REVERSE SAMPLING

A SIMPLE PROPOSAL TO ALLOCATE THE PROCEEDS OF LOW-VALUE CLASS ACTIONS

Shay Lavie[*]

> *"[A random selection] is resorted to as the fairest mode, and, in some sort, as an appeal to God . . . we can conceive of no mode so consonant both to humanity and to justice . . . In no other than this . . . way are those having equal rights put upon an equal footing, and in no other way is it possible to guard against partiality and oppression, violence and conflict."*
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> ~ United States v. Holmes, 26 F.Cas. 360 (Circuit Court, E. D. Pennsylvania. 1842).

INTRODUCTION

Class action is a very powerful enforcement tool. It forces the defendant to pay damages where the stakes are too low for individual litigation, and hence achieves

[*] SJD Candidate, Harvard Law School. E-mail: slavie@sjd.law.harvard.edu.

optimal deterrence.[1] However, oftentimes – especially in low-value claims – it is prohibitively expensive to locate and compensate each and every class member.[2] The individual award is simply too meager to justify a distribution scheme. The result is unclaimed compensatory damages.

Low-value class actions, then, pose a unique problem – how to allocate the class proceeds? As one attorney put it, "it's in everyone's best interest to stipulate . . . that the residual money will go somewhere."[3] Indeed, courts and legislators have found creative destinations to transfer these funds: back to the defendants, to the government, prospective consumers, various legal aid societies, charities, and so on. None of these solutions is satisfactory. In particular, these mechanisms fail to compensate the victims. They also invite abuse of power and entail substantive administrative costs.

This paper introduces a new method to allocate the proceeds of low-value class actions. Unlike other existing methods, the proposed mechanism diverts the money back to the place where it belongs – the class of plaintiffs. To overcome administrative difficulties, the proposal uses a simple principle: instead of distributing the money to all class members, more money can be paid to a random sample of the class, such that the expected value for each member remains the same. As simple as this suggestion may be, no previous literature has proposed to compensate only a random sample of the members of the class.

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[1] Aggregating the plaintiffs into one class also avoids the inherent advantages the defendant has when it deals with separated group of individual plaintiffs (*see*, *e.g.*, David Rosenberg, *Mass Tort Class Actions: What Defendants Have and Plaintiffs Don't*, 37 HARV. J. LEG. 393 (2000)).

[2] *See*, *e.g.*, Stan Karas, *The Role of Fluid Recovery in Consumer Protection Litigation: Kraus v. Trinity Management Services*, 90 CAL. L. REV. 961, 961 (2002).

[3] *See* S. Gale Dick, *Fluid Recovery: Flexible Ways to Settle Cases*, 13 ALTERNATIVES TO HIGH COST LITIG. 73 (1995) (citing Patricia Sturdevant).

Sampling was proposed,[4] and even used in several complex litigation contexts,[5] as a method to determine the defendant's aggregate liability (based on a random sample of plaintiffs). This paper suggests using random selection not to determine liability, but to allocate the money back to the class of plaintiffs – what I dub as "reverse sampling." According to the reverse sampling method, class action courts would randomly select litigants, and the chosen litigants would be awarded multiplied damages. The benefits of this simple method are twofold: primarily, it cuts administrative costs; a secondary benefit is improving class members' utility by enabling them to substitute a risky high-compensation for a guaranteed low-compensation. Finally, this proposal can easily be implemented. It requires no change in law; rather, it relies on equitable powers courts already employ in these contexts.

The paper is organized as follows. The first part uses a numerical example to demonstrate the basic framework, as well as the main advantages of the proposed mechanism. Part II surveys the existing alternatives to distributing the proceeds of low-value class actions, and compares these methods to the proposed solution. It argues that the proposed mechanism – reverse sampling – is superior to any existing alternative. Part II provides three paradigmatic examples of the use of reverse sampling. Part IV copes with potential objections. It focuses on potential criticism regarding the use of lotteries in legal decision-making, and submits that arguments against the use of lotteries are, to a large extent, irrelevant to the context of procedural, technical decision-making. Part V concludes.

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[4] David Rosenberg & Steven M. Shavell, *A Simple Proposal to Halve Litigation Costs in the United States*, 91 VA. L. REV. 1721 (2006).

[5] Robert G. Bone, *Statistical Adjudication: Rights, Justice, and Utility in a World of Process Scarcity*, 46 VAND. L. REV. 561 (1993). For a concrete example of the use of sampling to determine aggregate liability *see* Long v. Trans World Airlines, Inc., 761 F. Supp. 1320, 1325 (N.D. Ill. 1991).

I. BASIC FRAMEWORK: THE REVERSE SAMPLING METHOD

A. Numerical Example

Schmexpedia, an Internet-based travel reservation website, charged excessive fees – in the amount of $5 – per each reservation. It costs $1 per claim to dole out the money (*e.g.*, handling and mailing a check).[6] There are 1,000,000 class members. Hence, using the traditional approach, administrative costs are $1,000,000. The common fund is $5*1,000,000=$5,000,000, and the net fund, minus administrative costs, is $5,000,000 – $1,000,000 = $4,000,000. Each member gets $4 (common fund of $4,000,000 distributed to 1,000,000 class members).

Using reverse-sampling, the court randomly selects, say, 1 in 20 class members (5% of the class is chosen). Hence, only 50,000 – rather than 1,000,000 – plaintiffs are actually awarded damages. Administrative costs of distributing the money are only $1 (per claim) *50,000 (members) = $50,000, instead of $1,000,000. Accordingly, net value of the common fund is now $4,950,000. This is a net gain of $950,000 that can be shared among class members. Each of the 50,000 chosen members now gets $99. Expected value for each member is $4,950,000/1,000,000 = $4.95. As the following table demonstrates:

[6] This amount makes rough sense, taking into account that a single stamp costs 44 cents, and a standard envelope costs around 7 cents (*see*, respectively, Stamps for U.S. Letters to Rise to 44 Cents in May, Reuters, Feb. 10. 2009, http://www.reuters.com/article/idUSTRE5197CQ20090210; Amazon.com: Mead Press-It Seal-It #10 White Envelopes, 50 Count (75024): Office Products, http://www.amazon.com/Mead-Press-Seal-Envelopes-75024/dp/B000N4C1LO/ref=sr_1_1?ie=UTF8&s=office-products&qid=1274940735&sr=1-1 (last visited May 27, 2010)).

Table 1: Reverse Sampling v. Traditional Approach

	Traditional Distribution	*Reverse Sampling*
Individual claim	$5	$5
Class size	1,000,000	1,000,000
The common fund	$5,000,000	$5,000,000
Proportion of beneficiaries	1/1	1/20
Actual number of beneficiaries	1,000,000	50,000
Administrative costs per claim	$1	$1
Total administrative costs	$1,000,000	$50,000
Net common fund	$4,000,000	$4,950,000
Net award per beneficiary	$4	$99
Expected award per claim	$4	$4.95

Under the reverse sampling mechanism, then, Schmexpedia pays the same – $5,000,000. The expected value of each claim, however, is $4.95 under the reverse sampling mechanism and $4 under the traditional allocation approach. Under reverse sampling plaintiffs get $99 in 5%; under the traditional approach plaintiffs receive $4.95 with certainty.

B. Advantages of the Reverse Sampling Method

Reverse sampling has two major advantages: *first*, it economizes on administrative costs; *second*, it better satisfies class members' risk preferences.

1. Economizing on Administrative Costs

This is the main argument for implementing reverse-sampling. Administrative costs per claim are constant. By awarding more money to fewer members administrative costs are saved – a pure gain to the class. Recall the numerical example: using the traditional method, each member is awarded $4. Using reverse-sampling, the expected

gain to each member is $4.95. This difference – a net gain – is the results of cutting administrative costs, and distributing more money to fewer plaintiffs, chosen by a random sample. In the numerical example, the class-wide gain amounts to $950,000.

