adds a component of neutrality where each side has to agree on a third party certainly makes sense.

JONATHAN KLICK: Compared to what? The current system is awfully expensive, too. I think we need a lot more experimentation on this. In other areas of the law when sophisticated parties are given the option to choose

arbitration, they often do. So that would suggest that while it may be expensive, it is better than the alternative.

SCOTT HAZELGROVE: Yes, sir.

AUDIENCE MEMBER: This question is primarily to Mr. Taylor, but also to any of the others if they wish to respond. You spent the first portion of your remarks providing us with the quotes from the *Federalist Papers*, and all of those things are certainly things the Framers said and wrote. You could easily extract as much from the *Federalist Papers* reassuring those reading it that there were still substantial powers remaining to the states, that the federal government was not assuming all authority over all activity. There is probably very little, as I recall, in the *Federalist Papers* to suggest that the Framers ever suggested that torts committed by a specific person against another specific person within the boundaries of a specific state would have been comprehended in that understanding.

Madison himself, throughout his career, was someone who was as concerned about state as well as federal overreach. He wrote the *Federalist Papers*, and a little over ten years later, he wrote the Report of 1799 when he thought the federal government was going too far the other way. So I guess my question to you is, are you trying to convince us that Madison would have believed this proposal to be a good idea or simply that he would have believed it to be within the outer reach of federal commerce power authority? Thank you.

PAUL TAYLOR: Well, my presentation was just focused on what James Madison and Alexander Hamilton had to say in the *Federalist Papers*. I think my point was that while I think it would be unreasonable to expect the Founders to have envisioned the current tort system. One time I did a study of limits on lawyers' fees throughout the states during the colonial period, and there were dramatic limits on lawyers' fees. Delaware even charged lawyers extra money per line written on a complaint to just dampen down litigation. We have a much different litigation system than we did back then.

And so my argument was that they spent about a quarter of the time in the *Federalist Papers* talking about the Commerce Clause being necessary for Congress to be allowed to reduce barriers to the free flow of goods and services among the states. I think you can argue about the evidence, but if there is evidence that certain state tort laws are reducing that free flow of goods and services among the states, I think that clearly falls into the logic and the rubric of what Madison and Hamilton were discussing. Of course, there are a lot more quotes. I just quoted Lawrence Freidman who is a major legal historian about the dramatic increase in modern tort law starting in the 1950s.

But we live in a much different world. The question is whether or not the dynamics of this world fit into the rubrics that the Founders thought were appropriate for Congressional legislation.

SCOTT HAZELGROVE: Yes, sir.

AUDIENCE MEMBER: It seems to me that the relationship between patient and provider is contractual, but it is a contract where the provider has far superior bargaining power and that is why these problems are resolved in tort. The only thing I have heard regarding contracts is the idea that perhaps this should be referred to arbitration. Is anybody working on improving the medical contract? This has been done in other areas where consumers have lower bargaining power than sellers.

JONATHAN KLICK: Why do you think that the bargaining power is so asymmetric?

AUDIENCE MEMBER: Well, when I go into the Emergency Room and sign something, I need the service, and I am not going to be reading the contract.

JONATHAN KLICK: Sure. But there's an intermediary there, right, to the extent that you are insured. Your insurance company is an intermediary, and they surely have plenty of bargaining power, right?

AUDIENCE MEMBER: My insurance company is not negotiating with the hospital at that point. They are negotiating perhaps on how much they are going to pay the doctor. But I don't think they are negotiating on how careful the doctor is going to be or anything other than what they will pay for and what they will not pay for.

JONATHAN KLICK: Well, I think it is an empirical question. We actually do not know. You have your presumptions, and I think if you can come up with intuitions that suggest the opposite. If I am an insurer, I care about cost, and however that cost comes about is something that is potentially interesting to me.

AUDIENCE MEMBER: But if I go to my auto repair shop, I am expecting my car to be repaired. If I have a problem with it, I will sue under the contract and not in tort. If we could bring this area of the law closer to that, then we would not be talking about tort reform.

JONATHAN KLICK: And that would be great. But almost every jurisdiction says that we cannot have those kinds of contracts, and we are not going

to enforce those kinds of contracts. I think that is something that is worth going back to and re-examining quite frankly.

SCOTT HAZELGROVE: We have time for one last question.

AUDIENCE MEMBER: I am from California. I have been a judge for about twelve years, and spent twenty-five years as an insurance defense lawyer, where I handled many malpractice cases, chiefly for hospitals. This is really my observation. My experience has all been under tort reform in California, the ceiling limitation on noneconomic damages of $250,000.00, elimination of the collateral source rule, the ability of the defendant [inaudible] payment, and the interference under the contractual relationship with injured parties and their lawyer on contingent fee agreement. What I find is that there are no little medical malpractice cases in California. They are all large malpractice cases.

From my observations and my career, it is because it is so expensive to prosecute these cases with the rewards limited unless the injury is catastrophic. Is there a concern with the tort reform in a medical malpractice area with the deprivation of the access to justice by those people that do not have catastrophic claims?

DAVID KENDALL: So I can give you a conditional response. We have been trying to examine this issue for at least five years and the data is not quite there to say anything with great confidence. But there are at least implications in the data, which suggest that for access to care, the worst combination that you can have is a cap on noneconomic damages and collateral source reform because if that is the case—if I get some poor guy who is covered by some insurance but he does not have much in terms of economic losses, and we cannot get anything beyond that—I am just never going to take that case. There are indications of that in the data for sure.

And that is on top of all the other impediments that prevent a patient with severe injuries from going forward to begin with. So I think yes, there are some serious "access to justice" issues. According to the Harvard medical practice study, we know that only one of every fourteen patients with a severe disability gets compensation. So it is fairly limited.

SCOTT HAZELGROVE: Thank you guys very much for your presentations.

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[1] Letter from James Madison to Thomas Jefferson (Feb. 8, 1825), *in* 4 THE WRITINGS OF JAMES MADISON: 1819-1836, at 218, 219 (Gaillard Hunt ed., G.P. Putnam's Sons 1910).

[2] U.S. CONST. art. I, § 8, cl. 3.

[3] THE FEDERALIST NO. 11 (Alexander Hamilton) (Clinton Rossiter ed., 2003).

[4] *Id.*

[5] THE FEDERALIST NO. 42 (James Madison) (Clinton Rossiter ed., 2003).

[6] THE FEDERALIST NO. 1 (Alexander Hamilton) (Clinton Rossiter ed., 2003).

7 THE FEDERALIST NO. 12 (Alexander Hamilton) (Clinton Rossiter ed., 2003).
8 THE FEDERALIST NO. 17 (Alexander Hamilton) (Clinton Rossiter ed., 2003).
9 *Id.*
10 THE FEDERALIST NO. 46 (James Madison) (Clinton Rossiter ed., 2003).
11 THE FEDERALIST NO. 27 (Alexander Hamilton) (Clinton Rossiter ed., 2003).
12 DAVID E. EPSTEIN, THE POLITICAL THEORY OF THE FEDERALIST 53 (1984).
13 THE FEDERALIST NO. 31 (Alexander Hamilton) (Clinton Rossiter ed., 2003).
14 LAWRENCE MEIR FRIEDMAN, AMERICAN LAW IN THE 20TH CENTURY 372 (2002).
15 THE FEDERALIST NO. 42 (Alexander Hamilton) (Clinton Rossiter ed., 2003).
16 1 ANNALS OF CONG. 111 (1789).
17 THE FEDERALIST NO. 27 (Alexander Hamilton) (Clinton Rossiter ed., 2003).
18 *Id.*
19 INSTITUTE OF MEDICINE, TO ERR IS HUMAN: BUILDING A SAFER HEALTH SYSTEM (1999).
20 Daniel Kessler and Mark McClellan, *Do Doctors Practice Defensive Medicine?*, 111 Q, J, ECON. 353 (1996).
21 54 U.S. 363 (1851).

CLASS ACTIONS IN THE WAKE OF *DUKES V. WAL-MART*

Mark Perry, Joe Sellers

MODERATOR: While everybody's finishing up lunch, I wanted to get going with our next terrific presentation. We are very fortunate to have with us two hotshot litigators—I like the eye roll—both of whom were on the briefs on opposing sides in the *Dukes v. Wal-Mart*[1] case before the Supreme Court. Mark Perry is a partner with the law firm of Gibson, Dunn & Crutcher, and Joe Sellers is here from Cohen Milstein Sellers & Toll. They have asked me to encourage you to interrupt them as they make their presentation to ask questions. So please feel free to do that. They're just going to have a bit of an exchange here about the impact of the *Dukes v. Wal-Mart* case. And with that, gentlemen, take it away.

JOSEPH M. SELLERS: Good afternoon. I'm Joe Sellers. I'm going to start. We thought we would divide up our discussion about the decision, first commenting on the portion of the ruling addressing the requirements for satisfying class certification under Rule 23(a)[2]. And then turn to the Court's portion of the decisions addressing 23(b)[3]. Again, we really encourage you to ask questions or make comments. We hope this will be a discussion. I'll start, and then Mark will comment and we may agree or disagree, we'll see.

The significance of the *Wal-Mart* decision, I think has been the subject of a great deal of debate. There are those who characterize it as simply clarifying longstanding standards, and others who say it marks the end of many civil rights, and perhaps other class actions. My view is that the truth is somewhere in the middle. The decision, I think, will make civil rights cases, and especially equal employment class cases brought under Title VII[4] more difficult to bring, more costly and protracted to pursue, and probably harder, ultimately, for plaintiffs to prove discrimination. But it should permit some class cases, likely those that may be smaller in scope, to proceed.

So let me begin with what the Court decided, in my view. In large part, the Court's ruling under Rule 23(a), I think articulated standards for satisfying the commonality requirements of Rule 23, which was largely an endorsement of a consensus that had been reached by lower courts in several areas. While it's important that the Court make clear what its position is, I don't think it represented a dramatic change in most of the legal principles there.

First, it made clear that the satisfaction of the Rule 23 requirements must be based on evidence, and not just on pleadings. Again, I think that was a—we are long past the day when pleadings generally are regarded to

suffice, but the Court's pronouncement on that is always helpful. Second, the Court made clear that trial courts may, and indeed should, inquire into the merits of the underlying claims, to the extent it's necessary, and only to the extent it's necessary, to ascertain whether the requirements of Rule 23 have been satisfied. In doing so, it put the *Eisen v. Jacquelin Carlisle*[5] decision in its place.

But again, I think the majority of the circuits, and certainly—and even the Ninth Circuit, from which the appeal was taken, had endorsed that position. So that is, I think not—it's a relatively recent consensus that's formed amongst the circuit courts, but now the Supreme Court has spoken on that. What the Court said is that commonality may be satisfied by even one question, common to the class, but explained that the question must be critical to the underlying claims, and it must be importantly susceptible of adjudication on grounds common to the class.

So that means, of course, that you have to have a common question, and the common question must have a common answer, one that can be adjudicated on behalf of the class as a whole. For civil rights claims, I think the decision has some additional importance, particularly those challenging discretionary decision making. The Court articulated a standard, which we believe is a new standard, that to satisfy commonality, when there's a challenge to discretionary decision making, you need to show significant proof of a general policy of discrimination.

That standard sounds a lot like what you need to do to prove liability, and we know that class certification is not tantamount to proving liability. The Court didn't explain how much less than liability is needed, and didn't really define the standard, other than to find that it was not satisfied in this case by the record that was presented. It is also not clear whether that significant proof of a general policy of discrimination standard will apply outside of challenges to discretionary decision making, to other kinds of civil rights cases other than those challenging discretionary processes.

At least based on the current state of the law from the lower courts interpreting the *Wal-Mart* case so far, we obviously only have several months of decisions, it doesn't appear that in general, it applies. The courts have been applying it to other areas of employment law, such as wage and hour claims, where an overwhelming majority of the lower courts have interpreted the *Wal-Mart* decision as not applying to that body of law. It also isn't clear, because of the concerns expressed by the majority in the *Wal-Mart* case about the need to ascertain the intentions of individual managers, which gave rise to the requirement that there be a general policy of discrimination that must be shown.

