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LONG-SHOT CLASS ACTIONS:

Toward a Normative Theory of Legal Uncertainty

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I. INTRODUCTION

Many judges and legal scholars are extremely hostile to class actions in which plaintiffs, despite the fact that they would be unlikely to prevail if the case were litigated to a conclusion, nevertheless obtain a large settlement of their claims. For example, Judge Richard Posner, in an opinion denying plaintiffs the opportunity to maintain a class action, cited with approval Judge Henry Friendly's characterization of "settlements induced by a small probability of an immense judgment in a class action" as "blackmail settlements."[1] Professor George Priest, himself intensely critical of the rules governing class actions because they permit plaintiffs in class actions to secure substantial settlements even though they have little chance of prevailing, believes that there are judicial decisions refusing to certify class actions, purportedly because the requirements of the controlling rule have not been met, which are really explained by the court's desire to prevent plaintiffs with a small chance of winning from securing large settlements.[2]

The focus of this view on a normative evaluation of the results reached through settlement is remarkably rare in judicial opinions and legal scholarship. Settlement is, of course, the means through which the vast majority of litigation is resolved. There is, moreover, a large positive literature analyzing the factors that determine the settlement outcome.[3] What is lacking, however, is a normative theory for determining whether one outcome reached through settlement is "better" than another.[4] As a result, there is

1. In re Rhone-Poulenc, 51 F.3d 1293, 1298 (7th Cir. 1995)

2. George Priest; Procedural Versus Substantive Controls of Mass Torts Class Actions, 26 J. Legal Stud. 52 (1997)

3. For an excellent review of this literature, *see* Bruce L. Hay and Kathryn E. Spier, *Settlement of Litigation, in* 3 The New Palgrave Dictionary of Economics and The Law 442 (1998).

4. Hay and Spier, *supra* note 3, at 446 make it clear that parties' private settlement decisions do not yield outcomes that are socially desirable. Most important, the parties have no interest in producing outcomes that provide good incentives for the primary behavior out of which the

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no basis for evaluating various features of institutional design by reference to their impact on the settlement outcome.

The characterization of settlements in class actions secured by plaintiffs with "little chance of prevailing" as "blackmail settlements" implies that there is a normative foundation for regarding these settlements as socially undesirable. However, as far as I am aware, no one ascribing to this view has offered a systematic justification for it. Moreover, as articulated, it is substantially ambiguous. At what point is the probability of success so low as to justify the pejorative characterization "blackmail"? How large does the potential judgment have to be before it can be characterized as "immense"?

The principal purpose of this article is to make more precise the theoretical issues that are implicated by an effort to formulate normative criteria for determining the social desirability of "long-shot" claims seeking substantial recovery. My own conclusion is that if these theoretical issues are formulated precisely, the hostility to "long-shot" class actions is shown to be unsupported on any basis currently articulated in judicial opinions or legal scholarship. On the other hand, the concerns that motivate this hostility to "long-shot" claims are not frivolous. It is entirely possible that new theory systematically taking these concerns into account may provide a foundation for disapproving of settlements in class actions secured by plaintiffs with little chance of prevailing. This article may be viewed as a challenge to the adherents of the "blackmail" position to attempt to formulate and articulate a systematic justification for it.

There are two strands of currently available theory that might provide the basis for disapproval of the "long-shot" class action. The first focuses on the question of whether there is anything socially undesirable about a plaintiff taking advantage through settlement of a "small" chance that she may prevail. I am the coauthor of, as far as I know, the only article dealing directly with this question.[5]

The second strand of theory focuses on risk aversion.[6] A plaintiff will settle for less than the expected value (probability times magnitude) of her claim because the possibility of the negative outcome of no recovery weighs more heavily in her decision than the positive outcome of securing recovery. A defendant will settle for more than the expected value of her

case arises. They conclude (at 447) ". . . some settlement amounts are socially preferable to others, in that certain settlements will have undesirable effects on primary behavior. . . . Yet because the dispute comes after the primary behavior has occurred, parties will not take such behavioral effects into account when deciding on a settlement amount. Hence there is . . . a prima facie argument for some governmental intervention into the choice among settlement amounts."

5. *See* C. Frederick Beckner III and Warren F. Schwartz, *Toward a Theory of the "Meritorious Case": Legal Uncertainty as a Social Choice Problem*, 4 GEO. MASON L. REV. 801 (1998).

