Why Enable Litigation? A Positive Externalities Theory of the Small Claims Class Action

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WHY ENABLE LITIGATION?: A POSITIVE EXTERNALITIES THEORY OF THE SMALL CLAIMS CLASS ACTION

by

WILLIAM B. RUBENSTEIN
WHY ENABLE LITIGATION?:
A POSITIVE EXTERNALITIES THEORY OF THE SMALL CLAIMS CLASS ACTION

William B. Rubenstein*

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I.  INTRODUCTION

The class action mechanism made Phillips Petroleum v. Shutts\(^1\) possible; without it, no lawsuit would have been pursued, no Supreme Court decision provoked, no twentieth anniversary celebrated. The defendant owed thousands of dispersed plaintiffs minute amounts of interest on overdue natural gas royalty

\(^*\) Professor of Law, UCLA School of Law. I am grateful for helpful comments that I received from Steve Bainbridge, Mark Grady, Sam Issacharoff, Seana Shiffrin, and Steve Yeazell, and for the research assistance of Holning Lau. I am particularly indebted to Lynn Stout for helping me think through the relationship of externalities, collective action, and class actions.

\(^1\) 472 U.S. 797 (1985).
payments. With the value of their claims outweighed by the costs of pursuing them, most of these plaintiffs, the Supreme Court observed, "would have no realistic day in court if a class action were not available." But it was and they did. The class action mechanism enabled "the plaintiffs to pool claims which would be uneconomical to litigate individually," explained then-Associate Justice Rehnquist writing for the Court.

Embedded in this common account of the small claims case are two prevalent ideas about the class action mechanism: that it enables litigation by gathering plaintiffs together so that they can actively pool their claims and that the reason it does so is, figuratively speaking, to assure the plaintiffs' "day in court," or literally, to recoup the plaintiffs' losses. Of course, neither of these conventions is quite right: as the Shutts Court itself later acknowledges, plaintiffs in small claims class actions do nothing, they do that nothing far from the courtroom, and what they collect is likely to be about as close to nothing as was the effort they put in to collecting it. Nonetheless, like Shutts, most class action law tends to justify the device by reference to the plaintiffs' plight and as a means of vindicating the plaintiffs' interests. An important strain of the scholarly literature incorporates similar emphases. Scholars have demonstrated that the small claims class faces what economists call a "collective action problem" and they have applauded the class mechanism as the means by which the class overcomes this problem.

My goal in this Article, as may already be apparent, is to suggest some wrinkles in the collective action story of the small claims class action. I argue

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2 Shutts, 472 U.S. at 809.
3 Id.
5 A good explication of this theory in the class action literature can be found in Jonathan R. Macey & Geoffrey C. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1 (1991). Macey and Miller state that "[t]he class action is a tool for overcoming the free-rider and other collective action problems that impair any attempt to organize a large number of discrete individuals in any common project." Id. at 8. See also, Alexandra Lahav, *Fundamental Principles for Class Action Governance*, 37 IND. L. REV. 65, 70 (2003) (stating "[a]mong other things, class actions solve the collection action problems faced by individuals with claims too small to be economically adjudicated individually . . ."); Joseph A. Grundfest & Michael A. Perino, *The Pentium Papers: A Case Study of Collective Institutional Investor Activism in Litigation*, 38 ARIZ. L. REV. 559, 563 (1996) (stating, in a section entitled "The Theory of Collective Action and Class Actions," "[t]he class action device is an attempt to overcome the problem of dispersed injured parties whose damage claims are sufficiently small that they lack incentives to pursue individual litigation. Absent the class action device, collective action problems can prevent the aggregation of individual claims into one action that would support economically viable litigation."); Randall S. Thomas & Robert G. Hansen, *Auctioning Class Action and Derivative Litigations: A Critical Analysis*, 87 NW. U. L. REV. 423, 427 (1993) (stating "the class action aims to overcome the collective action problems inherent in any effort to organize a large group of individuals into one common project").

both that the means is not quite what the account’s name implies and that the end is not just what the account’s content suggests. But I come to praise this form of representative litigation, not to bury it. I therefore offer a new defense of the small claims class action, one based not on the collective action theory but on the related concept of positive externalities.\(^6\) The class action mechanism is important not just because it enables a group of litigants to conquer a collective action problem and secure relief, but also – perhaps more so – because it produces external benefits for society.\(^7\) It is these spillover effects, these externalities, that are under-produced in the small claims setting in the absence of the class form. By explicating this externalities theory of the small claims class action, my goal is not to displace but to supplement the collective action theory.\(^8\)

The externalities theory supplements the collective action theory because it explicates the ends that class actions serve, not just the means for accomplishing those ends.\(^9\) Moreover, like the collective action theory, the externalities theory employs economic insights to illuminate our understanding of litigation. The theories complement one another because they are both tethered to the economic conundrum presented by so-called “public goods.” The phrase “public goods” is meant to describe goods that governments must provide because private profit-oriented markets are unlikely to do so. Markets have difficulty producing public

\(^6\) An “externality is defined as 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.” ROBERT COOTER \& THOMAS ULEN, LAW AND ECONOMICS 45 (1988). A negative externality “results when the activity of one person . . . imposes a cost on someone else.” JEFFREY L. HARRISON, LAW AND ECONOMICS IN A NUTSHELL 42 (2d ed. 2000). “Positive externalities occur when the activities of an individual . . . result in benefits, the value of which the producer is unable to internalize or enjoy.” Id. at 46. The concept of externalities is generally traced to the British economist A. C. Pigou, who in 1920 stated that externalities are created by exchange when:

\begin{quote}
[O]ne person A, in the course of rendering some service, for which payment is made, to the second person B, incidentally also renders services or disservice to other persons . . . of such a sort that payment cannot be exacted from the benefited parties or compensation enforced on behalf of the injured parties.
\end{quote}


\(^7\) See RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 530-31 (6th ed. 2003) (discussing social benefits of litigation beyond dispute resolution).

