Law and Economics Analysis of Class Action Mechanisms

in the Comparative Contexts

Jing-Huey Shao, Guan-Lun Chiu

Abstract

Class actions are designed to provide claimants a mechanism to enforce their rights with the objectives to achieve economies of scale in litigation and to deter the misconduct. However, how do these class action mechanisms function so far from the economic perspective? This study categorizes class action mechanisms in common law and civil law systems according to their features for the purpose of economic analysis, as well as to analyze the underlying rationale of the legal structures in different class action mechanisms.

The three types of class action mechanisms for the purpose of economic analysis are as follows: Common Law, Civil Law Type 1 and Civil Law Type 2. The basic features of Common Law class actions are: (1) class actions require certification by the court; (2) the court appoints class counsels; (3) class actions involving damage claims are subject to specific notice and opt-out requirements; (4) the court should review the settlements and attorney fees of class actions.

The basic features of Civil Law Type 1 are: (1) the class action mechanism facilitates aggregating claimants by simplifying the filing procedure; (2) the court issues a public notice for potential claimants to opt-in the lawsuit.

The basic features of Civil Law Type 2 are: (1) non-profit organizations, government-sanctioned organizations, such as trade unions or labor unions are conferred with power to bring class actions with special litigating advantages under special laws; (2) No special oversight required by the courts over the case.

To determine which class action mechanisms better achieve the compensation and deterrence purposes, this study will utilize CBA model to discuss transactional costs, incentives and risks for the relevant parties as to which mechanism maximizes the claimants’ benefit.
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Jing-Huey Shao, Guan-Lun Chiu*1

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1.1 Introduction of Class Action

Class actions are designed to provide claimants an economically rational mechanism to enforce their rights. They are considered to be a useful procedure to achieve economies of scale in litigation, to enhance law enforcement, and to deter the misconduct. However, how do these class action mechanisms function so far from the economic perspective? Based on previous studies, this article categorizes types of class action mechanisms in different legal systems according to their features for the purpose of economic analysis, as well as to examine the merits and limitations in different types of class action mechanisms.

Class actions have two generally accepted objectives: one is compensation; the other is deterrence. To analyze class action mechanisms from an economic perspective, the purposes of these class action mechanisms are examined in order to determine whether they have met the set goals. With respect to the objective of compensation, one of the threshold questions is whether the mechanism can reach economies of scale because the compensation goal can only be achieved if the litigation cost is lower than the disputed claim amount. Provided the claim amount is fixed, economy of scale is the way to reach the compensation goal by lowering the cost of litigation. However, possible abuse of one party extracting benefit at the expense of another should not be ignored, either. Hence, regarding the discussion of transactional costs, this article also includes an exploration of the incentives and risks for clients and attorneys, and conclusions are drawn as to which mechanism maximizes the overall benefit of the plaintiff side.

1.2 Literature

For the purpose of evaluating merits and limitations of different types of class action, the transaction cost will be used as the tool to analyses, and hypothetical scenarios will be introduced to explore which type of class action is more accessible for claimants. Charles Silver has put forward the notion that transaction cost is a

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significant parameter in determining the collective willingness to enter lawsuit procedures. In a typical class action, individual loss is usually tiny, yet the number of people who suffer from the damages and injuries tends to be large. Therefore, the lower the transaction cost is, the more willing the victims will be to file a lawsuit.

Transaction cost is initially raised by Ronald Coase in his articles “The Nature of the Firm” and “The Problem of Social Cost.” The theory employed in this study is the original definition of transaction cost mentioned in “The Nature of the Firm”: “the most obvious cost of organizing production through the price mechanism is that of discovering what the relevant price are, and the cost of negotiating and concluding a separate contract for each exchange transaction.” In Coase’s view, firms and markets are alternative governance structures that differ in their transaction costs. Transaction cost will be the price mechanism utilized by different governance structures. The goal of this article is to discuss the advantages and disadvantages of different types of class actions, which in nature is a comparison of the transaction cost of different legal proceedings. Henceforth, transaction cost will be referred to as the “cost of running system” in this article.