6. For an excellent technical discussion, *see* Edi Karni, *Attitude Toward Risk*, *in* THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 114 (1998).

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liability because the negative outcome of having liability imposed weighs more heavily in her decision than the positive outcome of being exonerated. Settlement, then, is akin to insurance in that a premium is paid to avoid the risk of the negative outcome which each litigant wishes to avoid.[7]

As a positive matter, the worse the negative outcome is, the greater will be the premium that a party will pay. For the defendant, this depends on the magnitude of the liability to which she will be subjected if she loses the case. I interpret the characterization of the magnitude of liability as "immense" to mean so great that defendant will pay a "large" premium to avoid being subjected to even a small risk that liability will be imposed. The implicit normative basis for disapproving an outcome of this kind must be that a point is reached where risk aversion plays "too large" a role in determining how much the defendant will pay in settlement. As a result, recovery for the plaintiff is "too large" because of the extent to which plaintiff has exploited defendant's risk aversion.

I now turn to a more detailed analysis of these two strands of theory.

II. LEGAL UNCERTAINTY

A. Introduction

At bottom, the absence of a normative theory of legal uncertainty is attributable to the fact that no one knows what importance to assign to the possibility that a plaintiff might prevail if the case were litigated. There is no doubt that there are cases that might be decided differently by various judges or juries and either result would be affirmed on appeal. Indeed, with respect to jury trials such cases are popularly characterized as "for the jury." This characterization unmistakably implies that either imposing liability or exonerating the defendant is a reasonable result and that it is the role of the jury to determine the outcome. Such a view also implies that the different "priors" that different juries bring to bear in evaluating the evidence, rather than differences in the evidence itself, can lead juries to decide identical cases differently. This conception seems correct because the "priors" of a decision-maker, that is, the empirical generalizations and normative preferences brought to bear in drawing inferences from the (often conflicting) evidence, are important in determining the outcome.

What, then, is the "right" result to be reached through settlement when it is anticipated that some judges or juries would impose liability and others would not? More pointedly, is there a discontinuity in the appropriate normative criterion so that if only some "small" proportion of judges or juries would impose liability we should seek to minimize or, perhaps, totally

7. *See* Hay and Spier, *supra* note 4, at 442.

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eliminate, the influence of the possibility of the minority outcome on defendant's settlement determination?

B. Correct Decisions

There are two ways to approach this question. The first one I will consider starts with the assumption that there is only one "right" outcome. From this perspective, it seems plausible that, as a decision to impose or deny liability would be reached by only a smaller and smaller proportion of judges or juries, the inference becomes stronger that the decision supported by the minority is "wrong."

There are three major difficulties in formulating and implementing this conception:

(1) As a theoretical matter, (a) how do you determine what the correlation is between the proportion of judges or juries who would decide one way or the other and the probability that the outcome is "correct"; and (b) what is the normative relevance of different probabilities?

(2) As a practical matter, how can it be determined what the probability of a plaintiff prevailing is? We will rarely have information as to the outcome previously reached in similar cases. Even if we do, there is no way to determine the extent to which the different outcomes were attributable to variations in the "priors" of decision-makers or to differences in the evidence and arguments presented by counsel. Presumably, the "correct" outcome is to be determined on the basis of the evidence and arguments presented by counsel rather than some hypothetical process yielding "perfect information." As a result, if the presentations in two cases were significantly different, it is possible that both cases, although reaching different outcomes, were "correctly" decided.[8]

(3) What legal instrument can be employed to reduce or eliminate the influence of "small" minority sentiment on the settlement outcome? The choice of instrument must, of course, be appropriate for the normative theory that is sought to be implemented. The theory will have to specify either some probability that is so small that it should have no influence on the settlement outcome or some basis for varying the influence of the probability of success with the magnitude of that probability.

The version of these theories which posits that a claim should be dismissed unless it has some minimum chance of success would seem, in principle, to be the easiest to implement. The summary judgment standard could be redefined to require dismissal of the action if plaintiff did not have

8. This analysis can be extended by considering the possibility that the litigants are uncertain as to how good a job their counsel would do if the case were litigated. It is difficult to think of anything systematic to say how about how uncertainties of this kind should affect the settlement outcome.

