Damage Averaging—How the System Harms High-Value Claims*

The disappearance of the American civil trial has paved the way for a new order of dispute resolution—one marked by alternatives such as arbitration, mediation, and, above all, settlement. Nowhere has that shift been seen more than in tort cases.[1] In 1962, one in six tort cases went to trial; by 2002, only one in forty-six was tried.[2] In large part, this shift reflects the arrival of mass tort settlements, with headline-making examples such as Agent Orange, asbestos, tobacco, and Vioxx.[3] Whether it is the extreme cost, the uncertainty and unpredictability, or the potential for massive exposure (especially for the defendants), defendants and plaintiffs in mass tort cases avoid trials at all costs. Today, less than 1% of all mass tort cases proceed to trial.[4]

As a consequence of the vast majority of mass tort cases being settled by agreement between the parties, allocation of the settlement proceeds has become a massive undertaking, filled with ethical and practical difficulties for plaintiffs' attorneys entrusted with allocating aggregate settlement proceeds (as is the case in the majority of mass tort settlements).[5] When one or a small number of claimants settle with a defendant, it is relatively easy to determine how the proceeds of the settlement are to be split; it is far more difficult when a defendant establishes a $4.85 billion settlement fund for almost 50,000 claimants, as Merck & Co. did to settle nationwide multi-

* J.D. 2017, University of Texas School of Law. I would like to thank Alex Hernandez, Matt Sheehan, and the entire *Texas Law Review* for their dedication and time spent improving my work. I also owe tremendous gratitude to Professor Lynn A. Baker, whose deep passion for this topic provided the roots for my own and whose thoughtful comments greatly improved the early drafts and helped guide me through the entire writing process. Finally, I am immensely grateful to my wonderful girlfriend, Lauren, for her constant support and patience, and, of course, to my parents and loved ones for their perpetual belief in me. All remaining errors are my own.

1. Theodore Eisenberg & Charlotte Lanvers, *What is the Settlement Rate and Why Should We Care?*, 6 J. EMPIRICAL LEGAL STUD. 111, 133, 135 (2009) (noting that the settlement rate in tort cases is statistically significantly higher than the rate in other case categories such as contract and employment discrimination); *see also* Marc Galanter, *The Vanishing Trial: An Examination of Trials and Related Matters in Federal and State Courts*, 1 J. EMPIRICAL LEGAL STUD. 459, 466 (2004) (stating that in 1962, most federal civil trials involved torts: tort cases were 55% of all trials and 81% of all jury trials; by 2002, torts had dropped to under a quarter of all trials).

2. Galanter, *supra* note 1, at 466.

3. *Id.*

4. Pete Kaufman, *Ethics Challenges in Mass-Tort Litigation Settlements*, PLAINTIFF MAG. (Jan. 2014), http://www.plaintiffmagazine.com/recent-issues/item/ethics-challenges-in-mass-tort-litigation-settlements [https://perma.cc/K6SP-2VAH].

5. Charles Silver & Lynn Baker, *I Cut, You Choose: The Role of Plaintiffs' Counsel in Allocating Settlement Proceeds*, 84 VA. L. REV. 1465, 1465–67 (1998) (explaining that plaintiffs' attorneys dominate the allocation process in consensual group litigation).

district litigation (MDL) over the drug Vioxx.[6] As can be imagined, those claimants took Vioxx for various periods of time; had drastically diverse medical histories, employment opportunities, and family situations; and exhibited numerous other differences—no two claimants were identical in all regards. Had any of those claimants taken their case to trial, a jury would have been able to consider the facts and circumstances of each situation in determining an appropriate verdict. However, the individual settlement award for each Vioxx claimant was ultimately based on the calculation of "points" pursuant to negotiated formulas, grids, and matrices; while some variances between claimants affected their settlement payout, the settlement-allocation plan minimized, or even ignored, other important differences between claims that could or would have affected their expected value at trial.

Such an allocation method—known as "damage averaging," which occurs when a settlement-allocation plan does not adequately reflect unique differences "between claims that could or would affect their expected value at trial"[7]—has become a valuable arrangement for distributing settlement proceeds in complex mass tort actions. Yet, while damage averaging provides an efficient, objective, and equitable (both horizontally and vertically) system for apportioning settlement proceeds among claimants, it may inadequately compensate those claims which our legal system should value most—the high-value claims of the most seriously injured claimants.[8] Thus, while I will argue that the benefits of the overall use of damage averaging in mass tort settlements significantly outweigh the negatives, the allocation method is limited by its undervaluation of high-value claims and could be significantly improved.

In Part I of this Note, I further define and explain damage averaging as well as investigate why high-value claims are likely undervalued under such a system, while, conversely, low-value claims are typically overvalued. In Part II, I explain why damage averaging use has greatly expanded in mass tort settlements and examine the benefits and negatives of a damage-averaging allocation method. Next, in Part III, I discuss alternatives to damage averaging and present an argument for why damage averaging is the best current arrangement for the distribution of settlement proceeds. Finally, in Part IV, I recommend solutions to ensure that high-value claims are

6. Alex Berenson, *Merck Agrees to Settle Vioxx Suits for $4.85 Billion*, N.Y. TIMES (Nov. 9, 2007), http://www.nytimes.com/2007/11/09/business/09merck.html?_r=0 [https://perma.cc/JRG5-95FX].

7. Lynn A. Baker & Charles Silver, *The Aggregate Settlement Rule and Ideals of Client Service*, 41 S. TEX. L. REV. 227, 240 (1999).

8. While legally cognizable "high-value claims" are not necessarily identical to the claims of the most injured claimants, for simplicity I will use the two types of claims interchangeably. I admit that the two are not a perfect correlation, but since claimants with more serious injuries are far more likely to have high-value claims, my analysis will be unaffected by the decision.

accurately[9] valued—proposals that have the potential to reduce (or even eliminate) undervaluation of such claims and meaningfully improve the outcomes of damage-averaging apportionment.

