No. 20-1349

IN THE

Supreme Court of the United States

RACHEL THREATT,

Petitioner,

v.

JOANNE FARRELL, ON BEHALF OF HERSELF AND ALL OTHERS SIMILARLY SITUATED, ET AL.,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF THE CATO INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Federal Rule of Civil Procedure 23(h) permits a court to award only "reasonable" attorney's fees, subject to the right of class members to object. In this case, the Ninth Circuit upheld a fee award that awarded class counsel a windfall amounting to $6,700 per hour for the mere 2,158 hours committed to the case. In contrast, the fee award leaves only enough funds to award each class member $0.03 per dollar of harm suffered. The question presented is:

Whether the Due Process Clause of the Fifth Amendment and Federal Rule of Civil Procedure 23(h) require courts to reject proposed fee awards that deprive class members of their property without meaningful consent by class members.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Constitutional Provisions

Rules

Other Authorities

INTEREST OF *AMICUS CURIAE*[1]

The Cato Institute was established in 1977 as a nonpartisan public-policy research foundation dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Robert A. Levy Center for Constitutional Studies was established in 1989 to help restore the principles of limited constitutional government that are the foundation of liberty. Toward those ends, the Cato Institute publishes books and studies, conducts conferences and forums, releases the annual *Cato Supreme Court Review*, and files *amicus* briefs.

This case concerns Cato because it involves a threat to the integrity of the adversarial legal system and thus to constitutional due process.

SUMMARY OF ARGUMENT

Every first-year law student learns the uncomfortable rule that a bystander generally has no legal duty to save a child in danger, even if doing so would be relatively costless. *Buch v. Armory Mfg. Co.*, 44 A. 809, 810 (N.H. 1898). A moral duty certainly exists but, absent a special relationship between the bystander and the victim, the bystander may abstain from acting and allow the victim to perish.

For too many years, the Court has stood by, merely observing, while class members perished under the Ninth Circuit's class action jurisprudence. Unlike

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[1] Rule 37 Statement: All parties were timely notified of and have consented to the filing of this brief. Further, no party's counsel authored this brief in whole or in part and no person or entity other than *amicus* funded its preparation or submission.

Chief Justice Carpenter's hypothetical bystander in *Buch*, however, the Court has precisely the kind of relationship with class action victims that turns a moral obligation to act into a legal one. Specifically, the Fifth Amendment's Due Process Clause commands the courts—most especially the court of last resort—to assure that class members' life, liberty, and property are protected by due process of law.

The present federal class action regime is fraught with perverse incentives, removing all confidence that class counsel can be trusted to be stalwart—or even meek—protectors of class member's rights and property. Class members are deprived of their property without due process when courts approve fee requests without meaningful review because it allows class counsel to appropriate more than a reasonable portion of the pool of resources belonging to the class. Society is also harmed when courts grant a windfall for class counsel's frivolous class action claims.

The Court should grant the petition to recognize two important facts. First, that the Due Process Clause is not self-enforcing and requires, in the context of class action lawsuits, a "rigorous analysis" of all the requirements of Rule 23. *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 351 (2011). Second, that the U.S. judicial system exhibits strong path dependence, and that courts' abdicating their duty to engage in a rigorous analysis of every part of a Rule 23 claim creates a feedback loop of ever-increasing due process violations and frivolous litigation.

Class actions are often the only mechanism for protecting individual rights, but they are also subject to the potential for abuse. Class counsel who see an

opportunity for self-enrichment at the expense of their clients—the class—face few obstacles in doing so. Similarly, the same mechanism that serves to defend individual rights can easily be turned into a frivolous-litigation device, extorting large settlements from defendants based on flimsy or non-existent factual or legal grounds. Only careful, meaningful, and rigorous review of class action lawsuits by United States courts can minimize these dangerous potentialities. The Due Process Clause requires no less, and Rule 23 strongly suggests the same.