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some specified minimum chance of prevailing. Such an approach would, however, assign central importance to the question of whether plaintiff's chances of success were less than the requisite minimum. With so much at stake, both parties would commit very large resources to prevailing on the issue. The judge deciding the question would be exercising great and unprecedented power to dismiss a case at a preliminary stage. She would, moreover, be doing so on the novel ground that she predicts that plaintiff is very unlikely to succeed rather than the usual ground that she herself thinks that the claim has no merit. My speculation is that dismissal would rarely occur even if we could somehow choose the likelihood of success that in principle should be required for the case not to be dismissed.

If the normative theory adopted is that the influence on the settlement outcome of the possibility that plaintiff might prevail should be less as the plaintiff's chances of succeeding decline, it is difficult to think of any procedural device that could be employed to implement the theory. Judge Posner did choose the one procedural means available to him: denial of the right to maintain a class action. But even if one adopts some theory that "small" chances to prevail should have less influence on the settlement outcome than "large" ones, denial of the right to maintain a class action is a very poor way to implement the theory. As a positive matter, there is no doubt that the class action provides a more favorable settlement environment for a group of plaintiffs than individual actions by members of the group. As will be discussed in the next section, this is because risk aversion will weigh less heavily in a defendant's settlement decision in individual actions than in class actions. There is, however, no systematic relationship between the reduction in the amount realized through settlement by plaintiffs if required to sue individually and the appropriate decrease to reflect the "small" likelihood that plaintiff would prevail if the case were tried.

It is not clear what normative implications adherents of the "economic blackmail" view draw from the fact that plaintiffs will do better in settling a class action than individual actions. They could be saying that providing the less favorable settlement environment of the individual action is an appropriate way to reduce the impact of "small" chances of success on the settlement outcome. They could also be saying that plaintiff's chances of prevailing aside, the settlement environment of the individual action is, from the social point of view, "better" than that of the class action because defendant's risk aversion is less important in determining the settlement outcome. They may also be saying both of these things.

Accordingly, in the next section I turn to the second basic question that is implicated by the effort to formulate a normative view of "long-shot" class actions: What is the "right" influence that risk aversion should have in determining the settlement outcome?

Before doing this, however, I consider the second way in which the phenomenon of legal uncertainty may be analyzed.

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C. Social Choice

With respect to certain questions decided by judges or juries, there may be no "correct" answer—certainly no answer that can be reached through a feasible process that yields an answer that can be accepted with great confidence. This is so in many instances because there is no way to verify the different empirical and normative "priors" that lead decision-makers to arrive at different conclusions when confronted with the same body of evidence. The "for the jury" characterization, as contrasted with the "as a matter of law" characterization, is applied to that class of cases in which it is accepted that the "priors" of a decision-maker will be decisive and that "priors" leading to either result cannot be rejected as unreasonable.

The most important example of a question of this kind is the "reasonable care" standard. Under one conception or another, the costs of precautions reducing expected harm must be balanced again the harm that would occur if the precautions were not taken. With respect to both costs and benefits, there are empirical uncertainties as to how much a precaution would cost and how much it would reduce expected harm. Moreover, beyond the empirical uncertainties there is the troublesome question of valuing the costs of precautions and the reduction in expected harm on a common scale that permits both to be taken properly into account. This problem is particularly difficult because many of the things upon which value must be placed, such as arriving at a destination at a later time or experiencing pain, are not bought and sold. The economist's method of valuing things of this kind by asking what the price would be if these things were sold is rejected by many and recognized by its most passionate adherents to be very difficult to apply.[9]

In these circumstances, a decision-maker's unverifiable "priors" are likely to be decisive in deciding whether the cost of the precaution was more or less than the associated reduction in expected harm. Social choice theory begins with the recognition that when this is so, there is no "correct" answer. The crucial issue becomes the design of institutions that assign appropriate influence to various segments of opinion in the population.

The principal focus of social choice scholarship has been the legislative process. The theory teaches that in analyzing and evaluating an institutional means of making a social decision, three characteristics are of primary importance:

(1) the universe of people authorized to participate in the decision-making;
(2) the decision rule that determines the outcome when there is a division of opinion as to what the outcome should be;
(3) the agenda defining the possible outcomes that may be reached.