2. Better Satisfying Class Members' Preferences

This is a secondary argument for implementing reverse sampling. Not only does the sampling process cut administrative costs, it also enhances plaintiffs' utility.

The traditional distribution scheme awards guaranteed and small sums of money; with the reverse sampling method members are awarded larger sums in low probability. Which method would class members prefer? This is an empirical question, and experimental economics predicts that, in this type of situations, people prefer a fair gamble – exactly what the reverse sampling method provides. Dozens of experiments show a broader pattern of behavior under risky conditions – the so-called Tversky and Kahneman's Prospect Theory[7] – in which decision-makers are risk seeking with respect to low-probability gains.[8] "Tversky and Kahneman found, for instance, that when they asked individuals to choose between . . . a 10 percent chance at $500 – and the expected value of that gain – *i.e.*, a certain $50 – 78 percent of decisionmakers preferred the

[7] Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 236 (1979). For empirical evidence of some aspects of the prospect theory, *see, e.g.*, Wenlang Zhang & WillI Semmler, *Prospect Theory for Stock Markets: Empirical Evidence with Time-Series Data*, 72 J. ECON. BEHAV. ORGAN. 835 (2009).

[8] For an example of the preference for a risky gamble in the context of litigation management, *see* the experiment conducted by Chris Guthrie, *Framing Frivolous Litigation: A Psychological Theory*, 67 U. CHI. L. REV. 163, 180 (74), 187-191 (2000). For a survey of general corroborating experiments on the low-probability/risk-preference point, *see, e.g.*, Guthrie, *id.*, at 183-184. The corroborating experiments mentioned include real world scenarios, diverse participants, and actual awards. There are several explanations to this observed preference for risk. Decision-makers, for example, assign some weight to the feelings of hope and rejoice, which are associated with the low-probability gain decision (*see, e.g.*, Guthrie, *id*, at 198-201). Another explanation is purely rational – some people gain relatively more utility from a single large gain, whereas small gains do not really raise their utility (*see* Edward J. McCaffery, *Why People Play Lotteries and Why It Matters*, WIS. L. REV. 71, (1994)).

gamble."[9] There is no reason to think that these findings do not apply to decision-making as to the proceeds of class actions.[10] Previous literature has applied this risk-seeking phenomenon to other areas of law.[11]

To sum up: The reverse sampling method has two components: cutting administrative costs and randomization. Each component increases class members' expected gains.[12]

The next paragraphs describe the legal background and the alternative distribution mechanisms currently in use. Then, the paper shows that reverse sampling is superior to any existing distribution method.

II. REVERSE SAMPLING AND EXISTING MECHANISMS

A. *The Problem of Allocating the Proceeds of Low-Value Claims*

A large body of literature discusses class actions. Judges, scholars and legislators have come up with a host of legal structures. The vast majority of these proposals –

[9] *See* Guthrie, *supra* note 8, at 179-180 (referring to Amos Tversky and Daniel Kahneman, *Advance in Prospect Theory: Cumulative Representation of Uncertainty*, 5 J. RISK & UNCERTAINTY 297, 308 (1992)).

[10] The preference for a risky award depends on the distinction between "gain" and "loss" – people prefer low probability "gains"; but dislike low probability "losses" (*cf*., Christine Jolls, *Behavioral Economics Analysis of Redistributive Legal Rules*, 51 VAND. L. REV. 1653 (1998) (demonstrating that this differential framing might affect the choice between redistributive legal rules and taxes). It seems very plausible that a potential class action award fits the "gain" frame. Class members – typically, consumers – seem not to expect reimbursement, and conceive of the award as a prize. Likewise, even if consumers frame the overcharge as a "loss," with a "*moderate-to-high probability* . . . they tend to prefer the *risk-seeking* option" (Guthrie, *supra* note 8, at 179). In that case, consumers still prefer the risky reverse sampling mechanism to traditional, non-risky, distribution schemes.

[11] *See*, *e.g.*, Guthrie, *supra* note 8 (uses the risk-seeking pattern to explain frivolous, low-probability lawsuits); Dennis D. Crouch, *The Patent Lottery: Exploiting Behavioral Economics for the Common Good*, 16 GEO. MASON L. REV. 141 (2008) (the implication of low-probability risk seeking to patent policy); Stephen J. Choi & A.C. Pritchard, Behavioral Economics and the SEC, 56 STAN. L. REV. 1, 15 (2003) (explaining lottery-like investment behavior of many middle-class individuals as follows: "[a]t bottom, we suspect, is a utility function that favors a remote chance of striking it rich over the slow but steady gains from buying and holding a well-diversified portfolio"); Jolls, *supra* note 10.

[12] Note that the randomization component is beneficial even though, as the previous examples show, some class members are likely to hold distinct preferences against the risky gain. Overall, the randomization will be preferred if more people value it compared to the other option.

mandatory class actions,[13] sampling,[14] auctions,[15] empowered lead-plaintiff,[16] to name a few – aim at improving the process of imposing liability on the defendant.[17] While the process of extracting the money from the defendant is constantly debated, the question of how to completely distribute those funds has received little attention. A recent article epitomizes this lack of interest: "As long as the transaction causes the defendant to internalize the social costs of its wrongdoing . . . [the] court ought to approve."[18] However, the problem of complete distribution of class actions proceeds is of sizeable importance.

Individual claims are often very low relative to the efforts required to distribute the money. Sometime, the individual claims are so small that any individual distribution

[13] *See, e.g.*, David Rosenberg, *Mandatory-Litigation Class Action: The Only Option for Mass Tort Cases*, 115 HARV. L. REV. 831 (2002).
[14] *See supra* notes 4-5.
[15] The first judge to experiment with an auction was Judge Vaughn R. Walker in *In re* Oracle Securities Litig., 131 F.R.D. 688, 698 (N.D. Cal. 1990) (*see* Chief Judge Edward R. Becker, *Third Circuit Task Force Report on Selection of Class Counsel*, 74 TEMP. L. REV. 689, 708(44) (2001)). For academic writing on auctions *see, e.g.*, Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 105-116 (1991); Jill E. Fisch, *Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction*, 102 COLUM. L. REV. 650 (2002).
[16] *See* the Private Securities Litigation Reform Act (PSLRA), Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified in scattered sections of 15 U.S.C.), which requires the court to appoint a lead plaintiff, *i.e.*, a class member "that the court determines to be most capable of adequately representing the interests of class members" (15 U.S.C. § 78u-4(a) (3) (B) (i) (Supp. V 1999); and to empower the appointed plaintiff to select and retain lead counsel (15 U.S.C. § 78u-4(a)(3)(B)(v)). The legislation was inspired by Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L. J. 2053 (1995).
[17] Particularly, the literature is bothered with agency problems between the counsel and the class.
[18] Myriam Gilles & Gary B. Friedman, *Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers*, 155 U. PA. L. REV. 103, 153 (2006). Equally illustrative are the brief discussions made by the very same scholars who provide sophisticated mechanisms to improve the liability process. David Rosenberg, who champions the ground-breaking idea of mandatory aggregation coupled with damage-scheduling, holds that any remaining funds "would revert to the court for expenditure on some public use" (David Rosenberg, *Decoupling Deterrence and Compensation Functions in Mass Tort Class Action for Future Loss*, 88 VA. L. REV. 1871, 1896 (2002)). Jonathan Macey and Geoffrey Miller, who come up with the idea of a bid for the right to the entire fund, suggest that "[t]he court would then distribute the funds as in standard class action litigation - but the funds would come *before* trial" (Macey & Miller, *supra* note 15, at 107).

scheme is infeasible.[19] In other cases, the small individual claims prohibit some class members from filing the required statement and cashing their awards.[20] Either way, the prospect of some residual, unclaimed funds, is "virtually certain."[21] "The problem [of residual, unclaimed funds] is not rare and often involves significant amounts of money."[22]

Traditionally, courts have come up with several mechanisms to deal with these unclaimed funds. As will be demonstrated, reverse sampling is superior to these traditional solutions. Existing mechanisms are inefficient; they invite abuse of power; and cannot comply with the dual goal of deterring defendants and compensating victims.