ARGUMENT

I. WITHOUT MEANINGFUL REVIEW OF REQUESTED CLASS ACTION FEE AWARDS, CLASS MEMBERS ARE DEPRIVED OF THEIR PROPERTY WITHOUT DUE PROCESS OF LAW

The Fifth Amendment's Due Process clause protects the right of individuals to their liberty and property. Few forms of property are as crucial to a free society as the right to pursue legitimate legal claims, seeking to obtain a redress of wrongs. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 812 (1985). If successful, the damages needed to make the victim whole must be considered the legal property of the class, or else the right to bring a claim is illusory.

The current class-action regime raises due-process concerns by empowering class counsel to first generate the class and then control it though a few named plaintiffs. All attorney-client relationships are subject to standard principal-agent problems, long identified by law-and-economics scholars. Attorneys

will be tempted to act for themselves, rather than for their clients' benefit. Countering that temptation are personal ethics, the possibility of attentive clients, and potential disciplinary action. And yet, lawyer misbehavior is still disturbingly commonplace.

In a class action, the incentive to misbehave is even stronger because the vast majority of clients are not only inattentive but unaware that they are clients. Structuring an opt-out class requires mere identification of potential class members, a meager attempt at notification, and members' failing to opt out. Ignorant of their status as clients, absent class members cannot police counsel's behavior, leaving counsel free to enrich themselves in numerous ways.

Ever the innovator in ways to facilitate class counsel self-enrichment, the Ninth Circuit has now concluded that it need not meaningfully review an award that provides class counsel "compensation" of $14.5 million, all of which would be subtracted from the settlement amount. While contingency fee lawyers are entitled to compensation for the risk assumed, the approved fee award yields an hourly rate of $6,700, a 700% premium above the maximum billable rate for class counsel's firm.

Such appalling examples of self-enrichment at the expense of class members have become far too common, particularly in the Ninth Circuit. In refusing to operate in its proper role as a check on the avarice of class counsel, the court below facilitated the violation of class members' due process rights. Theft of class members' property would be condemnable if it occurred at the hands of any standard criminal. That it occurs at the hands of the class' own lawyers—and

is approved by not one but two federal courts—requires this Court's intervention.

A. The Common Pool Is the Legal Property of the Class

Fed. R. Civ. P. 23(h)(2) expressly allows class members to object to a fee award. This provision implicates two important truths. First, that damages recovered pursuant to a legal claim are the property of the class. *Klier v. Elf Atochem N. Am., Inc.*, 658 F.3d 468, 474 (5th Cir. 2011). Second, that class counsel faces perverse incentives towards self-enrichment, rather than protection of the class. The first of these two truths derives from the right of the individuals who comprise the class to pursue legal claims against the defendant. Once the court finds for the class, or the defendant agrees to a settlement, the class no longer has a legal right to the claims. In a very real sense, then, the right to seek redress becomes the right to whatever damages the litigation process has determined is necessary to make the class whole.

Class members' right to the pool of damages—including the right to exclude others—is no less grounded than the right to pursue legal claims. The Court has held that class counsel may not deprive class members of their property right in their legal claims by providing less than adequate representation. *Shutts*, 472 U.S. at 812. By the same measure, the Court should grant the petition to make clear that class counsel may not deprive class members of their property right to the proceeds deriving from the claims. Failure to do so will render illusory the right to the legal claims, in the first place.

B. Anything Greater Than a Reasonable Fee Award Is Theft of the Class's Property

Fed. R. Civ. P. 23(h) also permits courts to award only "reasonable" fee awards. In constraining class counsel's fee awards in this way, Congress provided a way to protect class members' property. The reasonability constraint balances the interests of class counsel in being properly compensated for exertions on behalf of the class with the interests of the class in preserving its rightful claim on the property. To properly strike that balance, courts must assure that unreasonable fee awards are not approved by means of a rigorous analysis.

It cannot be disputed in a free society that class counsel, having worked on behalf of the class, have the right to be paid the fair value of their services. The work of a plaintiffs' lawyer is not a mechanistic endeavor. It involves risk, and that risk will not be voluntarily assumed without compensation. Class counsel is therefore entitled to a risk premium, but that risk premium must be commensurate with the actual risk borne.