9. The difficulties in reaching an "objective" conclusion as to whether the defendant took reasonable care are discussed in Beckner and Schwartz, *supra* note 5, at 815–816.

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I have coauthored a series of articles applying this analysis to the criminal jury.[10] The starting point for this approach is that with respect to the "for the jury" cases, the jury is acting like an ad hoc legislature to resolve issues that the legislature could not or would not resolve by highly specific statutory language and has left for determination in the concrete context of an actual dispute. If this approach is accepted, the issue is not whether an outcome conforms to some assumed "correct" one (arrived at in some unspecified manner) but whether the various segments of "reasonable" opinion within the society have been assigned appropriate influence.

As far as I am aware, Judge Posner, in the *Rhone-Poulenc* case, was the first person to apply social choice theory to the question of whether plaintiffs should be permitted to maintain a class action. In that case, there was no question that plaintiffs had suffered great harm, because they had contracted the HIV virus from a drug to treat hemophilia manufactured by defendants. The contested issue was whether defendants had been negligent in failing to remove the substance causing the HIV infection from the drug. In deciding that the district judge abused his discretion in certifying a class action, Judge Posner relied upon three "concerns." He explained the first of these as follows:[11]

> The first is a concern with forcing these defendants to stake their companies on the outcome of a single jury trial, or be forced by fear of the risk of bankruptcy to settle even if they have no legal liability, when it is entirely feasible to allow a final, authoritative determination of their liability for the colossal misfortune that has befallen the hemophiliac population to emerge from a decentralized process of multiple trials, involving different juries, and different standards of liability, in different jurisdictions; and when, in addition, the preliminary indications are that the defendants are not liable for the grievous harm that has befallen the members of the class. These qualifications are important. In most class actions—and those are the ones in which the rationale for the procedure is most compelling—individual suits are infeasible because the claim of each class member is tiny relative to the expense of litigation. That plainly is not the situation here. A notable feature of this case, and one that has not been remarked upon or encountered, so far as we are aware, in previous cases, is the demonstrated great likelihood that the plaintiffs' claims, despite their human appeal, lack legal merit. This is the inference from the defendants' having won 92.3 percent (12/13) of the cases to have gone to judgment. Granted, thirteen is a small sample and further trials, if they are held, may alter the pattern that the sample reveals. But whether they do or not, the result will be robust if these further trials are permitted to go forward because the pattern that results will reflect a consensus, or at least a pooling of judgment, of many different tribunals.

10. *See* Edward P. Schwartz and Warren F. Schwartz, *And So Say Some of Us . . . What To Do When Jurors Disagree*, 9 S. CAL. INTERDISC. L.J., 429 (2000); *The Challenge of Peremptory Challenges*, 12 J.L. ECON. ORG. 325 (1996); *Capital Punishment as a Social Choice Problem*, 1 LEGAL THEORY 113 (1995); *Decisionmaking by Juries Under Unanimity and Supermajority Voting Rules*, 80 GEO. L.J. 775 (1992).

11. 51F. 3d at 1299–1300.

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> For this consensus or maturing of judgment the district judge proposes to substitute a single trial before a single jury. One jury, consisting of six persons, will hold the fate of an industry in the palm of its hand. This jury, jury number fourteen, may disagree with twelve of the previous thirteen juries—and hurl the industry into bankruptcy. That kind of thing can happen in our system of civil justice (it is not likely to happen, because the industry is likely to settle—whether or not it really is liable) without violating anyone's legal rights. But it need not be tolerated when the alternative exists of submitting an issue to multiple juries constituting in the aggregate a much larger and more diverse sample of decision-makers. That would not be a feasible option if the stakes to each class member were too slight to repay the cost of suit, even though the aggregate stakes were very large and would repay the costs of a consolidated proceeding. But this is not the case with regard to the HIV-hemophilia litigation. Each plaintiff if successful is apt to receive a judgment in the millions. With the aggregate stakes in the tens or hundreds of millions of dollars, or even in the billions, it is not a waste of judicial resources to conduct more than one trial, before more than six jurors, to determine whether a major segment of the international pharmaceutical industry is to follow the asbestos manufacturers into Chapter 11.

