

# Italy's Class Action Experiment

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## Introduction

In July 2007, a group of Italian investors sued an Italian dairy and food corporation, Parmalat Finanziaria S.p.A. (Parmalat), under the Securities and Exchange Act for damages sustained as a result of massive fraud.<sup>1</sup> The alleged fraud occurred in Italy, but the Italian plaintiffs sued in federal district court in New York.<sup>2</sup> Why would Italian plaintiffs sue an Italian company in an American court for fraud that occurred in Italy? The answer is simple: in 2007, Italy did not allow class actions for damages,<sup>3</sup> and the projected cost of litigation relative to the expected recovery made

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1. *In re Parmalat Securities Litigation*, 497 F. Supp. 2d 526 (S.D.N.Y. 2007).

2. *See, e.g., id.* at 532 (noting that plaintiff did not allege that any fraudulent acts or omissions by Parmalat's auditors took place in the US). The threshold issue before the court concerned the extraterritorial limits of the application of the Securities and Exchange Act (SEA). *See id.* at 531. The court held that SEA did not apply, in part, because the alleged fraud took place abroad. *See id.* ("Conduct in the United States will support application of the securities laws only when 'substantial acts in furtherance of the fraud were committed within the United States.' . . . In contrast, 'where the United States activities are merely preparatory or take the form of culpable nonfeasance and are relatively small in comparison to those abroad,' the securities laws do not apply.").

3. *See, e.g.,* BEUC, Eur. Consumers' Org., Private Group Actions Taking Europe Forward: BEUC Reflections on a Future European Collective Redress Scheme for Individ-43 CORNELL INT'L L.J. 147 (2010)

the individual pursuit of the plaintiffs' claims against Parmalat financially unattractive.<sup>4</sup>

For over thirty years, this has been a somewhat common story<sup>5</sup> because, despite its pervasiveness in the United States, the class action, which allows individuals to sue not only for injury they suffer but also on behalf of other persons similarly injured, remains a "unique American legal institution."<sup>6</sup> If one believes Meglena Kuneva, the current European Consumer Commissioner, Europe has no intention to change that. The Commissioner predicts that the old continent will never "go down [the American class action] road" with its "toxic cocktail" of contingency fees, punitive damages, and pretrial discovery.<sup>7</sup> However, a growing movement toward private enforcement of consumer protection laws in the majority of European countries tells a different story.<sup>8</sup> This Note analyzes the development of the Italian class action system from its inception in the original draft legislation of 2007 (Original Draft)<sup>9</sup> to the final version enacted into law in January 2010 (Final Draft).<sup>10</sup> The Note concludes that these two sequential attempts to produce a workable opt-in model for class action fail.

The analysis in the Note develops in four stages.<sup>11</sup> First, I demon-

nal Damage Claims 24-25 (Aug. 26, 2008) [hereinafter BEUC Reflections] (discussing the development of Italy's approach to collective actions for damages).

4. See *Commission Green Paper on Consumer Collective Redress*, COM (2008) 794 final (Nov. 27, 2008), available at [http://ec.europa.eu/consumers/redress\\_cons/green-paper\\_en.pdf](http://ec.europa.eu/consumers/redress_cons/green-paper_en.pdf) ("Currently, when [European] consumers affected by a malpractice want to pursue a case, they face barriers in terms of access, effectiveness and affordability. This is particularly true for claims that involve small amounts. [One of] [t]he sectors in which consumers find it most difficult to obtain redress for mass claims are financial services (39% of documented cases) . . .").

5. See generally Iliana T. Buschkin, Note, *The Viability of Class Action Lawsuits in a Globalized Economy—Permitting Foreign Claimants to be Members of Class Actions Lawsuits in U.S. Federal Courts*, 90 CORNELL L. REV. 1563 (2005). The practice begins in *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 977-78 (2d Cir. 1975), where three non-U.S. citizens joined in a class action against a Canadian company for violation of the securities laws.

6. Richard B. Cappalli & Claudio Consolo, *Class Actions for Continental Europe? A Preliminary Inquiry*, 6 TEMP. INT'L & COMP. L.J. 217, 218 (1992).

7. Meglena Kuneva, Eur. Consumer Comm'r, Press Conference Speaking Points: "Green Paper on Consumer Collective Redress" (Nov. 27, 2008), <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/657>.

8. See, e.g., Edward F. Sherman, *Group Litigation Under Foreign Legal Systems: Variations and Alternatives to American Class Actions*, 52 DEPAUL L. REV. 401, 402 (2002) [hereinafter *Group Litigation*]; see also BEUC Reflections, *supra* note 3, at 21-28 (showing that as of January 1, 2008, fourteen of the twenty-seven European Union Members have some form of collective redress available).

9. See Legge 24 Dicembre, n. 244, art. 2, para. 445-449, Dec. 24, 2007, in Gazz. Uff. 12 Gennaio 2008, n. 8 [hereinafter Original Draft] (providing legal framework for collective actions in Italy).

10. See Legge 23 Luglio 2009, n. 99, art. 49, para. 14, in Gazz. Uff. 31 Luglio 2009, n. 176, Supplemento Ordinario, n. 136 [hereinafter Final Draft]. The final draft went into effect in January 2010.

11. An earlier version of this note was completed before the introduction of the final draft and focused exclusively on concerns about the original draft. The final draft confirmed the adequacy of this prior analysis insofar as it addressed some of the concerns

strate that the original draft was defective and would have proved ineffective in enforcing plaintiffs' rights. Second, I explain that the defects that are commonly associated with other European group litigation devices—lack of funding, insufficient plaintiff participation, and insufficient finality for class action defendants—did not affect the original draft. Third, I argue that the defect of the original draft consisted in the way in which it solved two of these problems: insufficient participation and insufficient finality. More specifically, the draft's restrictions on standing and its odd *res judicata* rule for class action judgments would have given rise to either underbidding settlement wars between class action representatives or collusive settlements between these representatives and defendants. In either case, the result would have been inadequate settlements and underenforcement of consumer rights. Fourth, I show that the final draft aims to address precisely these collateral costs, but, to the extent it succeeds, it threatens to reintroduce in the system the danger of insufficient plaintiff participation.<sup>12</sup> In ultimate diagnosis, the residual defects of the Italian system reveal an inherent flaw in the opt-in model for class participation.

The Note is organized in two parts. Part I introduces the original draft by comparing it with other European group litigation devices and the American class action system. Part II identifies the original draft's shortcomings as a tool for enforcing plaintiffs' rights, explains the way in which the final draft addresses these shortcomings, and concludes with a list of residual concerns.

Why is this topic important? Despite its inadequacies, the new Italian system finally brings American-style class action to Europe. This is good news for both Italian and American consumers: as courts in Italy, and more broadly in Europe, enforce class action judgments rendered by Italian courts, they will become more hospitable to enforcing class action judgments rendered in American courts.<sup>13</sup> At least, the philosophical justification for closely scrutinizing American class action judgments in European courts stands to lose its main purchase.<sup>14</sup>

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about the original draft. The last section of this note discusses a new set of problems created by the final draft.

12. The final draft went into effect in January 2010.

13. See Richard H. Dreyfuss, *Class Action Judgment Enforcement in Italy: Procedural and "Due Process" Requirements*, 10 *TUL. J. INT'L & COMP. L.* 5, 7 (2002) ("Foreign courts are more likely to scrutinize the procedural aspects when presented with American judgments resulting from class actions because the procedure is unique and, to most legal practitioners in the rest of the world, largely unfamiliar."). This is especially true for judgments that do not involve punitive damages. See Michele Taruffo, *Some Remarks on Group Litigation in Comparative Perspective*, 11 *DUKE J. COMP. & INT'L L.* 405, 414 (discussing European jurisdictions' discomfort with punitive damages).

14. See Cappalli & Consolo, *supra* note 6, at 264 (discussing the philosophical reservations that the Europeans harbor about the American class action).