Whether or not that standard will apply with the same force when there's a challenge to discretionary decision making that doesn't turn on proof of intent, that is, claims that may rely on a disparate impact theory of discrimination, that the challenged practice allegedly has an adverse impact on a protected group without a good business reason. And it isn't clear, to

me at least, that they will have the same force, and require the same level or proof as the disparate impact claims.

Significantly, the Court's decision in large part was a repudiation—a rejection of the record that was supplied in support of the class certification decision. And in particular, it found that the—as you probably all read—found that the statistical analysis wasn't sufficiently refined, that the class was too broad, that the anecdotal evidence was insufficient, that the expert analysis was not adequately supported, and it didn't really comment on any of the other evidence that was supplied.

It is, again, I think going to be—is not entirely clear yet how much of the Court's decision on Rule 23(a) is going to have a force in cases where the classes pled are not nearly so broad, and where there are arguments that are made about the anecdotal evidence or other kind of evidence, where the proponents of class certification attempt to distinguish the factual record.

Again, the early decisions, most of which are district court, very few appellate decisions at this point, seem to, in significant part—in some cases at least, distinguish *Wal-Mart* from the pending cases on grounds that the class that was so broad, and the other class is narrower, or other factual distinctions that may permit parties to—and I'm sure we'll be debating for some months and years ahead, how much the decision has an application to circumstances that are different than those which the Court addressed. I think at this point, I'm going to stop and turn it over to Mark, and then come back to talk about Rule 23(b).

MARK A. PERRY: Well, as Joe predicted, I agree with him in significant part. Of course it's a middle ground. I mean the alarmists on both sides are wrong. To say that it's the end of class actions is not correct, and to say that it did nothing other than decide our particular case is not correct. And what we're going to see over the next few years is the courts sorting out these very things. But it does lay down some markers.

One of the significant markers, and points, I think, of disagreement I have with Joe is, he said civil rights cases three or four times during that presentation, as if they get a separate consideration under Rule 23. After 1991 and the amendments to Title VII,[6] a modern sex discrimination case, such as the one Joe brought here, isn't really a civil rights case in the way courts thought about that in the 1960s when the rule was enacted. It is an intentional tort case.

It requires a showing of intentional wrongdoing by a manager against the individual plaintiff, and when you look at it in that light, *Dukes* is very much in line with the previous intentional tort cases that the Supreme Court had decided under Rule 23, which narrowly limited the applicability of the rule, where these individualized issues were in play. Now, does that mean you can't have a class action employment discrimination case?

Of course not, but it does mean, as the Court indicated, that the questions have to be focused and refined and asked and answered in a way that

is much narrower than the original complaint did in the *Wal-Mart* case. Joe and his colleagues have come back with an amended complaint, a couple of weeks ago, and we're going to go through round two and see if that satisfies it. I have my own views, as Joe does as well. Judge Breyer's going to have to sort that out in the first instance. Joe mentioned that Rule 23 is more than a pleading standard, and of course, that's right, but it is also a pleading standard, and I don't think we should skip over pleading quite so quickly.

In the intervening years, since the first complaint was filed in the *Wal-Mart* case, we have had *Twombly*[7] and *Iqbal,*[8] and the general ratcheting up of the pleading requirements in federal court. Class allegations, in my opinion, are allegations like the elements of a cause of action, that they must be pleaded with sufficient specificity to allow the judge ultimately to make a determination. It's not sufficient to say there are common questions. Rather, you have to recite what the common questions are, and how they are supported by the evidence that you propose to put forward, and a court can evaluate that on the pleadings.

Most circuits are developing a law of challenging class certification allegations at the pleading stage, in addition to the Rule 23 certification stage. That's something I suspect will play out in our own case and in other cases, and it's a very important preliminary step. On the expert, or the evidence part—once we get into the Rule 23 analysis, there had been this debate in the lower courts, and it hasn't ended yet. There's a post-*Dukes* decision from the Eighth Circuit saying that *Daubert*[9] expert scrutiny doesn't apply at the class certification stage.[10] I think that's just dead wrong.

There's no way to distinguish under Rule 702,[11] or in federal court—I don't know what the rules are in state court—but in federal court, evidence rules don't make any distinction between class certification and trial. If your expert's not good enough to be used, he's not good enough to be used. One of the things that means, as a practical matter for litigants and for judges, is we're going to move a whole bunch of the expensive and difficult and time-consuming part of the case up to the Rule 23 stage, that the *Wal-Mart* decision and the consensus to go mention that it essentially endorses the IPO case from the Second Circuit,[12] the hydrogen peroxide case from the Third Circuit,[13] gives the litigants the incentive.

It almost mandates that the plaintiffs come forward with extensive expert analysis, which then requires the defendants to come forward with equally extensive expert analysis, much earlier in the litigation than would have been true ten years ago. That has an expense factor. It also has an investment factor. Once the parties get more and more invested in the case, their positions tend to solidify. Judges have to start shaking them up a little bit. I think that's going to be an accelerating trend we see, as the certification stage under these cases turns into a little more of a trial. How is that trial going to be, or that mini-trial going to be exercised?

I do disagree with Joe that this is a new standard for employment cases. The significant proof standard was not invented in *Wal-Mart*, it comes

out of the *Falcon* case.[14] It's been there for twenty years. And the *Watson* case[15] has always required—the *Watson* case interpreting the statute—has always required the plaintiffs to come forward with the significant proof of the particular employment practice that's being challenged. What's new after *Wal-Mart*, or what *Wal-Mart* has put a fine point on, is the stage of the litigation at which the plaintiffs must identify those employment practices. It used to be that alleging discrimination was sufficient, and the mechanism of discrimination would come out in the proof.

Wal-Mart accelerates that, to at least the classification stage, to more discreetly identify the practices, perhaps—I'll put perhaps in parentheses—the consequences, or at least the statistical outcomes and anomalies, earlier in the litigation. That is change, although of course, it's the law. With respect to the record that the plaintiff made in the *Wal-Mart* case, it was an extensive record. It was not good enough. It would not have been good enough in any circuit other than Ninth Circuit, even before *Wal-Mart*.

So the Supreme Court didn't change things in that respect. As I said, we're going to go through round two now and see whether these plaintiffs can satisfy on more limited classes—two class actions filed so far—an evidentiary record, and I'm sure Joe agrees that we look forward to—

JOSEPH M. SELLERS: Seeing a lot more of each other. One or two comments on what Mark said. Again, I think—I agree with him significantly on the *Daubert* standard. Although, the lower courts have been divided about this, I do not think there's anything about Rule 702 or any analogies probably in the state law that draws a distinction between stages of litigation. I expect, notwithstanding the Eighth Circuit's decision, that over time, the *Daubert* requirements will be applied at the class certification.

I have to take issue briefly with Mark about his characterization of civil rights class cases as nothing more than intentional tort cases. I do think, as we'll come to in a moment, when we talk about the monetary relief, that the Court's decision does treat back pay as tantamount to a tort-type remedy, and compels it to be assessed for purpose of class certification under 23(b)(3).[16] But I think that the class action civil rights cases continue to seek significant injunctive relief. This one did, and there may be opportunities for certification of the class for some portions of the relief under the traditional civil rights standards that were in place before. So unless you want to comment on that, why don't I go on to 23(b)?

MARK A. PERRY: I'll hold my tongue.

JOSEPH M. SELLERS: All right. I think the really significant part of the *Wal-Mart* decision comes from the interpretation of Rule 23(b) and the standards that apply to adjudicating back pay. Before the *Wal-Mart* decision, the overwhelming majority of the circuit courts to consider whether

back pay can be litigated on a class basis, pursuant to Rule 23(b)(2),[17] which is the section of Rule 23 which was designed to deal with civil rights cases, was that the back pay can be pursued—could be pursued under—as a 23(b)(2) remedy. Therefore, there was no need for notice and opt-out, and the only question was whether injunctive relief or whether monetary relief predominated.

Long before we had juries in these cases, and just as courts had made these decisions, for thirty years, most of the circuits were in agreement, both that back pay could be adjudicated on the basis—pursuant to Rule 23(b)(2), and significantly in a series of circuit decisions dating back to the late 1970s, that in circumstances, as we alleged in the *Wal-Mart* case, where either the discrimination alleged is very pervasive, or there is enough discretion in the process that it would make it very difficult to reconstruct the individual personnel decisions that would have occurred in the absence of discrimination at the remedial stage. This is the mandate the district courts have under Title VII, that in those circumstances, you can use some kind of formulaic approach, at least to adjudicate the overall amounts of back pay awardable, and in some circuits to actually compute the amounts, at least with respect to disparate pay claims, using a regression equation, to use that method to adjudicate the actual amounts lost for individual class members.

A version of that, which was endorsed by the Ninth Circuit,[18] called a sampling method, was rejected by the full Court with Justice Scalia characterizing it disparagingly as trial by formula.[19] And, in doing so, the Court expressed the view anchored in the language of Title VII, which prohibits the award of remedies to people not harmed by the discrimination—proven discrimination—that that gives rise to a right to the defendants, to employers, to assert defenses individually.

We had argued that the right to debate what factors go into this formula is a means by which to assert those defenses, and the Court clearly rejected that as not sufficient as a means to assert these defenses. Without any discussion of the circuit authority on the subject, or even citation to it, the Court just brushed aside about thirty-five years of jurisprudence in this area, making very clear that with respect to claims for back pay, and I presume other forms of monetary relief, which would be even more difficult to adjudicate in some formulaic basis, with perhaps—at least under Title VII—very rare exceptions.

Those claims all have to be susceptible to certification under 23(b)(3), and the proponents of certification there have to establish a—that the claims, that the facts common to the class—adjudication of the monetary relief predominates over the individual issues, and, importantly, that the employer has a right to assert defenses individually for each claim, each class member who seeks a claim for a claim of back pay. That is, I think, a much more dramatic part of the decision, and one that cannot simply be attributed to the facts of the case.

It is, there may be—although the right to assert a defense was anchored in the language of Title VII, there are undoubtedly other statutes which can be interpreted as giving rise to a right to assert individual defenses, and we have yet to see how much that's going to apply outside of the field of civil rights. But there will undoubtedly be litigation over that in the antitrust area, where economic modeling is frequently used, and in securities fraud area, and in other areas where those kinds of issues may come up. So I'll pause there and turn it over to Mark.

MARK A. PERRY: I certainly agree with Joe that this is the part of the opinion that will have the most wide-ranging effect in all kinds of cases, not just employment cases. There are a couple of important points. One is, Joe has been making this point that thirty-five years of precedent for ten years, and I keep saying Joe's wrong, and nine justices agreed with us at the end of the day. But the important thing on a going forward basis is that there are other things in Rule 23 where the courts have, in my view, just got it wrong from the outset.

Then you sort of build up this encrustation of an erroneous analysis—23(c)(4)[20] is the next one we're going to see issue certification with it. The existing law doesn't take account of the text of the rule, the structure of the rule, the history of the rule, the advisory committee notes, or the precedents. It simply has developed a rule. This [23](b)(2) certification of back pay was the same way. There were some old cases that just allowed it with no analysis, and they built up like barnacles on the hull of a ship, this thirty-five years of precedent.

When we got involved in this case, and just started arguing that it was wrong, that wasn't going to work in the District Court, that wasn't going to work in the Ninth Circuit, but it did work in the Supreme Court because the Supreme Court has laid out a mode of analyzing Rule 23 in the *Ortiz*[21] and *Amchem*[22] cases. Now, the *Wal-Mart* case becomes the third leg of the stool, if you will, that looks very closely to the text and structure of the rule, and the Advisory Committee notes take a prominent role.

