

Some economics of the class action

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Abstract

For a market society to work well, citizens have to be confident that transactions they enter into will be performed substantially as agreed. From very early on, it has been recognised that in case of non-performance the accessibility of a public court system is likely to sustain this confidence and can do so more cheaply and effectively than alternative methods. Alternatives may include not transacting at all, transacting only within a limited group of persons one knows well, possibly with group dispute resolution, or various forms of self-help.

The availability of the court system may be considered mostly a public good. Once available, all citizens may rely on it (no exclusion) and anyone's reliance does not exclude anyone else's. It may be considered part of the rule of law governing a particular society.

Unfortunately, the functioning of the court system requires resources, which are scarce and have a cost. Whilst the public good characteristics of the justice system seem to exclude the idea of providing it at full cost like a commercial commodity and hence command a public subsidy, some remaining costs will have to be borne by prospective litigants. As costs evolve over time, this may compromise access to the court system for some citizens and hence force them into the alternative methods just mentioned. At the same time, justice is a commodity, which is made available to citizens below its cost of production. Price cannot be used as a rationing tool to balance supply and demand; rationing will slide back to queuing, which explains the court delays. All of this is "not good for business" and hence forces us to imagine how justice can be provided more effectively and at lower cost.

For that task, we can adopt two broad approaches: increasing the means to pay available to those who cannot afford access to justice, and reducing the production cost of components of the justice system. Within the first broad approach, one can think of:

- transferring to the State the burden of prosecuting unperformed, damaging or illicit transactions
- legal aid or pro bono legal services by lawyers
- legal insurance
- punitive damages
- contingency fee arrangements, whereby a lawyer takes over part of the risk of a lawsuit by renouncing fees if unsuccessful, but claiming a percentage of gains if successful

As regards reducing the costs of the justice system, they too may take a variety of forms, such as:

- court streamlining in a variety of ways
- reversals of burdens of proof and presumptions of fact or law
- small claims courts, where lawyers are not admitted (citizens plead their own cases) and there is no appeal. As fewer resources are devoted to getting all relevant information in front of the court, one may expect the error rate in these cases to be higher than they would be otherwise
- class actions

Class actions are an attempt to bring scale economies to bear on legal proceedings, by bringing together cases that have a common base or cause into a single lawsuit leading to a judgment or settlement that binds the entire class. Legal procedures, lawyer time, evidence by experts and court resources are all used once for all, rather than multiple times during individual lawsuits. Where individual victims would have brought suit, the class action gives rise to economies of scale, may justify more extensive evidence and increase the chances of recovery for all class members and put all class members on the same footing as regards the assets of the defendant to satisfy all claims against it (as in a bankruptcy proceedings).

Where individuals would not have brought suit because the damage they suffered is too small in regard to the minimal fixed cost of a lawsuit (small claims, but in different sense also mass torts, where the evidentiary problems may be extraordinarily complex and costly), the class action may make it possible to

impose on a wrongdoer the full weight of individually small harms inflicted on individuals, that would otherwise go undeterred. From an economic point of view, this "internalisation" of costs, shoring up the deterrent effect of legal rules, is a desirable development. Where individual victims are facing a large enterprise that is a repeat player in similar matters, with an interest in fighting to prevent any adverse judgment, class action may level the playing field.

Whilst these potential benefits of the class action are largely undisputed, the actual engineering of the institutions gives rise to difficulties that need to be controlled to avoid that they turn into perversities. Broadly these difficulties are of three kinds: who is to be included in the class, how to make sure that class counsel behaves in the interest of all class members, and how is pay-out to be organised. A few words on each.

Who is to be included in the class? One might have thought that voluntary joining of cases might do the job, but as the number of potential class members grows the transaction costs of this approach becomes practically insurmountable and justify public regulation. No two cases are identical but we should like to bring together cases for which the same evidence is apposite. To leave an element of voluntariness in the process, one may provide an option for individual class members to opt out, with the possibility of pursuing their individual lawsuits (Behavioral economists might like this nudging process). This may, however, complicate the settlement process for the defendant. For this to work, class members have to be contacted directly or by public notice and this in itself may be contentious and costly. Finally, how to deal with future victims of whatever is at stake in the class action (think of future asbestos victims).

In actual practice of class actions, it is the class action counsel who play the lead role. There may be several, as different persons try to start a class action for a similar cause against a single enterprise. These actions will have to be joined and a single lead counsel appointed. Coordination amongst counsel may be tricky. Once the class and the counsel have been certified, counsel cannot not effectively be supervised by the class members represented. Will counsel be paid by the hours spent or as a percentage of the judgement or settlement? If the latter, counsel may go for a "sweetheart deal" with the defendant, spending few hours on the case, but leading to an interesting fee per hour spent, whilst the defendant comes away with a payment burden below what a court, with much more work for counsel, might have awarded. This is not in the interest of the class members. Symmetrically, when a defendant sees a host of class actions

against it arising, it may contact counsel for the weakest group, offer a modest settlement and get that endorsed by the court as binding on the class as a whole ("reverse auction"). The mere threat of a class action may lead respectable defendants to settle, even where case would probably have been dismissed by the court on trial ("blackmail settlement"). In all cases, the remuneration of class counsel is under judicial supervision. But can the judge really be expected to supervise closely? Empirical evidence from the US suggests that supervision is all the more likely to be perfunctory as the court's role is full.

Once a settlement or court decision has been reached, the damages awarded to the plaintiff class have to be distributed. As claims may vary, this may involve a complex process of individual certification. Where a portion of the victims cannot be individually identified, and yet deterrent effect requires the defendant to "cough up", a portion of the damages may have to be awarded to bodies that pursue interests such as those of the victim-plaintiffs in that class action. Deciding who should be the beneficiaries may be a delicate matter.

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