## I. Introducing the Italian Class Action System

### A. Previous Studies on Group Litigation Devices in Europe and Methodology

In the last decade, the European movement toward establishing group litigation devices for private enforcement of consumer rights has fascinated American scholars.<sup>15</sup> One explanation for this is simple. As Professors Issacharoff and Miller explain, “[f]or countries steeped in the civil law tradition, the move away from centralized public enforcement is a sea change in legal structures.”<sup>16</sup> For a long time, the Europeans have considered the American class action system to be philosophically troubling,<sup>17</sup> legally untidy,<sup>18</sup> and practically perverse.<sup>19</sup> But in the last decade this attitude has changed; there is an emerging consensus among European legislatures and legal scholars that, in one form or another, group litigation is necessary to deal with numerous consumer injuries that arise in the context of mass production and global markets.<sup>20</sup> The consensus has led to experimentation with various group litigation devices that differ fundamentally with the American class action system.<sup>21</sup>

Previous comparative studies have focused on these differences.<sup>22</sup> This Note shifts the focus to a comparison between the Italian class action regime and other group litigation devices already implemented in Europe.<sup>23</sup> It demonstrates that the Italian experiment is a significant advance by explaining how close it comes to a full-blown, American-style class action.<sup>24</sup>

Many previous studies have also looked at group litigation in Europe from a level of generality that allows for an understanding of its signifi-

15. See, e.g., Samuel P. Baumgartner, *Class Actions and Group Litigation in Switzerland*, 27 NW. J. INT'L L. & BUS. 301 (2007); Cappalli & Consolo, *supra* note 6; Richard Cappalli, *The Style and Substance of Civil Procedure Reform: Comparison of the United States and Italy*, 16 LOY. L.A. INT'L & COMP. L. REV. 861 (1994); Mauro Cappelletti, *Governmental and Private Advocates for the Public Interest in Civil Litigation: A Comparative Study*, 73 MICH. L. REV. 794 (1975); P. H. Lindblom & G. D. Watson, *Complex Litigation - A Comparative Perspective*, 12 C. J. Q. 33 (1993); Harald Koch, *Non-Class Group Litigation Under EU and German Law*, 11 DUKE J. COMP. & INT'L L. 355 (2001); Thomas D. Rowe, Jr., *Debates Over Group Litigation in Comparative Perspective: What Can We Learn From Each Other*, 11 DUKE J. COMP. & INT'L L. 157 (2001); Edward F. Sherman, *From “Loser Pays” to Modified Offer of Judgment Rules: Reconciling Incentives to Settle with Access to Justice*, 76 TEX. L. REV. 1863 (1998) [hereinafter *Loser Pays*]; *Group Litigation*, *supra* note 8; Gerhard Walter, *Mass Tort Litigation in Germany and Switzerland*, 11 DUKE J. COMP. & INT'L L. 369 (2001).

16. See Samuel Issacharoff & Geoffrey P. Miller, *Will Aggregate Litigation Come to Europe?*, 62 VAND. L. REV. 179, 180 (2009).

17. See Cappalli & Consolo, *supra* note 6, at 219.

18. See Taruffo, *supra* note 13, at 414-17.

19. See Issacharoff & Miller, *supra* note 16, at 179.

20. See Kuneva, *supra* note 7 (discussing the necessity of a collective action mechanism).

21. See *infra* notes 76-92 and accompanying text.

22. See, e.g., sources cited *supra* note 15.

23. See *infra* notes 70-83 and accompanying text.

24. *Id.*

cance and breadth—the entire continent.<sup>25</sup> This Note takes a different approach. It looks at one European class action device in particular: Italy's new class action regime for damages.<sup>26</sup> To that extent, it sacrifices breadth for detail, but it does so for the purpose of highlighting the significance of the Italian experiment for the future of class action in Europe.

The Note differs from previous studies also with respect to methodology. The analysis focuses on the details of the Italian regime, not simply for the sake of comparison, but to predict the regime's efficacy as a tool for enforcing consumer rights and deterring future wrongful conduct.<sup>27</sup> The predictions rely on both classic armchair analysis and inferences from empirical studies on American class action practice. With these preliminaries out of the way, the next section places the Italian class action regime in the context of the recent European experiments with group litigation.

## B. The Philosophical and Legal Background of the Italian Class Action System

The new Italian class action regime that went into effect in January 2010 is the boldest step in the European Union movement to enforce consumer protection laws through group litigation devices.<sup>28</sup> Unlike other European group litigation devices, which “offer [ ] behavioral remedies backed up by meager monetary penalties,”<sup>29</sup> Italy's new law establishes a class action regime for *damages*.<sup>30</sup> This development moves Italy's private enforcement mechanism away from its continental counterparts and closer to the American-style class action system under Rule 23 of the Federal Rules of Civil Procedure<sup>31</sup> and similar state procedural devices.<sup>32</sup>

In the past, Italy, like other European countries, flirted with the idea of implementing a class action system, but ultimately found the institution “troubling.”<sup>33</sup> The concerns were, in part, practical in nature.<sup>34</sup> For example, a class action system would shrink the power of attorney requirement from all represented parties to the named party,<sup>35</sup> and it would require additional “management and sanctioning” authority for judges to handle the action at a reasonable pace.<sup>36</sup> These measures, in turn, were inconsis-

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25. See, e.g., Cappalli & Consolo, *supra* note 6; Cappelletti, *supra* note 15; Lindblom & Watson, *supra* note 15; *Group Litigation*, *supra* note 8; *Loser Pays*, *supra* note 15; Rowe, *supra* note 15. But see Baumgartner, *supra* note 15; Cappalli, *supra* note 15; Koch, *supra* note 15; Walter, *supra* note 15.

26. See *infra* text accompanying notes 58-75, 181-209.

27. See discussion *infra* Part II.B, C.

28. See Casey W. Halladay & Marco Amorese, *Halladay and Amorese on Understanding Italy's New Class Action Regime*, 2008 EMERGING ISSUES 2609, (Sept. 29, 2008) (LEXIS).

29. See *id.* at 3.

30. See Original Draft, *supra* note 9, art. 2, para. 446(1).

31. FED. R. CIV. P. 23.

32. See Cappalli & Consolo, *supra* note 6, at 257.

33. See *id.* at 219-20.

34. See *id.* at 261-62.

35. *Id.* at 261.

36. *Id.* at 262.

tent with the Italian law and would have required readiness on the part of the legislature to revamp the relevant procedural restrictions.<sup>37</sup>

Certain “conceptual and philosophic[al]” concerns, however, were the main stumbling block to the adoption of American-style class action in Italy, and more generally in Europe.<sup>38</sup> Prominent among these concerns was what some commentators call “the dogma of . . . ‘exaggerated individualism’.”<sup>39</sup> In the European procedural mindset, the individual whose rights are implicated must have control over the course of litigation.<sup>40</sup> Theoretically, the class action device, by its very nature, dilutes the control of the individual in favor of an abstract entity—the class of plaintiffs.<sup>41</sup> American practice shows that control over litigation shifts even further from the class itself to the attorney representing its interests.<sup>42</sup> This outcome conflicts with bedrock European beliefs about the *personal* nature of legal rights, and the limited and technical role of lawyers in the course of civil litigation.<sup>43</sup>

Professor Koch highlights a different explanation for the European resistance to American-style class action.<sup>44</sup> Europeans “entrust the public interest to public institutions rather than to private law enforcers,” like the class action plaintiff.<sup>45</sup> Recent reforms in some European countries illustrate Europe’s continued preference for a top-down legislative approach to the expeditious resolution of large numbers of related claims for damages.<sup>46</sup>

European’s distrust of class actions also flows from what can be fairly described as guilt by association. Europeans often associate the American class action system with its financing mechanism—the contingency fees for plaintiffs’ attorneys.<sup>47</sup> Contingency fees continue to be illegal in most European countries, and they sit badly with the understood role of the lawyer as a “technical auxiliary” rather than a player with a profit-making interest in the outcome of the litigation.<sup>48</sup>

37. See *id.* at 261.

38. See *id.* at 219, 263; see also Koch, *supra* note 15, at 357–58.

39. See Cappalli & Consolo, *supra* note 6, at 264.

40. See *id.*

41. See John C. Coffee, Jr., *Understanding the Plaintiff’s Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 678 (1986) [hereinafter *Understanding the Plaintiff’s Attorney*] (“[I]n the context of class and derivative actions, it is well understood that the actual client generally has only a nominal stake in the outcome of the litigation.”).

42. See generally John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877 (1987) [hereinafter *Entrepreneurial Litigation*] (arguing that clients have no actual control over the class action attorney in large class action litigation).

43. See Cappalli & Consolo, *supra* note 6, at 275, 290.

44. See Koch, *supra* note 15, at 357–58.

45. *Id.* at 358.

46. See Issacharoff & Miller, *supra* note 16, at 182, 208–09; see also *infra* notes 87–88 and accompanying text (discussing so-called “funds solutions”).