There, you will find the distinction, and it's described in the opinion on the civil rights cases between those injunction-only challenges to de jure segregation that were prevalent in 1964, '65. When the advisory committee was debating this rule, and a modern post-1991 jury trial, compensatory damages, punitive damages claim, which as I said, it looks a lot more like a tort claim today than those old structural relief cases.

That will give the plaintiffs, in these cases and in other cases, a decision point. Rule 23(b)(2) remains, of course, available for injunction-only, structural type relief, possibly coupled with statutory remedies that are non-individualized, which Congress has the discretion to enact, and has enacted a number of statutes. Or, if the plaintiffs choose, however, to go for more individualized relief, back pay and damages in employment cases, and

analogous relief in other kinds of tort-like regimes, which many of the federal provisions are at the end of the day.

Whether it's securities or something else, they have basis in common law fraud. When the remedies look like the old common law remedies, then we're going to be in the world of [23](b)(3) and this heightened predominance analysis, which takes on—there's a squaring effect, like two squared is four, probably all knew that—commonality under the *Dukes* requirement, gets squared with the predominance test under *Amchem*, which says predominance is far more demanding than commonality.

So the plaintiffs first have to run through the commonality hoop. Then in a [23](b)(3) case, which is to say most monetary cases, that gets squared as predominance. That will affect the shaping of these cases and the early resolution of these cases on a going forward basis. A point on these individualized defenses, this was the single most important line of the *Dukes* decision, it is one sentence. "A class cannot be certified on the premise that Wal-Mart will not be entitled to litigate its statutory defenses to individualized clients."[23] That is an exceedingly important concept that was flatly rejected by the Ninth Circuit.[24]

The Ninth Circuit had said, "No, Wal-Mart will not be permitted to put on its defense." We challenged that on due process grounds, and on Rule 23 grounds, and on the Rules Enabling Act[25] grounds. The Court is not entirely clear. It grounds it in the Rules Enabling Act, although I think there are significant due process overtones here, particularly in a case where punitive damages are sought, because the Court has elsewhere said that a defendant cannot be punished without the right to present every available defense.

This analysis, of which defenses are in the case, and how they will play out, will become very important to future class certification challenges in the Ninth Circuit. It has been true in other circuits, particularly the Third, already, where defenses have been analyzed. It will become more important in those circuits that have, sort of, looked over this point. Again, this is an issue that comes up case after case after case because every statutory regime gives the defendant certain statutory remedies.

While the Court said statutory remedies, to my mind, there's absolutely no reason to stop there. It ought to include common law remedies, and anything that is available to block a claim, if it is the case, the Rules Enabling Act says, or ought to say, it cannot be precluded or deferred or kicked aside simply because it's as class action. This single sentence, as a practical matter, may have the most dynamic and sweeping change to the scope of a class action because it requires the courts to look through both sides of the "v." at the early stage, rather than only at the plaintiff's claims.

A lot of courts had, before *Wal-Mart*, been very carefully, rigorously scrutinizing the plaintiff's claims, but the defense's often got sort of left to the side. There's another error in that, I would submit. Since 2003, Rule 23(c)[26] has required the certification order. It's mandatory, not optional.

The certification order must recite the claims, issues and defenses that are suitable for class certification. Now, this is a rule that most courts don't adhere to. At least most certification orders don't comply with it, in part because the litigants don't point it out.

It's a very under-litigated provision of the rule, but it could be a very important. One, because what it says, to my mind, is both parties have an obligation to come to the court at the certification stage, identify the claims, issues, defenses in the case, and propose how they will be tried. The plaintiffs will know more, presumably, about the claims. The defendant will know more, presumably, about the defenses. Both of those must be put forward.

Some courts—the Third Circuit in the *Wachtel*[27] case—have gone so far as to say an actual trial plan should be submitted at the certification stage and incorporated by the court into the certification order. There is support for that in the Advisory Committee Notes, which say that a trial plan is the best way of ensuring both manageability and compliance with the claims issues and defenses requirements.

So again, I think *Wal-Mart* didn't need to go that far in this case to say that the Ninth Circuit was wrong, but I would say the handwriting is certainly on the wall as to rigorous enforcement of that particular requirement. I think it's in the litigant's interest to present to the courts a more robust analysis of how they propose to litigate these claims. One thing, it'll help us talk to each other about what we think the case is going to look like, and it should help the district judges get more involved in an earlier stage of these manageability questions, which the Supreme Court, case after case, is telling us to look there.

JOSEPH M. SELLERS: I want to just make a couple comments. I think that the notion of an all or nothing approach to certification of monetary remedies is maybe—again, the action may be in the middle. I think that one decision—and it admittedly is just one decision of one district court, but it continues to be one a lot of people look at—is the decision from the Eastern District of New York, in the *Vulcan v. New York City*[28] case. Here, the district court allowed, certified the monetary remedies, back pay claims, under 23(b)(3)—this was after the *Wal-Mart* decision—and allowed the adjudication of the total amount awardable to the class to be undertaken using a formula, but then preserved the right for the employer to assert as to a class of over 7,000 people, the rights to assert defenses individually for those claims they wished to challenge.

Thus, the New York court preserved the right to have a series of individual defenses. Relying on an early D.C. Circuit opinion, written for the court by then Judge Ruth Bader Ginsburg,[29] about why this particular approach is compatible with the Rules Enabling Act, and why it's an interpretation of substantive Title VII law, rather than simply an interpretation of procedure that would otherwise trump substantive rights.

The second point is that I think you're going to see more occasions where the cases are brought and the proponents of class certification seek certification under—for the injunctive relief under 23(b)(2). They may offer to the court, as an alternative to trying to have some partial certification of the monetary remedies of the sort I described in the *Vulcan* case, the possibility of just leaving those claims not certified for purposes of pursuing individual—the monetary remedies individually.

At that point, individual class members will have the prerogative to determine whether they wish to litigate the monetary relief remedies or not. But they may not press the court to certify those remedies. A great deal—I would say overwhelming amount of the jurisprudence that's developed from the circuit courts in the last fifteen years about Rule 23—has focused on the availability of monetary remedies and what form they should take, and how they would look, and whether you can pursue individual claims, must pursue individual claims, or to what extent you can pursue monetary relief on a class basis.

There may be those who simply don't wish to burden the court with that question, and proceed to allow individual class members, who by then would be members of a prevailing class, to pursue whatever individual remedies they wish, beyond the injunctive relief that's awarded to the class as a whole.

MARK A. PERRY: No, the plaintiffs are endlessly creative. Jack Coffey has written this article recently describing that strategy and others.[30] And interestingly, they're all strategies to go around the rule. The rule says what the rule says. Either you can certify the class in the rule or you can't. What the plaintiffs want to do is come up with these hybrid certifications, partial certifications, modified certifications, amalgam certifications. I've got a preliminary article, I think it's up on my website, talking about the point Joe just made, and pointing out of the due process, Seventh Amendment and other problems with it.[31]

There are other problems; 23(c)(4) is going to be where the real action is in a lot of these cases, as plaintiffs try to split it out, and the question of bifurcation. Liability and damages, the *Vulcan* case Joe mentioned. With the plaintiffs though, a lot of courts just want to, again, look at the plaintiff's side of the liability equation. I would argue that you've got to look at the plaintiff's claims and the defense's.

There again, if you look at the defense's too, you're going to defeat a lot of these cases here. But it's going to be very interesting—we're going to get the look here real soon—to see how these things play out because in a way, as this discussion I think illustrates, the *Wal-Mart* case settled some questions, but it raises many, many others. It will be an interesting time to be a class action lawyer, judge, litigant, or legislator perhaps, in the next ten years.

MODERATOR: Any questions before we adjourn?

MARK A. PERRY: All clear?

AUDIENCE MEMBER: So many claims [inaudible] Wal-Mart, a huge employer, with lots of different stores. As an economist, if all these stores operate in different parts of the country and they have different local labor conditions and dramatic differences [inaudible], the ability of Wal-Mart to discriminate, based on the competitive [inaudible] that they're dealing with. So if you could [inaudible] protect workers from discrimination. And I just was curious what type of evidence [inaudible], to establish that it was in fact discrimination. And I understand [inaudible] that all that evidence has now come up to the certification stage. What was their economic testimony, and was it real economists?

JOSEPH M. SELLERS: Well, let me start by addressing the broader question you raise. I'm not sure I want to characterize the experts as real economists or not. They were—they did statistical analyses that were—that took into account conditions and circumstances in each store. So people's pay structure, for instance, to the extent there was a claim of unequal pay, men and women in the same store, doing the same job at the same time were compared. This was not comparing somebody in New York with somebody in Tulsa.

So that's the first thing. There was no hiring claim in this case, where you might make the argument more powerfully, in my view, that the economic circumstance, the market might protect people or not because if there's a labor shortage, then even if an employer is uninterested in hiring a particular group because of discrimination, it may feel compelled to hire them. This was not that kind of case. It was a promotion case and a pay case.

There were analyses undertaken by the economists, labor economists and statisticians on both sides, who had a very robust debate about what variables to consider, like which the district court addressed to some extent in deciding that the plaintiff's approach seemed to make sense, sufficient to create what the district court characterized as an inference of discrimination, on which class certification would be based.[32]

My guess is today, going forward, the district court would feel compelled, after the *Wal-Mart* decision, to make more detailed findings about whose experts' analysis is more persuasive. It wouldn't necessarily be binding on the fact finder at trial. But there would probably be more findings than there were about that. Although, the district court decision was 84 pages, so it was not a skimpy treatment of the subject. But I do think that there are—there were practices that we alleged, which actually there was no dispute about.

The discretionary decision-making, which the Court wasn't very impressed with—the Supreme Court wasn't very impressed with—but there was no dispute that it was applicable throughout every store, and that the nature of the jobs were the same. Employees moved between stores and regions and divisions very seamlessly. There were no different requirements for performance in these jobs between stores in most jobs. So obviously, the Supreme Court has the last word on this, but we—there were reasons, which I don't have time to go into any more than I already have about why we thought bringing a company-wide case like that made sense. Time for one more?

AUDIENCE MEMBER: First of all, hats off to you both for midwifing this litigation all the way through to the blockbuster status that it has. Now, not just on the docket of course, but in terms of this whole body of law. I'm a federal judge, a federal district court judge, and I am a MDL judge. I just attended the MDL workshop a couple of weeks ago, and one of the comments that was made by professors mostly, was that there's a perceived lack of understanding—maybe appreciation, too—by the Supreme Court about how the big cases are going to be litigated in a nuts and bolts sort of way.

Now, nobody said it disrespectfully. I don't mean to sound disrespectful when I repeat what was said. But that's an intriguing notion to me that all this level of major multidistrict litigation is going on that isn't fully understood in terms of the mechanics by the highest court. So I wanted to ask you a question based on your experience in this one behemoth of litigation. After all was said and done, did you, and apart from wins and losses, did you come away with the sense that the Supreme Court grasped the way in which big cases are being handled and are being approached by judges all across the country?

JOSEPH M. SELLERS: I'll start. We may disagree on this subject.

MARK A. PERRY: Oh, I doubt it.

JOSEPH M. SELLERS: I think the answer is no.

MARK A. PERRY: Yes, I do.

JOSEPH M. SELLERS: I thought so. I don't think that the Court—I don't mean to say they have no appreciation for it. One thing that I think that Rule 23 and the Rules of Civil Procedure generally do is—are intended to—is give district courts a good deal of discretion in the way they manage these cases.

Obviously, within the boundaries of due process, the Rules Enabling Act, and the substantive underlying law, but I think that the level at which even the Court, in this case, seemed to engage in what I would describe as

re-finding a bunch of the facts that the district court made factual findings about, and not seemed in any way to recognize the deference that's normally given to district court factual findings, a point that Justice Ginsburg made in her dissent, I think reflects a sometimes—not suggesting always—but that the Court is not always as connected to, or appreciate the role, and the important role, the district courts play in complex litigation, which is sometimes complex, and sometimes messy.