\(^8\) The one scholarly article discussing class actions and externalities is Gerald A. Wright’s Note, The Cost-Internalization Case for Class Actions, 21 STAN. L. REV. 383 (1968-1969). Wright generally uses “externalities” to refer to the negative externalities underlying the legal case – of, for example, pollution – and does not use the language of externalities to refer, as I do, to litigation itself.

\(^9\) The “collective action” scholarship is relatively indifferent as to the goals of class cases. See, e.g., Macey \& Miller, supra note 4, at 11. Generally, though, the law and economics focus of this literature emphasizes the compensatory rather than deterrent aims of class suits by insisting that the class attorney is the agent for the immediate class members themselves and not for some larger social good. For an explanation and critique, see William B. Rubenstein, On What A Private Attorney General Is – And Why It Matters, 57 VAND. L. REV. 2129, 2161-2167 (2004). As I note there, id. at 2165 n.126, David Rosenberg's work uniquely emphasizes the deterrent ends of class action litigation in the mass torts context. As I argue below, see supra Part IV, litigation's positive externalities exceed both simple compensation and simple deterrence; therefore the theory I offer here does more than elaborate a deterrence theory of class actions.
goods because of two defining characteristics of such goods – “jointness of supply and impossibility of exclusion.” The example of a lighthouse helps illuminate these two characteristics: one person's use of its signal in no way diminishes anyone else's (jointness of supply) and it is generally impossible to provide a lighthouse to some at sea while excluding others (impossibility of exclusion). Private parties are therefore unlikely to invest in lighthouse construction: entrepreneurs are daunted by the impossibility of profiting, while for those needing the product, it seems rational to wait for someone else to pay and then to free-ride on the inevitable positive externality of her purchase. The inevitability of the positive externality exacerbates the collective action problem.

When scholars and judges argue that the class action mechanism solves a collective action problem what they are saying is that the mechanism makes possible the production of a good that would not otherwise be produced. That good is a lawsuit. As I explain in more detail below, litigation can be conceptualized as a public good, its pursuit produces positive externalities, and litigants in group-like situations therefore have incentives to free ride; where the individual stakes are low, this collective action problem is particularly acute. It is not illogical that scholars have focused on the collective action aspect of the problem when describing the class action, as representative litigation provides the needed solution. But the externality theory adds to the literature by supplementing this discussion of how the class action solves the problem with an emphasis on why the problem requires attention, why, that is, we need to create litigation. The externality theory appreciates the class action as a means, to be sure, but envisions its ends as encompassing spillover effects far beyond immediate plaintiff compensation. While the collective action theory tells us how to get the lighthouse built, the externality theory – like a good Los Angeleno – admires the quality of the light.

See RUSSELL HARDIN, COLLECTIVE ACTION 17 (Dorothy Sawicki ed., 1982) (“If a good is in joint supply, one person's consumption of it does not reduce the amount available to anyone else. . . If a good is characterized by impossibility of exclusion, it is impossible to prevent relevant people from consuming it.”).

For centuries, economists employed lighthouses as a prime example of a public good. But then in 1974, Ronald Coase argued that in fact lighthouses had often been produced by private parties. See R.H. Coase, The Lighthouse in Economics, 17 J. LAW & ECON. 357 (1974), reprinted in R.H. COASE, THE FIRM, THE MARKET, AND THE LAW 187 (1988). In response to Coase's article, David van Zandt helpfully clarified that lighthouses – like all goods – are produced through a combination of private markets and governmental action, though the precise mix of the public and private varies depending upon the characteristics of the goods in questions. David E. Van Zandt, The Lessons of the Lighthouse: "Government" or "Private" Provision of Goods, XXII J. LEGAL STUD. 47 (1993). Dean Van Zandt's article demonstrates that – whether or not the label "public good" is at all helpful – the nondepletable and nonexcludable characteristics of lighthouses means that their erection may require modes of public involvement that are distinct from public interactions with markets for depletable and excludable goods. I therefore employ the jargon of "public goods" and the example of "lighthouses" throughout the Article consciously, using these as shorthand for nothing more than the distinctive characteristics of such goods; I do not mean to imply that only the government can produce such goods, nor, conversely, that there is elsewhere a market completely free of public involvement.
II. SHUTTS AND COLLECTIVE ACTION

At first blush, Shutts exemplifies the dynamics of a small claims class action. The plaintiffs alleged that a single defendant economically harmed, in a similar fashion, thousands of individuals across all fifty states, the District of Columbia, and several foreign countries. If the harm alleged were indeed unlawful, each of these individuals would become a plaintiff with a meritorious cause of action. Yet, because each plaintiff’s claim was so insubstantial, no plaintiff had a stake that justified hiring an attorney for an hourly wage, nor would any attorney see a sufficient contingent fee justifying individual litigation. In addition, each plaintiff had some incentive to do nothing and wait for someone else to do something, then to freely ride upon the defendant’s change of policy or the issue preclusive potential of the initial judgment.