The following paragraphs briefly discuss the mechanisms and their inherent flaws.

1. Reversion to Defendant

Defendants argue that any unclaimed, residual funds should be returned to them. This mechanism, of course, reduces deterrence, and indeed it is rejected by most courts,[23] though some courts have approved it.[24]

[19] WILLIAM B. RUBENSTEIN, ALBA CONTE AND HERBERT B. NEWBERG, NEWBERG ON CLASS ACTIONS § 10:14 (4th ed.) (*available at Westlaw*).
[20] *Id*., id.
[21] *Id*., id.
[22] See Goutam U. Jois, *The Cy Pres Problem and the Role of Damages in Tort Law*, 16 VA. J. SOC. POL'Y & L. 264-265 (2008) (surveying class actions in which unclaimed monies were left, ranging from $1 million to $32 million).
[23] *See*, for example, Sam Yospe, *Cy Pres Distributions in Class Action Settlements*, 2009 COLUM. BUS. L. REV. 1014, 1042-1044 (2009).
[24] *See*, Rubenstein, Conte and Newberg, *supra* note 19, at § 10:15; Van Gemert v. Boeing Co., 739 F.2d 730 (2d Cir. 1984). *See* also the discussion in Jois, *supra* note 22, at 271-272.

2. Distribute Remaining Funds Pro Rata to Class Members

Where some plaintiffs claimed the money and others did not, courts can distribute the residual to the first group. This is the method the American Law Institute (ALI) endorses where "funds remain after distribution."[25] Conceptually, this distribution scheme envisions several stages. In the first one, after the notice of class action, class members are expected to cash out their awards. In the second stage, after finding out that many plaintiffs remained silent, a more extensive search might be held to induce more class members to claim their money.[26] In the final stage, the court distributes whatever money left to those who did file a claim in previous stages.[27]

This solution bears some resemblance to the reverse sampling approach, as some members of the class gain extra-compensation and others receive nothing. However, as will be further discussed,[28] the two solutions diverge practically and conceptually. Likewise, the pro-rata mechanism requires additional administrative costs of reaching out as many plaintiffs as possible, and holding multiple stages of distribution.[29] The

[25] Principles of the Law of Aggregate Litigation § 3.07(b) (American Law Institute, Tentative Draft No. 1, April 2008)).

[26] In one case, for example, once it found that there is a residual fund, the court allowed late filers to participate in the distribution plan (Fears v. Wilhelmina Model Agency, Inc., No. 02 Civ. 4911, 2005 U.S. Dist. LEXIS 7961, at *21 (S.D.N.Y. May 5, 2005), *vacated sub nom.* Masters v. Wilhemina Model Agency, Inc., 473 F.3d 423 (2d Cir. 2007)).

[27] "[I]f a settlement calls for individual payments to class members, and funds remain . . . at the end of the claims period [the first best solution is] additional payments to identified class members [unless these additional payments] would not be economically viable (Principles of the Law of Aggregate Litigation § 3.07 Illustration 2 (American Law Institute, Tentative Draft No. 1, April 2008)).

[28] *See infra* notes 79-85.

[29] In one case the court describes the pro rata distribution plan as follows:

> "The plan calls for the continued re-distribution of unclaimed funds to class members according to their pro rata shares, until the costs of such re-distributions make it economically unfeasible to continue doing so . . . This approach is consistent with the latest draft of the American Law Institute's Principles of the Law of Aggregate Litigation" (In re Tyco Intern., Ltd. Multidistrict Litigation, 535 F.Supp.2d 249, 2007 DNH 156, 262 (D.N.H. 2007)).

For another illustrative example of the multiple phases involved, *see* S.E.C. v. Bear, Stearns & Co. Inc. 626 F.Supp.2d 402, 417 (S.D.N.Y. 2009). Indeed, this multiple-distribution scheme is mandated by the ALI

American Law Institute support notwithstanding, courts dislike the pro-rata mechanism.[30] Allegedly, it provides an unfair "windfall" for the claiming plaintiffs,[31] at the expense of silent class members, who "will not receive any compensation, even indirectly."[32] In addition to fairness, another concern is "the adequacy of representation where the interests of the named plaintiffs lie in keeping the other class members uninformed."[33]

3. Escheat to the State

Courts can turn over the residual funds to the Federal Treasury or to the state. Similar to the former mechanism, this method envisions two stages: first, money is distributed to some plaintiffs, and then the remainder goes to the state. A more general version of this mechanism skips the first stage and funnels the entire fund directly to the government.[34] Those who praise this mechanism argue that this is actually what all plaintiffs want. Ex-ante, behind the veil of ignorance, the argument goes, victims want to be compensated equally. Where such compensation is impossible, what can be better than diverting the money to the government? After all, "all individuals expect to share equally in the provision of benefits by the state."[35]

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draft ("If . . . funds remain after distributions . . . the settlement should . . . provide for further distributions to participating class members unless the amounts involved are too small" (Principles of the Law of Aggregate Litigation § 3.07(b) (American Law Institute, Tentative Draft No. 1, April 2008)).

[30] Yospe, *supra* note 23, at 1045.

[31] *See*, *e.g.*, In *re* Folding Carton Antitrust Litig., 557 F. Supp. 1091, 1107 (N.D. Ill. 1983). *See* also the discussion in Yospe, *supra* note 23, at 1045.

[32] Stewart R. Shepard, *Damage Distribution in Class Actions: The Cy Pres Remedy*, 39 U. Chi. L. Rev. 448, 453 (1972).

[33] *Id*., id.

[34] *See* Goutam U. Jois, *The Cy Pres Problem and the Role of Damages in Tort Law*, 16 VA. J. SOC. POL'Y & L. 260 (2008).

[35] Jois, *supra* note 34, at 282-283.

This method has its own problems. First, it fails to compensate the victims.[36] The equal benefit the victims obtain from a richer government is questionable. Similarly, it is by no means self evident that victims want, ex-ante, the money to be escheated to the state. Moreover, this mechanism creates a trilateral process as it implicates in the litigation another party – the government[37]; and the prospect of a large award might distort the incentives of the government.

Essentially, escheat to the state is akin to tax.[38] As it is equally levied on all members of the class it is a regressive tax.[39] Even more bothering, the prospective award might create perverse incentives for the government, especially where public enforcement complements private enforcement.[40] When the government is likely to gain a sizeable share of the proceeds of consumer class actions, for instance, it is induced to impose a laxer regulation on standard form contracts.[41] Put differently, escheat to the state might lead to inefficient legal rules which ease the levying of taxes and their collecting.

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[36] This might create constitutional concerns: "the practice [of compensating a third party rather than class members] violates separation of powers because through the wholly improper mechanism of a purely procedural device, the substantive law is effectively transformed from a compensatory remedial structure to the equivalent of a civil fine" (Martin Redish, Peter Julian & Samantha Zyontz, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 FLA. L. REV., at *33 (forthcoming 2010)).

[37] The transformation from bilateral to trilateral adjudication raises constitutional concerns, as the "less-than-fully adversary trilateral process [is] wholly unknown to the adjudicatory structure contemplated by Article II" (Redish, Julian & Zyontz, *supra* note 36, at *34).

[38] Martha A. Churchill, *Fluid Recovery: Not a Class Act*, 72 MICH. B. J. 1184, 1185 (1993).