It's trying to resolve a dispute in a way that the Court finds to be fair. It may still have come out with the result it did, as a matter of finding that there was an abuse of discretion. But the abuse of discretion standard was never once articulated by anybody, at argument or in the decision, and I think that's unfortunate.

MARK A. PERRY: I think my perspective is a little different than that. We have a general Supreme Court that takes all kinds of cases, and some of them are trial procedure cases, and they're not in the main, trial lawyers, although there are Justices who have tried cases. But I think they look at things more through the lens of procedure, and we see some of that in the opinion, and the importance of the Rules Enabling Act, which ultimately binds the Supreme Court. Remember, the Federal Rules are written by the Supreme Court, not by Congress.

They're subject to a veto by Congress, but they're actually written by the Supreme Court and adopted by the Supreme Court, so that the Rules Enabling Act binds that Court. The Court decided in 1998 to make class certification decisions appealable in Rule 23(f). The Court decided in 2003 to add a series of procedural requirements, including the 23(c) series of things that must be laid out in the certification order, I think, precisely to address your question.

That is to say, the Court—the appellate courts, the circuit courts, and then the rare cases the Supreme Court takes, a class case, can never get down and do the discretionary decisions. I agree with you all on that point. But they can layer in a level of procedures. This Third Circuit trial plan requirement, for example, is a way of asking district courts to articulate on the record those factors that went into the certification decision, so that appellate review is possible.

Those appellate judges never have to sit through the trial. But of course, the district judge, but they can ask that things be articulated. Ultimately, does the Supreme Court know what it's like to try one of these cases to the end of it? No, I agree with Joe. I don't think that's the case.

But I do think they have sensitivity for how they're going to play out in the real world, and that by saying things like individualized defenses must be considered, that's a general prescription that then leaves a great degree of opportunity for the litigants, and discretion in the district courts to play that out in an actual case. Which is why, again, I do think we agree that the *Wal-Mart* decision answers some questions, but leaves many more

open; precisely because there's so much discretion in this area—case management discretion, as well as decision-making discretion that Rule 23 expressly confers. I mean that Rule uses the word "may" more than any other word. There are very few "shalls" in Rule 23. It is largely a discretionary rule.

MODERATOR: All right. Well, thank you both very much.

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1 Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541 (2011).
2 FED. R. CIV. P. 23(a).
3 FED. R. CIV. P. 23(b).
4 Title VII of the Civil Rights Act of 1964, 42 U.S.C. §§ 2000d (2006).
5 Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974).
6 Civil Rights Act of 1991, Pub. L. No. 102-166, 105 Stat. 1071 (1990) (codified in scattered sections of 42 U.S.C.).
7 Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007).
8 Ashcroft v. Iqbal, 556 U.S. 662 (2009).
9 Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579 (1993).
10 In re Zurn Pex Plumbing Prods. Liab. Litig., 644 F.3d 604 (8th Cir. 2011).
11 FED. R. EVID. 702.
12 In re Initial Pub. Offerings Litig., 471 F.3d 24 (2d Cir. 2006).
13 In re Hydrogen Peroxide Antitrust Litig., 552 F.3d 305 (3d Cir. 2008).
14 Gen. Tel. Co. of the S. W. v. Falcon, 457 U.S. 147 (1982).
15 Watson v. Shell Oil Co., 979 F.2d 1014 (5th Cir. 1992).
16 FED. R. CIV. P. 23(b)(3).
17 FED. R. CIV. P. 23(b)(2).
18 *See* Dukes v. Wal-Mart Stores, Inc., 603 F.3d 571, 604 (9th Cir. 2010).
19 Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 22541, 2561 (2011).
20 FED. R. CIV. P. 23(c)(4).
21 Ortiz v. Fibreboard Corp., 527 U.S. 815 (1999).
22 Amchem Prods. Inc. v. Windsor, 521 U.S. 591 (1997).
23 Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 22541, 2561 (2011).
24 Dukes v. Wal-Mart Stores, Inc., 603 F.3d 571, 629 (9th Cir. 2010).
25 Rules Enabling Act, 28 U.S.C. § 2072 (2006).
26 FED. R. CIV. P. 23(c).
27 Wachtel ex rel. Jesse v. Guardian Life Ins. Co. of Am., 453 F.2d 179 (3d Cir. 2006).
28 United States v. City of New York, 276 F.R.D. 22 (E.D.N.Y. 2011).
29 Dogherty v. Barry, 869 F.2d 605 (D.C. Cir. 1989).
30 John C. Coffee, *Litigation Governace: Taking Accountability Seriously*, 110 COLUM. L. REV. 288 (2010).
31 Mark A. Perry & Rachel S. Brass, *Rule 23(b)(2) Certification of Employment Class Actions: A Return to First Principles*, 65 N.Y.U. ANN. SURV. AM. L. 681 (2010).
32 Dukes v. Wal-Mart Stores, Inc. 222 F.R.D. 137, 150 (N.D. Cal. 2004).

DEVELOPMENTS IN PRODUCTS LIABILITY: GENERIC DRUG LITIGATION

Valerie Nannery, Mike Shumsky, Brennan Torregrossa
Moderator: Linda Kelly

LINDA KELLY: For our final session of the conference here, we're going to be talking about some developments in the products liability arena. There have been some very significant decisions that have reached the field of products liability as it relates to generic pharmaceuticals. We have a great panel of experts here on this line of litigation to help illuminate some of the changes, and maybe, talk about the direction of this arena of litigation going forward. We're going to start out with Mike Shumsky who is a partner here at the D.C. office of Kirkland & Ellis. Then we're going to hear from Brennan Torregrossa who is assistant general counsel with Glaxo Smith Kline, as well as Valerie Nannery who is litigation counsel with the Center for Constitutional Litigation.

We're going to have a bit of an interactive approach here to hopefully keep your attention as the afternoon grows late. We're going to start off by talking about a recent Supreme Court decision, *PLIVA, Inc. v. Mensing*,[1] which dealt with liability stemming from a generic version of the drug Reglan, which is a drug that was an innovator. Its use in this case involved some injuries that occurred to some patients who had taken a generic version of that drug. In June of this year, the Supreme Court came down with a decision with fairly wide, sweeping ramifications. So I'm going to turn it over to Mike Shumsky who was intimately involved with that case to tell us what it was all about.

MIKE SHUMSKY: Sure. Good morning, afternoon, I guess. My name is Mike Shumsky. As Linda said, I'm a partner at Kirkland & Ellis. I wrote the US Supreme Court briefs for the generic defendants in the *Mensing* case, and to sort of tee off our discussion, I thought it might be helpful to put everything in context, and talk a little bit about that decision. Then we can talk about its broader ramifications and where the law of products liability is likely to go from here. *Mensing* is an unusual case. For the last several decades, the overwhelming majority of products liability lawsuits have been brought against branded pharmaceutical manufacturers. There's a reason for that.

When Congress passed the Hatch–Waxman Act[2] in 1984, it bifurcated the approval process for branded drugs and generic drugs. Although branded drugs have to go through extensive clinical trials and enjoy a period of regulatory exclusivity before generic applicants can even seek FDA ap-

proval, and branded drugs also have patent protection that in many cases lasts over a decade. I think the average statistics show that it takes about twelve or thirteen years to approve a branded drug, generic drugs don't go through that process.

The basic principle of the Hatch–Waxman Act, is that generic drugs are identical copies of the branded product. The FDA's position back in the '80s, and ultimately Congress agreed, was that it would be unethical to require extensive clinical trials of generic pharmaceutical products because giving somebody a placebo when the generic version of the branded equivalent has already been demonstrated to be safe and effective would unnecessarily deprive individuals of medication that they needed. So, Congress passed an abbreviated approval process for generic pharmaceutical products.

Generics submit an abbreviated drug application to the FDA, and their goal is singular. Their goal is to demonstrate that the product is materially identical to the branded version of the product. The generic version contains the same active ingredient, same bio equivalents. That is, once the pill is swallowed, the active ingredient enters the blood stream at the same rate as the branded product. Because it's the identical product, the labeling for generic drugs has to bare the same label, the same warnings, the same risk information, and the same safety data as the branded product. The reason why most product cases, until now, have been brought against brand manufacturers is because branded products are on the market for a significant period of time before generics can ever be approved.

As I've said before, they've got patent protection and regulatory protection. The *Mensing* case is kind of quirky. The branded product in that case, a Wyeth product called Reglan, is not subject to a lengthy period of patent protection and was on the market for about five years, and then generics quickly followed. But at the time generics entered the market in this space with their metoclopramide products, their generic versions of Reglan, there were a number of other products used to treat the same conditions. This was a drug that treated severe gastrointestinal diseases and disorders. Because there were a number of competing products, Reglan never had a significant market share, and generic metoclopramide never had a significant market share.

Over time, however, the branded competitors dropped out of the market. Wyeth stopped making Reglan itself. It was transferred to a number of different companies. Suddenly, patients all over the country were being prescribed Reglan because that was the one product left to treat this disorder, and because there's an automatic substitution. Everybody was getting generic versions of it, and what emerged over time was a fairly prevalent risk of a movement disorder called tardive dyskinesia. I'm a defense lawyer, but I won't sugar coat it, it's a debilitating disease. It's very challenging for people who live with that disease to perform a number of basic functions. And it's embarrassing for them and their families.

As the prevalence of the usage of metoclopramide expanded, the number of people developing tardive dyskinesia rose. In the mid-2000s, a number of scientific papers came out saying that although the drug had been on the market for twenty years, there was a much greater risk associated with the product and, in particular, of this movement disorder called tardive dyskinesia than had previously been recognized. So, plaintiffs around the country began filing lawsuits not necessarily against the branded manufacturer of the product, because the plaintiffs hadn't taken the branded version of the product, they were all taking generic versions, but against the generic manufacturers of the product alleging that the warnings on Reglan were inadequate.

They weren't sufficient to warn physicians and patients that they might develop tardive dyskinesia if the drug was ingested over a long period of time. The generic defendants took a look at these lawsuits, and they said these cases are preempted. Our hands are tied by the Hatch–Waxman Act, which requires us to use the identical warnings that FDA required the brand manufacturer to use because our products are the same. And because federal law requires that our labeling be identical to the brand manufacturer's labeling, a state law that says we were obligated to use different labeling would impose conflicting requirements making it impossible for the generic defendants to comply with both their state and federal obligations.

You'd have a federal law saying your label should say *X* and a state cause of action that effectively, if it were successful, would say no, generic defendant, you're label was required to say *Y*. These cases were brought under a number of different theories. The two that went to the Supreme Court, one came from Minnesota, one came from Louisiana, but they had a number of different causes of action. Causes of action sounding in misrepresentation, negligence, fraud, a classic failure to warn claim, design defect, and products liability. If you can think of a cause of action, the plaintiffs somewhere in one of these cases had pleaded it.

But the underlying courts, the district courts, have looked at those cases, reviewed the complaints, understood that the problem with the plaintiffs' allegations, the core and essence of the complaint, was that the labeling on the product wasn't good enough. The two district courts that considered *Mensing*[3] and *DeMahy*[4] came to opposite conclusions. The district court in Minnesota, which heard the *Mensing* case said federal law precludes this lawsuit, pre-empts this lawsuit from going forward. The federal district court in Louisiana that had the *Demahy* case, which was later consolidated into the *Mensing*[5] case at the Supreme Court, said no, the cases can go forward.

On appeal, both the Fifth[6] and the Eighth[7] Circuits said these claims aren't preempted. They looked at three features of federal law that they said would have allowed the generic defendants to change the labeling and enhance the warnings. And they said, number one, there's an FDA regulation called the CBE, or changes being effected, regulation, which allows the

pharmaceutical manufacturer to unilaterally update their labeling with new safety information. Secondly, they said wholly apart from the label that's on the product, manufacturers, whether they're branded or generic, can send a letter to physicians. It's called the "dear healthcare professional letter," or "dear doctor letter," that literally says dear healthcare professional, new information regarding this drug has come to light. We want to share it with you. Here it is. Please consider this information when prescribing the product.