The class action mechanism solves this problem by pooling the plaintiffs’ claims together into one case and enabling the class attorney to take a fee out of the whole recovery, rather than out of one individual’s recovery. Because everyone’s take is thereby reduced, no one is riding for free. It is oft-repeated that the class action provides this solution, but in fact the class action mechanism works in harmony with fee rules to provide a solution: collective claims without a collective fee would do far less to solve the problem than would a collective fee without collective claims. The fee rules essentially establish a mechanism for taxing each class member her share of the costs in exchange for her share of the recovery. While no class member’s share of the costs alone produces litigation, the collective shares of all the class members comfortably cover the attorneys’ fees.

If the first common misstatement of the small claims theory relies on the form without reference to the fee, the second imagines that the small claims class action represents an instance of actual action among members of a collective. The class action mechanism may overcome a collective action problem, but it does not do so by motivating individuals within the group. This is a lovely tension that lies hidden between the lines of the Shutts decision. On the one hand, the Court acknowledges the problem of the small claims case and

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12 Shutts, 472 U.S. at 799. Phillips Petroleum’s leases were geographically centered in eleven different states, but the plaintiff/royalty owners were more widely dispersed. Id.

13 See generally 10 CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 2675 (3d ed. 1998). Depending upon the type of case, the fee in small claims cases can be a percentage of the fund recouped or it can be paid by the losing defendant pursuant to a fee-shifting statute or rule. Id. In either case, the plaintiff likely bears the cost, either directly in a contingent fee case, or indirectly in a fee-shifting case, as the defendant’s settlement offer to the plaintiff class is adjusted to account for the fee it must also pay the plaintiffs’ attorney.

implicitly embraces the idea that Rule 23 solves the collective action problem.\footnote{Shutts, 472 U.S. at 799.} In drawing this conclusion, the Court uses the active voice, stating that class actions “permit the plaintiffs to pool claims,”\footnote{Id. at 809.} rather than employing the passive voice to observe that the class action permits the plaintiffs’ “claims to be pooled.” The Court’s chosen locution implies that members of the class actively join together to pursue their common goal. Within a few pages, however, the Court insists that there is no need for plaintiffs to have any geographical relationship to the court in which the action is pending because the plaintiffs in a small claims class action do nothing—they are free-riders: “[A]n absent class-action plaintiff is not required to do anything. He may sit back and allow the litigation to run its course, content in knowing that there are safeguards provided for his protection.”\footnote{Id. at 810.} Moreover, in rejecting an argument that the Constitution compels an opt-in rather than opt-out procedure, the Court states outright that requiring individual action would defeat collective action:

Requiring a plaintiff to affirmatively request inclusion would probably impede the prosecution of those class actions involving an aggregation of small individual claims, where a large number of claims are required to make it economical to bring suit. The plaintiff’s claim may be so small, or the plaintiff so unfamiliar with the law, that he would not file suit individually, nor would he affirmatively request inclusion in the class if such a request were required by the Constitution.\footnote{Id. at 812-13 (citation omitted).}

What we are left with at the end of Shutts is approval for a mechanism (the class action) that solves a collective action problem (dispersed small claimants) by insisting that no one in the collective need take action. If collective action problems pose a challenge to collective action, it would seem a remarkable solution that could achieve the group’s results by insisting on group member inaction. Of course, in true small claims situations this may in fact be one of the many peculiar qualities of collective action problems, a question to which I turn in the next section.

Before turning there, however, one last aspect of the particular dynamics of the collective action problem in Shutts is worth relishing. After insisting that class members can do nothing, the Court acknowledges that 3,400 members, or 10%, of the class in Shutts did do something: they opted out.\footnote{Id. at 801.} If the class action mechanism was necessary to overcome the collective action concern that no sane
person would pursue a claim worth $100, what explains why 3,400 appear to have done just that? And if they did, was there ever really a collective action problem? It seems that the best explanation of the defectors here is that their claims were not worth $100, that they were not the average stakeholders. The Court’s breakdown of the geographic location of the leases (done for purposes of its choice-of-law analysis) reveals that the claims appear to be of quite diverse sizes. For example, in one class, 2,653 royalty owners in Oklahoma were owed $83,711 in royalties, or about $32 per royalty owner. In that same class, 1,244 royalty owners in Louisiana were owed $2,187,548, or about $1,758 per royalty owner. Given that the claims in Shutts were about the interest owed on these royalties, even the larger Louisiana stakeholders would not seem to have enough at stake to opt out of the class. But they did.

Regardless of why 3,400 claimants opted out, these data demonstrate the heterogeneity of the class members’ claims. This very heterogeneity could well have been a solution to the collective action problem: the claimants with significant enough claims to opt out theoretically had significant enough claims to litigate on their own. If so, they were well-situated to be champions for the rest of the class, who could reasonably free ride on their cases.