I. Damage Averaging: Why High-Value Claims Are Undervalued (and Low-Value Claims Are Overvalued)

Given the massive scale, complexity, and size of mass tort settlements, damage averaging has become a highly used (and effective) device for apportioning settlement proceeds among claimants. Damage averaging occurs when "a settlement allocation plan ignores or minimizes differences between claims that could or would affect their expected value at trial."[10] At some level, the settlement of any group lawsuit involves some degree of damage averaging—there is simply no way to evaluate every aspect of each individual claim that might affect the claim's value if litigated individually.[11] To do so would require resources and efforts that our current system of adjudication does not allow for and, frankly, will never feasibly allow for. Furthermore, while the settlement of any group lawsuit inevitably involves some degree of damage averaging, damage averaging becomes increasingly beneficial as the complexity of an action increases. Thus, it is no surprise that damage averaging has become a common and accepted allocation tool to manage the complexity of large-scale mass tort settlements.

Yet for all the benefits of damage averaging,[12] the allocation method has its detractors.[13] And while many of the purported concerns with the use of damage averaging are adequately addressed by state rules of legal ethics and professional responsibility,[14] or are simply not significant enough to overcome the numerous benefits of such an allocation plan,[15] the effectiveness of damage averaging as a settlement-allocation method is

9. In this Note, when I use the term "accurate" valuation, I do not mean it on an absolute basis, but rather as a proxy for comparing what a claim would be worth at trial, discounted for risk factors, time value of money, and other similar detractors from claim value. Thus, a claim that is "accurately" valued in my Note is one that matches the expected value at trial, discounted for the above factors.

10. Baker & Silver, *supra* note 7, at 240.

11. *Id.* at 241.

12. See *infra* Part II for a discussion of the benefits of damage averaging.

13. *E.g.*, Nancy J. Moore, *The Case Against Changing the Aggregate Settlement Rule in Mass Tort Lawsuits*, 41 S. TEX. L. REV. 149, 167–68 (1999); Steve Baughman Jensen, *Like Lemonade, Ethics Comes Best When It's Old-Fashioned: A Response to Professor Moore*, 41 S. TEX. L. REV. 215, 220–25 (1999).

14. *See, e.g.*, MODEL RULES OF PROF'L CONDUCT r. 1.8(g) (AM. BAR ASS'N 2015) (addressing conflict-of-interest dilemmas attorneys may face in group litigation).

15. *See, e.g.*, Jensen, *supra* note 13, at 216 (discussing the benefits of group litigation and damage averaging, including economies of scale, increased bargaining power, efficiency, and a significant reduction in the transaction costs of individualized treatment of claimants).

significantly limited by the undervaluation of high-value claims.[16] At this juncture, it is important to define what I mean by high-value claims being "undervalued." There are two possible ways that undervaluation of high-value claims in damage-averaging group allocation occurs,[17] and while damage-averaging allocation in an individual mass tort settlement can suffer from either type of undervaluation, one can expect both categories to potentially be problematic in significant numbers of settlements.

First, high-value claims, on average, obtain lower settlements than the same claims would have received had they been handled individually, whether by being brought as a separate action or by individualized treatment of the claim when allocating group proceeds (type one undervaluation). To illustrate type one undervaluation, one can imagine that a certain claim would be awarded $10 million at trial, or similarly, if examined for all of its nuances in individualized settlement allocation, receive a value of the same $10 million. On the other hand, when such a claim is allocated in a damage-averaging apportionment process—that is, based on the calculation of "points" pursuant to negotiated formulas, grids, and matrices that ignore unique differences between this claim and others—the valuation comes out to $5 million. In other words, such an example of type one undervaluation leads to a high-value claimant receiving a $5 million settlement value due to damage averaging, when the same claim would have netted $10 million in trial or in an individualized settlement-allocation process.

Second, the ratio between high-value claim payments and those awarded to lower value claimant groups is generally too small under a damage-averaging allocation (type two undervaluation).[18] For example, while high-value claims may receive ten times the amount of proceeds as low-value claims, they should be receiving twenty or thirty times the amount had all differences that could or would affect their expected value at trial been considered in evaluating both groups of claims.[19] Put another way, consider two claimants who both were harmed by taking a blood pressure medication. Claimant one is diagnosed with slight liver damage due to taking such medication—certainly not an optimal outcome, but treatable with a change in diet and lifestyle. Claimant two, however, suffers a heart attack based on

16. *See, e.g.*, Howard M. Erichson, *Beyond the Class Action: Lawyer Loyalty and Client Autonomy in Non-Class Collective Representation*, 2003 U. CHI. LEGAL F. 519, 552 (explaining that damage averaging reduces the value of strong claims and raises the value of weak claims); Nancy J. Moore, *The American Law Institute's Draft Proposal to Bypass the Aggregate Settlement Rule: Do Mass Tort Clients Need (or Want) Group Decision Making?*, 57 DEPAUL L. REV. 395, 408 (2008) (describing damage averaging as an allocation method in which "those with more serious injuries receive less than they would have under an allocation that gives more weight to individualized factors").

17. I label these as "type one" and "type two" undervaluation, and discuss them in the next few paragraphs.

18. Baker & Silver, *supra* note 7, at 243.

19. *Id.*

taking the medication and is left paralyzed, requiring constant medical care for the rest of his life.

At trial or in an individualized settlement-allocation process, claimant one would receive $50,000, while claimant two would be awarded $1 million. Conversely, with damage-averaging settlement allocation, claimant one is awarded $75,000, while claimant two receives $750,000. While in both scenarios claimant two is compensated significantly more generously than claimant one (as one would no doubt expect given the severity of their injuries), there is significant type two undervaluation occurring here. At trial or in an individualized settlement-allocation situation, claimant two's award of $1 million is twenty times the value of claimant one's $50,000 payout. However, with a damage-averaging allocation system, claimant two's award of $750,000 is only ten times the value of claimant one's $75,000 payout. This difference between the proportion of each claim's value against the other demonstrates type two undervaluation.