Three of these courts said barring all of that, there was nothing in federal law that prevented the generic manufacturer from simply going to the FDA and saying look, we've seen these studies, they demonstrate that there is an enhanced or more serious risk of this condition than was previously disclosed on the labeling. Please require the brand manufacturer to change its labeling so that we can update ours and conform our labeling to the branded manufacturers. Generic defendants were very happy with the rulings that came out of the Fifth and the Eighth Circuits, so they went up to the Supreme Court, which took the cases despite the absence of a circuit split.

In a very controversial 5–4 decision, a majority of the court with Justice Thomas writing, ruled in favor of the generic defendants and held that the plaintiffs' claims were preempted. The court did two very straightforward things under the FDA regulations, and one broader thing, which I think is really a watershed in the Supreme Court's preemption jurisprudence. With respect to the first two regulatory claims, the changes being effected on the CBE process and the dear doctor letter theories, the Court said no, the FDA has said that generic defendants can't use the CBE process to unilaterally alter their label because that would make their label different than the branded manufacturers and the statute and the regulations require that they have the same label.

So, the CBE theory is out. With respect to dear doctor letters, the Court said, if a generic defendant sent a dear doctor letter with additional safety information or different warnings that counts as labeling within the FDA regulations and within the definitions set forth in the statute. It too would be different than the warnings that were on the branded product. So, the generics can't send a dear doctor letter. But the Court had a little bit of a problem when it got to the third theory, the "you could have asked the FDA" theory because there's certainly nothing in federal law that would prevent or prohibit a generic manufacturer from simply asking the FDA for permission to change the label.

And that was where most of the fight happened at the Supreme Court. What the Court effectively said, was that the test for evaluating whether or not a claim is preempted—when you're talking about conflict preemption, and there is an assertion of a conflict between a state law requirement and a federal requirement—is whether or not the defendant in that case can act independently—can fulfill its state law obligations on its own without de-

pending on special requests to a third party—whether that's the FDA in this case or a brand manufacturer—because the generics have gone to the brand manufacturer and asked the brand manufacturer to change its labeling.

What the Court said is, where a defendant would have to rely on an uncertain action by a third party in order to do what the state law requires, that claim is preempted. That was not really something that the Supreme Court had made clear in its prior cases. I think the plaintiffs in that case argued that it was inconsistent with what the court had said a few years earlier in the *Wyeth*[8] case, which involved products liability claims against a branded manufacturer where the Court had said that in order for the brand manufacturer to succeed in a preemption defense, they would have to prove that FDA would not have approved the labeling change.

So the plaintiffs had argued at the Supreme Court in the *Mensing* case that the same thing ought to be true. The generics could have asked the FDA—before we can find preemption, the generics would have to demonstrate that the FDA wouldn't lift old permission or not branded. But the key line in Justice Thomas's opinion was the possibility of possibility is not sufficient to defeat a preemption claim. So the test that the Court established in that case is: Whether or not the generic could do something independently, on its own, to fulfill its state wide responsibilities, or, if it instead would require the FDA's assent or the brand manufacturer's permission.

Because the claims against the generic manufacturers in this case required the FDA to go along with the proposed labeling change, or for the brand manufacturer to go along with the labeling change, and hope, that the claims were preempted. Since that time, we can talk a little bit about this in the further discussion; there has been an enormous amount of post-*Mensing* litigation unfolding around the country. If you haven't had one of these cases yourselves, I can assure you, one of them is probably coming soon. Thus far, the lower courts around the country, almost uniformly, have taken a very broad view of the *Mensing* opinion.

To date, the Fifth Circuit, the Sixth Circuit, and the Eighth Circuit have all rejected post-*Mensing* cases where plaintiffs have tried to adjust their theories to get around *Mensing*'s bar on claims against generic manufacturers. There are about fifteen or sixteen different federal and state trial district courts that have rejected similar claims. There are a couple of exceptions. I've been involved in some cases in Las Vegas, Nevada where the courts have said there's no reason why a generic can't send a dear doctor letter. And there are some cases—one from South Carolina in particular—that have said in situations where a generic manufacturer hasn't promptly updated its label to conform to an updated brand label, then the plaintiffs' claims can proceed.

But by and large, those decisions are the outliers. Most courts have taken a position, which I would summarize roughly as follows: Because generic products must be identical to branded products, their labeling, in a

sense, is adequate as a matter of federal law. To the extent that there is any state law claim, which directly or indirectly challenges the sufficiency, the accuracy, the adequacy of warnings related information or safety and risk information associated with the generic product—those claims are foreclosed because they represent a collateral attack on a label that federal law deems adequate as a matter of law.

And that's the current state of play where we are today.

LINDA KELLY: Great. Well, thanks, Mike, for laying out the case for us. I want to talk now about what the ramifications of this decision are. Brennan, do you want to comment? Where does this lead us?

BRENNAN TORREGROSSA: Sure. So I'm Brennan Torregrossa. I'm assistant general counsel at Glaxo Smith Kline ("GSK"). But today, I'm actually going to step back from my roles as assistant general counsel at a brand manufacturer first, because what I say today are not the opinions of GSK. And second, because I don't really think that would be very helpful to you. Instead, I'm going to hearken back to my days when I was a clerk for Judge Herbert Hutton in the Eastern District of Pennsylvania, all those eons ago, and have a discussion with you about *Mensing* in almost like a clerkship-judge type manner. So, if I was your clerk, and you asked me okay, read *Mensing* and tell me, how is it going to impact my docket? And how is it going to impact my future docket? How would that conversation go?

Well, first, I'd go back to my office and pull up *Mensing* on my smart phone, which is unbelievable, instead of the old dial up way that I got the opinion. Then, after having read it on that small screen and further need glasses, I come back to you, and I think I have four things to really say on how *Mensing* will impact your docket now and in the future. First and foremost, and I think Michael touched on this very well, is *Mensing* sent a ripple—wave—throughout the docket. I had never seen a product liability decision come out of the Supreme Court with more follow up briefing and argument than *Mensing*.

The plaintiffs' counsel are simply not giving up, even though *Mensing* quite clearly said that generic drug manufacturers—claims against generic drug manufacturers are preempted under failure to warn theories and dear doctor letters. Plaintiffs' lawyers are trying any method they can to continue to litigate those cases in the lower courts. Now, why? Okay. Well, several reasons. I think first and foremost, generic manufacturers comprise an enormous portion of the market now. Something like 75% of drugs prescribed today are generics, and that number will only increase from here on out, so that's the number one reason there's a lot of cases.

Number two is they have a lot of current pending cases with nowhere else to go. We'll touch upon this later in regard to the *Conte*[9] decision. But a lot of plaintiffs' lawyers have clients that are asking what happened here?

And so plaintiffs' lawyers are using any method at their disposal to argue that there are ways around *Mensing*. So what do they include? Well, they include arguing that there are other points of contacts between generic manufacturers and doctors that include communication from sales representatives, and other communications.

Plaintiffs' lawyers have referred to the fact that because generic manufacturers have to certify that the labels they are using are used by the brand manufacturers, in fact, perhaps that certification somehow triggers some obligation or duty. For the most part, and Michael you can jump in here please if you know about it, I think the courts have so far rejected any sort of end run around *Mensing*, but that doesn't mean that they're not trying, and they're trying in spades. I think you continue to see that throughout your dockets. The second impact I think you're going to see is in black and white in the *Mensing* decision, and that is calls for a reform—calls for a reform in state legislatures, calls for reform in the regulatory arena like changes in the way that generic manufacturers observe health risks or adverse events that they received regarding their products.

Already, the public citizenry has filed a petition with the FDA to try and make generic manufacturers have the same CBE process applicable to them. In other words, they would have the same independent right to change labels based on warning information that they receive and thus have an ability to comply with both the state duty to warrant law as well as federal law.

We'll see where that goes. But I think you'll hear more and more of the call for that kind of reform because, as I said, generics continue to comprise a larger and larger size of the market. As that happens, what you'll see is a process that needs some regulating. In other words, with more and more generics, after the branded manufacturer has made the drug, patents expire, and the branded manufacturer has put all that money and research into it, you often have multiple generics out there. So the question is: Who is keeping track? Who is receiving that adverse event information that should keep an eye out for these patient safety issues?

Who should be the one that then puts that into a unified label and makes sure we have uniformity and a clear understanding of risk? I think you'll see calls for that sort of reformed process. Now, you'll note in the *Mensing* decision, there's actually a footnote by the majority that says that for the most part, okay, this is a rare issue because when a brand new manufacturer has put the product out on the market, it's out there for ten years or so with exclusivity. Through that history, we get a good sense of what the risk will be. And so this concern is somewhat lessoned because you've had that history.[10]

Well, as we go forth, as we move forward, and we have more and more generics that are used in different ways, we will see if that sort of prediction by the majority bares out, or are generics discovering more and more risks that then call for some sort of need for change in the way that we

monitor risk by generic companies. So, I think that's the second impact that you'll see in the papers and the legislatures, and perhaps even in your courts, in terms of trying to move the FDA in a direction of some sort of generic monitoring of adverse events in a single, unified way, or in a different way than we do now.

I think the narrowest reading of the *Wyeth v. Levine*[11] case would be that you need clear evidence, that's language that the court used, clear evidence that the FDA would have rejected the label that is being called for under the lawsuit, under state law duty to warn. That's probably the narrowest reading you could read in *Wyeth v. Levine*. So that doesn't mean preemption is not there. It doesn't mean that preemption isn't still a possibility. It left the door open for a preemption finding by courts like yourselves and others. But arguably put at fairly high standards to get there. Well, what *Mensing* does by a 5–4 decision is, I think, relax—you're going to see, and you're going to see more briefing, I think, in your dockets—potentially relaxes that standard.

The reason I said that is, as Michael aptly described, if Thomas is saying that it is an impossibility to comply with both federal and state law, if you cannot, yourself, independently act, then that kind of lessens the standard. Let me give you an example of what I mean by that. So if, for instance, there are circumstances where a branding manufacturer has to suggest a label change, not in the CBE process, but outside of it because it's a change, for instance, to the highlight section, which is a change in the way the FDA made concerning labels so that they're more understandable to patients.

If you're in that kind of arena and the decision is pending with the FDA, it's pending with an independent federal regulator, and the FDA has not decided, so you have no authority to make the change until that happens, under Thomas's reading in *Mensing*, that would be preempted. Now, and you'll see Justice Sotomayor, in fact, agrees with that. She has a section in her dissent, which says, I don't agree with the majority, but I would allow preemption in certain circumstances. One of those circumstances is if the regulator has a pending risk issue that is in their arena waiting for approval before it goes onto the label. Now, why is that important? That's important because that is often where we find ourselves with risks that find its way into your courts.

Often, you have a situation where science develops, and the law doesn't want to lead science, rather, the other way around. But science takes a long time to develop. And indeed, Michael and I were talking about how long the science around Reglan took to develop. So, if you have a situation where it's pending with the FDA, and you don't want to, under state laws, encourage any sort of rushing of decision by the FDA, because you want uniform and well thought out labels, you'll find yourself in a situation where you're going to have more and more briefing where the issue is with the FDA, but there can be no liability because to be told otherwise

would force the label to change before the FDA was ready and thus, an impossibility.

I think the fourth and final impact, although I'll just touch briefly on this because we're going to have some follow up, is this *Conte* notion. Will, if plaintiffs are unsuccessful in trying to do an end run around *Mensing*, will they try to hold companies, the branding manufacturers, somehow responsible for the label, even though it was not their product. The product that they took was the generic manufacturer's product. As we'll discuss, many courts, almost every court, has rejected that notion for what I think are very obvious and sound reasons. But I'm not going to dive into those.

I do want to identify that as on the tier of impacts, the fourth tier impact, will be on your dockets.

LINDA KELLY: Thanks, Brennan. Valerie, from your perspective, what do you think are the major impacts of the *Mensing* holding?