Nevertheless, the idea “transaction cost” conceptualized by Coase is the most rudimentary form, which has been successively expounded by later economists with amplified theories and evidences. In order to sort out an unambiguous categorization of the transaction cost for comparative studies, this study will adopt the classification of transaction costs done by Carl Dahlman in his article “The Problem of Externality.” Dahlman groups transaction costs into three types based on the different phases of contract-making, which includes “search and information cost”, “bargaining and decision cost”, and “policing and enforcement cost”.

2.1 Research Models

We will adopt CBA (cost-benefit analysis) approach to calculate the merits and drawbacks brought by different kinds of class actions to claimants and their attorneys with a focus on the plaintiff side. The basic theoretical framework for this study

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*Id.*
comes from Carl Dahlman, which deems the transaction cost as an integration of “information cost, bargaining cost, and monitoring cost,” with reference to the categorization of “cost of justice” into “monetary cost, opportunity cost, and intangible cost” proposed by Gramatikov et al. The aforementioned ideas crystallized into a function to analyze different class action mechanisms in this article.

According to this function, all the constituents of the transaction cost either pre-litigation or in-litigation will be taken into account. The information cost interlinks the two phases of the litigation, which includes the cost of searching for an attorney (pre-litigation) and the cost of evidence-collecting (during litigation), as well as other information collecting. The information cost can also be broken down into: the cost for use of information, discovery related costs, witness’ compensation, experts’ fees, and service for summons. The bargaining cost between a client and her/his attorney usually takes place before the litigation process on the content of legal service agreements. The monitoring cost is indispensable for the client to ensure the subsequent proceeding of the lawsuit. As the litigation proceeds, the court fee contains items ranging from translators’ fees, notary’s fees, copying and other overheads, filling fees, to bailiffs’ fees. Last but not least, attorney fee is involved in all the phases and procedures of the lawsuit. Encompassing the aforementioned, an inclusive function is as such:

\[
\text{Transaction cost} = \text{Information cost} + \text{Bargaining cost} + \text{Monitoring cost} + \text{Court fee} + \text{Attorney fee}
\]

\[
\text{TC} = \text{IC} + \text{BC} + \text{MC} + \text{CF} + \text{AF}
\]

\[
\text{Net Revenue} = \text{Judgment Award} - \text{Transaction Cost}
\]

\[
\text{NR} = \text{JA} - \text{TC}
\]

### 2.2 Types of Class Action Mechanisms

Different legal systems have developed different class action mechanisms based on their distinct backgrounds. These class action mechanisms are categorized herein

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8 Id

according to their features instead of rigidly sorting them by their jurisdictions. Hence, the three types of class action mechanisms for the purpose of economic analysis are as follows: Common Law Type, Civil Law Type 1 and Civil Law Type 2.

2.2.1 Basic Features of Common Law Class Actions

As class action is evolving progressively mature in the U.S. legal system, this article refers to the U.S. law as the representative example of the Common Law Type. Rule 23 of the U.S. Federal Rules of Civil Procedure specifies the main features of U.S. class actions. To qualify as a class action, a lawsuit needs to be certified by the court. After the certification, the court appoints a class counsel. Class actions involving damage claims certified under Rule 23(b)(3) are subject to specific notice and opt-out requirements. In addition, Rule 23(e) and 23(h) state that the court has the authority to review the settlements and attorney fees of class actions.