47. Kuneva, *supra* note 7.

48. See Cappalli & Consolo, *supra* note 6, at 290.

Despite these philosophical misgivings, in 1998, the European Commission issued a directive compelling member states to adopt legislation that would allow “qualified entities”<sup>49</sup> to seek injunctive relief on behalf of a class of consumers for violations of European Union consumer protection laws.<sup>50</sup> Italy first implemented the directive by allowing consumer protection organizations that were registered with the Ministry of Economic Development<sup>51</sup> to act as plaintiffs in actions to enforce the consumers’ “collective rights.”<sup>52</sup> “Collective rights” is a heterogeneous category that includes “the right to health protection, the right to the quality and safety of products, the right to receive adequate information, the right to be exposed to truthful advertisement, and the right to fairness and clearness in contracts.”<sup>53</sup> If the consumer organization succeeded in obtaining an injunction and the defendant failed to comply, the court could fine the defendant within a range set by law.<sup>54</sup>

In a nutshell, until recently, the group litigation system in Italy offered injunctive relief supported by minor fines but did not allow collective actions for *damages*.<sup>55</sup> Its short history has shown that the system does little to “encourage compliance by ‘deep pocket’ defendants” who can delay implementing the injunctions by simply paying the relatively meager penalties.<sup>56</sup> The case of Microsoft, which chose to pay €1 billion in penalties for abuse of dominant market position rather than comply with the injunction to disclose source codes, is a telling illustration.<sup>57</sup>

### C. The Elements of the Original Draft of the Italian Class Action System

At least in principle, the goal of the new Italian class action system is to offer a more deterrent alternative.<sup>58</sup> The main elements the system’s original draft can be grouped into five categories: (1) the requirements for standing; (2) the nature of admissible claims; (3) the notice requirements and class membership; (4) the trial process and the determination of damages; and (5) the *res judicata* effect of judgments.<sup>59</sup>

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49. See Council Directive 98/27, 1998 O.J. (L 166) 51 (EC). The directive defines “qualified entities” broadly as “any body or organization which . . . has a legitimate interest in ensuring” compliance with EU consumer protection provisions. *Id.* art. 3. The category includes both independent public bodies and private consumer protection organizations. See *id.*

50. See *id.* arts. 1–2.

51. Decreto Legislativo 6 Settembre 2005, n. 206, art. 37, in Gazz. Uff. 8 Ottobre 2005, n. 235 [hereinafter Legislative Decree].

52. *Id.* art. 139.

53. ELISABETTA SILVESTRI, CTR. SOCIO-LEGAL STUD., THE GLOBALIZATION OF CLASS ACTIONS: ITALIAN REPORT 6 (2007), available at [http://www.law.stanford.edu/display/images/dynamic/events\\_media/Italian\\_National\\_Report.pdf](http://www.law.stanford.edu/display/images/dynamic/events_media/Italian_National_Report.pdf).

54. Legislative Decree, *supra* note 48, art. 140(7). Fines range from \_516 to \_1,032 per day. *Id.*

55. See Halladay & Amorese, *supra* note 28, at 3.

56. See *id.*

57. See *id.*; Case T-201/04, Microsoft Corp. v. Comm’n, 2007 E.C.R. 4024.

58. See Halladay & Amorese, *supra* note 28, at 6.

59. See *id.* at 1; Original Draft, *supra* note 9, art. 2, para. 446(5).

First, consumer protection organizations registered with the Ministry of Economic Development that enjoyed standing in an action for injunction under the old system continued to have standing under the proposed law.<sup>60</sup> The proposed law, however, expanded standing to include other associations that were “adequately representative” (*adeguatamente rappresentativi*) of the collective consumer interests at stake.<sup>61</sup> This second category remained undefined.<sup>62</sup>

Second, as to the nature of admissible claims, a proponent with standing could bring a class action for damages whenever the collective interests of consumers were harmed by the defendant’s tortious conduct (*atti illecitti extracontrattuali*), unfair commercial practices (*pratiche commerciali scorrette*), or anticompetitive practices, (*comportamenti anticoncorrenziali*).<sup>63</sup> Based on these criteria, the court would determine in its initial hearing whether a claim was admissible.<sup>64</sup> The claim would be admissible unless it was “manifestly unfounded” (*manifestamente infondata*), there was a conflict of interest, or the court did not find a collective interest suitable for class representation.<sup>65</sup>

Third, once the proponent of the action convinced the court at the initial hearing that the claim was admissible, the proponent was responsible for publishing the contents of the claim in the media to notify potential members of their right to participate in the class.<sup>66</sup> From the time notice was published, through the appeals process, and up until the time of a dispositive ruling on the case, consumers who wished to participate could become class-members by communicating in writing to the proponent their decision to join the collective action.<sup>67</sup>

Fourth, if after trial the court ruled in favor of the class action plaintiff, it issued a declaratory judgment that prescribed the criteria under which damages for individual class members would be calculated.<sup>68</sup> Depending on the nature of the defendant’s acts, the court could also determine the “floor” recovery for class participants.<sup>69</sup> The defendant could make a payment proposal to the plaintiffs anytime within sixty days of issuance of the court’s declaratory judgment.<sup>70</sup> If the plaintiffs accepted the proposal, it would be binding.<sup>71</sup> If the defendant failed to make a proposal, or if the

60. Original Draft, *supra* note 9, art. 2, para. 446(1).

61. *Id.* art. 2, para. 446(2).

62. See Halladay & Amorese, *supra* note 28, at 4 (suggesting that the determination is made by the court).

63. Original Draft, *supra* note 9, art. 2, para. 446(1).

64. *Id.* art. 2, para. 446(3); see also Halladay & Amorese, *supra* note 28, at 4-5 (discussing the court’s “gatekeeper” function).

65. Original Draft, *supra* note 9, art. 2, para. 446(3). The phrase “manifestly unfounded” is the Italian procedural equivalent to the American 12(b)(6) mechanism of “failure to state a claim for which relief can be granted.” FED. R. CIV. P. 12(b)(6).

66. Original Draft, *supra* note 9, art. 2, para. 446(3).

67. See *id.* art. 2, para. 446(2).

68. *Id.* art. 2, para. 446(4).

69. *Id.*

70. *Id.*

71. *Id.*

plaintiffs rejected it, the case moved to a “chamber of conciliation” (*camera di conciliazione*)—a three-lawyer panel consisting of representatives from the plaintiff, the defendant, and the court.<sup>72</sup> The chamber of conciliation rendered a final and binding determination of damages for individual class members based on the criteria prescribed by the court in its declaratory judgment.<sup>73</sup>

Fifth, the *res judicata* provision for class action judgments distinguished between future individual actions and future collective actions against the same defendant. A class action judgment had no preclusive effect on *individual* actions by consumers who did not participate as class members or joined as independent parties before the final determination in the case.<sup>74</sup> But, the first class action judgment precluded future class actions brought against the same defendant on the same set of issues.<sup>75</sup>

#### D. A Comparison of the Original Draft with Other European Group Litigation Devices and the American Class Action System

Compared to other European group litigation devices, the original draft of the Italian class action system was similar to the Germanic *Verbandsklage*, or Public Interest Organization’s Action.<sup>76</sup> This kind of action is allowed in two categories of cases: (1) an organization can seek review of an executive agency’s decision on behalf of its members; or (2) consumer organizations can sue for declaratory relief or seek an injunction against businesses for misleading advertising or using unfair terms in their standard form contracts.<sup>77</sup> Unlike *Verbandsklage*, however, the original draft was more liberal on standing; organizations could sue on behalf of plaintiffs outside their membership, as long as the organization was adequately representative of those plaintiffs’ interests.<sup>78</sup> But more importantly, as to remedy, the organization was not limited to seeking declaratory relief or injunction and could bring an action for damages.<sup>79</sup>

It is true that other European group litigation devices provide relief in the form of damages. The prime example is the “model suit” created by the

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72. *Id.* art. 2, para. 446(6).

73. *Id.*

74. *Id.* art. 2, para. 446(5).

75. The final draft clarifies this point, which was left vague in the original draft. Final Draft, *supra* note 10, art. 49, para. 14.

76. See Walter, *supra* note 15, at 375–76 (describing the details of this type of collective action under Swiss and German law); see, e.g., Gesetz gegen den unlauteren Wettbewerb [Unfair Competition Act], June 7, 1909, RGBl. at 499 (F.R.G.); Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen [Standard Contract Forms Act], Dec. 9, 1976, BGBl I at 3317 (F.R.G.); Loi fédérale sur l’égalité entre femmes et homes [Loi sur l’égalité, Leg] [Act to Establish Equality Between Men and Women], srt. 7(1), Mar. 24, 1995, SR 151 (Switz.).