It is difficult to determine exactly what this passage means. It does seem clear, however, that Judge Posner believes that multiple individual trials are superior to a class action as the institutional means for resolving plaintiffs' claims. Moreover, his focus is not exclusively on correctness but, importantly, on the universe of decision-makers whose "priors" will be decisive. It is also clear that he prefers an agenda of individual cases to a single determination in a class action.

What appears to lie at the heart of his concern is the possibility that if a class action is permitted, "minority" sentiment may prevail with respect to all cases. The fear that this may happen will lead a defendant to settle for a large amount. Judge Posner regards this as an undesirable outcome if plaintiffs have only a "small" chance of prevailing and could sue individually if denied the right to maintain a class action.[12]

I join Judge Posner in believing that there are relevant differences, from the point of view of social choice theory, between a class action and individual actions. However, his claim that individual actions are "better" when judged from this perspective constitutes no more than assertion. Moreover, the question as to which is better is a difficult one. Indeed I am unaware of any scholarly writing that offers much help in answering it.

I begin by assuming, for present purposes, as Judge Posner apparently did, that the pattern of the plaintiff prevailing one in thirteen times, which occurred in the past, is likely to continue in the future. I interpret this to

12. Judge Posner apparently assumes, presumably because defendants had prevailed in some of the prior cases, that a victory in an individual case would not, through the doctrine of collateral estoppel, be binding against defendants in the remaining undetermined suits. If collateral estoppel did apply, it would seem that the charge of "economic blackmail" would provide the basis for disapproving of the collateral estoppel doctrine.

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mean that the "priors" of the population from which juries are taken are such that the great majority of individuals would not impose liability on defendants. In these circumstances, there are two possible objectives of institutional design: (1) all cases should be decided in accordance with predominant majority sentiment; or (2) minority sentiment should somehow be expressed in the universe of outcomes.

If the decision rule governing the jury requires a high degree of consensus and the composition of the jury is truly representative of the general population, substantial majority sentiment will always prevail.[13] For minority sentiment to become relevant, one of two things must be true: (1) sampling error occurs so that minority sentiment in the general population dominates in the particular jury; or (2) the consensus requirement for the jury is so great that the majority must logroll with the minority in order to achieve the necessary consensus. The important example is that a minority favoring exoneration is induced to vote to impose liability by the majority agreeing to the award of small damages. This cannot occur if, as in *Rhone-Poulenc*, the class action jury decides only the question of liability and a different jury determines damages.

The question, then, is how sampling error gives expression to minority sentiment in a class action or individual actions. The essential difference between a class action and individual actions is that if the class action is permitted, a defendant has a one-in-thirteen chance of losing all cases. If individual actions are required, a defendant is likely to lose one in thirteen of them and prevail in the others. As a result, the expected value of defendant's liability is one-thirteenth of plaintiff's total claims whether there is one class action or many individual actions. Moreover, if defendants are risk neutral, the recovery of each plaintiff will be the same whether they sue as a class or individually.

This is so because settlement plays an important social choice role that I believe has not been noted before. If the class action and individual actions were all litigated to a conclusion, the benefits of sampling error giving impact to minority sentiment would be distributed differently among plaintiffs, depending upon whether a class action or individual actions were used. In a class action, ex ante, plaintiffs each have an equal share in the one-in-thirteen chance of recovering. Ex post, all of them or none of them recover. In individual actions, ex ante, each plaintiff has a one-in-thirteen chance of prevailing. But, ex post, one in thirteen secures recovery and twelve in thirteen recover nothing.

13. Rule 48 of the Federal Rules of Civil Procedure provides "unless the parties otherwise stipulate . . . the verdict shall be unanimous." If there is any significant division of opinion within the population from which the jury is chosen, the jury is representative of the population and jurors vote sincerely, the unanimity requirement will rarely, if ever, be satisfied. If, however, one outcome is preferred by a large majority of the jury, the minority may accept that outcome. For a general discussion of this phenomenon, *see* Edward P. Schwartz and Warren F. Schwartz, *And So Say Some of Us, What To Do When Jurors Disagree*, 9 S. Cal. Interdisc. L.J. 429, 440 (2000).