Commentators tell us that Shutts is a small claims case presenting a classic collective action problem, but that may not be precisely right. The Supreme

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20 Id. at 815 n.6.
21 Id.
22 Id.
23 It is possible that those who opted out had some connection to a different attorney hoping to put together a class action—and secure the fee of it—in a different jurisdiction. Such disgruntled attorneys are often the source of objections to class action settlements. See William B. Rubenstein, A Transactional Model of Adjudication, 89 GEO. L.J. 371, 373 (2001) (hereinafter “Transactional Model”).
24 This is essentially the solution to the collective action problem of securities classes that Congress enacted in the Private Securities Litigation Reform Act of 1995 (“PSLRA”), 15 U.S.C. §§ 77z-1-78j-1 (2005) (authorizing plaintiffs with large interests to be lead plaintiffs, conduct the case, and chose counsel for the class.). Elsewhere, I have questioned what might motivate such claimants to go through the motions of filing class suits where their interests appear significant enough to sustain individual lawsuits. See Rubenstein, Transactional Model, supra note 21, at 399-400.
25 Heterogeneity of the claims could, in theory, present typicality problems for large claimants proposed to represent small claimants. See generally Rubenstein, Transactional Model, supra note 21, at 393-403. However, given the straightforward financial nature of the legal issues in Shutts, the heterogeneity of claims did not present the type of typicality problems that characterize large claim personal injury cases. See Shutts, 472 U.S. at 808-09 n.1 (noting that the named plaintiffs adequately represent the class and “all members of the class have the same interest in enforcing their claims against the defendant”).
26 If the large claimants established a recovery fund, presumably the costs of their attorneys could be shared throughout the class via common law fee sharing principles. See, e.g., Cent. R.R. & Banking Co. of Ga. v. Pettus, 113 U.S. 116 (1884); Trs. v. Greenough, 105 U.S. 527, 532 (1881); Sprague v. Ticonic Nat’l Bank, 307 U.S. 161 (1938). See generally WRIGHT ET AL., supra 13 note, at 322-23 (discussing “a common fund doctrine”).
Court tells us in *Shutts* that class certification is necessary to overcome that collective action problem, but that may not be precisely right. The Supreme Court also tells us in *Shutts* that the class action solves this collective action problem because the plaintiffs actively pool their claims and because the plaintiffs do nothing—two conclusions that seem to stand in inherent contradiction to one another. To understand these strands of collective action problems and their applicability to small claims class action requires a quick dip in the ocean of material known as the collective action literature.

III. THE SMALL CLAIMS CLASS ACTION AS A COLLECTIVE ACTION PROBLEM

The primogenitor of the collective action literature, Mancur Olson, used the phrase “collective action” in reference “to any problem that provides benefits and/or costs for more than one individual, so that some coordination of efforts is required.” Collective action questions are therefore questions about groups, group efforts, and the conditions under which groups form. To conceptualize the small claims class action as a collective action problem is to ponder the fate of the group of plaintiffs as a group. The collective action inquiry originates in the observation that no member of the group appears to have a sufficient incentive to act for the group. From this perspective, the problem of the small claims class action is that the group’s collective interests will not be pursued precisely because the claims are so small. The group will be inactive.

Interestingly, the collective action literature did not develop in response to group inaction, but rather in reaction to the seemingly peculiar reality of group action. Mid-twentieth century social policy across a variety of disciplines posited group-based activities. For economists, the formation of labor unions and their pursuit of workers’ interests provided an important aspect of modeling

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27 TODD SANDLER, COLLECTIVE ACTION: THEORY AND APPLICATIONS 9 (1992). See also Macey & Miller, supra note 7, at 8 n.6 (stating “collective action is used in the public choice literature to refer to any procedure for making decisions by groups of people”) (citing IAIN MCLEAN, PUBLIC CHOICE: AN INTRODUCTION 11 (1987)).

28 As Russell Hardin explains:

The logic of collective action is not a theory about interest group organizations. Rather it is a theory about whether there will be interest group organizations or any other kind of collective action. A group theory of politics might take interest group organizations for granted and go on from there to explain certain political outcomes. The general explanation of collective action starts with individual motivations in determining what kinds of collective actions are likely to be undertaken and what kinds are not.

HARDIN, supra note 11, at 14-15.

economic behavior.\textsuperscript{30} For political scientists, special interest group bargaining in
the legislative arena provided the key to understanding democratic governance.\textsuperscript{31}

At the heart of all these models lay an unexamined assumption: if individuals possessed shared interests, they would join together to form a group to pursue these collective interests. In his seminal work, \textit{The Logic of Collective Action},\textsuperscript{32} Olson demonstrated the illogic of that assumption. Olson showed that for most special interest groups, each individual’s stake is quite small, while the costs of learning enough to act, and then acting, typically outweigh the benefits.\textsuperscript{33} Moreover, since the benefits would necessarily be shared by everyone in the group if anyone in the group secured them (meaning that the benefits are public goods), each group member has an incentive to not act, to free ride.\textsuperscript{34} The conundrum Olson pondered was how to square the illogic of any individual acting for the group with the reality that many groups fitting this description—from special interest groups to government itself—actually do exist.\textsuperscript{35} Why and how did these groups form? How is it that existing groups appear to have overcome the collective action problem, the illogic of acting collectively?

The answer Olson identified is that groups form and pursue their interests, even though it is illogical for individuals in the group to do so, for reasons “other than the collective goods that governments and other organizations provide.”\textsuperscript{36} In other words, large groups do not exist because individuals have joined them to realize the small returns they will receive from concerted activity. Groups of people exist for other reasons. Olson identified five. First, some groups, like governments, exist through coercion, not voluntary individual joinder.\textsuperscript{37} Second, some voluntary organizations exist where there are “selective incentives,” collateral benefits or penalties that encourage membership more than

\textsuperscript{30} Id.