As we have seen, undervaluation of high-value claims is a phenomenon that is widely accepted and present in damage-averaging allocation. Theoretically, one would expect that if any mass tort claims are to be overvalued, they would be the highest value claims, ones associated with claimants who have suffered the most serious injuries. Yet in practice, the exact opposite occurs—low- (and even negative-) value claims are overvalued, while high-value claims are undervalued. What explains this phenomenon, which seems logically backwards? And what incentive schemes and characteristics of our mass tort settlement regime lead to such a result?[20]

At the outset, it is important to realize that allocation occurs from one common pool of proceeds, so any additional dollar disbursed to one claim must be subtracted from another claim's amount. If allocations were accurately priced based on differences between claims that could or would affect their expected value at trial, there would be no under (or over) valuation of settlement proceeds. But, once any claim within the group settlement is inaccurately valued, at least one other claim must be adjusted in order to make up for the over (or under) valuation. In practice, low-value

20. For purposes of simplicity, I will assume that settlement allocation will be undertaken by plaintiffs' attorneys in my discussion of current incentive schemes. While it is true that on occasion third parties allocate settlement proceeds, the vast majority of mass tort proceeds are allocated by plaintiffs' attorneys. *See* Silver & Baker, *supra* note 5, at 1465–67 (emphasizing that plaintiffs' attorneys "dominate the settlement process," including determining each plaintiff's share of the settlement proceeds). Furthermore, many of the same pressures faced by plaintiffs' attorneys in allocating settlement proceeds are also felt by third-party allocators.

claims are systematically overvalued, which means that there is less in the pool for high-value claims, leading to undervaluation of high-value claims.[21]

Most importantly, almost all mass tort settlements are conditioned on a very high opt-in percentage of claimants.[22] In other words, unless a large percentage of eligible plaintiffs agree to participate in the settlement process, the defendant usually can abandon the settlement.[23] For example, the Vioxx Settlement Agreement and the Amended World Trade Center Settlement Agreement required at least 85% and 95% of eligible claimants to opt in, respectively.[24] Thus, an allocating plaintiffs' attorney knows that he must have most of the eligible claimants opt in or the settlement is off, and with it goes his contingency fee payment. Moreover, plaintiffs with low-value claims often greatly outnumber those with high-value claims, meaning that significantly more low-value claimants must opt in to meet the high opt-in threshold requirement.[25]

As such, plaintiffs' attorneys feel significant pressure to distribute settlement funds broadly within the claimant group in an attempt to maximize the number of claimants who accept a particular settlement, irrespective of the accurate value of each claim.[26] As can be expected, money often talks in encouraging (or persuading) clients to opt in to a settlement.[27] Again, because of the zero-sum situation that limited settlement funds present, each dollar that is allocated to low-value claimants in an effort to entice them to opt in (and thus meet the minimum opt-in threshold) comes out of the pocket of high-value claimants, leading to significant undervaluation of their claims. Furthermore, even when defendants condition settlement on high rates of participation by plaintiffs with high-value claims, plaintiffs' attorneys may still have little incentive to adequately pay that subgroup of claimants.[28]

21. *See, e.g.*, Erichson, *supra* note 16, at 552 (explaining that damage averaging reduces the value of strong claims and raises the value of weak claims); Moore, *supra* note 16, at 408 (same).

22. *See* Jeremy T. Grabill, *Judicial Review of Private Mass Tort Settlements*, 42 SETON HALL L. REV. 123, 157–58 (2012) (noting that almost all mass tort settlements are not effective unless a large percentage of eligible claimants opt in to the settlement).

23. *Id.* at 158 (explaining that a defendant may abandon a settlement through a walk-away provision if too few plaintiffs opt in).

24. *Id.* at 157–58.

25. Silver & Baker, *supra* note 5, at 1531.

26. *Id.*

27. For example, assume that low-value claimants make up two-thirds of the settlement claimants, and that the expected value of each of these claims at trial would be $100. If allocating attorneys were to offer $100 to each of these claimants, it is extremely unlikely many would accept; in other words, $100 is not enough of a financial incentive to persuade clients to opt in to a settlement. So, an allocating attorney may offer each of these claimants $1,000, $5,000, or whatever reasonable amount is necessary to entice enough low-value claimants to opt in and allow the settlement to continue.

28. *See* Silver & Baker, *supra* note 5, at 1532 (noting that high-value claimants tend to be the most risk averse, are uninformed about necessary information regarding their power within the group of claimants, and lack the power to unilaterally block a group-wide deal, all of which

Finally, attorneys eager to sell a settlement have valuable strategies to ensure high-value clients opt in, regardless of whether their settlement proceeds are accurately priced.[29]

Additionally, there are other factors that may explain the undervaluation of high-value claims in mass tort settlements.[30] First, undervaluation of high-value claims can occur when aggregate settlements are inadequate in their total amounts. While both low-value and high-value claims may experience type one undervaluation in such a case, it is far more likely that high-value claims will be reduced below adequate valuation. In order to meet the high opt-in threshold, allocating attorneys are unlikely to lower low-value claim payouts below a certain minimum. For example, assume that low-value claimants make up one-half of the settlement claimants, and that their claims are identical in every way. Further, assume that the expected value of each of these claims at trial would be $500, but no low-value claimant will settle for less than $1,000. If an attorney allocates settlement proceeds to all claimants based on expected value at trial, he may find that the total settlement amount is insufficient to pay out all claimants. Assuming that the defendant will not increase its offer,[31] the allocating attorney must determine whose settlement payout will be decreased. But, he will be constrained, knowing that low-value claimants will not opt in for lower than $1,000 and that a high opt-in threshold is necessary for the settlement to continue. Thus, he will likely not reduce the value of low-value claimants' payouts, but rather subtract from what a high-value claimant will receive. Furthermore, keeping allocations to low-value claims consistent while decreasing the settlement proceeds to high-value claims leads to type two undervaluation harm as well.

significantly reduce any leverage high-value claimants have to insist on adequate settlement proceeds relative to the strength of their claim).