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What settlement does is to make the one-in-thirteen ex ante chance of prevailing the determining factor for all plaintiffs. Ex post, all plaintiffs, through settlement, realize the benefits of the ex ante chance of prevailing created by sampling error. This is so because a defendant in each individual case may know she has a one-in-thirteen chance of losing. She does not know, however, which plaintiff will be the winner. She settles to avoid the possibility that is it the plaintiff in the particular case who will be the winner. This is, moreover, true in all cases.

The small size of the six-person jury does make the chances of sampling error larger than they would be if the size of the jury were larger. But the impact of this error, again, a defendant's risk aversion aside, is the same whether a class action is maintained or each plaintiff sues individually. Every six-person jury, whether in a class action or individual actions, is as likely to be unrepresentative of the population from which it is chosen.

The more basic question is whether what is called sampling error is necessarily a bad thing. With respect to a binary question such as liability, it is impossible to devise any elegant means to give effect to minority sentiment because there is no continuous dimension such as damages on which to reflect divergent opinion. Minority sentiment can be given influence only by having it sometimes prevail. Sampling error is a crude way to do this. The larger the minority in the population at large and the smaller the sample, the greater will be the number of times that, as a result of sampling error, the minority has the requisite majority in a particular jury to achieve the outcome it prefers. Through settlement, the benefit resulting from the chance that minority sentiment will prevail is shared by all plaintiffs. This is a crude solution, but so, really, is having the majority always prevail.

There is, however, one important difference between the class action and individual actions in determining the impact of sampling error. If the class action is maintained, there is a small chance that defendants will lose all cases. This is a very bad outcome for defendants. If a large number of individual actions are maintained, there is a near-certainty that defendants will lose a proportion of them and prevail in the rest. In technical terms, there is more variance in the "all or nothing" class action. As a result, the possibility of an outlier jury granting recovery to all plaintiffs will lead to a higher settlement in a class action than the total of settlements in individual actions. Whether this is a good or bad thing depends on the normative theory of the role of risk aversion in determining settlement outcomes that is adopted. I now turn to that question.

III. RISK AVERSION

Risk aversion is one of the two factors that lead to the settlement of litigation. The first, of course, is the cost saving which can be shared by the parties. In addition, however, in the settlement calculation of each party, the

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unfavorable outcome—no recovery for the plaintiff, imposition of liability for the defendant—often weighs more heavily than the favorable one.[14] In simple terms, a plaintiff will value a one-in-ten chance of recovering one million dollars at less than one hundred thousand dollars and a defendant will value a one-in-ten chance of being liable for one million dollars at more than one hundred thousand dollars. Settlement at any figure between the two valuations will be mutually advantageous.

Thus it can be concluded that settlement is a good thing because it economizes on litigation costs and permits the two parties, in effect, to purchase insurance from each other against the risk of an adverse outcome. Because of these benefits, the great majority of cases are resolved through settlement.

The relevant complication, for present purposes, is that while all settlements (mistakes aside) are mutually beneficial in the environment in which they occur, there are different institutional environments that are more favorable to one party or the other. As a positive matter, there is no doubt that a class action is more favorable to a group of plaintiffs than are individual actions by members of the group. The higher stakes of the class action are attributable to two factors: (1) the aggregation of claims that would be brought individually if a class action were not permitted; and (2) the addition of claims that would be brought only if a class action were permitted.[15]

14. *See* Hay and Spier, *supra* note 3, at 442.

15. Among the remarkable aspects of Judge Posner's opinion in *Rhone-Poulenc* is that he regards the fact that there are plaintiffs who would secure relief only if a class action were permitted as a reason not to permit a class action because the possibility of recovery by these plaintiffs increases the potential liability of defendants and consequently the risk premium they would be prepared to pay in settlement. Judge Posner reasons (51f.3d at 1298):