\textsuperscript{31} Id. As Mancur Olson explained:

Thus many students of politics in the United States for a long time supposed that citizens with a common political interest would organize and lobby to serve that interest. Each individual in the population would be in one or more groups and the vector of pressures of these competing groups explained the outcomes of the political process. Similarly, it was often assumed that if workers, farmers, or consumers faced monopolies harmful to their interests, they would eventually attain countervailing power through organizations such as labor unions or farm organizations that obtained market power and protective government action.

\textit{Id.}

\textsuperscript{32} The full title is MANCUR OLSON, \textit{THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOOD AND THE THEORY OF GROUPS} (1965). The importance of Olson’s work is hard to overstate. See, e.g., \textit{SANDLER, supra} note 25, at 1 (In “the last quarter-century, few books in economics have achieved the wide-ranging, lasting, and profound impact of \textit{The Logic of Collective Action}.”).

\textsuperscript{33} OLSON, \textit{THE LOGIC OF COLLECTIVE ACTION, supra} note 28.

\textsuperscript{34} Id.

\textsuperscript{35} Id.

\textsuperscript{36} Id. at 20-21.

\textsuperscript{37} Id. at 20-21.
does the incentive of the particular collective gain.\footnote{Id.} Individuals join the automobile club for its free towing service, a positive selective incentive, but thereby create a special interest group for car drivers. Workers may have traditionally joined labor unions to avoid harassment by union leaders, a negative selective incentive. Third, Olson identified and isolated positive and negative social incentives as a unique form of selective incentives that encourage group membership in smaller, localized groups, though typically not in large, amorphous, nationwide ones.\footnote{Id. at 23-24.} He wrote that:

The censure or even ostracism of those who fail to bear a share of the burdens of collective action can sometimes be an important selective incentive. \dots Similarly, those in a socially interactive group seeking a collective good can give special respect or honor to those who distinguish themselves by their sacrifices in the interest of the group and thereby offer them a positive selective incentive. Since most people apparently prefer relatively like-minded or agreeable and respectable company, and often prefer to associate with those whom they especially admire, they may find it costless to shun those who shirk the collective action and to favor those who oversubscribe.\footnote{Id. at 29-30.}

Fourth, Olson posited that collective action can occur in “situations in which there are only a few individuals or firms that would benefit from collective action,” thus that collective action will sometimes take place in small groups without the necessity of selective incentives.\footnote{Id. at 29-30.} Finally, Olson posited that collective action could take place in groups where the group members had differently-sized interests.\footnote{OLSON, RISE AND DECLINE, supra note 27, at 29-30.} Such groups might be “privileged,” in that one member of the group would have benefits from pursuit of the group’s interests that outweighed her costs and could therefore be expected to act on behalf of the group; typically this is a group member with the largest stake.\footnote{Even if this large stakeholder’s benefits do not outweigh her costs, and the group is therefore not privileged, she might nonetheless be expected to take a lead in acting for the group given her disproportionate interest. Smaller stakeholders would accordingly be particularly likely to shirk. Olson therefore surmised that a particular collective action dynamic in heterogenous groups is the large stakeholders shoulder a disproportionate share of the costs; there is, he wrote, “a systematic tendency for exploitation of the great by the small.” OLSON, THE LOGIC OF COLLECTIVE ACTION, supra note 28, at 35.}

Summarizing, Olson concluded that “groups that have access to selective incentives will be more likely to act collectively to obtain collective goods than those that do not, and that smaller groups will have a greater likelihood of being engaged in collective action than larger ones.”\footnote{OLSON, RISE AND DECLINE, supra note 27, at 34.} Olson maintained that the relatively small number of individuals who join large groups -- e.g., taxpayer, consumer, environmental, or welfare organizations -- provided empirical proof of his theoretical insight.\footnote{Id. at 34-35.} The critical fact about these groups is they are “so
dispersed that it is not feasible for any non-governmental organization to coerce them,” but unlike workers in a single factory; nor are either positive selective incentives or social incentives available.

Olson’s hypothesis about collective action fits the small claims class action. As Olson would predict, given the small stake of each claimant, the significant costs of acting, the ability to free-ride, and the dispersed nature of the large impersonal group, no individuals will voluntarily act to pursue the group’s interests. No group will form. Moreover, the voluntary methods for overcoming this collective action problem are inapplicable. Social incentives cannot work because individuals are too dispersed to be in social contact with one another. Voluntary selective incentives are unlikely to work as well: the closest the law comes to providing free towing in exchange for group membership is the incentive payments to class representatives in class actions. While such incentive payments might induce action on behalf of the group, it is unlikely any group member would even know of such an incentive and even more unlikely that individuals would organize their economic lives around securing class representative incentive payments. Typically, these payments appear ex post, not ex ante, and are given for time spent on the lawsuit, not for having thought to organize it. Moreover, in true collective action situations, the selective incentives are provided to many group members so as to generate a group, not to one or a few group members so as to generate a champion.

The only plausible mechanisms for inducing group action in small claims cases are coercive, and class action law presently employs two: first, class members are coerced into joining the group by the fact that the class action extinguishes their claims; and second, class members are coercively taxed the costs of the collective endeavor, depending on the fee setting, either by the

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45 Id. at 34.