29. *See id.* at 1533–34 ("An attorney eager to sell a settlement that . . . is inadequate in the aggregate or that shortchanges a particular subgroup of claimants may emphasize horizontal equity to distract attention from the proposed settlement's defects. For example, an attorney might tell a client, 'You're only getting $5,000 for your lung cancer claim, but you're getting the same as other lung cancer victims and more than victims with asbestosis or pleural disease.' By appealing to a client's sense of proportion, an attorney may persuade the client to accept an offer that should be rejected because it is less than the expected value of the client's claim in individual litigation.").

30. While there is extremely limited (or no) empirical support to confirm these factors lead to undervaluation of high-value claims, there is also no empirical support to suggest that these factors have no role to play in the damage-averaging phenomenon. Moreover, these factors have significant logical footing, and certainly could explain the phenomenon. Having said that, continued empirical evaluations are needed to evaluate the causes of undervaluation of high-value claims along with overvaluation of low-value claims.

31. This assumes that the plaintiffs' attorney will even take the time and effort to negotiate further, given that an attorney may accept "a relatively cheap settlement that would nonetheless pay the attorney a handsome premium on his or her hourly rate." Charles Silver & Lynn A. Baker, *Mass Lawsuits and the Aggregate Settlement Rule*, 32 WAKE FOREST L. REV. 733, 751 (1997); *see also* Moore, *supra* note 16, at 407–08 (noting that aggregate settlements may be inadequate in their total amount due to an attorney's financial incentive to settle quickly, even if that means the total settlement amount is inadequate or "cheap").

Similarly, negative-value claims within the group settlement subtract from the overall pool, potentially leading to undervaluation for high-value claimants in the same way as above. By definition, negative-value claims are ones that will never be brought on their own because the costs of litigation exceed the potential benefits of the suit.[32] Thus, their expected trial values are negative, and on their own, their claim arguably should be worth nothing in a settlement.[33] Obviously though, to entice these claimants to settle and encourage finality in the overall mass tort litigation, they are offered tangible settlement proceeds that well exceed their theoretical claim value.[34] Whatever amount is allocated to such claims reduces the settlement amounts of all other claims within the group settlement; yet as discussed above, while all claims within the group settlement may be affected, it is more likely that the highest value claims will be most affected since low-value claims will only be reduced so much to ensure adequate opt-in numbers.

Finally, it is useful to summarize why low- (or negative-) value claims are overvalued in damage-averaging allocation schemes. First, negative-value claims by definition are worthless since the cost of bringing one exceeds the potential benefit; thus, no fiscally prudent attorney would ever bring a negative-value claim on its own, unless nonfinancial reasons justified bringing the suit. So, if negative-value claims are not intrinsically worth anything, and therefore should have a settlement value (or more accurately payment to the defendant) of $0, why are negative-value claims provided positive compensation in mass tort settlements?

The reason is that negative- (and low-) value claims provide significant benefits to high-value claims in the context of the overall outcome of settlement for claimants. Even those individuals with high-value claims are unlikely to find an attorney "who is both able and willing to risk the enormous resources necessary to litigate a mass tort case for a contingent fee interest in a single client's claim."[35] Thus, high-value claimants may need aggregation just to secure legal representation.[36] And while aggregating only high-value claims would solve the representation issue, the addition of negative- (and low-) value claims also provides greater economies of scale and increased efficiency, both of which lead to a reduction in per-person cost.[37]

32. *See* Benjamin P. Edwards, *Disaggregated Classes*, 9 VA. L. & BUS. REV. 305, 342 (2015) ("An individual claim has negative value when the litigation costs to bring it would exceed the possible benefit from suit.").

33. Yet as I will discuss over the next few pages, such claims are often not worthless and are in fact very valuable; that is, such claims may increase the total value of the overall settlement, among other benefits.

34. In theory, a settlement value of $0 would be worth more than these claims' value. Thus, any positive settlement amount is an allocation that significantly deviates from the underlying value of negative-value claims.

35. Jensen, *supra* note 13, at 216.

36. *Id.*

37. *Id.*

Furthermore, the aggregation of claims (including low- and negative-value ones) leads to bargaining leverage and representation by the most qualified attorneys in the country for the plaintiffs, and the potential for greater closure and finality for the defendant.[38] All three of these factors incentivize defendants to settle, and to settle for significant figures. Overall, negative- (and low-) value claims reduce costs for high-value claims, as well as increase the bottom-line payout.[39] In other words, even though high-value claims are undervalued in damage-averaging payouts, they may be even more undervalued in individual litigation.[40]

Thus, since negative-value claims do provide benefits to high-value claims and the overall settlement outcome, their inclusion in mass settlements makes financial sense. Yet, enticing negative-value claims requires overvaluing the claims; no claimant would ever join a mass tort litigation if his settlement amount was capped at $0 or if he was forced to pay the defendant. So, negative-value claims must be paid enough in settlement to incentivize the claimant to participate at all, which requires that the claim be overvalued. Similarly, low-value claims must be paid settlement proceeds that entice such claimants to opt in. Furthermore, given that plaintiffs with low-value claims usually greatly outnumber those with high-value claims,[41] such claimants are needed to satisfy the high opt-in threshold many settlements require. Because of this, low-value claims hold significant clout in ensuring the continuance of settlement, providing surprisingly substantial bargaining power for these claimants. Therefore, this bargaining power, along with the benefits that low-value claims provide to the overall settlement outcome and specifically to high-value claims, result in overvaluation of low-value claims in damage-averaging allocation methods.

II. Damage Averaging: Expansion in Tort Settlements; Benefits and Concerns

Before the explosion of mass torts in the late twentieth century, tort actions were generally brought by single, identified plaintiffs suing a specific defendant believed to have caused some injury to the plaintiff.[42] That is not to say that before the late twentieth century injuries that one thinks of as mass torts did not exist. On the contrary, industrial-worker harms, product

38. *Id.* at 216–17.

39. *See id.* (concluding that "most tort victims unquestionably benefit" from the structural features of aggregate litigation).

40. And, this is especially true when considering the *net* recovery of claims, given the spreading of expenses that occurs in group litigation.