> The reason that an appeal will come too late to provide effective relief for these defendants is the sheer magnitude of the risk to which the class action, in contrast to the individual actions pending or likely, exposes them. Consider the situation that would obtain if the class had not been certified. The defendants would be facing 300 suits. More might be filed, but probably only a few more, because the statutes of limitations in the various states are rapidly expiring for potential plaintiffs. The blood supply has been safe since 1985. That is ten years ago. The risk to hemophiliacs of having become infected with HIV has been widely publicized; it is unlikely that many hemophiliacs are unaware of it. Three hundred is not a trivial number of lawsuits. The potential damages in each one are great. But the defendants have won twelve of the first thirteen, and, if this is a representative sample, they are likely to win most of the remaining ones as well. Perhaps in the end, if a class-action treatment is denied . . . they will be compelled to pay damages in only 25 cases, involving a potential liability of perhaps no more than $125 million altogether.
>
> Suppose that 5,000 of the potential class members are not yet barred by the statute of limitations. And suppose the named plaintiffs in Wadleigh win the class portion of this case to the extent of establishing the defendants' liability under either of the two negligence theories. It is true that this would only be prima facie liability, that the defendants would have various defenses. But they could not be confident that the defenses would prevail. They might, therefore, easily be facing $25 billion in potential liability (conceivably more), and with it bankruptcy. They may not wish to roll these dice. That is putting it mildly. They will be under intense pressure to settle.

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I do not quarrel with the positive conclusion that the greater stakes in a class action will, *cetus parabus*, lead to a greater total recovery for plaintiffs than individual actions would, even if all members of the class were to sue individually. What I dispute is that there is any reason to believe that the lesser recovery through individual actions is the preferred outcome from the social perspective. Indeed, I see no alternative to being entirely agnostic with respect to this question. Thus it should play no part in the decision of whether to permit a class action. That decision should be made, as it most often is, based upon the efficiency of a class action as compared to individual actions. Moreover, from this perspective, the increase in plaintiffs who would be able to secure relief is one of the principal benefits produced in the class action.

There is no normative theory of which I am aware that provides a basis for preferring either the (more favorable to plaintiffs) settlement environment of the class action or the (more favorable to defendants) settlement environment of the individual action. For both plaintiffs and defendants, the root cause of risk aversion is that the possibility of an unfavorable outcome weighs more heavily in the settlement decision than does the possibility of a favorable outcome. The unfavorable outcome—no recovery—is the same for plaintiffs in a class action and in individual actions. The weight assigned to this possibility varies with the financial circumstances of the plaintiff and the severity of her need for money. For a plaintiff who is of limited means, requires substantial medical treatment, and has been impaired in her ability to earn income, the bad outcome of no recovery is a very bad one indeed. Such a plaintiff will be prepared to accept in settlement far less than the expected value of her claim.

The question of which level of risk aversion is better for a defendant is thus very much a question of the second-best. We begin with a plaintiff who, in any event, will be disadvantaged in settlement negotiations because of her risk aversion. The effect of this risk aversion is to some extent offset by the defendant's risk aversion. Just as a risk-averse plaintiff will be prepared to accept less than the expected value of her claim, a risk-averse defendant will be prepared to pay more than the expected value of her liability. The defendant will be prepared to pay more as a risk premium in a class action than the total of risk premiums in individual suits. But what basis is there for preferring one of these risk premiums to the other?

There are two principle obstacles to answering this question. First of all, the usual approach to risk-bearing has no relevance here. That approach emphasizes the costliness of bearing risk and the role of risk aversion in preventing the movement of resources to their highest-valued use. But settlement is a process in which each of the parties obtains insurance from the other. The settlement amount includes the net premium that the defendant pays. When the case is settled, no risk remains. Indeed, as noted above, this is an important reason why cases are settled. As a result, all that occurs in the end is a transfer payment from defendant to plaintiff.

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The only conceivable basis for preferring a larger or smaller payment would be the incentive effect on the behavior of the parties of their anticipating one amount or another. There is, however, no systematic relationship between the amount of the transfer and any of the choices made by the parties in the events out of which the dispute arises.

The second obstacle to choosing between the class action and an individual action is that if there were a systematic relationship between the role of risk aversion in the settlement outcome and the correct recovery in terms of incentives for primary behavior, it would not help in choosing the better settlement environment. The magnitude of defendant's possible liability is only one factor determining the role of risk aversion in the settlement process. If we knew what we wanted to accomplish, we would have to take account somehow of these other factors and arrive at a conclusion as to how risk adverse defendant would be in deciding how much she was prepared to pay in settlement. We would also have to determine the role of risk aversion in the plaintiff's settlement decision as well. All of this simply cannot be done.

IV. CONCLUSION

My immediate objective in writing this article was to expose the weakness of the theoretical foundation for the hostility toward long-shot class actions expressed in the "economic blackmail" characterization. As my analysis proceeded, however, I perceived a more general and very important question implicated by the manner in which Judge Posner justified his refusal to permit plaintiffs to maintain a class action.