46 Recent social science experiments have developed other examples of situations in which individuals take action although they appear to lack the incentives to do so. See, e.g., Russell B. Korobkin and Thomas S. Ulen, Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics, 88 CAL. L. REV. 1051, 1138-1143 (2000). Behavioral science provides explanations beyond those offered by Olson’s theory which further suggest reasons that collective action may be less of a problem than conventionally assumed.


48 See Hansberry v. Lee, 311 U.S. 32, 41 (1940) (noting “the judgment in a ‘class’ or ‘representative’ suit, to which some members of the class are parties, may bind members of the class or those represented who were not made parties to it”). For a thorough recent exploration of the principle, see Tobias Barrington Wolff, Preclusion in Class Action Litigation, 105 COLUM. L. REV. 717 (2005).
contingent fee their attorney extracts or by the defendant lowering its settlements offer to the class by the amount it must separately pay the plaintiffs’ attorneys.49

While the small claims class action thereby conquers the collective action problem, several characteristic features of this achievement can now be delineated. First, although the small claims class action solves the collective action problem, it does not result in collective action. No group is formed. A grouping of claims occurs, to be sure, but this is not, pace Shutts, the same thing as a group of people pooling their claims. Because no group of people is formed, the class in the small claims class action never itself encounters any of the costs or benefits of group activity. Individuals in the group do not meet one another, trade stories or ideas, or raise consciousness. The group confronts no organizational issues central to normal groups: it does not have to develop internal governance rules or bylaws; it need not identify and select leaders nor develop a means for doing so; it does not have to keep membership records, collect dues, police the boundaries of who is in and who is out. The small claims class is a void, not a group.

Second, not only does no group form, but no group member is even responsible for the grouping of claims that does occur: an external third party, the class’ counsel, groups the claims. She is able to do this because the law imposes a coercive grouping on the class members through the preclusion and fee mechanisms. This coercive grouping is therefore distinct from the coercion that attends union or synagogue membership, both of which are typically compelled by group members themselves. This coercion is more like coerced government taxation. But even that is an imprecise metaphor because at least with respect to coerced government taxation, the taxed can vote the bums out. Ideally, the class representative can control and fire class counsel, but this ideal exists in a theoretical realm far removed from the practice of complex litigation. Even where a majority of class members do appear and object to a settlement, their numbers are not necessarily controlling.50 The third party who groups the class’s claims exerts near total control over the group-that-does-not-exist. To make matters even worse, she often does so with her own interests—her fee—conflicting with the interests of the class members she represents.51

49 See supra note 13.


51 This second point—that no group member controls the small claims class—must be relaxed in certain heterogeneous class actions, just as Olson predicted it might be. See supra note 33. Specifically, since Congress’s enactment of the PSLRA, it has become more evident that many securities classes are heterogeneous with regard to the stakes of the class members, perhaps even “privileged” in Olson’s terms, in that some class members may have claims that are economically viable legal claims. See Rubenstein, Transactional Model, supra note 21, at 395-400. As large institutional investors have begun to act as lead plaintiffs in these cases, they themselves have become agents for overcoming the collective action problem; as Olson predicted, they likely shoulder all, or a disproportionate fraction, of the costs expended by class members in their cases.
Third, it is predictable that no group member will attempt to form a group and that no group will actually form since it is legal claims that the group members have in common with one another. The absence of group-based activity underscores that litigation in the United States is decidedly individualistic in nature. Our procedural rules imagine lawsuits as individual pursuits and vest control of a cause of action in an individual; while joinder is generally welcomed at a transactional level, it is exceptional and must be justified by reference to specific rules--and even then, the individual litigant retains adjudicative control. It is remarkably rare that individuals themselves—not through an attorney’s work—form a group for the purpose of sharing the costs of pursuing a joint legal cause. The closest analogy may be the activities of the NAACP Legal Defense Fund in the Brown era. But of course the group members there came together for the political purpose of supporting one another and their common cause, not simply for the economic purpose of sharing their litigation costs. Given the pervasively individualistic nature of American adjudication, it is not surprising that individuals possessing small legal claims generally do not think to contact one another, jointly hire counsel, and share litigation costs -- even in this age where the internet significantly reduces the transaction costs of doing so.

In the small claims case, there is neither a group itself, nor any real control by any particular group member. If the collective action literature is interested in the study of when groups form to pursue their interests, there is not much to study in the small claims class action. Small claims class actions are a form of externally-coerced collective taxing, a subset of collective action but not one involving the collective activity of a group. No coordination of effort occurs among class members in the small claims class.

The collective action heuristic is helpful in making sense of the small claims case because this conceptualization identifies that absent particular forms of government intervention, the litigation marketplace will not generate legal claims sufficient to redress plaintiffs’ harms and protect their interests. It is the government action of Rule 23 and fee shifting rules, though, not the activities of any class members, that solve this collective action problem. Specialized government market interventions are called for in situations of market failure, such as those involving externalities. Perhaps this presents a better, if not a distinct, way of conceptualizing small claims cases.

52 See Yeazell, supra note 7, at 47-55; Rubenstein, Divided We Litigate, supra note 40, at 1644-54.

53 The very existence of Federal Rules of Civil Procedure 18 and 20 shows that the default structure of litigation is one plaintiff, one defendant, and one claim. These rules liberally permit claim and party joinder, as do Rules 13, 14, 19, 23, and 24, but such joinder devices nonetheless require a litigant to demonstrate that the proposed claim or party fits within the particular rule structure.