The Ninth Circuit explicitly recognizes the importance of risk in the test it applies to judge the reasonableness of fee award requests. *Resnick v. Frank (In re Online DVD-Rental Antitrust Litig.)*, 779 F.3d 934, 954–55 (9th Cir. 2015) (requiring the district court to consider "whether the case was risky for class counsel"). In practice, however, the court's risk analysis suffers a catastrophic break with reality.

Even a passing analysis of the fee award would reveal the fantastical nature of the implied risk premium approved by the Ninth Circuit. Class

counsel submitted 2,158 hours for compensation. *Farrell v. Bank of Am. Corp., N.A.*, 827 Fed. Appx. 628, 632 (9th Cir. 2020) (Kleinfeld, J., dissenting). If billed at the maximum hourly rate for class counsel's firm—$800 per hour—the total compensation due would be a little more than $1.7 million. *Id.* Instead, class counsel asks for $14.5 million, or $6,719.18 per hour. *Id.* Even if the firm's most expensive lawyers worked every billable hour for this case—a doubtful proposition—the risk premium would be 739%.

By comparison, usury laws in 40 states limit interest rates on loans to 40% and two more limit it to less than 100%. Thomas W. Miller, Jr. & Harold A. Black, "Examining Arguments Made by Interest Cap Advocates," in *Reframing Financial Regulation: Enhancing Stability and Protecting Consumers* (Hester Peirce & Benjamin Klutsey, eds. 2016). Only nine states have no limit on loans. *Id.* Importantly, only part of an interest rate represents risk imposed on the lender. Kenneth S. Lyon, *Why Economists Discount Future Benefits*, 92 Ecol. Modelling 253 (1996) (explaining that interest rates reflect both a time preference and a substantive risk component). In all but 11 states, then, the risk premium for lenders is statutorily limited to less than 10% of what the Ninth Circuit has approved in this case.

Perhaps class counsel's bearing the up-front costs of litigation is less like a loan and more like an investment. *See*, *e.g.*, Jeremy Kidd, *Probate Funding and the Litigation Funding Debate*, 76 Wash. & Lee L. Rev. 259 (2019) (describing the characteristics of various contingent legal arrangements). The average rate of return on projects funded by angel investors was 27% in 2010, but the returns to individual

projects ranged from negative returns to returns of ten times the investment. *Angel Market Returns*, Right Side Capital Mgmt., LLC (2010), https://bit.ly/3n9HG7M. Importantly, those returns are not exclusively risk premium, as angel investors will be actively engaged with the startup for four to six years in order to realize those kinds of returns. Robert Wiltbank & Warren Boeker, *Returns to Angel Investors in Groups* (2007), https://bit.ly/3az03y1. The type of risk associated with startup investing is also of a different type, representing the risk of creating and selling brand new products and services.

There are some investments where the risk is so high, and the returns to speculative, that no one is willing to speculate as to the possible rate of return. *E.g.*, David Dawkins, "Elon Musk's SpaceX Gets Bullish $100 Billion Valuation from Morgan Stanley, Double What Investors Said It Was Worth In August," *Forbes* (Oct. 23, 2020) (describing analysts' refusal to estimate returns on Elon Musk's efforts to explore Mars and deep space). Other efforts like Starlink—putting broadband-like internet into every home via space—would have been science fiction five years ago but are now considered potential technologies, and with far less of a risk premium than that approved by the Ninth Circuit. *Id.*

Class action lawsuits are subject to risk, to be sure, and compensation should be had for that risk, but the risk borne by class counsel in this case was hardly the stuff of science fiction. At its heart, however, this case is concerning not just because of the fantastical nature of the fee award, but because the court did little more than glance at the award before approving it. Due process requires something more than blanket

"discretion to choose how [to] calculate [fees]." *Jones v. GN Netcom, Inc. (In re Bluetooth Headset Prods. Liab. Litig.)*, 654 F.3d 935, 944 (9th Cir. 2011). By failing to offer meaningful review and rigorous scrutiny, the Ninth Circuit has sanctioned the theft of class members' property. The Court should grant the petition to make abundantly clear that such theft will not be countenanced in the U.S courts.