77. Walter, *supra* note 15, at 375.

78. Original Draft, *supra* note 9, art. 2, para. 446(2).

79. Original Draft, *supra* note 9, art. 2, para. 446(1).

German Capital Markets Model Case Act.<sup>80</sup> In this system, plaintiffs who are similarly injured agree in advance to bring the case of a single model plaintiff to judgment.<sup>81</sup> This representative case sets controlling legal principles for all similar claims brought by the other plaintiffs in the future.<sup>82</sup> So, for example, if the defendant's liability is determined in the test case, that determination controls in future cases where plaintiffs similarly injured sue separately for a determination of their damages.<sup>83</sup> The German model suit, however, does not provide for the "expeditious resolution" of a large number of claims in the same action.<sup>84</sup> By contrast, the original draft of the Italian system did; recovery was determined at the conclusion of the case for all those who decided to opt in the class.<sup>85</sup>

Some European countries provide expeditious resolutions of large numbers of claims for damages in one stroke through legislative means—the so-called "funds solutions."<sup>86</sup> For example, the German Parliament created a fund for the victims of the drug Contergan, which was prescribed to pregnant women to treat nausea and vomiting associated with morning sickness, after the drug was found to cause birth defects.<sup>87</sup> These top-down solutions, however, stand in stark contrast with a class action regime that "allow[s] non-state actors to assume the collective responsibility" that the funds solutions reserve exclusively for the state.<sup>88</sup> Unlike funds solutions, the original draft of the Italian class action system provided for the expeditious resolution of large numbers of claims for damages through bottom-up, private means.<sup>89</sup>

To summarize, the original draft of the Italian class action system had the potential to accomplish what the other main European group litigation devices—*Verbandsklage* and the model suit—cannot, namely expeditious resolution of a large number of similar claims for damages.<sup>90</sup> Unlike the

80. Kapitalanleger-Musterverfahrensgesetz [Act on the Initiation of Model Case Proceedings in Respect of Investors in the Capital Markets], Aug. 16, 2005, BGBl. I at 2437 (F.R.G.) [hereinafter Model Case Proceeding Act].

81. *See id.* § 8, para. 2 (directing the Higher Regional Court to designate a model plaintiff from the pool of plaintiffs in light of the amount at issue and any agreement made among the plaintiffs).

82. *See id.* §16 (describing the effect of the model case ruling).

83. *See* Issacharoff & Miller, *supra* note 16, at 182.

84. *See id.* at 182-83. *But see* Walter, *supra* note 15, at 375 (arguing that the determination of liability in such cases usually forces the defendant to settle with all the plaintiffs similarly injured).

85. *See* Original Draft, *supra* note 9, art. 2, para. 446(6).

86. *See* Walter, *supra* note 15, at 376 (discussing Germany's version of funds solutions).

87. *Id.*

88. *See* Issacharoff & Miller, *supra* note 16, at 209. The relative merits of top-down state decision-making, and bottom-up private enforcement, when it comes to the effective enforcement of plaintiffs' rights, are not the focus of this paper.

89. The potential capture of private rights by politics remains a serious worry about top-down solutions through legislative means. In a feigned effort to address private rights, politicians may use legislation against particular companies to "punish enemies and reward friends." *See id.* at 201 (arguing for the independence of private rights enforcement from politics).

90. *See supra* notes 76-85 and accompanying text.

fund solutions, it could accomplish this objective through private rather than state legislative means.<sup>91</sup> Hence, the new Italian class action regime, as formulated in the original draft, constituted a significant advance over other European legal mechanisms advancing similar policy objectives. The regime promised to bring to Europe for the first time the American-style class action for damages.<sup>92</sup>

The class action regime contemplated in the original draft differed, however, from its American counterpart in certain fundamental respects, including each of the five elements discussed above.<sup>93</sup> Moreover, the regime emerged in a legal context that until very recently discouraged “entrepreneurial litigation”<sup>94</sup> by banning contingency fees for plaintiffs’ attorneys.<sup>95</sup> A comparison between the original draft and the American class action in federal courts will lay the groundwork for evaluating the original draft’s efficacy as an instrument for enforcing plaintiffs’ rights.

In the United States federal courts, class actions are governed by Rule 23 of the Federal Rules of Civil Procedure.<sup>96</sup> Rule 23(a) permits any member of the class to bring an action on behalf of other members as long as (1) the class is large enough that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representatives are typical of other members in the class, and (4) the representatives will fairly and adequately protect the interests of the class.<sup>97</sup> By contrast, standing under the original draft did not explicitly include any of the requirements of Rule 23; there was merely a general requirement that the court find a collective interest suitable for class action representation.<sup>98</sup> Indeed, standing did not extend to just any class member. Only certain organizations registered with the Ministry of Economic Development and other organizations that were adequately representative of the collective consumer interests at stake could bring an action on behalf of a class.<sup>99</sup> No matter how liberally the courts read the requirement, one thing was clear: class members would not have been able to bring an action in their individual capacities as members of the class but, instead, would have had to do so through the intermediation of an organization.<sup>100</sup>

91. See *supra* notes 86–89 and accompanying text.

92. See Halladay & Amorese, *supra* note 28, at 3.

93. See *supra* notes 58–75 and accompanying text.

94. See generally *Entrepreneurial Litigation*, *supra* note 42 (describing entrepreneurial litigation in the class action context and discussing its vices and virtues).

95. On July 4, 2006, the Italian parliament repealed the regulations providing for “the setting of obligatory fixed rates or minimum tariffs, i.e., the prohibition on agreeing on fees linked to the attainment of the objectives pursued,” thus allowing for contingent attorneys’ fees. See Decreto Legge 4 Luglio 2006, n. 223, art. 2, para. 1(a), Gazz. Uff. 4 Luglio 2006, n. 153 [hereinafter Decree-Law No. 223].

96. FED. R. CIV. P. 23.

97. FED. R. CIV. P. 23(a).

98. Original Draft, *supra* note 9, art. 2, para. 446(3).

99. *Id.* art. 2, para. 446(2).

100. See Halladay & Amorese, *supra* note 28, at 4.

The most striking difference between the two systems, however, concerns class membership. Under Rule 23(c), the court excludes from the class only members who request exclusion.<sup>101</sup> The American system represents the opt-out version of class membership—one is automatically a member of the class unless, upon notice, one elects not to participate.<sup>102</sup> By contrast, the original draft proposed an opt-in system—one was not automatically a member of the class and those who intend to participate could become members only after communicating in writing to the proponent of the action their decision to join the class.<sup>103</sup> The opt-out/opt-in distinction is significant in evaluating the effectiveness of the original draft because of concerns about potential plaintiffs' inertia in taking affirmative steps to join the class, and the lack of incentive for defendants to settle the case in an opt-in model.<sup>104</sup>

## II. The Effectiveness of the Italian System Under the Original Draft

### A. Concerns About the Effectiveness of the Original Draft

From a social policy point of view, a class action system is a private mechanism for enforcing plaintiffs' rights and deterring future wrongful action on the part of prior offenders.<sup>105</sup> The system's effectiveness in pursuing these goals depends in part on its financing.<sup>106</sup> The system allows for collective litigation of claims that are too small to be litigated one-by-one.<sup>107</sup> For example, the mechanism makes a significant practical difference in the enforcement of consumer protection laws where the claims are typically small and the victims typically numerous.<sup>108</sup> Understandably, this is also the context in which the group litigation devices in Italy, and more generally in Europe, are designed to operate.<sup>109</sup> By aggregating small claims into one action, the system renders the cost of litigation non-prohibitive for individual consumers.<sup>110</sup>

At the end of the day, however, there will still be some costs, and, unless a class action system appropriately addresses its source of funding, the system itself risks becoming largely ineffective. Hence, from a system designer's point of view, an important question always is, who will end up

101. FED. R. CIV. P. 23(c)(2)(B)(v).

102. FED. R. CIV. P. 23(c)(3)(B).

103. Original Draft, *supra* note 9, art. 2, para. 446(2).

104. See Halladay & Amorese, *supra* note 28, at 5.

105. See generally *Understanding the Plaintiff's Attorney*, *supra* note 41 (examining private enforcement and the behavior of attorneys who specialize in class action litigation).

106. Cappalli & Consolo, *supra* note 6, at 225 (discussing "facilitative value" of class actions); see also *id.*, at 236 (noting that, in determining whether an attorney is an adequate representative of a class, courts often scrutinize the personal finances of the plaintiff's attorney because the burden of funding the litigation).

107. *Id.* at 225.

108. *Id.*

109. See discussion *supra* Part I.B.

110. See *Understanding the Plaintiff's Attorney*, *supra* note 41, at 685–86 (discussing economic interests in class action litigation).

bearing the upfront costs of litigation in a class action?<sup>111</sup> The individual consumer is out of the question. After all, the system is in place to address the consumer's liquidity problem in bringing his own lawsuit. So expecting him to foot the litigation bill for the whole class is unrealistic in the normal case. There are, however, three other candidates for bearing the financing burden: the plaintiffs' attorneys, consumer organizations, and the government.