I came to believe that the reasons articulated in Judge Posner's opinion were so unpersuasive as to raise serious doubts as to whether they were really the ones that motivated him to intervene so decisively to prevent plaintiffs' maintaining a class action.[16] The nice points about the role of risk aversion in determining the settlement outcome, and sampling error resulting from the six-person jury, particularly as obscurely articulated by Judge Posner, seem inadequate to induce Judge Posner to take the initiative and rescue defendants from the perils of a class action. I speculate that what really moved Judge Posner was a belief that too much power has been conferred on juries and that juries are using that power systematically to discriminate against defendants. I am not alone in this interpretation. Judge Spiegel, in declining to rely on Judge Posner's opinion to deny plaintiffs the right to maintain a class action, commented:

16. The settlement-oriented theory contained in the opinion was not advanced by defendants but rather was formulated and introduced on Judge Posner's initiative. Judge Posner further conceded that defendants would not argue that certification of a class action would worsen the settlement environment for them because "such an acknowledgment would greatly weaken them in any settlement negotiations" (51 F.3d at 1296).

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> While Judge Posner's economic theories and distrust of juries may carry weight in the Seventh Circuit, we are still bound by the Federal Rules of Civil Procedure. It causes this Court pause that one of this nation's most respected jurists has lost faith in the very system in which he participates.[17]

The concern of special importance to me is not that Judge Posner has lost faith in the jury but rather that he has apparently lost faith in careful economic analysis as a mean for achieving a better legal system. As I believe I have demonstrated, a judge seeking to apply economic analysis to the question of whether long-shot class actions should be permitted encounters difficult theoretical and practical issues.

Traversing the distance between theory as articulated in academic literature and theory as the basis for formulating and implementing legal rules is not an easy matter. The designation "law and economics" strongly implies that adherents of the movement possess useful insights as to how theory can be integrated into a legal system so that it better meets the needs of the people governed by the system. It would be expected that the most influential law and economics scholar, provided with the opportunity to use economic theory in his capacity as a judge, would make a very important contribution to an understanding of how economic theory can be fruitfully integrated into the legal system.

This promise is, however, unfulfilled in Judge Posner's opinion in *Rhone-Poulenc*. The opinion is an unhappy mixture of expediency (do anything to reduce the harm inflicted by irresponsible juries), obfuscation (what, exactly is the theory of the case?) and disingenuousness (tears for defendants settling to avoid bankruptcy but apparent indifference to victims settling to avoid destitution).

This failure can be viewed from a more general perspective than the contribution of law and economics to a good legal system. Those of us in the legal community who continue to cling to the hope that there is some meaning to the notion of the "rule of law" struggle to capture the constraints upon purely ideological decision-making by judges that, if in place, would make the legal system a better one. Law and economics scholars believe that the rigorous use of economic analysis is one such constraint. One would expect that Judge Posner would share this view. But I perceive a disturbingly large possibility that Judge Posner did not honor this constraint in his opinion in *Rhone-Poulenc*. If he had done so, he could not have decided the case on the basis of an unacknowledged belief about the poor

17. In re Tectronics Paging Systems, 168 F.R.D. 203, 209–10 (S.D. Ohio 1996). Judge Posner's opinion has received mixed reviews from other courts. *Compare* Costano v. the American Tobacco Company, 84 F.3d, 743, 746, 752 (5th Cir. 1996) (citing Judge Posner's opinion with approval and concluding its lengthy opinion by stating: "the collective wisdom of individual juries is necessary before this court commits the fate of an entire industry, or indeed the fate of a class of millions, to a single jury") with Valentino v. Carter Wallace, 97 F.3d 1227, 1232 (9th Cir. 1996) (We . . . do not accept [defendants] invitation to adopt the principles of Rhone-Poulenc as the law of this circuit").

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functioning of juries. Nor could he have offered as “cover” for doing this the poorly reasoned economic analysis contained in the opinion.

I confess that my condemnation of the opinion is largely fueled by my admiration for the clarity and rigor of many of Judge Posner’s academic writings. I conclude by wondering whether these characteristics are simply much less important in judicial opinions or whether the quality of the legal system is impaired by judges writing opinions that are defective in these respects.

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