In addition to the stated procedural features of U.S. class actions, the most influential factor that motivates the initiation of class actions by attorneys is the huge financial incentive comprised of potential punitive damages and a contingency fee arrangement that are prevalent in class actions.10

2.2.2 Basic Features of Class Actions in Civil Law

Most of the civil law countries adopt class action mechanisms by using opt-in designs to aggregate claimants, with some minor variations. This is because civil law countries still feel uncomfortable about binding parties without clear authorization.11 With regard to potential compensation, they offer significantly less than those in the common law countries because civil law countries apply punitive damage only when law specifies. Even if punitive damage is stipulated by the law, the damage amount is usually capped by a certain fixed amount or within fixed times of the actual damage. Also, contingency fee arrangements are prohibited or only allowed under restrictions in most civil law countries. Besides the referenced common features, in this article, the class action mechanisms in civil law countries are further categorized into two types.

2.2.2.1 Civil Law Type 1

Civil Law Type 1 (“Type 1”) class action mechanism facilitates aggregating claimants by simplifying the filing procedure. After the court issues a public notice,

the claimants can join the lawsuit by registration. Except for the stated feature, this type of class action is essentially identical to traditional joinder claims or intervention claims used for solving multiple-party disputes.

**2.2.2.2 Civil Law Type 2**

The Civil Law Type 2 ("Type 2") class action mechanism confers non-profit organizations ("NPOs"), government-sanctioned nonprofit organizations ("GSOs"), such as trade unions or labor unions to bring class actions with litigating advantages under special laws. By enjoying these advantages, such as court fees discounts for bringing class actions, the qualified organizations usually can provide convenient means for potential plaintiffs to opt-in the class. Although this type of mechanism does not prevent other individuals or entities from initiating suits, a qualified organization will have a better position and economic sense by which to file class actions.

**3.1 The Economic Analysis of Class Action Mechanisms**

**3.1.1 Common Law Type**

For the Common Law Type, potential claimants simply decide whether to opt-out of the class or not, and almost no transaction cost is assumed for joining the lawsuit or negotiating among the parties. Therefore, the size of the class is usually large. On the other hand, plaintiffs’ attorneys are subject to only minimal monitoring by dispersed and disorganized clients, who essentially function as entrepreneurs by bearing a substantial amount of the litigation risk and exercising plenary control over important decisions. Therefore, the transaction cost in regard to bargaining or monitoring between claimants and attorneys is low and negligible because attorneys have substantial control over the cases.

In terms of incentives, claimants have high incentive to join class actions because attorneys will bear the relevant costs for them under contingency fee arrangements. However, since the attorneys for plaintiffs will generally advance the expenses of the class actions and will not be reimbursed unless the action is favorable, they will estimate the cost in advance and the expected reward to determine if the action justifies the risks being undertaken. Contingency fee arrangements

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associated with punitive damage create a huge incentive, which highly motivates lawyers to undertake large cases. (See table 1)

For the purpose of quantitative analysis, we use a hypothetical scenario to illustrate how the economic function could apply to a class action case in the common law type.

Scenario 1: Supposed the case is a class consumer dispute in the U.S. which involves 3000 consumers, with individual monetary damage at $100. If a class action has been adopted to institute a lawsuit for damage claim, the transaction cost involved mainly includes the information cost of $10,000 and attorney fees contingent upon the result of the case. Bargaining cost and monitoring cost are negligible as attorneys have control over the case and hence no substantial cost between them and claimants. Also, court fees are assumed to be the same among different jurisdictions so we set it zero in each scenario.

Under this framework, we hypothesize that on winning the case, the sum of damages award is actual damage plus a punitive damage of 1.5 times actual damage, which amounts to $750,000 (3000*100*[1+1.5]), and makes a sum of $250 for each claimant. And because the contingency fee arrangement is usually one-third of the judgment award, $250,000 will be considered attorney fee and be taken into account as one of the transaction costs. Through the class action, the individual transaction cost is to be lowered to $87 (260000/3000=87). The eventual net revenue for each consumer will end up as $163 (250-87=163). On the other hand, if the case has been lost, there is no need for the losing party to pay for attorneys. All TC will be bore by the attorneys, which makes it a zero-cost pact for the clients. So the function can be applied as follows:

\[
\text{Win: } \text{NR} = \text{JA} (750,000) - \text{TC} [\text{IC}(10000) + \text{AF}(250,000)] = 490,000 \\
\frac{\text{TC}}{n} = \frac{260,000}{3000} = 87 \\
\frac{\text{NR}}{n} = \frac{490,000}{3000} = 163 \\
\text{Lose: } \text{NR} = \text{JA} (0) - \text{TC} [\text{IC}(10000) + \text{AF}(0)] = -10,000
\]