VALERIE NANNERY: Well, if I were your clerk, I would tell you something a little bit different than what Brennan would have told you if he were your clerk. The result of the *Mensing* decision is not that generic manufacturers are immune from products liability suits generally. Design defects claims still lie against generic manufacturers, particularly when the drug has been pulled from the market, which we have seen countless times in the past couple of decades where a drug has been recalled, even though it was approved at an earlier time, because it's no longer considered safely designed.

Manufacturers should have known that, stopped making it, and pulled it from the market because the risk of the drug does not exceed its utility. The authorities are split on that. So there is no rule for you to follow from *Mensing* that would preempt design defect claims against generic manufacturers. But getting to failure to warn claims, they are not all obliterated by the *Mensing* decision. Where the name brand manufacturer has stopped selling the drugs, which we see in a lot of older drugs where there are only generic bioequivalent drugs available, but there's been a change in the risk assessment of that drug.

Because there is no name brand manufacturer, there has been no updated label in the *Physicians' Desk Reference*, which is where many doctors get their information about drugs. The *Physicians' Desk Reference* ("*PDR*") is provided by name brand manufacturers to doctors to give them information about the risks of their drugs. It includes the labels from the name brand drugs only. But if there is no name brand manufacturer, there would be no monograph for the name brand drug in the *PDR*. The failure of the generic manufacturers to communicate the increased risks associated with the use of that drug would not be immunized by the *Mensing* decision.

Mensing on its face also only applies to pre-2007 claims when the federal law was changed.

Now, I am not going to offer an opinion as to whether the changes in the federal law would affect the outcome. Whether it would be the same outcome post-2007 as it would pre-2007, but *Mensing* only directly applies to pre-2007. You would have to engage in a detailed analysis of whether the changes in federal law impact whether failure to warn claims are preempted against the generic manufacturers. There is also the potential for claims against generic manufacturers who are either owned by the name brand manufacturers or who have a contract with the name brand manufacturers to produce the generic counterpart drug.

There is also the potential for claims for failure to warn when the reference listed drug manufacturer, the name brand manufacturer withdraws from the market, and a generic manufacturer is designated as the reference listed drug holder. In those cases, those cases where the generic manufacturer is a subsidiary of the name brand manufacturer, or where the generic drug manufacturer has been designated as the reference listed drug holder, we would be in a situation like *Wyeth* where the Supreme Court has held that failure to warn claims continue and are not preempted by federal law against name brand manufacturers.

What Brennan told you about claims against name brand manufacturers for products liability is true, that when a name brand manufacturer has a pending application to the FDA for changes to the label that prevents them from providing a greater warning, a stronger warning, to physicians. That has been true since before *Mensing*. That is not new. I don't expect you to see an increase in those types of claims by name brand manufacturers. However, name brand manufacturers might try to latch on to pending the portion of the *Mensing* decision, which says that it requires an independent action by the drug manufacturer in order for the claims to not be preempted.

That was not part of the holding in *Wyeth v. Levine* in the first place. But name brand manufacturers might say, "Hey, we can't act independently either. We can issue a change that's being effected, but the FDA can always come back and say, 'oh no, you can't warn about that because we didn't review that.'" The FDA has never—the name brand manufacturers and the generic manufacturers have never been able to cite to FDA action preventing them from providing stronger warnings to doctors. The FDA has never come in and said, "oh no, no, your label is too strong. We did not approve that." It would be a strange course of events for that to happen.

What we have had happen instead, is that manufacturers resist updating their warnings until they really have no choice. We saw this with antidepressant drug labeling earlier in the 2000s when they received a black box warning about suicidal ideation amongst teenagers. They knew for a while because they had done studies, but they resisted the urge to update their warnings until there was a swell of opinion in the public that this

should be changed. So manufacturers have resisted those changes. But because of *Mensing*, and we will get into this when we discuss the *Conte* decision next, a lot of the precedent needs to be reexamined. The reason why plaintiffs are not letting go of claims against generic manufacturers for one, is that you, like I, probably ingest generic drugs regularly.

Most people receive generic drugs as a course—as a rule. It is expected that when you go to fill a prescription, if a generic is available, you will receive a generic prescription drug. It is a basic principle of products liability law that if you were injured by a product, you can sue the manufacturer if the product is defective. I think that a lot of people, myself included, my mother, and probably many judges, who take generic drugs, were alarmed to discover that they might not be able to sue the manufacturer of the drug when they are injured in a way that was not revealed in the warning of the drug simply because they received the generic drug and not a name brand drug.

The reason why all these claims keep going forward against generic drugs is because many courts have said that you cannot sue a name brand manufacturer for liability even if the warnings for their drugs were the ones that your doctors relied on in making a prescription decision.

BRENNAN TORREGROSSA: Just two responses to that. I mean, I think Valerie is right. You're going to see a push on design defect cases and generic drug manufacturer cases. Now, for the most part, I think many states refuse to allow design defect cases because this is not like a lawnmower. I mean, this is a drug that was incredibly expensive to develop and produce. You can't just simply put a flap on the lawnmower or on the drug to fix it. It's very different, and I think most courts and judges and states have said we're not going to allow an alternative design theory for that reason. It has to be a failure to warn. But I agree with Valerie. They're going to test that principle of law. If not before you, before state legislatures.

The second point I would make is—it was sparked by some of the things that Valerie said, I think you're going to see a lot more discovery in your cases about other litigation or other regulatory actions within the FDA's framework. So, in other words, if you have a case about drug facts, you're going to see increasing subpoenas coming out of your courts, increasing discovery battles over the ability and necessity to take discovery of what the FDA did with respect to drug *Y* because in that instance, they may be able to show that the CBE change was rejected.

And that the FDA pulled down a label because it wasn't supported by the science or a risk that was simply not supported by the science and unduly worrying the people who are taking it, the patients. So I think you'll see much more increased discovery along those regulatory lines.

VALERIE NANNERY: I have one more type of failure to warn claim that several courts have held are not preemptive post-*Mensing*. So looking at

this drug in particular, metoclopramide, under the name brand Reglan, the label had not been changed from 1984 to 2004. For 20 years, it was the same label. During that time, the name brand manufacturer changed. It used to be AH Robbins and then Wyeth inherited it. At that time, Wyeth did not update the label. But even when Wyeth got out of the market in 2001, the generic manufacturers could have, in 2004 when the label was updated, sent a dear doctor letter containing current information about the drug.

If the generic manufacturers knew that the doctors probably were not aware of this, because there was not a publication in the *PDR*, and since 2001, there has not been a publication of the Reglan label in the *PDR*, then generic manufacturers could have provided that warning to doctors. It's not an additional warning, it's the current warning. They could have sent that. And several courts have held that those types of failure to warn claims survive the *Mensing* decision.

LINDA KELLY: Okay. I'm going to let Mike react to the reactions, and then I think we'll shift to the *Conte* discussion, and then we can talk about them all together because it kind of all flows together. So, Mike.

MIKE SHUMSKY: Sure. I guess two things, although I'll preface it by saying I have enough time arguing in front of a three judge panel. I feel it more challenging to argue in front of a 100 judge panel. Obviously, my clients have a different perspective on *Mensing*'s implications than Valerie's clients do. And I alluded to this earlier. Each of the theories that she has identified has been rejected by multiple courts. The same claims, in fact, post-*Mensing* were raised in the Eighth Circuit when *Mensing* went back on remand. They were raised in a series of three cases, *Smith*,[12] and *Wilson*,[13] and *Morris*[14] in the Sixth Circuit Court of Appeals in Ohio. Recently, the Fifth Circuit in the *Demahy*[15] case, on remand, directed entry of judgment in favor of the defendants, even after the plaintiffs' shifted tact.

So I give the plaintiffs' lawyers credit for being creative and for being persistent. But they're losing that on the preemption front. To just shift away slightly from preemption for a second, I would just make a point, which is whether or not *Mensing* forecloses those claims, all of that should have sounded a little bit strange to your ears as a state law matter. As far as the design defect claim goes, virtually every state in the country has adopted Comment K of the Restatement. Brennan alluded to that a second ago. But Comment K basically says we recognize that there are certain kinds of products which are inherently dangerous, prescription drugs are the best example of that.

Every drug is dangerous for someone so, provided that the drug is not defectively manufactured, i.e., it's supposed to have 500 mg of acetaminophen but things went awry at the factory, and it has 5,000 mg of acetaminophen, and as long as the product has an adequate warning, there is no design

defect claim. And that's the law virtually everywhere in the country. So I think it's a little bit of a stretch to bring a design defect claim against a generic product.

As far as some of the other things, in particular, the last thing that Valerie said, which is that there's an obligation to publish the label in the *Physicians' Desk Reference*, I would challenge you to look at the precedents of the past court decisions in your state and find a failure to warn case that has recognized liability for not providing the warning somewhere other than "accompanying the product." In the history of American products liability law, that's where the warning belongs. It belongs with the product itself, not in a reference book compiled by a third party, not in a separate letter that you send to somebody after the fact. And drug companies, for 100 years, have fulfilled that in two ways.

They've printed a label and affixed it to the bottle or the vial that the product comes in. And they've included a fold out package insert, because there's a lot of information that you have to provide about drugs that can't fit right on the label with the product. I know of no precedent anywhere in the country that has recognized a cause of action as being viable under state law, the new preemption aside, for failing to provide labeling warnings or other information through some third means or some other means other than the one that has always existed in products liability.

When you sell a lawnmower to someone, you put labels on the lawnmower. You include an instruction guide. But I've never seen a lawnmower case where someone has been held liable because they didn't also publish safety information in a local newspaper or in a trade journal for farmers and agricultural experts. So leave it at that.

LINDA KELLY: Okay. So let's shift now to the *Conte* case, Valerie, and *Conte v. Wyeth*[16] was a state court case in California decided in 2008. It involved the same drug, Reglan. But this time, the parties at the table were the brand name manufacturer and the plaintiff. And the drug ingested was actually a generic. And Valerie argued that case, so I think she's a great person to tell us what it was all about, and then we'll have a discussion around the table.

VALERIE NANNERY: Well, I can pick up the *Conte* case where Mike left off. Failure to warn looks at the realities of how people receive warnings. And in drug litigation, the way people receive warnings is different than the way they receive warnings about lawnmowers or pencils. They don't look at the actual label, particularly when it's a generic drug. They're required to put the label accompanying the product, which goes to the pharmacist, and the person receiving the drug never sees it. The generic label itself would have been difficult prior to 2005 for doctors to even read. The way doctors are warned about drugs and the way that name brand manufacturers have argued they should be able to warn about drugs is by warning doctors.

The way they provide this information to doctors has been primarily through the *Physicians' Desk Reference*. They have also sent out detail men to market the products, and they frequently encourage off label use, use for the drug for longer periods of time than is indicated on the label of the drug as well as for completely novel uses that you might not have thought of. So the *Conte* case—and I will also say that this equally applies to *Kellogg v. Wyeth*,[17]—*Conte* was decided in 2008—*Kellogg* was decided just a year ago at the District Court of Vermont—it came out the same way. Both plaintiffs, in both cases, took the same drug as Gladys Mensing.

They both received generic versions of the drugs for gastric reflux and their doctors relied on the information that they received throughout their history of practice primarily from the name brand manufacturers. The way doctors prescribe drugs is, if it's a general course of their practice, they don't refer to the *Physicians' Desk Reference* every time they prescribe a new drug. I'll ask you the last time you went to a doctor's office, whether your doctor in prescribing you Amoxicillin for an infection or Allegra for your allergies looked at the *Physicians' Desk Reference* to see what the contraindications for that drug were. Usually, it's just based on their common practice.

The manufacturers know this, and this is why direct letters to healthcare providers when there is a new updated— warnings are essential. It is essential for the manufacturers to keep doctors apprised of changes in the warnings on their drugs. But your doctor writes you a prescription and doesn't check that little box at the bottom that says "dispenses written" or "do not substitute," and your pharmacist picks whichever substitute is available at the pharmacy. The doctor doesn't know which generic drug you will receive in advance, nor do you. You take the drug because it operates in your body the same way the name brand drug does.