IV. THE SMALL CLAIMS CLASS ACTION AS A POSITIVE EXTERNALITY PROBLEM

The externality conceptualization of the small claims class action focuses not only on why an individual litigant would not rationally file suit, but additionally, and perhaps more importantly, on the social costs of that lost opportunity. Litigation may provide benefits for the parties to the action -- a plaintiff’s recovery, a defendant’s dismissal, a settlement exchanging money for repose -- but lawsuits can also produce value for those not parties to the particular case. Economists label these social benefits “positive externalities” and teach that such externalities are likely to be under-produced. In the following paragraphs, I will develop an account of litigation externalities and then attempt to show how this account provides insight into the conventional understanding of class action lawsuits.55

The economic account of litigation begins with the proposition that a lawsuit represents a transaction and a legal system is a market(place) for such transactions.56 This is true of litigated cases, but the point becomes especially obvious in a legal system that primarily produces negotiated settlements.57 In a lawsuit, a plaintiff trades her claim for money, the defendant trades its money for finality; the lawsuit is a transaction in which res judicata is bought and sold.58 It may seem odd that disputants would come to a courthouse rather than just settling the dispute privately. However, plaintiffs turn to law because bargaining within an adjudicative framework serves at least two important functions. First, the possibility of a third-party providing a judgment gives leverage to the person filing suit.59 Second, litigation provides the plaintiff with a formal mechanism for obtaining factual information; this levels out information asymmetries that

55 I am not, of course, the first person to utilize economic analyses of the class case. For an overview of the vast literature, see Robert G. Bone, Civil Procedure: The Economics of Civil Procedure 261-65 (2003). Nonetheless, as noted at the outset, nothing in this literature discusses small claims class actions in terms of positive externalities. See supra notes 5-11 and accompanying text.

56 I have argued elsewhere that complex class actions can be conceptualized as transactions. Rubenstein, Transactional Model, supra note 21, passim. I adapt that argument here to apply to all lawsuits.

57 See, e.g., Russell Korobkin & Chris Guthrie, Psychology, Economics, and Settlement: A New Look at the Role of the Lawyer, 76 Tex. L. Rev. 77 (1997) (stating that 90-95% of cases that are not dismissed before trial end in settlement).

58 See Rubenstein, Transactional Model, supra note 21, at 419 n.213 (stating “[in a lawsuit] what is bought and sold are rights to sue”). When a judicial decision is rendered, that too can be conceptualized as a transaction—res judicata is exchanged for money—though one ordered by the court.

might otherwise preclude settlements (i.e., deals) from being made. Litigation promotes contract/agreement/settlement primarily through information exchange and the risk of an adverse judicial decision.

If litigation is a transaction, a properly structured litigation system should produce an efficient quantity of litigation. What constitutes the efficient level of litigation could be viewed in Pareto optimal terms: every exchange (lawsuit) that would better both parties without making anyone else worse off should take place; if precisely this amount of litigation—no more, no less—occurs, the litigation system has achieved Pareto optimality. If litigation exchanges take place that benefit the parties but harm third parties, this spillover effect, or negative externality, demonstrates that the system is not in a Pareto optimal state; one might say it has exceeded it by producing too many detrimental exchanges. Conversely, if trades can still be made that would benefit parties without making anyone worse off and such transactions are not taking place, the system is also not in a Pareto optimal state; one might say it has not reached it by failing to produce enough beneficial exchanges. The absence of Pareto optimality constitutes market failure and market failure justifies some new form of government intervention.

Most typically, the government intervenes in markets to interrupt negative externalities; less frequently, government intervenes to encourage positive externalities. Negative externalities are more likely to exist than positive ones for the simple reason that these costs are not borne by the parties to the transaction; as such, they do not operate to deter transactions unless there is a mechanism for internalizing them, that is, unless the transacting parties experience these costs and pay them. For example, passengers and airlines transact with one another for transportation services, but one spillover effect of airline travel is the noise that is created for homeowners in the vicinity of the airport. If the parties have to pay these costs, airline travel will be made more costly. Internalizing

60 For a richer analysis, see Bone, supra note 45, at 203-31.
61 See Walter Nicholson, Microeconomic Theory: Basic Principles and Extensions 217 (1989) (defining Pareto optimality as "[a]n allocation of available resources in which no mutually beneficial trading opportunities are unexploited. Or more simply, an allocation in which no one person can be made better off without someone being made worse off.").
63 For a cogent discussion, preceding a sharp critique, see Aaron Wildavsky et al., At Once Ubiquitous and Elusive, the Concept of Externalities is Either Vacuous or Misapplied, in Culture and Social Theory 55, 55-84 (Sun-Ki Chai & Brendon Swedlow eds., 1988).
64 For an analysis of externalities utilizing this problem as its paradigm, see Richard A. Ippolito, Economics for Lawyers 228-46 (2005).
65 See id.
the negative externalities results in fewer transactions. Positive externalities are likely to be under-produced because the parties to the transactions that produce them do not directly reap their benefits. If at least some of the value of the positive externality can be internalized, it will encourage more transactions that then produce more positive externalities.