Therefore, for the Common Law Type, the class action for consumer litigation

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carries little risk for claimants and sets few barriers for entry, which effectively enhances their willingness to claim for compensation provided the attorney are willing to handle the case. Furthermore, for this specific type, TC mainly consists of IC and AF. Thus as the number of clients in class action increases, TC shouldered by each individual will be lowered. This type has epitomized economies of scale in class action.

### 3.1.2 Civil Law Type 1

With regard to transaction costs, because Type 1 class actions are basically consensual group lawsuits adopting an opt-in mechanism, the transaction cost for joining the class is high because each plaintiff needs to take some form of action in order to be included in the lawsuit. In addition, negotiations among the parties are required to elect the representative plaintiff and the class counsel, which also build up the transaction cost. Therefore, the size of the class is usually small, not as thousands of claimants which are often seen in the common law type. Meanwhile, since the class counsel does not have the same controlling power as that in common law type of class actions, the relevant bargaining costs and the monitoring costs between the attorneys and their clients are high. In terms of incentives, because civil law countries usually prohibit contingency fee arrangements and do not recognize punitive damage awards unless the law specifies, the claimants have low incentive to file suits due to having to bear all the costs. On the other hand, even though attorneys do not have the large financial stakes as those in the common law type, they can get rewards from their legal services without risk by case or by hourly rate. Therefore, the incentive for the attorneys in this case is positive. (See table 1) Also, the information cost in civil law countries is usually not as high as the common law type due to different designs in evidence and civil procedure laws.

For the purpose of quantitative analysis, we also use a hypothetical scenario to illustrate how the economic function could apply to a Type 1 case.

Scenario 2: suppose a class action of consumer disputes, which consists 50 claimants, with average monetary damage at $100 per person. And there are some bargaining and monitoring costs occur between claimants and attorneys. Also, the attorney fee should be paid regardless of the outcome of the case. If a class action has been taken up, the function will be:

\[
TC = IC(\$2000) + BC(\$200) + MC(\$500) + AF(\$1000)
\]
The average transaction cost will be $74 \left(\frac{2000+200+500+1000}{50}=74\right) for each client. If the lawsuit has been won, the sum of damages award is actual damage plus a punitive damage of 0.5 times actual damage.\textsuperscript{15} Hence, added together for each individual will be $150\left(100\ast\left(1+0.5\right)=150\right)$, which renders the net revenue $76 \left(150-74=76\right)$ per person.

\textbf{Win:} \textit{NR= JA(}$7,500\textit{- TC [IC(}$2000\textit{)+BC(}$200\textit{)+MC(}$500\textit{) + AF(}$1000\textit{)]= $3,800} \\
\textit{\(\frac{TC}{n}=3700/50=74\)} \\
\textit{\(\frac{NR}{n}=3800/50=76\)} \\

\textbf{Lose:} \textit{NR= JA (0)- TC [IC(}$2000\textit{)+ BC(}$200\textit{)+ MC(}$500\textit{)+ AF(}$1000\textit{)]= -$3,700}

Under Type 1, claimants are responsible for choosing the representatives of the jurisdiction. And in this context, claimants need to bear risks ranging from adducing evidence to monitoring and the result of the case. Compared to the common law type, having to advance all the costs makes significantly high entry requirement for the claimants. Therefore, class action under this system will not be a strong stimulator for the consumers to lodge a suit.