Because this was for a chronic condition, your doctor reauthorizes it, and you develop a neurological condition, which Mike alluded to earlier. But this neurological disease is incurable, and it's permanent. It involves grotesque facial grimacing and tongue thrusting and involuntary movements of the feet and the hands in a way that makes it very difficult to communicate with other people and breathe and drink and eat and talk. It is a debilitating condition. If you knew when you started taking this drug, or if your doctor knew that there was a high likelihood that you would get this condition, they probably wouldn't have prescribed that drug to you.

That's what a product's liability failure to warn claim is. You sue the manufacturer of the drug that you received for products liability, the generic manufacturer, so in this case, Mike's clients, because you were injured by their product. But then you also sue the company that produced the information about the drug on which your doctor relied. Your doctor relied on the name brand manufacturer's information, and so you sue the name brand manufacturer for misleading your doctor about what the risks associated with the drug were.

The manufacturers knew for a while that although the label stated that the incidents of this debilitating condition was only one in 500 people, with long term use, it is as many as one in five people suffer from this condition, particularly if they're elderly, and particularly if they're women for some reason. That's just the way this drug is metabolized. It causes a neurological disease 20% of the time. And so, you sue your doctor for medical negligence, because maybe he wasn't paying attention. You sue the generic, and you sue for products liability against the generic manufacturer, which, post-*Mensing*, is questionable whether you have a claim. It depends on what the contours of those claims against the generic manufacturer are.

But your claims against the name brand manufacturer are based on the Restatement of Tort (Second) §§ 310 and 311,[18] which I hope were provided to you, which basically state that a doctor has a duty to any person who, in the course of an activity in the furtherance of his own interest, relied on the doctor. So the name brand manufacturer provides us a warning, hoping that doctors will write prescriptions for Reglan, and undertakes to give that information to another doctor, and realizes that the safety of the doctor's patients depend on the accuracy of that information. And these patients will be injured as a result.

The California Court of Appeals and the District of Vermont held that under common law tort, drug manufacturers have a duty to use due care when providing this information. This is not the same as a products liability claim. This is merely the duty to not mislead physicians about the risks associated with the use of the drug. Both the court in *Conte* and the court in *Kellogg*, said that it is entirely foreseeable. In fact, it is routine that a physician will prescribe a drug in reliance upon the information disseminated by a name brand manufacturer, and the patient will receive an ingested generic drug.

This is based on the way doctors warn, as well as the laws that exist in almost every state that require pharmacists to put a generic drug in that bottle, if it is available. This holding was based on the way the market works in the pharmaceutical market. And it was also based on decades of common law that hold that it doesn't matter if the person giving you the information benefits personally from giving you that misinformation. If they know that that information is incorrect, and they know that it is reasonably foreseeable that you will rely on that information in making a decision and be injured as a result, that person making those statements should be held liable for that.

None of these cases have actually found liability against a name brand manufacturer. The elements of the claim are very different from a products liability claim. The injured party has to show first that there was a duty, and here, the duty is based on the foreseeability of harm, that there was a breach of that duty, that they misled the doctors, that that misleading information caused their injury, and that they were damaged as a result. They have to prove every element of that claim. This case was the first case of

its kind to actually hold that you could sue a name brand manufacturer for this kind of claim—the first case that has stood, because prior to the *Conte* decision there was a decision in the District of Maryland called *Foster*, [19] which resulted in the decision from the Fourth Circuit that held the exact opposite.

But the District of Maryland in that case held, yes, you could sue a name brand manufacturer for misleading your doctors in making a prescription decision. But in 1994, the Fourth Circuit said it would extend the limits of foreseeability too far to hold a name brand manufacturer responsible when a patient receives a generic drug. It didn't say that it wasn't foreseeable. It did not say that it was not reasonable for doctors to rely on the name brand manufacturers warnings. It simply avoided the issue and engaged in circular reasoning. And for the seventeen years that have followed that decision, virtually every court to address this type of liability has simply followed the *Foster* decision and has not engaged in its own independent analysis.

The difference between the *Conte* decision, the *Kellogg* decision, and all of these other cases, is that the courts in *Conte* and *Kellogg* engaged in independent analysis based on the common law of the states of California and Vermont, which are probably very much like the common law of the states where you sit. Given the current holding in *Mensing*, which leaves consumers of generic manufacturers without a cause of action in many cases, all of those cases need to be revisited because *Foster* was based on the underlying premise that you would be able to sue a generic manufacturer for its inaccurate labeling for products liability.

Now that that premise has been completely abolished, in some cases by the *Mensing* decision, the reasoning of *Foster* must be revisited by the courts that have already decided that.

LINDA KELLY: Thanks, Valerie. Brennan and Mike, reactions?

BRENNAN TORREGROSSA: Sure. So *Conte* and *Kellogg*, for your purposes, aren't really new developments. The issue for you is does *Mensing* do anything that changes the status quo in those cases? I think the answer is resoundingly no. In fact, *Mensing* in many ways affirms what many courts have done, which is, reject *Conte* and *Kellogg*, and here's why. First and foremost, *Conte* and *Kellogg* stand alone. I don't just mean that a few courts have rejected their reasoning, fifty-four decisions in twenty-three states have rejected the *Conte* theory of liability. It's been nearly unanimous in its rejection.

So, if you spread out the judicial opinions in this conference room, and you took a gavel, and you chucked it, it would likely land on language that is critical of *Conte* and *Kellogg* for many reasons, which I'll go through in a second. For the most part, it has been resoundingly rejected. Second, does *Mensing* change the analysis? No, not at all. In fact, in the *Mensing* case,

the underlying case involved a theory of liability against the brand manufacturer. That was rejected by the Eighth Circuit for many of the reasons that the other fifty-three courts had rejected it. And it went up to the Supreme Court on the preemption issue with respect to the generic manufacturers.

If you read the *Mensing* opinion, it's clear both in the majority, by Justice Thomas, and the minority, by Justice Sotomayor, that they recognize their preemption finding is withholding any kind of relief on behalf of people who take products by generic manufacturers. There have been several courts, in fact, the Sixth Circuit just released an opinion, that looked at this very issue. Does *Mensing* change the analysis? They said no. And, I respectfully disagree. I think they did use their independent judgment in issuing that opinion, and here's a perfect quote from them. They just simply said, "Just because a company is in the same business as a tortfeaser, the company is not automatically liable for the harm caused by the tortfeaser's product."[20]

I think, that if you read all of the decisions, and in fact, there are *Conte* score cards out there, and that's where I received this information about fifty-four courts rejected it in twenty-three states, the theme you get back is as follows from these judges: As a judge, you have to draw—very tough at times—policy lines. I mean, it's not all about application of the law. But at times, it's application of policy to apply the law. What they said there is it's simply unfair. This stretches, as Valerie said, it's a direct quote, "stretches foreseeability too far." That's particularly true in this context where you have pharmaceutical companies like GSK and others that put significant resources towards developing drugs.

When they do that, to hold them as an insurer forever and ever, I think really promotes bad policy. It has the potential, the very dangerous potential, to take money away from the development of future drugs that can benefit all of the people in this room or the people that we love. And I'll give you sort of a human story that really brought that to home when I started working at GSK. One of my friends, a neighbor actually, also worked at GSK. He was a scientist. I asked him what do you do? We were talking, and I said to him, did you ever work on a drug that made it to the market? Which ones have you worked on?

He kind of laughed at me, and he said almost everyone I know, every scientist that I work with, has never worked on a product that made it to market or anywhere near market. You can dedicate your life for fifty or sixty years, and you will never see a product that touches the light of day, that ever treats a single patient, or does anything for anyone because it is so hard, and it is so expensive, and it is so important that we get it right. To me, that really brought it home, because as a lawyer, I was sort of thinking imagine spending your entire life dedicating yourself to the profession of law, becoming a judge like yourself, writing hundreds and hundreds if not

thousands and thousands of opinions and not one of them ever being of any precedence or seeing the light of day by anyone.

That would be an extremely difficult concept for me to handle, to devote my career to sort of checking off compounds that can't help people. But that is what scientists do. And so, when you talk about policy and talk about taking money away from the pursuit of science, good science, I think that's where courts have gotten it right and said this is just too far, and we're going to draw a line here. And I think I'll leave it at that.

LINDA KELLY: Okay, thanks. Mike.

MIKE SHUMSKY: Sure. I don't have any deep thoughts on the *Conte* issue. I'll update Brennan's scorecard. My colleague, Jay Lefkowitz, who argued the *Mensing* case at the Supreme Court, argued and won the *Conte* issue in New Jersey last Friday, so it's fifty-five courts in twenty-three states now. I think what Brennan sort of began with and some of the things that Valerie hinted at and suggests is that at the end of the day, this is really a policy matter for the legislatures in your states to resolve and not really a place where judges ought to strike out and try and create or craft new law. There are bedrock principles of products liability jurisprudence which have always required that a plaintiff be injured by the defendant's own product.

Many states, and New Jersey is a great example of this—I mention it only because it's on my mind from that case last Friday—New Jersey has a products liability statute, which severely restricts the kinds of causes of action that can be brought and doesn't include the foreseeability cause of action that the California court in *Conte* recognized and the District of Vermont recognized in the *Kellogg* case. So, in cases, particularly where legislatures have controlled the products liability through a statute, these claims are a particularly poor fit. At the end of the day, if I had to make a prediction, I suspect that a number of state legislatures and perhaps state supreme courts will revisit the *Conte* issue.

At this point, those two decisions really sit on the very margin of the jurisprudence. And given the sort of sound, overwhelming rejection of those principles over a very long period of time, both pre-*Conte* and pre-*Kellogg* and post-*Conte* and post-*Kellogg* that have actually considered what those courts have said and whether or not they fit with the laws of the states in which the follow up cases have been brought. Given that those decisions have really have sort of set aside as quite dramatic outliers, ultimately, it's for politicians to make the law in this area, and that's where I think the next movement really is.

LINDA KELLY: I think, Mike, you've anticipated one of the follow up questions that I had. And I'm going to ask Brennan and Valerie to comment as well. In Justice Thomas's opinion in *Mensing*, he refers to the unfortunate hand that federal drug regulation has dealt the plaintiffs in the

case. I think signaling that from his point of view, the decision is a pretty strong bar to failure to warn claims going forward against generics. So, we do agree that we have a policy issue to address through the legislative processes. Are there *Conte* type claims that are the logical follow-ons where we would be pursuing the brand name manufacturers to seek remedies for the claimants?

What's the right path forward here, Valerie? I'll let you start, and then I'll ask Brennan and Mike.

VALERIE NANNERY: Well, the right path forward depends on who you see as the wrong doers in these cases. But for the history of products liability law, in terms of holding accountable the manufacturers of the products, it has always been the case that you can sue manufacturers of defective products when they fail to warn of the risks associated with the use of that product, thereby making it defective. The Supreme Court in *Mensing* has made those claims unavailable to many plaintiffs and left them out of court with no remedy in many cases. The only way to fix that in those cases is a statutory remedy that retroactively makes it clear that generic manufacturers are actors who can actively change their label or seek changes to their label and act to update those warnings.

A regulatory response would be forward looking, prospectively, would allow generic manufacturers to provide dear doctor letters, and to initiate changes being effected on their own, and would undo *Mensing* in the future. There's currently at least one pending citizen's petition to the FDA to correct that. I don't think that the right way forward necessarily bars claims against name brand manufacturers because if you look at them as tortfeasors as well, they're different types of claims. So you have claims against generic manufacturers for the use of their products, and that's a nonfeasance issue. They failed to do something they should have done. But when you look at name brand manufacturers, it's a malfeasance issue. They did something wrong.