41. Silver & Baker, *supra* note 5, at 1531.

42. RICHARD A. NAGAREDA, MASS TORTS IN A WORLD OF SETTLEMENT, at vii (2007); Samuel Issacharoff & John Fabian Witt, *The Inevitability of Aggregate Settlement: An Institutional Account of American Tort Law*, 57 VAND. L. REV. 1571, 1572, 1577–78 (2004).

liability, environmental harm, and similar injuries very much did exist.[43] Rather, changes in tort theory, economic theory, and civil procedure, as well as political developments, expanded the availability of remedies, consolidation, and group litigation, making mass tort actions feasible, efficient, and effective.[44]

Yet the defining features of mass torts—"numerosity, geographic dispersion, temporal dispersion, and factual patterns"—created significant challenges for the conventional tort system, requiring the formation of new and innovative mechanisms to deal with the complexity and sheer size of these new actions.[45] While class certification and multi-district litigation were created to manage claims all across the country, damage averaging began to be used as an alternative to individualizing damage determinations as a mechanism to reduce the extensive transaction costs of allocating damage awards in mass tort settlements.[46] And as the size, complexity, and costs of mass tort actions continued to multiply, the use of damage averaging increased alongside it. But, this is only the beginning. The increasingly interconnected world, globalized by the Internet and other modern technologies, suggests that mass tort actions are likely only to grow in magnitude, complexity, and cost. In such a world of global economies, product markets, and businesses, individual damage determinations may not be practical, leaving damage averaging as the vital core of the mass tort system.

A. Benefits of Damage Averaging

First and foremost, damage averaging provides an efficient method of allocating settlement proceeds to claimants. The significant reduction in the transaction costs of individualizing damage determinations is the single biggest benefit, and one that will only continue to be more beneficial as mass tort actions grow in complexity and scope. Second, damage averaging is an equitable and objective method of settlement distribution, providing both

43. NAGAREDA, *supra* note 42, at viii; *see also* Issacharoff & Witt, *supra* note 42, at 1579–81 (noting that "it is a standard observation among historians that tort . . . law arose out of the mass harms thrown off by mid-nineteenth-century industrialization," and that in the late 1800s "common carrier accidents dominated the personal injury docket" in Oakland, California).

44. NAGAREDA, *supra* note 42, at 4–10. *See generally* Issacharoff & Witt, *supra* note 42 (discussing the evolution of mass tort aggregation and mass tort actions).

45. NAGAREDA, *supra* note 42, at xii; Issacharoff & Witt, *supra* note 42, at 1618.

46. *See* John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877, 919 n.104 (1987) ("Damage averaging is most likely to be accepted by courts and attorneys where the transaction costs of individualizing the damage determination are the highest."); *see also* Issacharoff & Witt, *supra* note 42, at 1625–26 (noting that among the most notable trends in the disposition of mature tort claims "is the rise of administrative grids similar to those used in workers' compensation and auto accidents to manage settlements").

vertical and horizontal equity,[47] while taking into account principles of rough justice. Vertical equity entails compensation for claimants according to the losses they may recover in civil litigation,[48] or put another way, vertical equity ensures that more deserving claimants receive more than less deserving claimants.[49] Conversely, horizontal equity in settlements occurs when similarly situated claimants are compensated equally.[50] Finally, rough justice means that settlement amounts may be adjusted or averaged "in light of the practical limitations of compensating many people through a massive settlement scheme."[51]

According to the American Law Institute's *Principles of the Law of Aggregate Litigation*, which reflect the combined work of scholars, litigants, and judges, allocations of awards should be distributed according to these principles of vertical equity, horizontal equity, and rough justice.[52] In other words, (1) more deserving claimants should receive larger payments than less deserving ones, based on the damages they may recover in civil litigation, (2) similarly situated parties should receive similar amounts, and (3) attorneys should be mindful of the practical limitations of administering a complex compensation scheme.[53] Damage-averaging allocation processes follow the suggestion of the Principles precisely, ensuring vertical and horizontal equity, while limiting the transactional costs of settlement-proceeds allocation. And such values are extremely important; it makes sense for higher value claims to receive larger settlement payments than lower value claims and for equally situated claimants to be treated similarly, all while attempting to reduce the significant costs incurred in directing a complex compensation system.

47. While damage averaging results in horizontal equity, jury trials do not. *See* Alexandra D. Lahav, *The Case for "Trial by Formula,"* 90 TEXAS L. REV. 571, 584 (2012) (explaining that "jurors exercise substantial leeway in determining damages, which in turn permits variation in outcomes of similar cases," and noting that empirical research confirms that there is variability in jury awards); *see also* VALERIE P. HANS & NEIL VIDMAR, JUDGING THE JURY 162 (1986) (analyzing two categories of personal injury claims—"claims that involved wrongful death, medical malpractice, product liability, and street or sidewalk hazards" and "claims involving automobile accidents or injuries on someone else's property"—and asserting that "[e]ven when the seriousness of the injury was similar, someone hurt in an automobile accident was likely to receive only one-third of the money that someone hurt in a workplace accident received"); Randall R. Bovbjerg et al., *Valuing Life and Limb in Tort: Scheduling "Pain and Suffering,"* 83 NW. U. L. REV. 908, 924 (1989) (noting that "horizontal" equity is the extent of variation within a single category of cases with similar injury severity). This lack of horizontal equity is a significant downside to individually litigating mass tort claims.

48. Adam S. Zimmerman & David M. Jaros, *The Criminal Class Action*, 159 U. PA. L. REV. 1385, 1453 (2011).

49. Michael D. Sant'Ambrogio & Adam S. Zimmerman, *The Agency Class Action*, 112 COLUM. L. REV. 1992, 2061 (2012).

50. Zimmerman & Jaros, *supra* note 48, at 1453.

51. Sant'Ambrogio & Zimmerman, *supra* note 49, at 2061.

52. PRINCIPLES OF THE LAW OF AGGREGATE LITIG. § 1.04 cmt. f (AM. LAW INST. 2009).

53. *Id.*; Sant'Ambrogio & Zimmerman, *supra* note 49, at 2061.