[39] Moreover, often the victims of the class are poorer than average, and taxing them is particularly unjust.

[40] Jois, who praises the escheat mechanism, notes that where the state is a party to the proceedings (defendant, in his example), the escheat proposal should be qualified (Jois, *supra* note 34, at 298). He fails to observe that in many areas the state is not a formal party, but it does directly influence the legal background – either by regulation or public enforcement.

[41] Governmental incentives can be distorted in a similar way when its actions can stimulate further private litigation. In that case, the looming escheat might induce the government to encourage private enforcement, thus creating over-deterrence. Notable areas in which public regulation interweaves with private enforcement are securities and antitrust.

Not only does it fail to compensate victims, escheat to the government also distorts its ex-ante incentives for optimal regulation. Indeed, courts do not often employ this distribution method.[42]

4. Fluid Fund – Price Reduction

Rather than compensating the victims, courts can compensate other prospective consumers, *e.g.*, through a price reduction. An illustrative case is *Daar v Yellow Cab*,[43] in which the defendants set the meter rates in excess of those approved by the utility commission. The settlement fund was to be returned to the class by reducing cab fares in future years.

One drawback of this method is obvious: the original victims are not compensated. Another difficulty is the "substantial operating costs. . . [and] sophisticated skills of economic analysis [required to implement the price reduction mechanism]."[44] But there are even deeper problems with the price reduction approach: Ironically, price reduction can be a boon for the defendant, who now enjoys a competitive advantage.[45] Hence, price reduction for prospective clients will generally fail to achieve optimal deterrence.[46]

[42] *See* Yospe, *supra* note 23, at 1047; Jois, *supra* note 34, at 273.
[43] 433 P.2d 732, 63 Cal.Rptr. 724 (1967).
[44] Anna L. Durand, *An Economic Analysis of Fluid Class Recovery Mechanisms*, 34 STAN. L. REV. 173, 201 (1981).
[45] WILLIAM B. RUBENSTEIN, ALBA CONTE AND HERBERT B. NEWBERG, NEWBERG ON CLASS ACTIONS § 10:18 (4th ed.) (*available at Westlaw*).
[46] Unless the defendant has a monopoly, or "where the reduced prices are not likely to attract purchasers at the expense of substitute products" (Rubenstein, Conte and Newberg, *supra* note 45 (citing II REPORT ON CLASS ACTIONS 579 (Ontario Law Reform Commission 1982)). *See* also Durand, *supra* note 44.

5. *Cy Pres* Distribution

This distribution mechanism becomes increasingly popular,[47] as well as increasingly controversial.[48] The *Cy pres* distribution approach indirectly benefits class members, diverting the money to "its next best compensation use."[49] The idea is simple and appealing – channeling the funds to a third party, such as charity organization, whose goals indirectly benefit the victims.

In actuality, however, things are not as rosy as they may seem at first blush. On the contrary: the *cy pres* mechanism is fraught with problems. First, class members are not compensated,[50] and the trilateral adjudication process raises constitutional concerns.[51] Moreover, transferring the money to charity is supposed to fulfill class members' preferences; but, who knows what class members really want? Attorneys and courts – their benevolence notwithstanding – do not survey the class before deciding where to funnel the money on its behalf.[52]

While "there must be a 'nexus' between the injury sustained by the class and the prospective benefit that the class obtains through the distribution of residual funds to *cy*

[47] Martin Redish, Peter Julian & Samantha Zyontz, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 FLA. L. REV. (forthcoming 2010).
[48] *See, e.g.*, Adam Liptak, *Doling Out Other People's Money*, N.Y. TIMES, November 26, 2007; Redish, Julian & Zyontz, *supra* note 47; Yospe, *supra* note 23; Jois, *supra* note 34.
[49] Rubenstein, Conte and Newberg, *supra* note 45, at § 10:17.
[50] For this reason, the American Law Institute advises a parsimonious use of the *cy pres* doctrine: only when class members cannot be easily identified, or the individual distributions are small: "If individual class members can be identified through reasonable effort, and the distributions are sufficiently large to make individual distributions economically viable, settlement proceeds should presumptively be distributed directly to individual class members" (Principles of the Law of Aggregate Litigation § 3.07(a) (American Law Institute, Tentative Draft No. 1, April 2008)). Similarly, when some class members are easily identified and others are not, the ALI advises doling out the remaining money pro rata to the already identified class members (*see* the ALI Draft, § 3.07(b), *supra* note 25 and the accompanying text).
[51] *See supra* notes 36 and 37 for similar problems in the context of the escheat mechanism.
[52] *Cf*, Martha A. Churchill, *Fluid Recovery: Not a Class Act*, 72 MICH. B. J. 1184, 1187 (1993) (asserting that "no class action plaintiffs are known to have surveyed the consuming public they 'represent.' In [one case] an intervenor suggested a poll of class preferences, but that request was denied").

pres beneficiaries,"[53] such a nexus hardly exists in many cases,[54] and the *cy pres* practice seems to be "getting out of hand."[55] Over $1,000,000 was distributed, for example, to the American Red Cross for Hurricane Katrina Relief, allegedly remedying price fixing of infant formula.[56] In another antitrust case, the court approved *cy pres* grants to 15 beneficiaries, ranging from schools, to the Legal Aid Bureau, to an art museum.[57]

The unfettered judicial discretion to dole out money through the *cy pres* mechanism is bothering.[58] As Professor Samuel Issacharoff – the main author of the ALI Principles of the Law of Aggregate Litigation draft – warns, "[i]t is . . . an invitation to wild corruption of the judicial process."[59] Apparently, the decision as to the winning charity is biased according to the presiding judge's and the attorneys' preferences.[60] Many *cy pres* grants are made to legal aid societies or charitable arms of bar associations,[61] in which plaintiffs' attorneys are heavily involved.[62] Another illustrative

[53] Yospe, *supra* note 23, at 1018-1019.
[54] For examples and a more detailed discussion *see* Yospe, *supra* note 23, at 1023-1026.
[55] *See* Adam Liptak, *Doling Out Other People's Money*, N.Y. TIMES, November 26, 2007 (citing Professor Samuel Issacharoff).
[56] *In re* Infant Formula Multidistrict Litigation, No. 4:91-cv-00878-MP, 2005 U.S. Dist. LEXIS 32957 (N.D. Fla. Sep. 8, 2005).
[57] Superior Beverage Co. v. Owens-Illinois, Inc., 827 F. Supp. 477, 478 (N.D. Ill1.9 93). Other examples exist: *cy pres* grant in an antitrust case was aimed at developing a Center for Competition Law at the George Washington Law School (*see infra* note 63 and the accompanying text); in another case, the benefiting organizations included civil legal services and medical center (Fears v. Wilhelmina Model Agency, Inc., 2005 WL 1041134, at 11 (S.D.N.Y. May 5, 2005), *vacated sub nom.* Masters v. Wilhemina Model Agency, Inc., 473 F.3d 423 (2d Cir. 2007)). For a survey of other cases that demonstrate the "attenuated connection between the direct interests of the class members and the charity receiving the *cy pres* award," *see* Redish, Julian & Zyontz, *supra* note 47, at *23-*27.
[58] Unsurprisingly, judges (and counsels) support the *cy pres* doctrine, and oppose competing solutions. As explained in the New York Times, "[l]awyers and judges have grown used to controlling these pots of money, and they enjoy distributing them to favored charities, alma maters and the like" (Adam Liptak, *Doling Out Other People's Money*, N.Y. TIMES, November 26, 2007).
[59] *See* Adam Liptak, *Doling Out Other People's Money*, N.Y. TIMES, November 26, 2007.
[60] For a more detailed discussion and examples *see* Yospe, *supra* note 23, at 1027-1031.
[61] "Since the early 1990s, the *cy pres* doctrine has been revived as a means for distributing residual funds in class-action lawsuits to legal aid and address-to-justice programs" (*Legal Aid is Paid a Visit by an Old Friend*, 33 MONT. LAW. 26, 26 (2007)). *See* also the examples in Yospe, *supra* note 23, at 1027 (49). In addition to legal aid societies, law schools and hospitals are also popular targets for *cy pres* award (Adam Liptak, *Doling Out Other People's Money*, N.Y. TIMES, November 26, 2007).