\textbf{3.1.3 Civil Law Type 2}

In Civil Law Type 2 class actions, because GSOs provide convenient means for potential claimants to opt-in the class, the transaction costs for plaintiffs to join the lawsuit are low. In addition, because GSOs will be the representative plaintiff and class counsel, this saves the cost of bargaining and monitoring between claimants and representatives. In terms of incentives, because GSOs bear the relevant costs for claimants, the incentive for claimants to join class actions is high. On the other hand, although GSOs bear costs, they will usually have external funding and enjoy some advantages, such as court fee discounts.\textsuperscript{16} Also, similar to semi-public agencies,

\textsuperscript{15} Chi-Ying, Lee, \textit{Punitive Damages under Article 51 Consumer Protection Law}, National Taiwan University 2008.

\textsuperscript{16} Taiwan Consumer Protection Law, Article 52: “If a consumer protection group brings a litigation in accordance with Article 50 in its own name, the court fees for the portion of the claim exceeding NTS$600,000 shall be waived.” Article 53,”Consumer ombudsmen or consumer protection groups may petition to the court for an injunction to discontinue or prohibit a business operator’s conduct which has
GSOs sometimes have some power in obtaining evidences with less cost. Therefore, they will have a positive incentive to initiate class actions compared to civil law type 1. Lastly, they also cannot claim for fees for their legal services according to special laws such as consumer protection law or investor protection law. (See table 1).

Again, a hypothetical scenario is to illustrate how the economic function applies to a Civil Law Type 2 case.

Scenario 3: This case is another consumer class dispute which involves 300 clients, with average monetary damage at $100. If class action of Civil Law Type 2 has been adopted, the function will be:

$$TC = IC ($1000) + BC(0) + MC(0) + AF (0)$$

Win: $NR = JA ($45,000) - TC [IC($1000)] = $44,000$

$$TC/n = 1000/300 = 3$$

$$NR/n = 44000/300 = 147$$

Lose: $NR = JA (0) - TC [IC($1000)] = -$1,000$

The individual TC will be $3(1000/300=3). If the lawsuit has been successful, the sum of damages award is actual damage plus a punitive damage of 0.5 times actual damage. Hence, the revenue for each individual will be $150(100*(1+0.5)=150), which makes the net revenue $147 (150-3=147) per person. For Type 2, the responsibility for the claimants to bear is rather limited, as the risk of adducing evidence and monitoring falls upon the representatives, i.e. GSOs. Moreover, this type of class action enjoys preferential treatment by the special laws, such as consumer protection law or investor protection law, which substantially reduces the entry barrier as compared to Civil Law Type 1. To sum up, class action under this system will be a potent motivator for consumers to lodge a complaint.

In conclusion, the Common Law Type and Civil Law Type 2 are comparatively favorable according to the analysis under CBA model, which includes the

17 Taiwan Securities Investor and Future Trader Protection Act, Article 34, When the protection institution institutes an action pursuant to Article 28 and applies for a provisional injunction or a provisional attachment, it shall state the reasons for the claim and the provisional injunction or provisional attachment. A court may rule that the protection institution's application as referred to in the preceding paragraph be exempted from the requirement for provision of security.
consideration of transaction costs, incentives and risk analysis. However, there are two major concerns for the Common Law Type that need to be addressed. First is the agency cost problem. This stems from a concern that the lack of client monitoring might lead an entrepreneurial attorney to “serve his own interest at the expense of the client.” 18 There are several ways of reducing agency costs, such as monitoring, bonding or ethical obligation. 19 However, studies have shown that these methods may only have limited functions. 20 Another way of reducing agency cost is to align the incentives of the agent and client, by which fee arrangements are the most intuitive and the most common method. 21

From an economic point of view, contingency fees do not provide a perfect incentive because they internalize all of the costs but generate only part of the benefits (usually one-third in the U.S.) 22 to the plaintiffs’ attorney. It is believed that this makes it likely for some cases to settle when it is in the interest of class members to go to trial because the attorney can obtain a relatively high fee by settling and avoid the costs of a trial. 23 In terms of other fee arrangements, hourly fee arrangements also permit opportunism to incur additional fees because they encourage externalizing the cost of work. Also, regarding fee-for-service arrangements, attorneys will internalize the cost of additional time spent on the service and externalize the benefit. In short, the stakes in class actions are generally too large to have a perfect shield against the abuses caused by the fee arrangements under the Common Law Type.