B. Concerns with Damage Averaging

Critics of damage averaging point to three main concerns with the allocation method: (1) conflicts of interest for attorneys representing multiple clients in a mass tort suit, (2) litigant autonomy concerns, such as the "right of self-determination" of each mass tort plaintiff to claim and receive damages by the same individualization process that would have been available in a separate individual action,[54] and (3) undervalued recoveries for the highest value claims, and overvaluation of low- (or negative-) value claims.[55]

First, it is true that conflicts of interest exist when an attorney represents numerous clients in a mass tort litigation. Yet, the ABA Model Rules of Professional Conduct address such conflicts and require informed consent before damage averaging can occur.[56] ABA Model Rule 1.8(g) states that "[a] lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients . . . unless each client gives informed consent, in a writing signed by the client."[57] Thus, the client has an opportunity to waive the conflict, if he so desires.[58] If not, he is free to hire another attorney and seek an individual action.[59] Such a consent requirement provides ample protection against any conflict of interest that the attorney may be limited by.[60]

Second, individualizing damage determinations is certainly beneficial in some situations. But in the context of expansive and complex mass tort settlements, such a system is inefficient, extremely time intensive, expensive, and may not even provide better results than damage averaging, given the infinite number of potential differences between claims. Even assuming that an individualization process of damage determination is financially beneficial for all mass tort plaintiffs (which is highly unlikely, given that many damage awards under such a method would be lower than settlement proceeds allocated under a damage-averaging system), claimants still have the power to accept or decline any proposed settlement allocation. If a claimant is unhappy with his allocated share of the total settlement proceeds, he can decline the settlement offer[61] or attempt to negotiate for a higher payment.

54. David Rosenberg, *Individual Justice and Collectivizing Risk-Based Claims in Mass-Exposure Cases*, 71 N.Y.U. L. REV. 210, 214 (1996).

55. Erichson, *supra* note 16, at 552.

56. MODEL RULES OF PROF'L CONDUCT r. 1.7(b), r. 1.8(g) (AM. BAR ASS'N 2015).

57. *Id.* r. 1.8(g).

58. Lynn A. Baker, *Aggregate Settlements and Attorney Liability: The Evolving Landscape*, 44 HOFSTRA L. REV. 291, 322 (2015).

59. *Id.*

60. *Id.* at 316, 322.

61. *Id.* at 322.

Finally, undervaluation of high-value claims is a significant concern in damage-averaging settlement allocation, and the most serious limitation of the method. Having said that, such concerns are not unique to damage-averaging schemes, as undercompensation of individuals with high-value claims is a serious problem throughout the tort system.[62] In fact, according to Professor Michael J. Saks, "[the] pattern of overcompensation at the lower end of the range and undercompensation at the higher end is so well replicated that it qualifies as one of the major empirical phenomena of [individual] tort litigation ready for theoretical attention."[63] Part IV of this Note suggests solutions to ensure that high-value claims are more accurately valued, proposals which I hope will improve the general outcomes of damage-averaging apportionment and specifically the outcomes for the highest value claims.

III. Damage Averaging: Alternatives

There are two main alternatives to a damage-averaging allocation method: (1) individualized treatment of claims in group litigation and (2) opting out of aggregate litigation entirely and proceeding in an individual lawsuit. Evaluation of each alternative makes clear that damage averaging is the best current arrangement for the distribution of settlement proceeds. As discussed in Part II, while individualizing damage determinations can be beneficial in some situations, in the context of mass tort settlements, such a system is expensive and inefficient.[64] Furthermore, given the significant number of differences between claims, it may not even provide better results than damage averaging. Thus, individualizing treatment of claims in settlement allocation is an inferior compensation scheme to damage averaging.

Opting out of aggregate litigation entirely and proceeding in an individual lawsuit is also an alternative to group litigation and damage averaging. Yet for many of the reasons discussed throughout this Note, individual mass tort suits rarely are beneficial for plaintiffs. Even those individuals with high-value claims are unlikely to find an attorney "who is both able and willing to risk the enormous resources necessary to litigate a mass tort case for a contingent fee interest in a single client's claim."[65] Thus, high-value claimants often need aggregation just to secure legal representation.[66] Additionally, the aggregation of claims leads to bargaining

62. Baker & Silver, *supra* note 7, at 243.

63. *Id.* (quoting Michael J. Saks, *Do We Really Know Anything About the Behavior of the Tort Litigation System—and Why Not?*, 140 U. PA. L. REV. 1147, 1218 (1992)).

64. See *supra* Part II for a discussion of the benefits of damage averaging.

65. Jensen, *supra* note 13, at 216.

66. *Id.*

leverage and representation by the most qualified attorneys,[67] and aggregate litigation provides greater economies of scale and increased efficiency, both of which lead to a reduction in litigation cost (and a potential increase in net settlement value) for each claimant.[68] Moreover, jury trials are unpredictable, presenting significant risk for a plaintiff who decides to take a tort case to trial,[69] and individuals who opt out of aggregate litigation are likely to find that individual actions are hard to undertake, expensive, risky, and unpredictable. Furthermore, a plaintiff who does not participate in group litigation loses all of the significant benefits such aggregation provides, such as substantial bargaining power, economies of scale, and increased efficiency.

Given the current alternatives to damage averaging, it is clear that such an allocation method is the most efficient, equitable, and objective scheme available today.