Furthermore, as discussed below, "risk" in the judicial context correlates positively with the frivolity of the claim. A truly frivolous claim would pose the greatest risk of failure—at least in jurisdictions outside the Ninth Circuit, those that take their responsibility to protect class members' rights seriously. Courts must consider that reality when determining whether "risk" should be rewarded.

C. Courts Cannot Simply Defer to Class Counsel in Determining the Reasonableness of a Fee Award Request

Given the perverse incentives that permeate our opt-out class action regime, there is a strong reason to believe that class counsel will engage in self-enrichment at the expense of the class. W. Bradley Wendel, *The Problem of the Faithless Principal: Fiduciary Theory and the Capacities of Clients*, 124 Penn. St. L. Rev. 107, 113 (2019). Class action lawsuits are often the only way to feasibly redress wrongs inflicted on a large number of victims. *Califano v. Yamasaki*, 442 U.S. 682, 700–701 (1979). Class actions are also a hotbed of perverse incentives. John C. Coffee, *Rethinking the Class Action: A Policy Primer on Reform*, 62 Ind. L.J. 625, 628 (1987). Without careful supervision by courts, class counsel

face numerous ways in which they can violate the due process rights of class members with impunity.

The attorney-client relationship is a classic principal-agent arrangement, subject to all of the usual "pathology[ies]." Mila Sohoni, *Crackdowns*, 103 Va. L. Rev. 31, 59 (2017). The existence of these pathologies is one reason that, traditionally, a principal-agent relationship gives rise to fiduciary duties. *E.g.*, *Condon Auto Sales & Serv. v. Crick*, 604 N.W.2d 587, 599 (Iowa 1999). Not only have courts not imposed strong fiduciary duties on class counsel, but the Court's adoption of an opt-out regime in *Shutts*, 472 U.S. at 812–13, has virtually guaranteed that class counsel will engage in self-dealing.

Class members typically have suffered only small—or possibly only *de minimis*, statutorily defined—harms, so they have little incentive to learn of the existence of class actions in which they may have legal interests. Class counsel, having assembled named plaintiffs, have no incentive to generate an attentive class that could disrupt class counsel's ability to sell off class claims at pennies on the dollar. "Notice" therefore comes cloaked as a junk mail postcard or spam email, most of which will be discarded without any understanding that the right to object to class counsel's shenanigans just disappeared along with the "notice." *Sullivan v. DB Invs., Inc.*, 667 F.3d 273, 329 n.60 (3d Cir. 2011) (en banc) (finding that response rates "rarely exceed seven percent"); *Gascho v. Global Fitness Holdings, LLC*, 822 F.3d 269, 296 (6th Cir. 2016) (Clay, J., dissenting) ("the median response rate in a study of consumer class actions was 5-8%").

Only meaningful and rigorous review of class counsel's actions can prevent the victims' being victimized, once again. This time, they are victimized by the very instrumentalities that were designed to protect their due process of rights. First, they are victimized by their counsel, who face numerous ways in which to pursue their own interests at the expense of the class. Second, they are victimized by the courts, who watch the first brutalization but do nothing to stop it. While a bystander typically has no legal duty to intervene to stop a crime, that changes if there is a special relationship between the victim and the bystander. Can there be any more special relationship between the government and the people who are the source of the government's legitimacy?

The government, in its various forms, has been entrusted with the protection of its citizens, especially in their life, liberty, and property. U.S. Const., amend. V. Deprivations may occur, but the courts have been tasked with ensuring that any such deprivations occur only after due process of law. There has been no due process of law for class members for many years, at least in the Ninth Circuit, and the Court has stood by and watched. The Court should grant the petition and end that period of neglect.

