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George L. Priest

Yale Law School

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Economics of Class Actions

George Priest

Actually, I'm just a setup act for Chris Buckley. He is going to be making the principal presentation on this panel. I'm going to start by talking about some very simple economic features—I would not even call them principles—but features of class action litigation which you're all aware of. I have two basic points to make.

Let me lead up to the first one. The economics of class actions are pretty simple. As you all know and everyone knows, class actions serve the purpose of aggregating common claims. This creates something of an economy of scale, hopefully, whereby a large number of claims can be resolved with, supposedly, greater efficiency and greater dispatch than resolving each of the claims individually. This would be especially true and it has been true with class actions which involve claims that are small on their face and that might not justify individual litigation but which, when joined as a class, become worthwhile to litigate. Although this point is often made, the economy of scale argument does not apply only to small claims. There is no reason not to realize economies of scale of large claims just as of small claims, but oftentimes for reasons we will talk about later, there are grounds that may caution against aggregating large claims in a class. There are broader issues with regard to aggregation itself.

As an institution in the civil justice system, the class action has taken on a new life in the last two decades as standards of liability have expanded, especially given the inherent uncertainties in the process of resolution of trial by jury in the mass tort context. These are not new points to any of you, but I do want to add one thing in a moment, especially in the mass tort context. The position of a defendant in a class action resembles the position of the Soviet Union after World War II. To our modern sensibility, we viewed the relationship with the Soviet Union and the United States, as one of mutually assured destruction. This is the idea that kept nuclear war away, because both countries could destroy each other easily.

In the context of a mass tort class action, there is no "mutual" to the assured destruction. The great economies that are created by bringing together in a class thousands of individual claims, even if those individual claims are small, means that there is nothing mutual about it. There is some expense, of course, on the part of the class attorney and some risk that the class attorney's time will be wasted or the expenses of litigation will be wasted, but, for
defendants, there’s a very large risk. There is really a nuclear bomb assured destruction form of risk which leads to a very unusual statistic. This is not a confirmed statistic, but I haven’t seen any exceptions to it and I’ve been looking for exceptions for some time. As the stakes of the defendant become greater, the defendant tends to settle out those cases that the defendant might lose, even possibly might lose. In some context, remember, in products liability plaintiffs win about forty-two percent of the time and in malpractice they win about thirty-nine percent of the time.

According to common belief—again, it’s very difficult to get statistics of this nature—there are no mass tort class actions that are ever litigated. They are all settled. There is no success rate one way or another for plaintiffs or defendants in mass tort class actions because, once a class action is certified, because of the assured destructive capability of that class action with regard to, a mass tort context, where we’re dealing typically with substantial damages per class member, the defendants always settle. None of the cases are ever litigated. There are no records in class actions that are settled. This is a little different in the context of other forms of consumer class actions and quite different in the context of civil rights class actions where damages are not at issue. But, where damages are a substantial issue, the combination of the expansion of liability, the uncertainty of the process, and the way our class action procedures are devised, almost always leads to automatic settlement or guaranteed settlement once a class action is certified.

That means that the certification process then becomes the only avenue for a court to rule in a way that is relevant to the ultimate outcome of the case. Does the court certify the class action or not? This is not exactly an economic point, it’s an economic point along with a procedural point. Our current class action procedures are affected very substantially by the treatment of the class action in the federal rules or in state procedural rules, as well as a procedural decision unrelated to the substantive merits of the case.

In Rule 23, under the *Eisen* case decided by the Supreme Court many years ago, the basic principle is established that a court should not review the claims in a case on their substantive merit for purposes of certification. Certification is regarded as a procedural action only. In all of the federal rules and in the state rules of civil procedure, Rule 23 or its analogue appears in the denominated parties section, where the only question is who are going to be the appropriate parties in the case. The general proposition is that the substantive merit of the claim should not be subjected to review. Basically, the *Eisen* case established the proposition that the class ought not to be certified, given the other requirements for certification of a class, just because the claims of the case have some merit. The converse has been said in many cases, too, that certification ought not to be denied if the various qualifications for class certification are met even if the merits of the case are weak.