example is an antitrust case in which the class attorney proposed a *cy pres* distribution to the George Washington Law School – his *alma mater*[63]; the court approved.[64] Another problem is localism bias.[65] In a national class action that was adjudicated in Georgia, for example, the main beneficiaries were Georgia charities.[66]

Unfettered judicial discretion leads to yet another difficulty with the *cy pres* doctrine. The lucrative awards induce associations – particularly charitable arms of bar association – to lobby themselves as potential beneficiaries of *cy pres* grants.[67] Expenses made to publicize legal aid societies might be privately efficient, as they increase the odds of winning a *cy pres* grant, but from a social perspective this race is a pure waste.[68]

Moreover, even what seems as the greatest promise of *cy pres* grants – the ease of administrating them – is not wholly fulfilled. First, careful judges do not choose beneficiaries at their whim. Rather, they invite charitable associations to apply and hold

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[62] "[*C*]y *pres* grants in several recent cases have gone to advocacy groups that count among their board members the same plaintiffs' attorneys who negotiated the fluid recovery settlement" (S. Gale Dick, *Fluid Recovery: Flexible Ways to Settle Cases*, 13 ALTERNATIVES TO HIGH COST LITIG. 73 (1995)). No wonder, then, that these groups have been lobbying legislatures to institutionalize the *cy pres* mechanism. Indeed, some states have enacted new statutes accordingly (*see*, Adam Liptak, *Doling Out Other People's Money*, N.Y. TIMES, November 26, 2007).

[63] Diamond Chem. Co., v. Akzo Nobel Chems. B.V., No. 01-2118, 2007 U.S. Dist. LEXIS 49406 (D.D.C. July 10, 2007). The *cy pres* grant was aimed at developing a Center for Competition Law at the George Washington Law School. For a more detailed description *see* Yospe, *supra* note 23, especially at 1028.

[64] Jois, *supra* note 22, at 266, refers to a similar example, in which plaintiffs' counsels – alumni of Vanderbilt Law School – recommended a *cy pres* award to Vanderbilt Law School, to establish a dispute resolution program.

[65] "[T]here is a tendency for charities located near the district in which the class action was filed to benefit disproportionately from *cy pres* distributions" (Yospe, *supra* note 23, at 1030).

[66] In re Motorsports Merchandise Antitrust Litigation, 160 F. Supp. 2d 1392 (N.D. Ga. 2001). In another illustrative decision from the Southern District of New York, the money was distributed to New York City organizations, though most of the members in the class were not from the New York City Metropolitan area (Jois, *supra* note 22, at 267(32), discussing Fears v. Wilhelmina Model Agency, Inc., 2005 WL 1041134, at 11 (S.D.N.Y. May 5, 2005), *vacated sub nom.* Masters v. Wilhemina Model Agency, Inc., 473 F.3d 423 (2d Cir. 2007)).

[67] *See* Yospe, *supra* note 23, at 1035-1036 for several examples of such lobbying behavior.

[68] *Cf.*, Jack Hirshleifer, *The Private and Social Value of Information and the Reward to Inventive Activity*, 61 AMER. ECON. REV. 561 (1971).

hearings in which the most appropriate associations have the opportunity to be heard.[69] Alternatively, careful courts can delegate the task of sorting beneficiaries to appointed committees.[70] A second source of administrative inefficiency stems from ongoing supervision – courts sometimes want to make sure that the chosen organization indeed uses the money to the broad benefits of class members.[71]

B. The Superiority of Reverse Sampling

Reverse sampling is superior to any existing mechanism to distribute the proceeds of low-value class actions. It achieves optimal deterrence, as the defendant has to fully bear the results of its wrongdoing; other proposals – reverting the money to the defendant and forcing price reduction – leave the defendant with some gain. Reverse sampling performs better than the pro rata distribution option – it has a greater administrative efficiency because it cuts the number of victims to whom money is transferred as well as the efforts to locate these victims.

Furthermore: reverse sampling compensates the victims, as each member of the class is entitled to an expected sum that is similar to his or her loss. Other mechanisms – notably, *cy pres* and escheat to the state – fail to do so. One might argue that

[69] The *cy pres* process in Superior Beverage Co. v. Owens-Illinois, Inc., 827 F. Supp. 477, 478 (N.D. Ill1.9 93), followed this prescription. First, notice was published (including in the Wall Street Journal). The court indeed received applications and then held hearings for an entire day. *See*, Yospe, *supra* note 23, at 1053-1054.

[70] *See, e.g., In re* Folding Carton Antitrust Litig., 744 F.2d 1252, 1253 (7th Circ. 1984) (appointing an "Administrative Committee," composed of counsels for the parties as well as an independent member). For a more detailed discussion *see* Yospe, *supra* note 23, at 1055.

[71] In one *cy pres* case, for example, the court divided the money between several charitable organizations, holding that "[a]fter the initial distribution, additional distributions will be contingent upon achievement. Each entity will provide the Court in an annual report, with information detailing what the project has accomplished and the Court will retain jurisdiction over this aspect of the lawsuit" (Fears v. Wilhelmina Model Agency, Inc., 2005 WL 1041134, at 11 (S.D.N.Y. May 5, 2005), *vacated sub nom.* Masters v. Wilhemina Model Agency, Inc., 473 F.3d 423 (2d Cir. 2007)). Ongoing supervision is especially likely where courts use the *cy pres* grants to create new organizations. *See*, S. Gale Dick, *Fluid Recovery: Flexible Ways to Settle Cases*, 13 ALTERNATIVES TO HIGH COST LITIG. 73 (1995).

compensation is not an important goal in low value claims. This argument might well be true. But even if compensation is not an important goal in itself, compensating the victims has important instrumental advantage – it allocates the money impartially and avoids perverse incentives. When a third party – be it the government or a charity organization – sees a huge windfall, it is likely to change its behavior accordingly. These distortions do not occur when the money is conveyed to where it belongs – the victims.

Compared to the increasingly popular *cy pres* method, the superiority of reverse sampling is particularly salient. Where the *cy pres* doctrine fails to pay class members, creating unfettered judicial decision-making, the reverse sampling method mandates courts to transfer the proceeds to the victims. Where the *cy pres* doctrine wastes judicial time and encourages charities to compete for windfalls, reverse sampling avoids perverse incentives. The following table sketches superiority of reverse sampling vis-à-vis existing mechanisms:

Table 2: The Superiority of Reverse Sampling

	Deterrence	*Administrative Efficiency*	*Judicial Decision-making*	*Third Party Beneficiary*	*Compensating the Victims*
Reversion to defendant	Incomplete	High	Mechanical	No	No
Pro rata distribution	Yes	Moderate[72]	Some discretion[73]	No	Yes (expected award)[74]
Escheat to the state	Yes	High	Mechanical	Yes	No
Price reduction	Depends[75]	High	Requires expertise[76]	No	Partially[77]
Cy pres	Yes	High	Unfettered	Yes	No
Reverse sampling	Yes	High	Mechanical	No	Yes (expected award)

The following paragraphs delineate paradigmatic cases in which reverse sampling is beneficial.

III. PARADIGMATIC REVERSE SAMPLING CASES

The reverse sampling method cuts the costs of awarding money to the victims. There are at least three possible sources of these costs: handling the payment, locating the victims, and proving their claim.