D. Courts Should Apply a Rigorous Analysis to Every Component of Rule 23

If the Court grants the petition, as it should, there will still be the question of what standard to apply. Fortunately, the Court has already provided the standard, in the form of the "rigorous analysis" standard required by Rule 23(a). *Dukes*, 564 U.S. at 350 ("Rule 23 does not set forth a mere pleading

standard . . . certification is proper only if the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied"). The Court, in *Dukes*, was only asked to address the requirements of the certification process, but due process violations are rampant throughout the class action process, to the extent that courts fail to provide rigorous scrutiny of the actions of class counsel.

A rigorous-analysis standard is but one possible solution, maybe not even the most comprehensive one. The Court could, for example, reconsider its declaration in *Shutts* that an opt-out class action was not a violation of the Due Process clause. 472 U.S. at 812. That decision was a pragmatic one, recognizing that there were serious problems with an opt-out mechanism, but concluding that too many socially optimal class actions would be infeasible under an opt-in regime. *Id.* As technological innovations have reduced transactions costs, the Court's concerns, in *Shutts*, may no longer be realistic.

Given the ability to mobilize millions of activists for nearly any cause on Twitter or other social media platforms, it is likely that all socially optimal class actions would now be feasible under an opt-in regime. Under an opt-in regime, only those class members who have affirmatively consented to class counsel's representation would be bound by the actions of counsel, including the transfer of class members' property to counsel in the form of a fee award. An opt-in regime would also generate competition between aspiring class counsel, improving class members' interests on price (lower fee award) and quality (better responsiveness, higher damages) dimensions.

The Court could revisit the *Shutts* determination that opt-out class actions are constitutional. Doing so would be disruptive but might prove a net benefit because of the improved protections of class members' rights. If that is a bridge too far, however, the next best alternative is *not* to do nothing. The Court must recognize the strong potential for self-dealing by class counsel and mandate that lower courts turn a skeptical eye to all settlements and approve only those that, after a "rigorous analysis," are proven to properly defend class members' rights and property.

II. COURTS THAT FAIL TO PROVIDE MEANINGFUL REVIEW OF FEE AWARDS INCENTIVIZE GREATER NUMBERS OF FRIVOLOUS LAWSUITS

The need to protect class members' due process rights is the primary reason the Court should grant the petition, but it is not the only reason. If the Ninth Circuit's new standard for (not) reviewing fee requests is allowed to stand, it will lead to an increase in the number of frivolous lawsuits and impair judicial efficiency and the rule of law.

It has been said that "there are no solutions, there are only tradoffs." Thomas Sowell, *The Vision of the Anointed* 142 (1995). The tradeoff with class action lawsuits is that the same mechanisms that permit greater number of low-value claims into the system also allow no-value claims. Legitimate class action lawsuits often exhibit per-victim damages small enough that only the economies of scale achievable by the class action mechanism can entice a lawyer to represent the class. Repeated exposure to those kinds of claims can desensitize courts, making it difficult for

them to recognize frivolous claims, where the value of the claim is not only low, but zero.

The tradeoff is inevitable—more frivolous lawsuits in exchange for allowing low-value claims to proceed—but that does not mean that courts can just ignore the probability of frivolous litigation. The Ninth Circuit, by approving the certification of an arguably frivolous claim and then approving, without rigorous review, a grossly exaggerated fee award, has affirmatively promoted frivolous litigation. It has done so by establishing a standard whereby class counsel can use a single windfall victory to subsidize many frivolous claims across time.

Seeking rewards from unproductive behavior is known as "rent-seeking" and has long been endemic to the legislative and executive branches. The Court faced administrative rent-seeking in *N.C. State Bd. of Dental Exam'rs v. FTC*, 574 U.S. 494 (2015), in which the Court rejected North Carolina's attempt to shield the Board's decisions from antitrust scrutiny because the Board consisted of "market participants" who stood to gain from the decisions they made. *Id.* at 510. *See also St. Joseph Abbey v. Castille*, 712 F.3d 215, 226 (5th Cir. 2013) (rejecting a state regulation restricting casket sales as rent-seeking by market participants who could charge higher prices). The Court has also rejected a form of judicial rent-seeking, in mandating recusal of a state supreme court justice whose main campaign contributor had a case pending before his court. *Caperton v. A.T. Massey Coal Co.*, 556 U.S. 868, 876 (2009).