In the context of the economic effect of the aggregation of these claims and the extraordinary settlement power created by the aggregation of claims in a class, we have
to rethink whether the rule makes sense. I would argue something more. Class action procedures and the class action case law has developed and flowered in the last fifteen years. We have seen a development of the analysis of the various requirements for class action certification. Numerosity is a pretty easy requirement to deal with, but what does it mean for claims to be common, for the claims of law to be common among members of the class? How do we evaluate the adequacy of representation by a named class member or by counsel? How do we evaluate the typicality of the class of the representative class members’ or named class members’ claims to those of the class? How do we decide the superiority question? Is the class action a superior way of bringing the litigation? Is it manageable?

The first point I want to make is that, over time, we’ve seen the development of a definition of commonality and a definition and an evaluation of adequacy of representation. The definition and evaluation of typicality, manageability, and superiority introduce, given the clear procedural nature of those requirements, is a means of substantive review of the class action before certification is granted. That’s a good thing, although I think it should go further. I think given the great hydraulic pressure that is created by the aggregation of cases, that it’s necessary to evaluate the ultimate merits of the case as best as possible at the point of certification. If the economic power of the certification of the class is such that, if certified, the defendant will settle on some terms, then it seems to me that it’s necessary in order to achieve the goals of justice in our society, to evaluate the merits of the claims as to whether the claims have sufficient merit on their face without a lot of discovery and to examine whether the claims have sufficient potential merit to justify the creation of great economic power through class certification.

When we look at many modern class action cases we see some of that going on. For example, in In re Rhone-Poulenc, a decision by Chief Judge Richard Posner of the Seventh Circuit considered an interlocutory appeal of partial class certification. Judge Posner was considering certification of a claim brought by individuals who had contracted the HIV virus from a blood transfusion. Posner went through the various requirements, numerosity, commonality, adequacy, and economic worth. Really, on their face, there’s nothing you can say about these requirements that the plaintiffs didn’t meet. It was a pretty clear claim. There was no contributory negligence defense in any of these claims. You could argue about whether the damages were individualized, but that’s not an overwhelming complexity to deal with in most class actions. Yet, Posner made the point, that a lot of these cases’ claims were already litigated. There had been thirteen trials. The plaintiffs had lost twelve of them. Posner, looking at the fact that in twelve of thirteen of cases the plaintiffs lost, ordered the decertification of the class. I don’t think it’s a wrong decision. I think it’s probably the right decision, but it has to be viewed as, not a determinative view but a preliminary view of the merits into the certification decision for purposes of placing some form of judicial and legal control over this great economic power that is created by certification alone.
I have one more point about the economics of class actions, and this deals with the administration of class actions. I have served for ten years now as a special master in a large federal class action in New Jersey. The point I want to make is that, after the class is certified, and even after there are initial liability decisions, there are very serious economic agency problems with a court supervising or attempting to supervise the administration of the class by the class attorneys.

Those of you who have administered class actions will know something of this, but the economics and the method of dealing with the issues that arise in class action administration change very dramatically after there is a settlement. With a settlement the court has to face, through its assistant or special master (if fortunate as a state court judge), the administration of the settlement and the distribution of the settlement funds. There are different relationships created between all of the parties following a settlement, and those relationships mean that, it is often the case that administration of the remaining class issues is delegated to the class attorneys who have very complicated arrangements and relationships with various members of the class. Those various relationships become different after the settlement occurs, yet it remains the court’s responsibility to monitor the administration of the settlement. As a general matter, it’s most typical not to have a special master, but the special master was appointed in the case in which I was involved because it was a very complicated liability case. The judge thought the case involved computers and thought I knew something about computers, but it turned out the case, once you looked at it, did not involve computers at all. Neither the judge, nor I, nor anybody else, knew what the case was about until we really got into it.

There is a tendency on the part of judges to delegate to the class attorneys the administration of the settlement. Because of serious agency problems, I believe that delegation of this nature becomes very problematic from the standpoint of achieving justice for each member of the class.