[72] *See supra* notes 28-29 and the accompanying text.
[73] As to the number and depth of distribution phases required. *See supra* note 29 and the accompanying text.
[74] *See* also *supra* notes 31-32 and the accompanying text regarding the unfair windfall to some plaintiff that this method creates. *See* also *infra* notes 115-117 and the accompanying text.
[75] *See supra* note 46.
[76] *See supra* note 44 and the accompanying text.
[77] Depends on prospective customers – to the extent they are likely to be the same previously injured plaintiffs, the price reduction scheme is more compensatory.

A. High Handling Costs

This paradigmatic case is similar to the aforementioned numerical example. All victims are known, but awarding them the money entails some constant costs per claim (*e.g.*, verifying the claim, or handling the forms and mailing a check). When these costs compose a non-trivial portion of the individual awards – as it is common in low-value claims – reverse sampling is beneficial.

B. High Search Costs

In this paradigmatic case, victims are not easily identified:

> A small hotel chain charged each customer excessive fee in the amount of $2. Customers are not readily known. But the hotel can identify them through a costly process (*e.g.*, tracking the credit cards used to pay for the hotel). Normally, these per-claim identification costs surpass individual awards, and courts would have turned to one of the aforementioned existing methods. Rather, courts should use reverse sampling. They can do so by paying damages, for examples, only to the customers in a certain, random, day.[78]

Similar to the first paradigmatic case, the high administrative costs relative to the individual award prohibit traditional compensation. In this second case the administrative costs stem for the need to identify class members, rather than handling the payment. In both cases reverse sampling is superior to other existing mechanisms.

1. A Note on the Differences Between Reverse Sampling and Pro Rata Distribution

At first blush, the two distribution schemes might look similar: some class members receive the entire fund, while others get nothing. In both, one might argue that some class members receive an unfair "windfall." However, the two methods diverge, conceptually and practically.

[78] This example draws on *In re* Hotel Telephone Charges, 500 F.2d 86 (9th Cir.1974).

The purpose of pro rata distribution is distributing individual claims to as many class members as possible. The search for class members is not-random; rather, it is based on cost-effectiveness – how to locate the largest number of plaintiffs with the cheapest expenses. The purpose of reverse sampling, in contrast, is distributing more money to fewer members. In fact, reverse sampling repudiates too extensive a distribution – when too many members receive compensation, more is spent on administrative costs (per award), and class members' preferences for risky gamble are not satisfied.[79]

Practically, a court that adheres to the ALI instructions and implements the pro rata approach should take all economically viable measures to locate as many class members as possible.[80] First, typically, letters are sent; if participation is low, courts can use "publication, posting, public service announcements, or other means, apart from individual mailed notices."[81] To further identify silent members, "courts may . . . direct . . . class counsel or a settlement administrator . . . to try to locate . . . class members by referring to public records such as driver registrations or Social Security records, by checking telephone directories, by hiring professional locator services, or by other means."[82] These efforts are costly. Often, they are also useless. One court describes this process in the following terms:

[79] Decision-makers tend to be risk-seeking as to low probability gains; however, they become risk-averse as to moderate-to-high probability gains (Guthrie, *supra* note 8, at 179-180). When more plaintiffs are awarded, the odds of winning the "lottery" become higher, and risk-preferences might flip. It is common to treat 10% as low probability (*see supra* note 9 and the accompanying text). Hence, a wider distribution scheme is futile from the reverse sampling perspective.
[80] *See supra* note 27.
[81] Rubenstein, Conte and Newberg, *supra* note 45, at § 10:14.
[82] Rubenstein, Conte and Newberg, *supra* note 45, at § 10:14.

> "Consistent with the premise articulated by the American Law Institute, this Court and the Fund Administrator exhausted every possible avenue to distribute funds to aggrieved [plaintiffs]. While the first distribution phase resulted in a significant response rate-44%-and the Fund Administrator distributed $284,919,173, representing 66% of the Distribution Fund, this Court determined that more could be done. As a result, a second distribution phase employed targeted outreach aimed at increasing the number of [plaintiffs] filing claims. This additional effort yielded 10,299 additional claims, leading to the distribution of another $92,956,548 to aggrieved [plaintiffs]. In everyone's estimation, the law of diminishing returns suggests the game is no longer worth the candle" (S.E.C. v. Bear, Stearns & Co. Inc. 626 F.Supp.2d 402, 417 (S.D.N.Y. 2009).

Reverse sampling envisions a different process. The number of identified class members is irrelevant, and these costly, recurrent search efforts are saved. Rather, reverse sampling emphasizes randomness – it is perfectly fine to locate a small, random, sample of class members, to which the entire fund is funneled.

In addition to administrative saving, the use of reverse sampling in lieu of pro rata distribution potentially mitigates another concern. As mentioned, the pro rata distribution is sometimes perceived as unfair, as it leaves the plaintiffs that were located with a "windfall" whereas silent plaintiffs get nothing.[83] This perception of unfairness makes some sense, as the court essentially prefers class members who are easier to locate – perhaps the more informed ones, who read the right newspapers and websites – at the expense of the hard-to-reach/non-informed members. Reverse sampling does not discriminate between class members on the basis, for example, of their access to information about the action – "[r]andom decision mechanisms are the embodiment of fair allocation procedures."[84] Hence, reverse sampling is likely to raise fewer concerns about unfair "windfall" to proactive, informed class members.

[83] *See supra* note 31-32 and the accompanying text.
[84] Felix Oberholzer-Gee, Iris Bohnet, Bruno S. Frey, *Fairness and competence in Democratic decisions*, 91 PUBLIC CHOICE, 89, 89 (1997).

Of course, the distinction just made between pro rata distribution and reverse sampling is not clear-cut; rather, the choice of distribution mechanism in actual cases is more likely to reflect a continuum between reverse sampling and pro rata distribution. And, on the margin, there might be distribution schemes which resemble both – very few beneficiaries, one-shot search of plaintiffs, etc. Moreover: courts that do take the pro rata approach should make it as close as possible to reverse sampling. The search of class members, for example, should not strive to reach maximum quantity; and it should be based, as much as possible, on random characteristics (*e.g.*, all the consumers in a certain day, all purchasers in a certain store etc.[85]).

C. High Proof Costs

In this paradigmatic case the victims have to bear high per-claim costs in order to receive compensation:

> A car manufacturer repainted used car and sold them anew to known and identified consumers. Damages are small in size – $500 on average – and range between $0 and $1000. To prove damages, class members have to provide expert appraisal opinion, which costs several hundred dollars. Very few consumers find it valuable to come forward and prove their claims. Reverse sampling can rectify this state of affairs, randomly choosing some victims, and awarding them the appropriate multiplier of their damages.[86]

This paradigmatic case is similar to the previous ones, in the sense of high administrative per-claim costs relative to the individual award. Unlike the two previous paradigmatic examples, the constant per-claim costs are borne by class members who

[85] Where the pool of targeted class members is smaller, the court can employ more sophisticated and costly (per claim) search efforts. For examples of such more extensive search efforts *see supra* note 82 and the accompanying text.

[86] This example draws on BMW of North America, Inc. v. Gore, 517 U.S. 559 (1996). This paradigmatic application of the reverse sampling method is akin, in a way, to punitive damages – few victims win inflated awards. However, unlike punitive damages, the non-chosen victims get nothing.

have to prove their damages (in previous examples the administrative costs are borne by the fund itself).

Courts frequently require class members to prove their claims.[87] Proof requirement range from filing a statement,[88] to affidavits, purchase records and so on.[89] Oftentimes, many class members – particularly those with the smaller claims – do not find it in their interest to bear the costs of proving their claim.[90] In that case, some individual awards are left unclaimed. The reverse sampling can solve the problem by awarding more money to fewer claimants, making it valuable for the small-award plaintiffs to prove their claim as well.[91]

IV. POTENTIAL OBJECTIONS TO THE REVERSE SAMPLING MECHANISM

Several objections can be leveled against the reverse sampling mechanism. At best, however, they just limit the set of circumstances in which reverse sampling should be applied.