Individual plaintiffs may bring a frivolous claim as a form of judicial rent-seeking, hoping for an

unmerited transfer from defendant to plaintiff. The reality is that lawyers are complicit in that decision—and might do less of it if federal courts were more willing to impose sanctions for Rule 11 violations—but the decision to rent-seek is made by the individual client. In a class action, however, putative counsel construct the claim, choose the named plaintiffs, and exert almost unlimited control over every aspect of the claim. It is therefore lawyers who are engaged in rent-seeking in the class action context.

Class action rent-seeking is more troubling than individual rent-seeking for three reasons. First, because it is a lawyer engaged in that behavior, and when the guardians of the law repeatedly abuse the law for personal gain, the rule of law suffers. Second, because class action rent-seeking will be harder to detect: small-value claims are the defining feature of class action litigation. Third, because class action lawyers often engage in strategic rent-seeking, utilizing present litigation not for its immediate benefit to the class or even society, but as an investment in future enrichment. *See* Jeremy Kidd, *Modeling the Likely Effects of Litigation Financing*, 47 Loyola U. Chi. L.J. 1239, 1261–63 (2016).

The existence of binding precedent in our judicial system creates path dependence, where a change in legal doctrines today carries over to the future. Individual cases can be brought because they offer the possibility of obtaining a particular change in the law, much like legal "research and development" for future lawsuits. Maya Steinitz, *How Much Is that Lawsuit in the Window? Pricing Legal Claims*, 66 Vand. L. Rev. 1889, 1908 (2013).

Neither class members nor the judicial system should be considered instrumentalities for the personal enrichment of class counsel. Under the Ninth Circuit's new rule, every frivolous case now has a higher top end. By approving a fee request far beyond any reasonable level of compensation for effort and risk, the lower court provided a windfall to class counsel. In statistical terms, the lower court significantly increased the expected value of every frivolous case. Moreover, while it is likely that some of that windfall will go towards personal consumption by counsel, some of it will almost certainly be used to subsidize other frivolous litigation, since each one of those "investment" opportunities now has a higher expected rate of return.

In this context, the Ninth Circuit's consideration of the "risk" to class counsel takes on a more sinister tone. If "risk" can be interpreted as the likelihood of losing the case, then every frivolous claim is risky, and the further from established law, the greater the frivolity and risk. If allowed to stand, the Ninth Circuit's test would effectively allow class counsel to take their windfall and cross-subsidize even riskier—more frivolous—litigation. That elevated level of "risk" would then be justification for even more questionable fee awards. Again raising the specter of due process violations, this cross subsidization would be accomplished with property taken without permission from the class.

The wheels have been set in motion for the Ninth Circuit's class action jurisprudence to escape the bounds of rationality, with significant harms to the rule of law. Given the Court's recent rulings relaxing the requirements for personal jurisdiction of

corporate defendants, *See Ford Motor Co. v. Mont. Eighth Judicial Dist. Court*, 141 S. Ct. 1017 (2021), the Ninth Circuit's rule stands to escape the bounds of the Ninth Circuit. Corporate deep pockets, wherever located, will find it increasingly difficult to avoid being subject to such reckless rules.

CONCLUSION

The Court should grant the petition to curb in its infancy the Ninth Circuit's gross expansion of judicial rent-seeking. The most straightforward means to that end is to require the type of "rigorous analysis" required by the Court in *Dukes*. 564 U.S. at 351. Lower courts would still be able to compensate class counsel for their effort and risk, but would avoid cross-subsidizing future frivolous cases.

Respectfully submitted,

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