The entrepreneurial attorney is the financier and "motor force" of the class action system in the United States.<sup>112</sup> The explanation for this is simple: clients are often unaware that they possess actionable claims.<sup>113</sup> It is the attorneys who can identify the illegal conduct that gives rise to such claims and then identify the claimholders themselves.<sup>114</sup> The attorneys assume this task for their self-interest. Under the contingency fee system, the attorney's profit is a percentage of plaintiffs' recovery.<sup>115</sup> The contingency fee system allows the attorney to fund the litigation.<sup>116</sup> The attorney's expertise as a litigation specialist allows him to allocate energy and resources in those cases that offer the most profitable contingent fee and, indirectly, the largest benefit for plaintiff class members.<sup>117</sup> The amount of recovery might not be the best proxy for the system's effectiveness, but it is a useful one. Moreover, the system has a certain financial stability because attorneys can achieve portfolio diversification by handling a large number of lawsuits, in contrast to plaintiffs who are involved in only one case.<sup>118</sup>

The original draft of the Italian class action system seemed to remove the entrepreneurial attorney from the picture by giving consumer organizations exclusive standing to sue on behalf of a class, thus depriving the system of what in the American experience is its main motor force.<sup>119</sup> The underlying worry was that consumer organizations, unlike entrepreneurial attorneys, would not be able to secure funding to finance class actions.<sup>120</sup> The worry is understandable when one considers the possible funding alternatives for a suit brought by a consumer organization.

The government is one possible funding alternative. For some commentators, this alternative is not viable because government "[f]unding is never certain, and in times of austerity consumer organizations may find

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111. See Issacharoff & Miller, *supra* note 16, at 197-98.

112. Cappalli & Consolo, *supra* note 6, at 288; see also Issacharoff & Miller, *supra* note 16, at 199.

113. *Entrepreneurial Litigation*, *supra* note 42, at 900.

114. See *id.* at 885.

115. See Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees in Class Action Settlements: An Empirical Study*, 1 J. EMPIR. LEGAL STUD. 27, 32 (2004). This is not just analytically true; empirical studies show that "the level of client recovery is by far the most important determinant of the attorney fee amount." *Id.* at 28.

116. Issacharoff & Miller, *supra* note 16, at 198.

117. See *id.*

118. See *id.*

119. See *supra* notes 60-62 and accompanying text (discussing standing in the Italian system).

120. See Issacharoff & Miller, *supra* note 16, at 199-201 (analyzing the funding problem of funding facing consumer organizations).

that their budgets are among the first to be slashed.”<sup>121</sup> A different concern is that “organizations . . . funded by public authorities . . . [may] become[] captive to politics.”<sup>122</sup> Since the independence of consumer groups from politics is undermined when the government foots the bill, there is no guarantee that the class action device will be used as an effective mechanism for enforcing consumer rights rather than as a tactical weapon for clubbing political enemies.<sup>123</sup>

Another alternative source of funding could be the consumer organizations’ own membership.<sup>124</sup> Organizations could charge their members sufficiently high dues to cover anticipated litigation costs. Two problems plague this approach. First, the solution gives rise to a free-rider problem: if the consumer organization brings an action on behalf of all those injured, then nonmembers will be able to share in the benefit of recovery without sharing in any of its costs.<sup>125</sup> When that happens, the organizations’ ability to attract members is seriously compromised. Second, even if the organizations bring actions only on behalf of their members, it is unrealistic to expect members to invest in membership dues in exchange for the mere hope that someday they might be able to share in a class action recovery.<sup>126</sup> This is especially true in the consumer context where potential recovery for individual class members is small.

A straightforward solution would be for the organizations to condition membership, and thus indirectly potential benefits, on taking a cut from the members’ recovery if the class action succeeds.<sup>127</sup> This is not an option in most European jurisdictions, however, because of the ban on contingency fees.<sup>128</sup> Moreover, most European countries have a “loser pays costs” system, which requires the losing side to pay the other side’s attorneys’ fees.<sup>129</sup> If the case succeeds, the consumer organization stands to be compensated for the cost of litigation, and if the case fails, the organization is on the hook for paying the defendant’s attorneys’ fees. So, at the end of the day, the organization has a lot to lose in bringing a class action. This decision matrix renders the prospects of consumer organizations pursuing a class action highly unlikely.

In summary, there was a legitimate worry that consumer organizations would not be able to secure funding to finance their class action litigation under the original draft. In giving consumer organizations exclusive standing in a class action, the original draft seemed to render the system economically unworkable and ultimately ineffective.

The financing issue was only one of the concerns about the effectiveness of the original draft; the other was the opt-in requirement for class

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121. *Id.* at 201.

122. *Id.*

123. *Id.*

124. *Id.* at 200.

125. *See id.* at 200–01.

126. *See id.* at 201.

127. *Id.*

128. *Id.* at 198.

129. *See Loser Pays, supra* note 15, at 1863.

membership.<sup>130</sup> The Italian law required potential class members to notify the representative plaintiff, in this case the consumer organization, of their intention to join the class.<sup>131</sup> Commentators highlight three potential problems that the opt-in feature can generate.

The first problem is the prospect of low participation by plaintiffs.<sup>132</sup> Recall that part of the rationale behind a class action system is to enforce claims that are too small to be pursued individually by bringing them together in the same action.<sup>133</sup> From that perspective, a class action system that fails to bring together several claimholders in the same suit undermines its own *raison d'être* of making individual unmarketable claims collectively marketable. Consensus has it that an opt-in system fails at doing just that.<sup>134</sup> An often-quoted source of support for this consensus is the Eisenberg and Miller study on class action plaintiffs' behavior in the opt-out system, which shows that in the face of notification "class members usually do nothing."<sup>135</sup> The study found that "on average less than [one] percent of class members opt-out and about [one] percent of class members object to class-wide settlements."<sup>136</sup> Moreover, opt-out rates vary by case type, with the lowest rate of opt-out at 0.2 percent in consumer protection cases.<sup>137</sup> Considering that the opt-in system requires the consumer to take affirmative steps to join the class, the consumer's tendency to do nothing buttresses the expectation that participation in the opt-in system will be low.

The second problem is that the opt-in system imposes a low level of deterrence for class action defendants.<sup>138</sup> This concern is related to the insufficiency of participation problem—the lower the number of plaintiffs who participate in the action, the lower the amount of potential recovery. Because deterrence is thought to increase in direct proportion to the defendant's monetary penalty, a low turnout of plaintiffs undermines a meaningful threat against future wrongful acts on the part of defendants.<sup>139</sup>

130. See Issacharoff & Miller, *supra* note 16, at 202–08 (comparing opt-in and opt-out mechanisms).

131. Original Draft, *supra* note 9, art. 2, para. 446(2).

132. Issacharoff & Miller, *supra* note 16, at 203–06.

133. See *supra* notes 107–08 and accompanying text.

134. See Rachel K. Alexander, *Federal Tails and State Puppy Dogs: Preempting Parallel State Wage Claims to Preserve the Integrity of Federal Group Wage Actions*, 58 AM. U. L. REV. 515, 544 (2009) ("[T]he opt-in requirement substantially limits the size of the group action, generating participation between only fifteen and thirty percent.").

135. See Theodore Eisenberg & Geoffrey Miller, *The Role of Opt-Outs and Objectors in Class Action Litigation: Theoretical and Empirical Issues*, 57 VAND. L. REV. 1529, 1532 (2004) (demonstrating that class members seldom opt-out by analyzing thousands of class actions from 1993 through 2003); see also Issacharoff & Miller, *supra* note 16, at 203 (noting "class members usually do nothing" when informed of their status).

136. Eisenberg & Miller, *supra* note 135, at 1532.

137. *Id.* (finding a mean opt-out rate of 4.6% in four mass tort cases, 2.2% in three employment discrimination cases, and below 0.2% in thirty-nine consumer protection cases); see also *id.* at 1549 (providing table listing opt-out statistics by case type).

138. See Issacharoff & Miller, *supra* note 16, at 207 (comparing the deterrent effect of opt-in and opt-out systems).

139. See *id.*

Low deterrence is, therefore, as serious a concern as low participation.