IV. Damage Averaging: Solutions to Ensure High-Value Claims Are More Accurately Valued

As discussed in Part II, the use of damage averaging as a settlement-allocation method provides significant benefits.[70] Similarly, Part III posits that damage averaging is the best current arrangement for the distribution of settlement proceeds.[71] Yet two things remain true: (1) high-value claim undervaluation is a significant drawback to the use of a damage-averaging allocation process and (2) while the majority of mass tort settlements trust plaintiffs' attorneys to equitably distribute settlement proceeds,[72] current incentive structures may ensure that plaintiffs' counsel is the wrong group to ensure adequate compensation for high-value claims. Thus, I propose three potential solutions to reduce (or even eliminate) undervaluation of high-value claims in a damage-averaging allocation scheme: (1) a rule requiring defense counsel to allocate settlement proceeds; (2) the use of a tiered system of minimum-participation thresholds based on claim value levels, with the highest value claims having the highest opt-in threshold and the lowest value claims having a significantly lower opt-in threshold; and (3) a rule requiring all mass tort settlements to include significant extraordinary-injury buckets to compensate the highest value claims. I believe that the implementation of one, or some combination, of these proposed mechanisms will meaningfully improve the general outcomes of damage-averaging apportionment, specifically the outcomes for the highest value claims.

67. *Id.* at 216–17.
68. *Id.* at 216.
69. Lahav, *supra* note 47, at 584.
70. *See supra* Part II.
71. *See supra* Part III.
72. Silver & Baker, *supra* note 5, at 1505.

A. Current Incentive Structures for Plaintiffs' Attorneys in Allocating Settlement Proceeds

The current mass tort settlement system does not appropriately incentivize plaintiffs' attorneys to protect against unfair allocations.[73] Currently, a plaintiffs' attorney charged with allocating proceeds has little financial incentive to ensure that high-value claims are adequately compensated.[74] Individualized allocation requires significant time, effort, and cost, and since the allocating plaintiffs' attorney will receive payment on a contingency basis, it generally makes no difference to him which claimants ultimately receive more of the proceeds—his portion will remain the same.[75] Accordingly, a plaintiffs' attorney's incentives are to minimize his investment of time and effort on allocation issues, and the easiest way to do so is to ignore or minimize differences between claimants, lumping claimants into classes and subclasses based on easily definable criteria.[76] Unfortunately, this damage averaging forces the holders of high-value claims to subsidize the holders of low-value claims, as we have seen before.[77]

Yet, even more worrisome are situations in which plaintiffs' attorneys may actively favor a biased allocation.[78] For example, "if the attorney uses a sliding-scale contingent fee, as opposed to a fixed percentage, she will be motivated to distribute the amounts in such a way as to maximize the total fee by keeping the percentages higher for certain claimants."[79] Similarly, since the attorney will generally "earn more money from cases in which he is retained directly, as opposed to those in which the attorney receives the case from—and [thus] must share the contingent fee with—a referring attorney," he has an incentive to favor a biased allocation towards clients he

73. *See, e.g.*, John C. Coffee, Jr., *Conflicts, Consent, and Allocation After* Amchem Products—*or, Why Attorneys Still Need Consent to Give Away Their Clients' Money*, 84 VA. L. REV. 1541, 1549–50 (1998) (explaining that "plaintiffs' counsel has little incentive to expend the time or effort, or to incur the costs, necessary to effect a 'fair' allocation"); *see also* Moore, *supra* note 16, at 408 (noting that "a common attorney has little financial incentive to ensure horizontal equity among the various clients"). But see Silver & Baker, *supra* note 31, at 753, 773, for the proposition that the aggregate settlement rule, Model Rule 1.8(g), is a governance structure that "discourages attorney opportunism and helps manage allocation conflicts by constraining settlement-related activities."

74. *See* Coffee, *supra* note 73, at 1550 (explaining that "plaintiffs' counsel's incentive is to minimize its investment of time and effort on allocation issues," which "forces holders of high-value claims to subsidize holders of low-value claims"). *But see* Silver & Baker, *supra* note 31, at 777–78 (discussing potential malpractice liability as a force that discourages attorneys from allocating settlement proceeds in a manner that significantly undervalues some plaintiffs' claims relative to others, though acknowledging that its strength as a deterrence may vary greatly from case to case).

75. Coffee, *supra* note 73, at 1550.

76. *Id.*

77. *Id.*

78. Moore, *supra* note 16, at 408.

79. *Id.* at 409.

retained directly.[80] Thus, if we are to improve settlement-fund distribution methods under damage-averaging schemes, it is vital to consider new and innovative methods of allocation. Otherwise, both biased allocations and the undervaluation of high-value claims will continue.

B. Requirement That Defense Counsel Allocate Settlement Proceeds

Unlike plaintiffs' counsel, defendants' attorneys have a significant incentive in ensuring that high-value claims are adequately compensated. For a defendant, high-value claims are precisely the claims that it fears and wants to reduce liability from. On the other hand, low- (or negative-) value claims are often relatively insignificant for defendants, especially in small quantities. This is why defendants generally require a certain subset of super-high-value claims to opt in as a condition of settlement, while at the same time are content with a small portion of low-value claims being left unresolved. Thus, if defendants' counsel were required to allocate settlement proceeds, it is likely that high-value claims would have significantly higher allocations than in the current system. Furthermore, since defendants' counsel typically works on an hourly basis, rather than a contingency basis, there would be an incentive to individualize allocation for claimants in order to increase billable hour fees. Overall, increased individualization, as well as incentives to compensate the highest value claimants adequately, could eliminate undervaluation of high-value claims and ensure a more accurate distribution scheme.

The downside to such a proposal would be cost and effort; individualized evaluation of claims takes time and has a serious financial cost. To ensure costs stay low, defendants' counsel could be provided by the defendant an upfront maximum budget for allocating proceeds, which would vary based on the size of the settlement. So, for example, large settlements could have allocation budgets capped at $5 million; defense counsel would submit hourly reports but know that they would only be reimbursed for work up to said $5 million. In this way, claimants would receive some level of individualized proceed evaluation, defendants' counsel would be incentivized to participate (given the extra income for the firm), and costs would continue to remain reasonable, with no opportunity to rise to unreasonable levels. And, most importantly, high-value claims would be more likely to be adequately valued.

80. *Id.* at 408–09.