A. The Practical Scope of Reverse Sampling

One Objection is related to the practical scope of reverse sampling. Should it be limited to low-value claims? What are low-value claims? The reverse sampling logic

[87] Rubenstein, Conte and Newberg, *supra* note 45, at § 10:14. Note that this state of affairs, in which class members are required to prove their individual awards, is independent of the aggregate determination of damages. Damages are often determined based on average, aggregate evidence, similar to the car manufacturer example (*see* the cases cited in Rubenstein, Conte and Newberg, *supra* note 45, at § 10:5(1)). Once the court determines total damages, however, it has to distribute them, and here the court might require individual damages.

[88] *Id.*, at § 10:14.

[89] Rubenstein, Conte and Newberg, *supra* note 45, at § 10:12.

[90] "Experience has demonstrated that persons with modest or nominal individual potential recoveries will not bother to file a proof of claim" (Rubenstein, Conte and Newberg, *supra* note 45, at § 8:41).

[91] Similarly, the reverse sampling is valuable even where all class members find it economically viable to prove their claims (*e.g.*, the cost of proving the claim is lower than the smallest claim). In that case, the fact that only a small random sample of plaintiffs is entitled to come up and prove their claim raises the expected value of each individual claim.

applies to both low and high value claims – paying to some plaintiffs more money is more efficient than paying to all plaintiffs less money. However, high value claims compose a non-trivial portion of one's wealth. In these circumstances, and to the extent that there is no prior insurance available, individual insurance considerations should be taken into account, and these claims might not be appropriate for the reverse sampling method. Low value claims, however, have a meager effect on one's wealth; hence they should benefit the most from reverse sampling. Courts should use their discretion to determine "low-value" claims, in the same way they currently decide whether to use *cy pres* mechanisms should be employed or not.

B. Fairness, Lotteries and the Legal Process

Another possible objection refers to the inequality among plaintiffs – some plaintiffs gain more, while others receive nothing. However, plaintiffs are treated equally – they all receive exactly the same expected award. In fact, as aforementioned,[92] the very use of random sampling eliminates arguments regarding unfairness, for example, between silent and proactive plaintiffs. "None of the personal characteristics that typically interfere with decision processes . . . enter procedures based on chance . . . The rich and the powerful do not have any better chances than the poor and the humble."[93] Indeed, lotteries embody blind justice.[94] In a well known decision, *United States v. Holmes*,[95] the

[92] *See supra* notes 83-84 and the accompanying text.
[93] Oberholzer-Gee, Bohnet, & Frey, *supra* note 84, at 89.
[94] The potential use of lotteries to achieve justice has attracted previous literature. Jens Timmermann, for example, suggests using a weighted lottery as a fair and non-consequentialist solution to a longstanding philosophical question – whether to save the many or the few from dying (Jens Timmermann, 64 *Analysis* 106 (2004)). Akhil Amar proposes choosing representatives by lottery voting to create "a richer democracy" in which each person truly has one vote (Akhil Reed Amar, *Choosing Representatives by Lottery Voting*, 93 Yale L. J. 1283, 1283 (1984)).
[95] 26 F.Cas. 360 (Circuit Court, E. D. Pennsylvania. 1842).

court convicted a crewman for not using a lottery to determine which passengers would be sacrificed to save a ship:

> "When . . . a sacrifice of one person is necessary to appease the hunger of others, the selection is by lot. This mode is resorted to as the fairest mode, and, in some sort, as an appeal to God, for selection of the victim . . . we can conceive of no mode so consonant both to humanity and to justice . . . In no other than this or some like way are those having equal rights put upon an equal footing, and in no other way is it possible to guard against partiality and oppression, violence and conflict."[96]

As lotteries are "the fairest mode," what can be argued against their use in distributing the proceeds of low-value class actions? Lotteries have several drawbacks; and even more so, criticism can be raised against the very use of lotteries in judicial decision-making.

1. A Note on Lotteries in Legal Decision-making

Lotteries have been used throughout the history in various legal, political and social contexts.[97] In particular, "random lotteries . . . tend to be used to distribute goods or obligations for which equal division among all participants is not practicable, and when there is no clear alternative distribution criterion."[98] Not only are they fair mode of

[96] *Id.*, at 367.

[97] "Oil drilling leases, cellular telephone licenses, military draft, jury duty, and baggage inspection at the Mexican border are all assigned by using lotteries" (Oberholzer-Gee, Bohnet, & Frey, *supra* note 84, at 89). Lotteries are used as a tie-breaker in mayoral elections. In one town in California in 2002, lottery determined the winner of tied elections, with "[n]o costly run-off elections, no appeals to the courts, just a cut of the cards. What could be fairer?" (Gary E. Bolton, Jordi Brandts & Axel Ockenfels, *Fair Procedures: Evidence From Games Involving Lotteries*, 115 THE ECONOMIC JOURNAL 1054, 1055(5) (2005) (citing the CBS News)). Past republics, *e.g.*, Athens and the Venetian Republic, used lotteries to appoint official to governmental positions (Amar, *supra* note 94, at 1289-1290). Other examples of the institutional use of lotteries include: allocation of scarce medical resources, regulating inheritance, admission to schools, enforcement, entitlement to public housing (JON ELSTER, SOLOMONIC JUDGMENTS 62-62 (1989)).

[98] Gary E. Bolton, Jordi Brandts & Axel Ockenfels, *Fair Procedures: Evidence From Games Involving Lotteries*, 115 THE ECONOMIC JOURNAL 1054 (2005).

distributing scarce resources, lotteries can mitigate the risk of corruption,[99] and reduce participants self-interest.[100]

Notwithstanding, the use of lotteries in these contexts have several drawbacks. Here are the main ones. First, the use of lotteries might imply that a certain decision is not amenable to a reasoned determination.[101] The perception of unreasoned decision-making might harm judicial legitimacy.[102] Moreover, the use of lotteries creates an appearance of impartiality, and enables decision-makers to relinquish their responsibility to take tough, substantive decision.[103] Examples of attempts to mask or avoid substantive decision-making might include the diversity visa lottery,[104] race-neutral law school admission lotteries,[105] and death penalty commutations.[106] A related point is accountability – it is hard to monitor random determinations and rotated decision-

[99] "[A] lottery principle might be introduced . . . in order to improve the workings of the free market by preventing graft, kickbacks and other forms of underhand dealing [*e.g.*, broadcasting licences and oil drilling franchises]" (BARBARA GOODWIN, JUSTICE BY LOTTERY 169 (1992)). "Random selection prevents officials from using their discretionary power to play favorites, punish enemies, enrich themselves or simply bask in the arbitrary exercise of power [and] prevents potential appointees or recipients from bribing and threatening officials" (Elster, *supra* note 97, at 111).

[100] *See, e.g.*, Elster, *supra* note 97, at 87 ("[p]erhaps the main argument for lottery voting is that it reconciles honesty with self interest").

[101] "[T]he use of lotteries to resolve decision problems under uncertainty presupposes an unusual willingness to admit the insufficiency of reason. Usually, we do not want to cope with indeterminacy, but to avoid it" (Elster, *supra* note 97, at 38).

[102] *See* Elster, *supra* note 97, at 102 (In legal contexts . . . 'random' is often synonymous with 'whimsical', 'capricious' and 'arbitrary'"). Whether public perceptions dislike random decision-making on these grounds is an empirical question. There are good reasons to believe that accurate judicial decision-making is not highly valued – *e.g.*, litigants almost always prefer to settle (*see* generally LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE 248-275 (2002)).

