Professor Rubenstein – A General Theory of the Class Suit

1. Professor Rubenstein's Proposition

Professor Rubenstein argues that the categories of class action litigation under Federal Rule of Civil Procedure 23(b) can be summarized within a single theoretical framework. The Professor's theory proposes that class litigation is structured to internalize externality problems that arise from an individual-oriented litigation system. An externality is "a cost or benefit that the voluntary actions of one or more people imposes or confers on a third party or parties without their consent." A negative externality results when one's actions impose a cost on another, while a positive externality exists when one's actions benefit those beyond the litigant, such as general deterrence of tortious conduct. Professor Rubenstein posits that representative litigation spreads the positive and negative externalities inherent to an individual-oriented adjudication process.

Rule 23(b) establishes four categories of class cases: (1) incompatible standards cases; (2) limited fund cases; (3) injunctive relief cases; and (4) aggregated money damages cases. Professor Rubenstien suggests that representative litigation does more than overcome collective action problems (where no individual has a sufficient self-interest to pursue a group's collective interest); rather, it controls negative externalities produced by individual litigation and creates positive externalities that would not otherwise be realized. For example, early litigants in limited funds cases deplete the fund and impose negative externalities on later litigants. Representative litigation equitably distributes this cost among all of the litigants in order to enable participation by the later litigants. In injunctive relief cases, the class structure increases access to the courts (a positive externality), internalizing the cost by subjecting those

who would have sought individual relief to a more burdensome class procedure. Representative litigation creates positive externalities for society (such as deterrence) when it enables under-produced litigation. For example, the small claims class aggregates negative value claims to create positive externalities like compensating injured parties and deterring tortious conduct. The costs of creating these social benefits are internalized in the adjudication process and "paid" by the litigants.

2. Can the structuring of any cause of action be explained by the externality theory?

I agree that class suits may function to redistribute externalities, but I am curious as to whether the externality theory may underlie any litigation model. Whether a claim is brought usually depends on whether the potential recovery justifies the risk and expense; thus, the abundance of a particular type of litigation is directly influenced by its damages model. Increasing the recovery threshold or lowering the burden of proof enables more individual litigation for that cause of action, thereby creating the desired positive externality by internalizing the costs in the adjudication system. For example, state consumer law statutes such as the Texas Deceptive Trade Practices Act transform negative value claims into individually viable lawsuits. *See* TEX. BUS. & COM. CODE §§ 17.41-.63; *see also Amstadt v. U.S. Brass Corp.*, 919 S.W.2d 644, 649 (Tex. 1996) (noting that the purpose of the DTPA is "to encourage consumers to litigate claims that would not otherwise be economically feasible and to deter the conduct the DTPA forbids"). This is done through a combination of fee shifting and damage multipliers. *See PPG Industries, Inc. v. JMB/Houston Centers Partners LP*, 146 S.W.3d 79 (Tex. 2004) (purpose of treble damages provision is "to encourage *privately initiated* consumer litigation, reducing the need for public enforcement" of deceptive business practices) (emphasis in original).

The positive externalities created by enabling consumer claims closely resemble those created by small claims classes: the litigant is compensated for its damages, consumers benefit as a whole from the deterrence of deceptive business practices, and future litigation costs and settlement ranges become more predictable to other businesses. While class suits enable litigation of negative value claims through aggregation, consumer statutes do so in the form of exponential damages and the shifting of attorney's fees. In both instances, social costs stemming from the underproduction of a positive externality are internalized by re-structuring a cause of action. In this sense, perhaps any damages model can be viewed from an externality perspective.

Correlation of class litigation to other internalization mechanisms could provide empirical support for the Professor's theory. If a type of claim could typically be brought only via class action (such as the small claims cases), but mechanisms like the DTPA have otherwise created the positive externalities and shifted the negative ones, then a corresponding reduction in class suits in that arena may suggest that class suits are externality-driven. In other words, if class actions were less prevalent in consumer cases (*i.e.* where the externality problem has been reduced), then this would suggest that class suits serve an internalization function. The same effect could be present in injunctive class litigation. For example, is there less injunctive class litigation where there is pervasive regulation and enforcement by government agencies? Are more injunctive class suits filed in less regulated areas? Representative litigation may therefore function to fill the gaps left by other internalization mechanisms.

3. <u>A Rawlsian perspective may support the negative externality theory of the class suit:</u>

Professor Rubenstein suggests that representative litigation is also structured to reduce negative externalities. Limited fund class suits force prospective claimants to consolidate their

action and achieve an equitable distribution of an insufficient source of recovery. The Professor characterizes this type of action as imposing a cost on early-comers (who would have recovered more) to the benefit of late-comers (who would not have otherwise brought their claim due to fund depletion). But why is this desirable? Is protecting late comers paternalistically motivated, or perhaps a mechanism for spreading the loss across more people? The negative externality theory could be further developed by discussing the rationale behind this cost spreading. One possible justification could be given from a Rawlsian perspective.

John Rawls devised a system of fairness that addresses the problem of distributive justice: because no one knows his place in society, nor his fortune in the distribution of assets or abilities, principles of justice should be chosen behind a veil of ignorance (the "Original Position"). John Rawls, *A Theory of Justice* (Harvard University Press 1971). Viewing the limited funds distribution problem from the Original Position, one would not know if they would be one of the few first-comers who recovers or one of the thousand later-comers who does not. A rational person with knowledge of these odds, but not of their individual position, would choose a system of equitable distribution like the limited-funds class: nobody feasts, yet nobody famines. The limited funds suit can also be viewed under Rawls' Maximin principle, which selects a system that maximizes the position of the least well-off. Limited funds classes serve this principle by maximizing the size of the fund through minimizing litigation costs, thereby eliminating negative externalities (assuming of course that one big lawsuit expends fewer resources than a thousand smaller ones).

Further support for this proposition may be drawn from specific class action procedures, such as notice requirements to unnamed class members and selection criteria for class

representatives in mandatory settlement classes. For example, one case involving a mandatory settlement class takes a Rawlsian approach to address the potential imposition of negative externalities on unnamed members in selecting a class representative. *See Uhl v. Thoroughbred Tech. & Telecomms. Inc.*, 2001 U.S. Dist. LEXIS 13115, 2001 WL 987840 (D.Ind. 2001). In *Uhl*, because the class representative "did not know whether his property (or anyone else's) was located on the [more favorable] Side or the [less favorable] Side, he lacked any incentive to negotiate a more favorable outcome for either group, and the knowledge necessary to create such an outcome." *Id.* Thus, the member would be a good class representative because he would be "particularly careful to make sure the compensation would be fair and reasonable no matter where [his] land ended up being. . . ." *Id.* *Uhl* provides a concrete example of a Rawlsian externality justification in a limited funds situation involving competing interests.

4. Conclusion

In sum, Professor Rubenstein's theory is a plausible explanation of the purpose of representative litigation. Comparison of the class suit to other internalization mechanisms like consumer protection statutes, government regulation, and other damages models could help further develop the Professor's argument. Finally, a discussion of the philosophies or motivations for redistributing negative externalities could help illustrate the justifications for the externality approach.