They misled the public or the doctors about what the risks of their drugs were. And letting them off the hook for that malfeasance doesn't seem to be good public policy. If a legislature decides to enact a law to prevent that going forward, that may be a policy issue. But in terms of the legal issue, the common law is that you have a duty to exercise due care in your interactions with other people and not cause them harm. If you fail to exercise that due care, then you should be liable for the harm that you cause. That is just basic common law. If there are policy reasons to go away from that basic rule, then the courts may take that into consideration.

But for the history of pharmaceutical manufacturing, pharmaceutical manufacturers have always said, don't let anybody sue us for anything. Immunize us from suit, in general, because the FDA approved our drugs, and we're performing a public good. Don't pay attention to our profits.

BRENNAN TORREGROSSA: You know, I think enacting *Conte* type claims in response to this situation would be to give absolute credence to the notion that bad facts make for bad law. It's certainly understandable to eliminate the requirement of privity when you, in fact, make the product, and we shouldn't provide a shield simply because we use middle-men or middle-women to deliver our products to people who alleged that they were then injured.

To eliminate privity and some sort of sense of duty and impose duty and foreseeability in this way when brand name manufacturers didn't provide the product that was taken, in this kind of unique scenario where it did all the development work, came up with the incredible invention, took it to patent, took it to market, and then let it go to be used forever and ever for the benefit of patients, to hold a company liable sixty years later because someone took a generic drug of theirs or another company that's based on your patent I think is just simply too far. I very much worry, and this is heartfelt—I very much worry about the slippery slope that would be caused by that.

At the bottom of that slope, you could see some very unintended, yet, unfortunate consequences. They include simply repeating things that others said. What if a doctor reads a label and then repeats it? What if one of you has an experience with a product, think it is good, and repeat it, or repeat its risks and benefits that someone else then takes? What if this information is in a medical journal in a continuing medical education program like our brethren and sistren in the medical field have right now? What kind of liability are you going to impose on them for those things?

I think it would lead to very unfortunate consequences, and it would not be supported by what we think are concepts of fairness under the law.

LINDA KELLY: I'd like Mike to address the issue of fairness. I'm sorry. I was going to just let Mike and then Valerie, back to you.

MIKE SHUMSKY: Sure. Just quickly, I mean, I think their comments address sort of a legislative fix for the *Conte* issue. There is a push, obviously, to outright reverse *Mensing*. They've both mentioned the citizen's petition. Anybody can ask the FDA to do something. The vehicle for doing that is a citizen's petition. There's one that's been filed asking FDA to change the regulations so that generics can change their labels independently of the brand manufacturer without FDA approval. There have also been stirrings of movement in Congress to change the Hatch–Waxman Act to allow generics to do that. I'm a lawyer, not a politician, not an aspiring politician. I won't purport to have any great policy expertise.

But I feel like I know this industry pretty well, and if I were asked to evaluate the merits of that kind of a legislative action, my approach would be a very practical one, which is, what are the costs and benefits of adjusting the Hatch–Waxman regime in this way? I think there are three things

that really sort of stand out to me as weighing into that calculus. One, as I sort of alluded to, at the very beginning of my remarks, is that there is a big difference between brand manufacturers and generic manufacturers. Brand manufacturers, as Brennan said, are innovators. They spend an enormous amount of money. They have enormous budgets to do research and development and get drugs to market and, when they're successful, to make very significant profits during the exclusivity periods that they earn for having made it through the regulatory gauntlet and brought an improved product to market. They have a lot of money. Generics are very different. For the most part, with a couple of exceptions, generics are very small companies, very small market capitalizations, if they're even publically traded. They don't have big R&D budgets, and they don't profit to the same extent as branded manufacturers for the products they sell. They're competing on price, not innovation. So there are razor thin profit margins for them. To take just metoclopramide as an example, there are more than thirty different companies making that product.

Because generics have different responsibilities under federal law, they're not set up to do the kinds of things that brand name manufacturers do. They don't have huge budgets and huge amounts of money to do active literature monitoring, to review long-term results from the products. They're making copies of products that have already been proven to be safe and effective and that have been, in many cases, on the market for more than a decade or even two decades before they even come to market.

So they don't have the kinds of resources to fulfill an obligation to extensively monitor the scientific literature, and they're not really in a very good position to monitor the scientific literature and assess whether or not the labeling needs to be changed because they don't have the underlying clinical data that the brand manufacturer developed in order to get approval for the product. So a study might come along saying that there is a risk of a certain condition, but they have no sense of whether or not that condition was previously discovered, whether or not the FDA knew about that condition during the clinical trials.

They can't put the information they receive in context, so they're for the most part, poorly funded, poorly resourced economically, but substantively as well. They just aren't in a position to be creating a safety label out of thin air because that's not their role, that's not their responsibility under federal law, and that's not how their businesses have been set up.

The second practical consideration really comes down to the sameness principle. Think about it practically for a second. If we lived in a world where every generic manufacturer was responsible for its own labeling and could put whatever labeling it thought was required on its product, where would each of you be when you walk into your local Walgreens or CVS and go to pick an ibuprofen product off the shelf?

You pick up Advil, brand name ibuprofen, and you'd read one set of warnings and precautions. But then you'd pick up the Walgreens or the

CVS brand, different warnings potentially, different precautions. And then you pick up a product made by another generic manufacturer, Teva or Baxter or Qualitest, or any of the dozens of other companies that make generic ibuprofen, and they have their own warnings and their own precautions on the product. And at the end of the day, you have no idea what to believe about the product. That really, I think, drives a stake through the heart of the Hatch–Waxman Act. Again, the whole point of that statute is that generics and brand names are the same, they're identical.

Consumers are supposed to be confident that when they take a generic version of the branded product, it's exactly what's in the branded product with the same benefits and the same risks as the branded product. Creating this sort of patchwork quilt where, on the manufacturer by manufacturer basis, products that report to be the same in substance would have different warnings is, I think, a crazy, undesirable, practical outcome of adopting a legislative regime under which generics would take on the same responsibilities as brand manufacturers. The very last thing I want to say, and it's a tough argument to make, it's probably not something that anyone wants to hear.

But the reality is–it is the reality–which is generic warning labels, generic product information is never read by physicians to the extent that physicians look at information. When you go to your physician, and they say I'm going to give you Allegra for your allergies, and they write out a prescription for Allegra. If they've looked at something, they've looked at the *Physicians' Desk Reference* entry for Allegra or they've looked on the FDA website. It's all online. All you have to do is type in the name of the drug, and you can pull up the label right there in the doctor's office. They've looked up Allegra.

They haven't looked up a particular manufacturer's generic version, and they certainly haven't compared the Teva label to the Mylan label to the Baxter label to the Qualitest label and so on and so forth. They've looked at the branded product labeling. But no physician, and it's just the truth, actually looks at the generic product label. So when you're trying to make a legislative decision, and you're focusing on it in a practical way, is imposing liability on generics based on a failure to warn theory or imposing a duty on generics to maintain their own independent labeling in light of the costs that I talked about before—the consumer confusion, the lack of resources that generics have based on the way that businesses have been structured under the existing framework.

In light of the risks, what benefits are there from that system? And the reality is, well, all of my generic clients take their safety obligations very seriously and have dedicated staff that stay on top of the FDA website and learn about brand manufacturers' changes and implement those changes as soon as practicable. The reality is, imposing liability or duties in this context is not going to make a difference to consumers or patients. It is the rare—I would argue, never say never, but virtually nonexistent physician

that has ever looked at a generic product label in his or her life. Ask your own physician next time you're there.

So in light of the costs, I just don't see a practical benefit to revolutionizing Hatch–Waxman law in the way that people are talking about doing.

LINDA KELLY: All right. We're almost out of time here. So I think I'm just going to give you one minute to close out, each of you, if you want to. Mike, maybe you've spoken your peace.

MIKE SHUMSKY: I have.

LINDA KELLY: Okay. Valerie?

VALERIE NANNERY: Before I get to the point I wanted to address that Brennan made, *Conte* and *Kellogg* do not stand alone. There is a case out of Alabama called *Weeks v. Wyeth*[21] that allowed the same sort of claims to go forward against name brand manufacturers against a motion to dismiss. And that was from a federal court. They certified that question to the Alabama Supreme Court.[22] If the Alabama Supreme Court addresses this issue, it would be the first state supreme court in the nation to address this issue under their state tort law. No state supreme court has said there is no possibility of suing a name brand manufacturer when it misleads the medical community about the risks associated with the use of its drugs.

There also have been cases in the Court of Common Pleas in Philadelphia, *Clark v. Pfizer*,[23] as well as in Massachusetts, a tort case involving Reglan, where the name brand manufacturers moved to dismiss the claims against them, and they lost that motion to dismiss and the court let those claims stand for the meantime. But the question regarding whether it's fair to be able to sue a name brand manufacturer for misleading the medical community about the risks associated with this drug is easily answered by the *Conte* court, which asked what is unfair about requiring a defendant to shoulder its responsibility for injuries caused at least in part by its negligent or intentional dissemination of inaccurate information?

There is nothing inherently wrong with suing multiple tortfeasors concurrently for different torts, even though there's only one injury. In the case of a car accident, you can sue the manufacturer of your car for faulty brakes. You can also sue the other driver for the driver's negligence. And just because there is a product involved, it doesn't mean that all the claims are suing in products liability. As the court in *Conte* recognized, name brand manufacturers enjoy many benefits and advantages, including a period of exclusivity and the ability to charge much higher prices for their product.

So, it is not true that they are the core, name brand manufacturers, and they also often capitalize on this, but they also capitalize when their drug

goes generic by producing generic drugs of their own. But the most important reason to hold them accountable for their malfeasance and the reason why it is not unfair to hold them accountable is because they are in the best position to know about the risks associated with the drug because of their innovation and the period of exclusivity that they enjoy. They are the experts on the drug, and they possess knowledge that may not be common amongst the other manufacturers of the drug and clearly would not be common amongst the prescribers of the drug.

So it is fair to hold them accountable when they fail to exercise reasonable care in providing that information.

LINDA KELLY: Thanks, Valerie. Brennan, close us out.

BRENNAN TORREGROSSA: Well, because I'm hearing zippers and people bagging up, I think I'll just end by saying I think fifty-four courts got it right.

LINDA KELLY: All right, very brief. Please join me in thanking the panelists.

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2 Pub. L. No. 98-417, 98 Stat. 1585 (1984).
3 Mensing v. Wyeth, Inc., 562 F. Supp. 2d 1056 (D. Minn. 2008).
4 Demahy v. Wyeth, Inc., 586 F. Supp. 2d 642 (E.D. La. 2008).
5 PLIVA, Inc. v. Mensing, 131 S. Ct. 2567 (2011).
6 Demahy v. Actavis, 593 F.3d 428 (5th Cir. 2010).
7 Mensing v. Wyeth, Inc., 588 F.3d 603 (8th Cir. 2009).
8 Wyeth v. Levine, 555 U.S. 555 (2009).
9 Conte v. Wyeth, Inc., 85 Cal. Rptr. 3d 299 (App. 1st 2008).
10 PLIVA, Inc. v. Mensing, 131 S. Ct. 2567, 2581 n.9 (2011).
11 Wyeth v. Levine, 555 U.S. 555 (2009).
12 Smith v. Wyeth, Inc., 657 F.3d 420 (6th Cir. 2011).
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19 Foster v. Am. Home Prod. Corp., 29 F.3d 165 (4th Cir. 1994).
20 Smith v. Wyeth, Inc., 657 F.3d 420, 423 (6th Cir. 2011).
21 Weeks v. Wyeth, Inc., No. 1:10-cv-602-MEF, 2011 U.S. Dist. LEXIS 35137 (M.D. Ala. Mar. 31, 2011).
22 Weeks v. Wyeth, Inc., No. 1:10-cv-602-MEF, 2011 U.S. Dist. LEXIS 151595 (M.D. Ala. Aug. 25, 2011).
23 2008 Phila. Ct. Com. Pl. LEXIS 74 (Pa. Mar. 14, 2008).