In fact, common law countries such as the U.S. has adopted some other ways to reduce the agency costs problem, one of which is allocating certain elements of litigating authority to the courts. 24 This method includes the basic features of common law class actions aforementioned, such as class certification, appointment of class counsel and judicial review over the settlements and attorney fees. However, while the court is given a stronger role and is entitled to encourage and advise the parties, its intervention reduces the benefit brought by the advocacy systems. 25 In addition, judicial review may have the problems of inherent bias and uncertainty. 26

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18 See Macey & Miller, supra note 11
20 Id.
21 Id. at 384.
22 Id. at 338.
26 Macey, Jonathan R. and Miller, Geoffrey P., Judicial Review of Class Action Settlements (September
particular, U.S. courts usually review attorney fees by using “Lodestar” or “Percentage” methods, which are similar to the hourly fee and contingency fee arrangements. Hence, similar problems may still occur.

The Private Securities Litigation Reform Act (“PSLRA”) was amended to realign interests by conferring a greater role for institutional investors in litigation in securities class actions. However, the same rationale cannot be fully replicated to other types of class actions when there is usually no specific plaintiff who has a comparatively large stake in the litigation.

Another problem that exists in the Common Law Type is that an increase in frivolous lawsuits. Since aggregation of a lawsuit increases the bargaining power of the plaintiffs, which turns the table on the defendants, a class action puts the defendant in the position of being rendered insolvent by a single trial, saddling them with a large undiversifiable risk. In addition, because the fee award tends to be a function of the recovery, attorneys will be more willing to go after large cases which are against deep pocket defendants. Taking securities class actions as an example, the evidence indicates that suits tend to correlate with higher quality underwriters, which are associated with higher quality offerings. This correlation demonstrates that something other than merit drives plaintiffs’ attorneys. Furthermore, empirical studies show that most securities-fraud class actions are frivolous. Class actions have become an effective tactic by which defendants can reach a settlement even if their suits are unmeritorious, which increases not only the cost of business but also that of the judicial system. Hence, even though the Common Law Type saves transaction costs related to the initiation of claims, preserving class benefits and causing frivolous lawsuits are still serious problems.

4.1 Deterrence Effect

American literature generally agrees that the deterrence effect is one of the most important goals of class actions. In civil law countries, the significant impact of

28 See Wang & Chen, supra note 9, at 141.
30 See Silver, Charles M., supra note 1, at 194 -240.
32 Id.
class disputes on the society also brings those countries’ attention to the promotion of more efficient enforcement. With the gradual acceptance of punitive damage awards in some law areas such as consumer protection, it is posited herein that the deterrence effect of class actions is also reflected in the civil law context.

To determine whether the class action mechanism effectively deters wrongful acts, we apply the formula \( B = p \times S \) used for analyzing the deterrence effect. Assuming that the defendant did commit a wrongful act, the apprehension rate \( p \) would be the probability of the plaintiffs initiating a lawsuit seeking compensation. Sanction \( S \) would be the damage that the court orders a plaintiff to pay to the defendant. Lastly, benefit \( B \) would be the benefit which a defendant can obtain by conducting wrongful acts.