Two things happen after a class action is settled and the class settlement has to be administered by attorneys. One is that opposing attorneys disappear. You no longer have defendants and for the most part, they don’t care how the class is administered. They have settled the case. Once the settlement is approved, they’re out, and there is no longer a counterweight to monitor the plaintiff’s attorneys as to what they will do.

Secondly, with regard to the class attorneys there is, in the context of the administration of a settlement, a change in the underlying normative structure of the enterprise. The underlying normative structure of litigation is not finding out what the law is, achieving justice, and determining whether the claimants deserve to recover and how much they deserve to recover. Once there is a settlement, those underlying norms change, in part, because the attorneys don’t want any problems, or they want to forget about problems, or because they are sympathetic to the various parties with whom they deal. There is a substantial shift from what I might call justice norms to what I call communitarian norms. In the administration of a class action, there is a norm of helping...
everybody out, making sure everybody gets something, even those that have the weakest
claims or nonexistent claims. This leads to problems in terms of achieving those goals and
achieving that justice.

For example, we deal with the notion that we have named plaintiffs or
representative plaintiffs and that the attorneys report to the representative plaintiffs and
the representative plaintiffs make the decisions and sign off on what the attorneys do.
That is a total myth. In the case in which I was involved, the representative plaintiffs were
wonderful people, serious people, tried to keep abreast, but of course they were totally
subject to the information and advice provided to them by the class attorneys. Given all
of the complexity of absent class members, they are less able to make any informed
decision than a litigant in any normal case would be.

In essence, we ought to view this as having been turned over to the class attorneys
and simply accept that fact. Because of these agency problems, and because of the shift
of norms toward the communitarian view, there are many deviations or potential
deviations between what the judge would do if he or she were administering the case
myself versus having a special master administering it.

As another example, there are constant attempts following settlement to strain the
class definition. That occurs prior to the settlement to some extent, because once the
parties are pretty sure they’re going to settle, both the plaintiffs and defendants want to
define the class as broadly as possible. The plaintiffs want this because it will help justify
their attorney fee petition; the defendants want the result because it will give them greater
claim preclusion in the future. Even after you have the class definition, the class hearing,
the fairness hearing and the settlement approved, there are constant strains on the class
definition to provide a little money to other people that the class attorneys think ought to
have a little money or would prefer to have money or are disappointed that the dividing
line in the class definition kept them out. It is very difficult to deal with supplicants of that
nature after the fact; and, I think, given the very limited attention that a court can give to
what the class attorneys do, we have substantial strains on the definition of justice in class
action settlements.

There are many similar strains in the definition of a class action distribution plan.
Again, my case involved a substantial amount of money, $415 million, so there was a lot
of money to distribute and substantial strains on the distribution plan as to dividing the
money according to the harms that were suffered by individuals. Again, as I mentioned,
this communitarian norm creates a desire to give some money to everybody and to give
some money even to those that have nonexistent claims or claims of next to zero merit,
to keep them happy. Settlement funds become a social welfare pool of money as opposed
to the distribution of a judgment to each and every deserving person according to their
comparative levels of desert.

Furthermore, even after the distribution plan is defined, there are substantial
strains because people are disappointed. Some people want a little more money. Some
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wish they had worked longer at the plant. Class attorneys are less able than a judge or special master to resist these constant strains. The point, I think, that the picture of the judge as a neutral arbiter resolving only the claims brought by the two parties, attendant only to the issues brought before the judge, and responsive to the procedural stature only of a class certification have to be amended given the economic realities of class action practice.

First, I think it’s absolutely crucial that there be some review of the ultimate substantive merit of the claim in the class certification hearing, especially if there are substantial stakes at issue. Second, the administration of the class action leads to problems that are never seen by judges. Our system of justice delegates the administration of the class settlement to the class attorneys alone without judges really knowing what results. To achieve the justice ambitions that we have for our system through the administration of a class, the court has to create a means of serious supervision over the activities of the class attorneys.

Notes

2. See In re Rhone-Poulenc Rorer Inc., et al., 51 F.3d 1293 (7th Cir. 1995).