The third problem with the opt-in system is what commentators call “insufficient finality.”<sup>140</sup> Under the opt-out model, the party at fault can quantify its overall exposure by being in a position to identify those who have chosen to pursue their claims independently.<sup>141</sup> By contrast, in the opt-in system, the party at fault is only aware of his potential exposure in relation to the members of the class because “only those who affirmatively join the litigation are bound by the outcome” and cannot participate in future litigation against the same defendant over the same set of issues.<sup>142</sup> Since in the opt-in system the defendant cannot calculate his exposure to future litigation, neither can he calculate the value of the original class action in a way that can guide his settlement decisions. To that extent, the opt-in system undermines the incentive of the defendant to settle a class action. Some authors convincingly argue that “peace [for the defendant] indirectly benefits members of the class because defendants will pay more for settlements that offer assurances against future litigation.”<sup>143</sup> So, insufficient finality seemingly undermines the system’s effectiveness in enforcing plaintiffs’ rights.

#### B. Addressing the Concerns About the Original Draft

The previous section described three concerns that might be raised about the original draft of the Italian class action system: lack of funding, insufficient plaintiff participation, and insufficient finality for class action defendants. This section argues that these concerns were unwarranted.

The funding concern relied on the premise that barriers to entrepreneurial litigation undermine the source of funding for a class action system.<sup>144</sup> Traditionally, the main barrier to entrepreneurial litigation in Italy and other European countries has been the ban on contingency fees for plaintiffs’ attorneys.<sup>145</sup> On July 4, 2006, however, the Italian parliament repealed the ban on contingent attorneys’ fees.<sup>146</sup>

Admittedly, only consumer organizations had standing under the original draft,<sup>147</sup> but the restriction, by itself, does not undermine the prospects of entrepreneurial litigation. Various modes of financing could introduce or substitute the role played by the entrepreneurial attorney in the

140. *See id.* at 206–07.

141. *See* Halladay & Amorese, *supra* note 28, at 6.

142. *See* Issacharoff & Miller, *supra* note 16, at 206.

143. *Id.*

144. *See id.* at 197–98.

145. *See* Taruffo, *supra* note 13, at 415 (“[One] thing that seems unacceptable to Europeans is the U.S. system of contingent fees and particularly the practice of proportioned fees, in which the plaintiff’s lawyer gets a percentage of the amount recovered.”); Issacharoff & Miller, *supra* note 16, at 198 (“Attorneys are good litigation funders. . . . [T]hey have the ability to assess the value of suits. . . . Because attorneys handle numerous lawsuits, moreover, they can achieve portfolio diversification in ways not possible for ordinary clients, who are usually involved in only one.”).

146. *See* Decree-Law No. 223, *supra* note 95, art. 2. The decree lifts “the prohibition on agreeing on fees linked to the attainment of the objectives pursued.”

147. *See* Original Draft, *supra* note 9, art. 2, para. 446(1).

American system.<sup>148</sup> For example, consumer organizations could auction-out their rights to sue to law firms who could better assess and diversify the costs of class action litigation.<sup>149</sup> In addition, even active and sophisticated parties with a genuine stake in the controversy, like consumer organizations, could be “captured” by entrepreneurial attorneys who could then use the contingency fee system already in place to organize, finance, and lead the class actions.<sup>150</sup> Alternatively, consumer organizations could play the role of the entrepreneurial attorneys by conditioning membership in the organization with a financial stake in potential class action recovery now that this type of agreement is enforceable under the Italian law.<sup>151</sup> And there was always the possibility that entrepreneurial attorneys would themselves create consumer organizations that are “adequately representative” in the sense required for standing.

Hence, at least in principle, entrepreneurial litigation under the original draft was no longer impossible in Italy. It is important to emphasize the significant shift from the old system. The opportunities for financing sketched in the previous paragraph did not exist under the old, “loser-pays-all-costs” rule for attorneys’ fees, which continues to be the norm in Europe.<sup>152</sup> In that system, potential exposure to the high litigation costs of the defendant would arguably incline a consumer organization to behave timidly even when faced with a meritorious suit in the absence of some countervailing financial reward that would make the risk worth taking.<sup>153</sup>

The two remaining concerns were those about the effects of the system’s opt-in feature: insufficient plaintiff participation and insufficient finality for class action defendants. The argument that plaintiff participation in the opt-in system would be low relies on an unwarranted inference. The argument infers that the consumers in an opt-in system will do nothing when faced with the choice of joining a class action from the fact that the American consumers in the opt-out system usually do nothing when faced with the choice of excluding themselves from one.<sup>154</sup> This argument is

148. See Issacharoff & Miller, *supra* note 16, at 197–202 (suggesting various ways in which consumer organizations with standing could finance class action litigation using a system of contingent fees).

149. See *id.* at 198 (explaining rationale for attorney-funded class actions).

150. *Id.* at 196–97.

151. See *id.* at 200–01 (discussing conditional memberships in consumer organizations); Decree-Law No. 223, *supra* note 95, art. 2 (allowing agreements that condition professional fees on the achievement of the objectives pursued).

152. See Rowe, *supra* note 15, at 159 (“Loser-pays rules governing liability for attorney fees [are] followed nearly everywhere but in the United States . . . .”); *Loser Pays*, *supra* note 15, at 1863 (noting that the American system, under which parties bear their own litigation costs, “stands in sharp contrast to the . . . [rule] that the loser must pay the successful party’s attorneys’ fees” followed in most European nations).

153. See Issacharoff & Miller, *supra* note 16, at 200 (“[Under the loser-pays-cost system,] if a case succeeds, the benefits of the judgment go to class members rather than to the organization. If a case fails, a representative organization has to pay both its attorneys’ fees and the defendants’ attorneys’ fees.”).

154. See *supra* notes 135–37 and accompanying text.

spurious.<sup>155</sup> It is no surprise that when notified about a class action, consumers in the opt-out system rarely decide to exclude themselves from it: their claims are usually individually unsustainable.<sup>156</sup> Understandably, these plaintiffs would not choose to opt out of a lawsuit with some potential recovery, however small, when there is little prospect of pursuing their claims independently. In other words, the behavior of the opt-out consumer is rational: if the consumer “does nothing, he loses nothing other than an essentially worthless right to bring his own lawsuit, but he gains the right to participate in the proceeds of the litigation.”<sup>157</sup> By contrast, the opt-in consumer faces the inverse choice: if he does nothing he gets nothing, but if he joins the action, he gets something, that is, the right to participate in the recovery.<sup>158</sup>

Admittedly, the consumer’s choice in the opt-in system would depend on, among other things, the quality of notice about the class action and the ease of participation.<sup>159</sup> But if potential class members are properly notified and participation is easy—for example, through signing a standard opt-in form and mailing it in a pre-paid envelope—there is no reason to expect anything less than robust participation.<sup>160</sup> This should be particularly true for plaintiffs subject to the Italian regime who are consumers with otherwise unmarketable claims and nothing to gain by holding out, but nothing to lose and something to gain by joining in. More importantly, under the original draft, the plaintiff had an extended time-window to join the action—from the moment notice was given to the time the court issued a dispositive ruling in the case.<sup>161</sup> The extended opt-in period would have played a significant role in increasing participation as it allowed potential plaintiffs an opportunity to learn about the course of litigation and make an informed decision about whether to join based on the likelihood of success at the crucial time right before the court determined defendant’s liability.

In addition, the American commentators who predict insufficient participation in the opt-in model fail to view it in conjunction with its companion piece in the majority of European group litigation devices: restricted standing.<sup>162</sup> The relevance of restricted standing to participation is conspicuous in the extreme hypothetical case where the system restricts standing with respect to a type of claim—for example, those based on the

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155. See Issacharoff & Miller, *supra* note 16, at 204 (noting the problem with inferring that opt-in rates will be low from the data showing low opt-out rates in the American system).

156. See Cappalli & Consolo, *supra* note 6, at 225 (explaining the rationale for a class action system as a means to allow collective litigation of claims that are too small to be litigated one-by-one).

157. See Issacharoff & Miller, *supra* note 16, at 204.

158. See *id.*

159. See *id.* at 206.

160. See *id.*

161. See Original Draft, *supra* note 9, art. 2, para. 446(2).

162. See, e.g. *Group Litigation*, *supra* note 8; see also Issacharoff & Miller, *supra* note 16, at 192 (“Class action procedures in Europe often restrict lead plaintiff rights to organizations that represent consumer interests.”).

defendant's anticompetitive conduct—to only one representative consumer organization.<sup>163</sup> In that case, each potential class member has only one chance to pursue his claim against a defendant, which is when the consumer organization brings it. As indicated earlier, the consumer cannot pursue the claim individually in the future because it is too small to justify the cost of litigation, and no other organization can bring the same claim on behalf of a group of consumers because the law restricts standing to only one entity.<sup>164</sup> Understandably, the plaintiff's incentive to join the class action is strongest in the case where only one organization has standing to bring a particular type of claim because in that case the plaintiff's opportunity to recover is unique. But, generalizing from this extreme case, one would expect the consumer's joinder incentive to vary inversely with the number of consumer organizations that enjoy standing—the fewer the organizations, the rarer the consumer's opportunity to bring his claim and the stronger his incentive to join a class action the first chance he gets.