### 4.1.1 Common Law Type

For the common law class actions, the apprehension rate is more complex because it will likely be driven not only by the merits of the case, but also by the allure of a large amount of compensation. If we exclude the rate of frivolous suits, the \( p \) would be low since lawyers would only undertake cases that would be likely to reimburse their costs. Therefore, there is uncertainty of \( p \) in the common law context. In addition, for not being rendered insolvent by a single trial, defendants are likely to settle for a smaller amount without going to trial. These factors result in a more contingent or even diluted deterrence effect. (See table 2)

### 4.1.2 Civil Law Type 1

As for Type 1 class action, because it is essentially the same as traditional joinder lawsuits, the transaction costs are too high for the plaintiffs or the attorney to initiate the suit. Therefore, the \( p \) is low. In addition, with less utilized punitive damages, the sanctions in civil law countries are comparatively lighter than that in the common law countries. Hence, the defendant will not correct his wrongful behavior if the benefit is larger than the sanction (\( p \) multiple \( S \)). (See table 2)

### 4.1.3 Civil Law Type 2

On the other hand, for Civil Law Type 2, if GSOs have sufficient funding and less financial concerns related to bringing a lawsuit, they are more willing to pursue cases according to the merits of the case rather than the potential reward. Therefore, the apprehension rate should be theoretically higher than that in the U.S. Although Type 2 has the same problem with the low compensation due to less punitive damage, its overall deterrence effect is better than Type 1 because of a higher apprehension rate. (See table 2)
In conclusion, while the Type 1 class action mechanism has failed in achieving the deterrence effect, the Common Law Type and Civil Law Type 2 seem to be the two better choices for the deterrence objective. However, which one is more cost efficient, and which one is better for improving behavior? While the Common Law Type has higher compensation but a lower and more unpredictable apprehension rate, Civil Law Type 2 has lower compensation but a higher apprehension rate. Becker’s article introduced the idea that enforcement effort (apprehension rate) and sanctions are substitutes in the enforcement. A lower level of enforcement effort can be offset by increasing sanctions, which economizes on enforcement cost. Therefore, the U.S. type will save more enforcement cost if not taking into account the costs wasted on frivolous claims.

However, what if the defendants are imperfectly informed about apprehension rate just as the uncertain p in the Common Law Type? Bebchuk argued that when individuals observe this probability with some random error, it may be optimal to employ less than the maximum feasible sanction with a greater probability of apprehension. While raising the probability is costly, it may improve behavior. Therefore, because Civil Law Type 2 is more ascertainable with regards to the p and S, it is less risky and is better for improving behavior even though the cost is higher.

5.1 Conclusions and Recommendations

5.1.1 Market/Contract Failure

From the empirical research and the foregoing economic analysis, Civil Law Type 1 seems to fail in achieving both of the objectives of the class action mechanism. On the other hand, although the Common Law Type has met some parts of the objectives, it exhibits some significant deficiencies, such as attorney fee abuses and frivolous lawsuits. These deficiencies impose social costs on the public by entrepreneurial lawyers in the guise of class actions.

These unsolved problems in the Common Law Type of class action to a certain extent reflect “contract failure.” Contract failure, like Hansmann described, “is likely to be a problem if consumers seek to purchase public goods/service from profit-seeking producers.” Can class actions be considered a type of public good?

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37 Id.
According to some scholarly work, class actions do reflect to some extent the public good and public policy, because: (1) it takes longer to resolve class actions than most other litigation; (2) class actions require the court to play a more active monitoring role. In class actions, regardless of whether they are injunctive suits or damage suits, the benefited parties usually go far beyond the party that brings the suit, which echoes the viewpoint that “the efficiency in private enforcement is not the same as efficiency in producing the social utility of enforcement.”

5.1.2 Why a GSO or an NPO?

When facing contract failure problems, academics suggest that nonprofits (“NPOs”) are likely to be the more suitable suppliers. This is because, in contrast to profit-driven lawyers, NPOs, by nature, prohibit the distribution of profits – the “non-distribution constraint,” which makes an NPO lack the incentive to exploit consumer welfare. Hence, an NPO is a better institutional design “for solving the contract-failure problem in the production of public goods and services.”