[103] *See* Carol Necole Brown, *Casting lots: the illusion of justice and accountability in property allocation*, 53 BUFF. L. REV. 65, 73 (2005) ("[e]ssentially, casting lots obscures the decision to avoid making difficult choices"). Elster, *supra* note 97, at 99 (due to the use of lotteries "each case might be less carefully considered [by judges and jurors]").

[104] "Lottery visas look neutral. Nevertheless, a closer look reveals a fiery debate on their motivation and impact" (Liav Orgad & Theodore Ruthizer, *Race, Religion and Nationality in Immigration Selection: 120 Years after the Chinese Exclusion Case*, 26 CONSTITUTIONAL COMMENTARY 237, 290 (2010); *see* also Stephen H. Legomsky, *Immigration, Equality and Diversity*, 31 COLUM. J. TRANSNAT'L L. 319 (1993)).

[105] "The District Court took the Law School to task for failing to consider race-neutral alternatives such as 'using a lottery system' . . . But . . . *a lottery would make that kind of [required] nuanced judgment impossible*" (Grutter v. Bollinger, 539 U.S. 306, 340 (2003) (emphasis added)).

[106] *See* Daniel T. Kobil, *Due Process in Death Penalty Commutations: Life, Liberty, and the Pursuit of Clemency*, 27 U. RICH. L. REV. 201, 216 (1993).

makers.[107] Finally, lotteries might be an inefficient mechanism of allocating resources – they infringe the principle that entitlements should be distributed to those who value them the most.[108]

In the very context of reverse sampling – *i.e.*, distributing the proceeds of low-value class actions – these arguments appear weak. First, lotteries are widely perceived as a fair allocation procedure,[109] and can even substitute for a fair outcome.[110] Hence, the use of a lottery to allocate the proceeds of low value class actions can enhance public legitimacy. Second, the use of lotteries in this procedural, technical context masks no substantive decision-making. On the contrary, it fulfills the very principle that the money belongs to the members of the class.[111] Similarly, the use of lotteries in this procedural context does not make courts unaccountable – they are fully responsible for their substantive decision to impose liability. In contrast, the use of lotteries guarantees mechanical procedural decision-making, free of biases and favoritism. Finally, lotteries in this context do not interfere with allocative efficiency. In sum, while the use of lotteries might be problematic in substantive decisions, the technical distribution method proposed here should not raise these concerns. The use of lotteries in the determination of substantive rights is one thing, and the use of lotteries in the technical allocation of previously determined rights is another thing.

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[107] *See* Elster, *supra* note 97, at 92.

[108] Elster, *supra* note 97, at 117 (lotteries serve as a costless substitute for optimal decision-making). A notable example might be random military draft, which fail to consider allocative efficiency. An anecdotal example from the seventeenth century is the random appointment of professors to various subjects, which "resulted in the great mathematician Jakob Bernoulli teaching medicine instead of mathematics for quite some time" (Oberholzer-Gee, Bohnet, & Frey, *supra* note 84, at 89-90). However, where the randomly distributed entitlements can be costlessly traded, "there is not even a loss in allocative efficiency" (Oberholzer-Gee, Bohnet, & Frey, *supra* note 84, at 89).

[109] *See supra* notes 92-96 and the accompanying text.

[110] *See* the experimental games in Gary E. Bolton, Jordi Brandts & Axel Ockenfels, *Fair Procedures: Evidence From Games Involving Lotteries*, 115 THE ECONOMIC JOURNAL 1054 (2005).

[111] For this principle *see, e.g.*, the ALI draft, *supra* note 25.

Above all, the use of lotteries to allocate the proceeds of low-value class actions is appropriate compared to the alternatives. Jon Elster discusses alternative modes of decision-making where a good cannot be divided without a loss of value, and his typology is illustrative of low-value claims. One distribution approach Elster discusses is "absolute equality."[112] Alas, this equality comes at the expense of efficiency – where "cutting a child in two would reduce its value to nothing,"[113] each member prefers a random decision-making, "substituting equality of chance for equality of outcomes."[114] This absolute equality method – which exalts formal equality among class members – forms the theoretical basis of the traditional distribution approach, and dictates the principles behind the ALI draft. There are all reasons to think that class members would prefer, ex-ante, lotteries to formal equal distribution, *i.e.*, "cutting a child [and] reduce its value."

Another approach that Elster discusses is "queuing" – *i.e.*, the scarce resources are distributed on a first-come-first-serve basis.[115] This method is close to pro rata distribution, where the court locates only a small proportion of the members of the class. Elster is inconclusive with regard to this mechanism. It is more acceptable where the order of the queue is based on some reasonable, substantive policy considerations; or when the queue is close to a "natural lottery," *i.e.*, the order reflects a random process.[116] The current pro rata distribution doctrine reflects a preference for informed, proactive

[112] Elster, *supra* note 97, at 69.
[113] *Id.*, at 70.
[114] *Id.*, at 69.
[115] *Id.*, at 71.
[116] "For a queue to be assimilable to a natural lottery, it must be organized in a way that does not waste resources, and the order in which people enter the queue should reflect a truly random process" (*Id.*, id.).

class members at the expense of silent ones.[117] If anything, a more random process would be more publicly acceptable.

C. *Other Considerations*

One may also argue that compensation should be decoupled from deterrence, *i.e.*, class action proceeds should not be given to class members. There are two main reasons for decoupling damages. First, consumers do not want to pay more and insure themselves against several risks that are currently compensated, such as pain and suffering.[118] Second, a decoupled system maintains the victims' incentives to take appropriate precautions.[119] However, these considerations are generally irrelevant to low-value class actions, which do not typically implicate pain and suffering awards, and in which the victims' precautions usually have no bearing on the scope of damages.

* * *

These potential arguments cannot undermine the justifications for reverse sampling. At best, they should limit its scope. Moreover, there should be a presumption in favor of compensating the victims in these cases, preferably through reverse sampling for the reasons already stated (mainly, cutting administrative costs). In particular, as the foregoing discussion demonstrates, compensating the victims makes sense for several instrumental reasons. First, in this kind of low-value claims, it is plausible to believe that class members cannot affect the harm. Hence, class members' ex-ante incentives are irrelevant. Second, class members' expected recovery is very small; thus, awarding them the proceeds should not affect optimal deterrence. In contrast, granting the money to the

[117] *See supra* notes 79-85 and the accompanying text.
[118] Robert Cooter, *Towards a Market in Unmatured Tort Claims*, 75 VA. L. REV. 383 (1989).
[119] *Cf.*, Robert D. Cooter & Ariel Porat, *Anti-Insurance*, 31 J. LEGAL STUD. 203 (2002).

government distorts governmental enforcement incentives. Third, compensating the victims restrains the court's freedom to dole out the money to other parties.[120] In sum, awarding the money to class members is the most neutral and impartial distribution, and it is instrumentally superior to other options.

V. CONCLUSIONS

The normative prescriptions of this paper are clear and simple: when individual distributions are sufficiently low with respect to the efforts needed to identify class members, courts should distribute the proceeds to randomly selected small fraction of the class – what I dub as "reverse sampling." This proposal is practical, and does not require any legislative change. Rather, it uses the equitable powers courts already employ when they award *cy pres* grants.

The thrust of the reverse sampling argument is the high per-claim costs required to distribute the money back to the victims. It might be that with sufficiently good technology, per-claim distribution costs will be virtually zero. In that case, reverse sampling loses its appeal. Alas, oftentimes per-claim distribution costs are prohibitively high. In these situations, as the paper demonstrates, reverse sampling performs better than any existing solution to the problem of low-value class actions – it directs the money to the group of plaintiffs, satisfies their risk-preferences, and cuts administrative costs.

[120] Which also prevents a wasteful race to the court (*see supra* note 68 and the accompanying text).