The original draft contained another unique feature that was designed to play a role in increasing plaintiff participation. As discussed in Part I, under the original draft, a class action judgment would preclude future class actions against the same defendant on the same set of issues.<sup>165</sup> The preclusive effect of a class action judgment rendered unique the opportunity to sue the same defendant on the same set of issues collectively with other consumers similarly injured. The uniqueness of this opportunity makes the incentive to opt in the action that is most likely to go to judgment first that much stronger and the worry about insufficient participation that much more unmotivated.

The remaining concern involved the prospects of insufficient finality for class action defendants in an opt-in system. Some commentators have already noticed, however, that it is quite possible for an opt-in system to secure the finality guaranteed by the opt-out model.<sup>166</sup> For example, the system could allow those who do not opt in to bring individual actions in the future but bar them from participating in future class actions.<sup>167</sup> Since pursuing consumer claims on an individual basis is not economically viable, such an opt-in system would effectively bar any future actions against the defendant and, thus, guarantee for him global peace. As explained in the previous paragraph, the original draft did something very similar: it gave the consumer class member a one-time chance to opt in a class action, not by barring him from participating in a future class action, but by barring future class actions against the same defendant on the same set of issues.<sup>168</sup> Hence, the *res judicata* effect of a class action judgment under the original draft puts the concern about insufficient finality to rest.

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163. It is important to note that the Italian system does not restrict standing to only one organization for every type of claim. See *supra* notes 60–62 and accompanying text.

164. See *supra* note 156 and accompanying text.

165. Final Draft, *supra* note 10, art. 49, para. 14.

166. See, e.g., Issacharoff & Miller, *supra* note 16, at 207.

167. *Id.* (“A rule that allows only one opportunity to participate in a class action would accomplish effective global peace.”).

168. See *supra* note 165 and accompanying text.

In summary, it is important to emphasize that the garden-variety worries about other European group litigation devices did not apply to the original draft of the Italian class action system. The original draft guaranteed a way of financing through the mechanism of contingency fees; it provided a strong incentive for plaintiffs to participate in the system both by restricting standing and offering them a one-shot chance to enforce their claims through the class action device; and it secured global peace and finality for the defendant from collective litigation initiated by those who failed to opt in the first class action that went to judgment. Other problems, however, plagued the original draft.

### C. The Achilles' Heel of the Original Draft

A contingency fee structure for awarding attorneys' fees can create certain "misincentives" for the plaintiffs' attorneys.<sup>169</sup> In *Chesny v. Marek*,<sup>170</sup> Judge Richard Posner illustrated the attorneys' misincentive to settle an action prematurely through the following hypothetical:

Suppose a defendant offers \$100,000, the contingent fee is 30 percent regardless of when the litigation ends, and the lawyer is sure he can get a judgment for \$120,000 if the case is tried but knows that it will cost him, in time and other expenses, \$8,000 to try it. His client will be better off if the case is tried, for after paying the lawyer's fee he will put \$84,000 in his pocket rather than \$70,000 if it is settled. But the lawyer will be worse off, since his additional fee, \$6,000 (\$36,000 - \$30,000) will be less than the trial costs of \$8,000 that he must incur.<sup>171</sup>

The misincentive to settle prematurely was much stronger under the original draft. Consider the situation where two consumer organizations' class actions, with their own opt-in class members, are pending against the same defendant. Call these actions A and B. Under the original draft, if A was settled, B was precluded and vice versa.<sup>172</sup> In this context, there was a clear incentive for both plaintiffs' attorneys to settle their suits prematurely: if B was settled first, A was precluded and A's attorney got nothing in attorneys' fees because there would be no recovery for his class members. Since the same was true for B's attorney, the predicament would create a race to the bottom where both sides would try to underbid each other with respect to settlement. The losers of the underbidding contests would not just be the plaintiffs' attorneys; the underbidding would adversely affect the overall recovery of consumers as well. The effectiveness of the class action system in enforcing consumer rights and deterring future wrongful acts on the part of defendants would be compromised to the same extent.

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169. Joseph A. Grundfest & Michael A. Perino, *The Pentium Papers: A Case Study of Collective Institutional Investor Activism in Litigation*, 38 ARIZ. L. REV. 559, 566-67 (1996); see also *Entrepreneurial Litigation*, *supra* note 42, at 887 (tracing misincentives, in part, to the practice of direct plaintiff solicitation and a lack of referral process in the legal profession).

170. 720 F.2d 474 (7th Cir. 1983).

171. *Id.* at 477.

172. See Original Draft, *supra* note 9, art. 2, para. 446(5); Final Draft, *supra* note 10, art. 49, para. 14.

One might argue that a situation where the defendant faces two or more pending class actions would not be common enough to make the problem pervasive. But the temptation for the defendant to find ways of “promoting” other class actions upon being served with one is just too great to be underestimated.<sup>173</sup> How could the Italian system, then, solve this problem?

The most straightforward solution would be to legislatively change the preclusive effect of the first class action judgment. This would remove the incentive to underbid and settle prematurely in the context of two or more pending class actions. But, as indicated in the previous section, the preclusive effect of the first judgment affects the robustness of opt-in participation in a class action and, more importantly, allows the defendant to achieve finality. Absent the coercive choice created by the preclusive effect of the first class action judgment, the consumers' incentive to opt in a class action is weakened and, with no guarantee of finality, the defendant's incentive to settle the suit is seriously compromised.<sup>174</sup> In other words, a system adopting the opt-in model is forced to choose between the undesirable effect of underbidding contests and insufficient finality coupled with weak participation, each with its negative consequences for the enforcement of consumer rights.

An alternative solution would be to restrict standing for each type of admissible claim to only one consumer organization. This would prevent the predicament of two pending class actions with their potential for an underbidding contest. For example, the law could restrict standing in a class action for anticompetitive conduct to only one consumer organization. This possibility was consistent with the proposed law insofar as there were no floor restrictions on the number of consumer organizations that were guaranteed standing under the original draft.<sup>175</sup>

Restricting standing by type of claim to only one consumer organization, however, would give that organization monopoly power in the legal representation market for that type of claim. And “[f]or class actions, no less than for any economic market, monopoly power carries the usual potential for higher prices and lower output.”<sup>176</sup> In the class action context, “higher prices come in the form of excessive fees for class counsel, and lower output consists of low-quality representation of the class in the form of an inadequate settlement.”<sup>177</sup> Again, the ultimate result would be underenforcement of consumer rights and weak deterrence of wrongful behavior.

The potential for collusive settlements between the representative consumer organizations and defendants exacerbates the concern about inade-

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173. The restriction on standing might cabin this opportunity to some extent. See Original Draft, *supra* note 9, art. 2, para. 446(1).

174. See *supra* text accompanying note 165.

175. See Original Draft, *supra* note 9, art. 2, para. 446(1).

176. Richard A. Nagareda, *The Preexistence Principle and the Structure of the Class Action*, 103 COLUM. L. REV. 149, 164 (2003).

177. *Id.*

quate settlements.<sup>178</sup> As Professor Coffee has shown, where class action battles are fought between repeat players who have litigated and negotiated settlements in similar cases many times in the past “the defendants receive a ‘cheaper’ than arm’s length settlement and the plaintiffs’ attorneys receive in some form an above-market attorneys’ fee.”<sup>179</sup> The potential for collusive settlement is increased where the consumer organization is not just a repeat player but the only player in the litigation and settlement of a type of claim. In fact, the potential for collusive settlement between the party in control of the litigation and the defendant is so significant in the consumer context that some commentators have suggested an auction approach for consumer class actions, whereby bidders compete to buy the consumers’ rights and then pursue these rights independently and on their own account.<sup>180</sup> Restricting standing to only one organization is a move in the opposite direction, increasing both the incentive and opportunity for collusive settlement between consumer organizations and class action defendants.

The last two sections reveal the implicit strategy of the original draft. Realizing that an opt-in model left on its own could not secure finality for defendants, the draft tried to compensate by restricting standing to a few organizations and by making class action judgments preclusive on collective actions against the same defendants on the same set of issues. These attempts indeed fixed the insufficient finality problem. But they both came at a high cost: the outcome was either an underbidding settlement contest between representative organizations or an increase in the potential for collusive behavior between the representative organizations and class action defendants. Both scenarios would result in inadequate settlements and, consequently, a class action system that would be ineffective at enforcing consumer rights and deterring future wrongful acts on the part of defendants.