However, non-profit organizations will not voluntarily address contract/market failure and provide support for class actions. This justifies government intervention, which mandates that market participants establish NPOs or GSOs to fulfill the need for law enforcement. Meanwhile, there might be concerns about whether using GSOs or NPOs will reduce the benefits of advocacy systems. In theory, only when information collectors being the “judge and the party” at the same time will this type of problem arise. Based on current practices, we believe that Civil Law Type 2 could be exempt from this problem because GSOs or NPOs are still advocates as long as they are independent from any of the parties in the proceedings. In addition, although non-profits might be expected to operate less efficiently than for-profits, the disparity in behavior is not overwhelming if proper legal restraints or monitoring to provide the good to many persons than it does to provide to one person because one person’s enjoyment of the good does not interfere with the ability of others to enjoy it at the same time; second, once the good has been provided to one person, there is no way to prevent others from consuming it).

39 See Coffee, Jr., supra note 12, at 1534.
40 See Wang & Chen, supra note 9.
44 Id.
46 See Rosenfield, A., supra note 22.
Another possible criticism might be that government support may undermine the independence of NPOs or GSOs because of potential financial connections and political intervention. However, this concern could be solved by a certain degree of independence from finance and politics, NPOs or GSOs will be more likely to be exempt from interventions from the government. Currently, Germany, Japan, Korea and Taiwan have adopted this type of class action mechanism. Relevant issues in the ensuing practice are worth observing and further study.

48 See Hansmann, supra note 37. (For example, state corporation law commonly makes it difficult for entrepreneurs to take stock in firms they create as a means of providing compensation for their future services.)
50 See Lin, supra note 41.
## APPENDIX

Table 1

+: favorable    -: unfavorable

<table>
<thead>
<tr>
<th></th>
<th>U.S.</th>
<th>Civil Law Type 1</th>
<th>Civil Law Type 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Transaction Costs</strong></td>
<td>● Principal: +(opt-out)</td>
<td>● Principal: — (opt in mechanism, negotiate to appoint the representative plaintiff)</td>
<td>● Principal: + (modified opt-in)</td>
</tr>
<tr>
<td></td>
<td>● Agent: +(attorneys have control)</td>
<td>● Agent: — (difficult for attorneys to deal with principals who still have control)</td>
<td>● Agent: + (NPOs have control)</td>
</tr>
<tr>
<td><strong>Incentives</strong></td>
<td>● Principal: +(bear no costs)</td>
<td>● Principal: —(bear the litigation costs)</td>
<td>● Principal: + (usually bear no costs)</td>
</tr>
<tr>
<td></td>
<td>● Agent: +(bear costs; they usually can get settlement from deep pocket defendants; contingency fees)</td>
<td>● Agent: + (get reward from their legal services)</td>
<td>● Agent: +/- (bear the cost but usually have external funding and some discount for court fees)</td>
</tr>
<tr>
<td><strong>Risk</strong></td>
<td>● Principal: + (no risk b/c they bear no costs)</td>
<td>● Principal: — (bear costs)</td>
<td>● Principal: + (bear no cost)</td>
</tr>
<tr>
<td></td>
<td>● Agent: — (bear costs)</td>
<td>● Agent: + (bear no costs)</td>
<td>● Agent: +/- (bear costs but have external funding and court fee discounts)</td>
</tr>
<tr>
<td></td>
<td>U.S.</td>
<td>Civil Law Type 1</td>
<td>Civil Law Type 2</td>
</tr>
<tr>
<td>------------------</td>
<td>-------------------------------------------</td>
<td>-----------------------------------------------------------------------------------</td>
<td>-----------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Apprehension rate (p)</td>
<td>• Low (excluding the rate of frivolous suits-the allure of large compensation, not the merit of the case) • Largely influenced by S</td>
<td>• Lowest (TAC and INC analyses both indicate a low likelihood to initiate the suit)</td>
<td>• High (the agent is less likely to be influenced by private interests)</td>
</tr>
<tr>
<td>Sanction (S)</td>
<td>• High</td>
<td>• Low</td>
<td>• Low</td>
</tr>
</tbody>
</table>
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