C. Tiered System of Minimum Opt-In Threshold Based on Claim Value Level

Currently, the vast majority of mass tort settlements require a very high percentage of claimants to opt in.[81] In other words, the defendant is often protected by a walk-away provision which provides the defendant the right to abandon the settlement if an inadequate percentage of eligible plaintiffs agree to participate in the settlement process.[82] Yet, while some settlements have a tiered system of minimum-participation thresholds based on claim-value levels,[83] many do not. Thus, because plaintiffs with low-value claims usually greatly outnumber those with high-value claims—meaning that significantly more low-value claimants must opt in to meet the high opt-in threshold requirement[84]—plaintiffs' attorneys feel significant pressure to distribute settlement funds broadly within the claimant group in an attempt to maximize the number of claimants who accept a particular settlement, irrespective of the accurate value of each claim.[85]

Yet, in much the same way that defendants' attorneys have a significant incentive to ensure that high-value claims are adequately compensated, the use of a tiered system of minimum-participation thresholds based on claim-value levels incentivizes whoever is allocating settlement proceeds to accurately compensate high-value claims. Under such a tiered system, the highest value claims would have the highest opt-in threshold, and the lowest value claims would have a significantly lower opt-in threshold.[86] Thus, one would expect to see a shift in settlement-proceeds allocation in order to ensure that each value level opt-in threshold is met. In other words, as compared to a regime with a single opt-in threshold, one would expect more dollars to be allocated to high-value claims, to ensure that group's high opt-in threshold was met. Conversely, since lower percentages of low-value claim opt ins would be necessary, one would expect low-value claims to be offered lower awards than they currently are.[87] Overall, this shift in incentives would likely lead to more accurate valuations for high-value claims.

81. Grabill, *supra* note 22, at 157–58 (noting that almost all mass tort settlements are not effective unless a large percentage of eligible claimants opt in to the settlement).

82. *Id.* at 158.

83. So, for example, the settlement agreement might require that 100% of high-value claims, 90% of medium-value claims, and 70% of low-value claims opt in, or the defendant can walk away from the deal.

84. Silver & Baker, *supra* note 5, at 1531.

85. *Id.*

86. *See supra* note 83.

87. Additionally, one would expect that the defendant would care less about the plaintiffs' lawyer falling short on the opt-in threshold for the low-value claims, since the likelihood that another attorney is willing to represent one (or a few) of such claimant(s) and take the case to trial is close to zero.

D. Requirement That All Settlements Include Extraordinary-Injury Buckets

Finally, I propose that all mass tort settlements be required to include significant amounts in extraordinary-injury buckets. While many settlements do have such pockets for high-value claims,[88] and other settlements designate a subset of super-high-value claims that will be paid significantly more than all other claims (to ensure they opt in to the settlement), a bright-line rule that requires extraordinary-injury buckets with substantial amounts set aside would increase total settlement proceeds to high-value claims. Defendants designating a subset of super-high-value claims could still occur, but significant extraordinary-injury buckets would allow high-value claimants the opportunity to receive more than originally allocated. Since this would reduce settlement proceeds for other claimants, there is a risk that fewer would opt in. But, given the miniscule number of claimants that currently do not opt in to settlements, it is extremely unlikely that opt-in thresholds would not be met solely because of this change. On the other hand, this would allocate more of the settlement proceeds to high-value claims, offsetting current undervaluation of such claims and helping move towards accurately valuing high-value claims. Even if this requirement does not eliminate undervaluation of high-value claims, it would be a shift in the right direction and be an easily implementable first step towards accurate allocation of such claims.

Conclusion

Mass tort litigation is complex, expensive, and time-consuming. And whether it is this extreme cost, the uncertainty and unpredictability, or the potential for massive exposure (especially for the defendants), parties in mass tort cases avoid trials at all costs. Thus, the vast majority of mass tort cases are settled by agreement between the parties. Yet, allocation of the settlement proceeds has become a massive undertaking, filled with ethical and practical difficulties for plaintiffs' attorneys who are increasingly entrusted with allocating aggregate-settlement proceeds. As a potential solution for many of these complications, damage averaging provides an efficient, objective, and equitable (both horizontally and vertically) system for apportioning settlement proceeds among claimants. Moving forward, mass tort actions are likely to only continue to grow in complexity, magnitude, and costs; the Internet and other modern technologies, as well as the entanglement of

88. *See, e.g.*, VIOXX MASTER SETTLEMENT AGREEMENT 19–20 (2007), http://www.beasleyallen.com/alerts/attachments/Vioxx%20Master%20Settlement%20Agreement.pdf [https://perma.cc/JY23-VCVE] (describing the requirements for claimants to be eligible for extraordinary-injury payments, and capping such payments at $195 million); *see also* 2015 DEPUY ASR SETTLEMENT AGREEMENT 45 (2015), https://www.usasrhipsettlement.com/Un-Secure/Docs/Final_2015_ASR_Settlement_Agreement.pdf [https://perma.cc/VKL2-G6NN] (explaining extraordinary-injury-fund award categories and benefits).

worldwide economies, product markets, and businesses ensure that. In such a world, it is likely that damage averaging will become increasingly more integral to the continued achievability and practicality of the mass tort system.

Yet, for all of its benefits, damage averaging may inadequately compensate those claims which our legal system should value most—that is, high-value claims, ones in which the claimant is most seriously injured. While undercompensation of individuals with high-value claims is not unique to damage averaging schemes—rather, it is a serious problem throughout the tort system—it nevertheless is a significant limitation on the effectiveness of damage averaging as a settlement-allocation method. Thus, this Note has presented three potential solutions to reduce (or even eliminate) undervaluation of high-value claims in a damage-averaging allocation process: (1) a rule requiring defense counsel to allocate settlement proceeds; (2) the use of a tiered system of minimum-participation thresholds based on claim-value levels, with the highest value claims having the highest opt-in threshold and the lowest value claims having a significantly lower opt-in threshold; and (3) a rule requiring all mass tort settlements to include significant extraordinary-injury buckets to compensate the highest value claims. The implementation of one, or some combination, of these proposed mechanisms has the potential to positively impact the compensation high-value claims receive, as well as improve the systematic outcomes of damage-averaging apportionment.

—Rony Kishinevsky