#### D. The Final Draft and Its Problems

The final draft enacted into law in January 2010 overlaps with the original draft in many respects, including the nature of admissible claims, the opt-in requirement for class membership,<sup>181</sup> and the res judicata effect of class action judgments.<sup>182</sup> There are, however, significant differences that concern, among other things, the standing requirements,<sup>183</sup> the notice requirement,<sup>184</sup> the trial process<sup>185</sup> and the determination of damages.<sup>186</sup>

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178. See Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiff’s Attorney’s Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 44-45 (1991) (discussing the potential for collusive settlements as an agency problem).

179. John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 COLUM. L. REV. 1343, 1365, 1367 (1995).

180. See Macey & Miller, *supra* note 178, at 105.

181. See Final Draft, *supra* note 10, art. 43, paras. 3, 9.

182. See *id.* art. 43, paras. 1, 14.

183. *Id.* art. 43, para. 1.

184. *Id.* art. 43, para. 9.

In particular, the final draft liberalizes standing by allowing individual consumers to bring a class action, in addition to the consumer organizations that enjoyed standing under the original draft.<sup>187</sup> The trial process is also different: unlike in the original draft, the defendant does not have an opportunity to make a settlement offer after the court determines that the claim is admissible. The final draft also renounces the three-party chamber of conciliation as the forum for making a determination of damages;<sup>188</sup> damages are determined at the end of the trial by the sentence of the court.<sup>189</sup> The law expands the court's management and sanctioning authority over the case to include the authority to determine the opt-in period,<sup>190</sup> measures for the presentation of proof, rules for disciplining the parties, and the formalities of notice to potential plaintiffs.<sup>191</sup> How do these changes affect the traditional concerns raised about European group litigation devices, particularly plaintiff participation and finality for class action defendants?

At first glance, the new standing provision re-invites the concern about low participation.<sup>192</sup> But this concern might be premature when one considers that the other variable affecting participation, the *res judicata* effect of class action judgments, remains the same as in the original draft. More specifically, the first class action judgment precludes future class actions against the same defendant on the same set of issues.<sup>193</sup> As indicated earlier, the unique opportunity to bring a suit through the class action vehicle might serve as a strong incentive for consumers with otherwise unmarketable claims to opt in the class.<sup>194</sup> As in the original draft, the *res judicata* provision also puts to rest the concern about finality.<sup>195</sup>

The final draft also seems to address the competitive underbidding scenario created by two pending class actions, a concern raised in the previous section. Under the final draft, the judge will consolidate multiple pending lawsuits brought against the same defendant in the same tribunal.<sup>196</sup> Moreover, after the judge presiding over the first class action determines the action's opt-in period, subsequent class actions brought during that period in other tribunals will be dismissed and the respective plaintiffs will be given no more than sixty days to bring their actions in the first tribunal.<sup>197</sup> The judge in the first action can consolidate these subsequent actions once they are refiled in the first tribunal.<sup>198</sup> To close the loop, the

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185. *Id.* art. 43, paras. 4-13.

186. *Id.* art. 43, para. 12.

187. *Id.* art. 43, para. 1.

188. *See id.* art. 43.

189. *Id.* art. 43, para. 12.

190. *Id.* art. 43, para. 9.

191. *Id.* art. 43, para. 11.

192. *See supra* notes 132-37 and accompanying text.

193. *See* Final Draft, *supra* note 10, art. 43, para. 14.

194. *See supra* note 165 and accompanying text.

195. *See supra* notes 166-68 and accompanying text.

196. Final Draft, *supra* note 10, art. 43, para. 14.

197. *Id.*

198. *Id.*

law precludes any class actions brought after the opt-in period of the first class action expires.<sup>199</sup> Hence, the consolidation procedure seems to take away from the defendant the opportunity to create a “race to the bottom” with plaintiffs’ attorneys bidding against each other for lower settlements.<sup>200</sup>

Despite its initial promise, consolidation gives rise to its own problems. For example, the “first-to-file” venue provision allows the defendant to control venue by “promoting” the first class action in its favored tribunal because, as explained in the previous paragraph, all subsequent actions brought during the first opt-in period against the defendant will be consolidated in that tribunal.<sup>201</sup> The ability to control venue carries significant weight, particularly when one considers the extensive management and sanctioning authority the final draft grants to the presiding judge.<sup>202</sup>

In addition, the consolidation procedure is fraught with uncertainty. For example, it is unclear whether the sixty-day window for re-filing subsequent class actions in the first tribunal tolls the maximum 120-day opt-in period<sup>203</sup> of the first action, or whether the opt-in period determined in the first class action controls. If the subsequent class actions toll the 120-day opt-in period of the first action, the case can, at least theoretically, go on forever. On the other hand, if the opt-in period determined in the first class action controls, then the sixty-day window for re-filing the subsequent action in the first tribunal is less meaningful because, unless brought within the first opt-in period, the subsequent action is precluded.

Finally, and most importantly, the new opt-in period provision threatens to have an adverse affect on plaintiff participation. Unlike the original draft, which extended the opt-in period from the time notice was given to the time the court made a dispositive ruling in the case,<sup>204</sup> the final draft shortens the opt-in period to a maximum of 120 days.<sup>205</sup> The restriction works in conjunction with the *res judicata* provision to guarantee finality for class action defendants. But it does so at the cost of undermining plaintiff participation. The longer opt-in period in the original draft was important for robust participation because it gave potential plaintiffs not only an opportunity to learn about the progress of a case, but also the maximum amount of time to make a decision about whether to join based on the probability of success up until the crucial point when the court was ready to determine liability.<sup>206</sup> The final draft, in contrast, calls for an opt-in decision *ab initio*<sup>207</sup> and, in depriving the plaintiff of information about the course of litigation and its probability for success, it weakens the joinder incentive. The analysis in the last two sections suggests that the opt-in

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199. *Id.*

200. See *supra* notes 172–73 and accompanying text.

201. Final Draft, *supra* note 10, art. 43, para. 14.

202. See *id.* art. 43, para. 9.

203. *Id.*

204. See Original Draft, *supra* note 9, art. 2, para. 446(2).

205. Final Draft, *supra* note 10, art. 43, para. 9.

206. See Original Draft, *supra* note 9, art. 2, para. 446(2).

207. Final Draft, *supra* note 10, art. 43, para. 9.

model suffers from an inherent instability. The original draft was forced to choose between the Scylla of insufficient finality and the Charybdis of the collateral costs that the various maneuvers for securing finality introduce in the system. The final draft attempts to address these collateral costs while preserving finality by introducing a procedure for consolidating multiple actions that are pending during the opt-in period. But, consolidation succeeds at addressing the collateral costs of the original draft only at the cost of threatening to undermine robust participation.<sup>208</sup> Hence, despite what some analysts have suggested,<sup>209</sup> it might be impossible to implement rules that compensate for the problems inherent in the opt-in model so as to secure outcomes similar to those that can be obtained in the American opt-out regime.

## Conclusion

Despite their misgivings, European countries have long flirted with the idea of implementing some form of American-style class action. Italy's new experiment is a significant step in that tradition. The experiment is significant relative to European group litigation devices, because it institutes for the first time in the continent a class action regime for damages rather than behavioral remedies backed up by meager penalties. But the experiment also betrays the same hesitancy about full-blown American class action that other European devices imply. Most prominently, the Italian system comes with an odd *res judicata* provision, and an opt-in model for class membership. These features, and the way in which they interact, have serious consequences for the system's efficacy.

The heart of the problem with the Italian system consists in an inherent instability in the opt-in model for class membership. Systems that adopt this model, if left unchecked, run the risk of insufficient finality for class action defendants. At the same time, any attempt to secure finality, by tinkering with the *res judicata* effect of class action judgments, or by restricting standing to decrease the number of class actions, generate their own serious problems. More specifically, they produce either a high risk for underbidding settlement wars between class action representatives or collusive settlements between these representatives and class action defendants. The attempt to address these collateral problems reintroduces the concerns about insufficient participation. In either case, the outcome is underenforcement of consumer rights.

The conclusions are both predictive and analytical in nature. This article predicts that the Italian system will be ultimately ineffective at enforcing consumer rights. The more general, analytical point of the study concerns the opt-in model: despite what some commentators have argued,

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208. See *supra* notes 205-07 and accompanying text.

209. See Issacharoff & Miller, *supra* note 16, at 207 ("It would appear possible, even within the constraints of an opt-in procedure, to implement rules that provide protections against future litigation similar to those that can be obtained in an opt-out regime.").

it might turn out to be impossible to compensate for the inherent problem of insufficient finality without adversely affecting the effectiveness of the system as a whole.