The class action represents a governmental intervention into the market of legal claims. Absent the availability of the class form, litigants are capable of buying and selling only their own rights. What the government does through the class action mechanism is authorize one litigant to transact other litigants’ causes of action. The government generally offers this authorization in a handful of situations captured by Rule 23(b). As I argue more fully elsewhere, all the various types of class cases can be understood as necessitated by the externalities of individual litigation. This is perhaps simplest to see in situations of negative externalities. In a limited fund class case, for example, individual lawsuits produce spillover effect on persons not parties: by depleting the defendant’s available resources, the early individual cases harm later litigants. The class action solves this problem of negative externalities by internalizing them. The class action takes the spillover effect, the burden of scarce resources, and shares that burden among all of the claimants, including the early ones.

The small claims class action does not immediately appear to fit this paradigm. Individual lawsuits do not produce negative externalities because there are no individual lawsuits. No class member has enough at stake to file suit. Yet the small claims situation can be conceptualized in externalities terms: the absence of individual lawsuits represents market failure because the market has produced too few, not too many, transactions. The absence of individual cases under-produces positive externalities. The class form represents a government intervention in the individual litigation market aimed at producing small claims cases so as to generate the positive externalities of such lawsuits.

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66 See id.
67 See STEVEN C. HACKETT, ENVIRONMENTAL AND NATURAL RESOURCES ECONOMICS: THEORY, POLICY, AND THE SUSTAINABLE SOCIETY 45-48 (2d ed. 2001) (stating “[b]ecause those who benefit from positive externalities do not pay for them, their willingness-to-pay is not included in market demand, and accordingly, market demand is too small”); COOTER & ULEN, supra note 8, at 411 (explaining that in the external benefit situation the “benefit-creator engages in a socially sub-optimal amount of the benefit generating activity”). The “classic example of a good that produces positive externalities is the inoculation, which not only lessens the incidence of disease in the recipient, but also inhibits contagion, producing a benefit for others.” Jeffrey Standen, Private Remedies for Public Purposes, 36 WILLAMETTE L. REV. 927, 931 n.13 (2000).
68 HACKETT, supra note 55, at 47 (explaining “[i]f the benefits flowing to free riders were included in the market, such as through compulsory taxes or user fees, market demand would shift out and a larger equilibrium quantity would result”).
70 See BONE, supra note 45, at 261-65.
But why? What are the positive social benefits of $100 lawsuits that are lost in the small claims situation? What are the positive externalities that flow from individual litigation? Most generally, as Judge Posner explains, litigation “establishes rules of conduct designed to shape future conduct, not only the present disputants’ but also other people’s.” These “rules of conduct” constitute goods with the attributes of public goods: the rules of conduct are not diminished when used and no individual can be excluded from using them. I return to the public good nature of a lawsuit below, but before doing so, it is important to sketch out in more depth than does Judge Posner’s comment the precise nature of the good itself. Thus, more specifically, the positive externalities of individual lawsuits can be grouped into four sets of effects: 1) decree effects; 2) settlement effects; 3) threat effects; and 4) institutional effects.

Individual lawsuits resulting in judicial decisions produce external decree effects. The legal principle developed in the case will create more certainty in structuring social behavior and lower the need for future adjudication concerning the decided issue. If future litigation does arise, the decree from the initial case will serve as stare decisis, hence making resolution of later cases more efficient. Beyond these general legal effects, the decree in the initial case could also be used to preclude re-litigation of factual issues in future cases among the same or similarly situated litigants. And most immediately, the decree may actually require a party to cease a practice affecting a group of individuals, even though the initial case was prosecuted by only one of them. An individual lawsuit that produces a judicial decision thereby has generated significant social benefits in terms of shaping conduct, reducing litigation costs, and preserving judicial resources.

Individual lawsuits resulting in settlements, not judicial decisions, may nonetheless have similar positive externalities as settlement effects. To pick up where the last list left off: if one litigant successfully challenges a policy that affects many persons, a defendant may agree to change its behavior as to the entire class. Even if a defendant does not agree as a formal matter to change its general policy as a consequence of the initial case, it may nonetheless do so informally lest it be faced with repeated lawsuits. This would especially be true if a group of plaintiffs is closely associated with one another or share legal counsel -- in such a situation, information about the initial settlement can easily be passed among similarly situated parties who can then use it to their advantage. The converse is true as well: shared information about a weak settlement may

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71 POSNER, supra note 9, at 530-31. See also Kenneth E. Scott, Two Models of the Civil Process, 27 STAN. L. REV. 937, 938 (1974) (describing a “behavior modification model” of litigation in which “[n]ot the resolution of the immediate dispute but its effect on the future conduct of others is the heart of the matter”).

72 See infra Part V.

73 This is one of the primary reasons that Professor Fiss opposes settlement. See Owen M. Fiss, Against Settlement, 93 YALE L.J. 1073, 1085 (1984).
deter future litigants. Similarly, settlements by some defendants within an industry could encourage other defendant/competitors to settle. The information externalities of settlements are well known and account for much of the attempt to both publicize and keep confidential such information. In sum, settlements, as well as judicial decrees, produce positive externalities: they change behavior beyond the parties to the initial suit; they reduce future litigation costs by establishing settlement ranges; and they preserve judicial resources.

The very threat of individual litigation, absent settlement or decree, may also produce positive social benefits. The risk of litigation is a cost that parties must factor into decision-making in any sphere. The most familiar example is that of tort law, where it is said that the costs of accidents, including the litigation costs and legal remedies, structure social decision-making. The same could be said of the contracting and property realms as well. In undertaking a cost-benefit analysis, a party would logically consider both the risk of losing litigation and the risk that such litigation will actually be filed. If the latter factor is small, it will increase the likelihood a party will engage in the behavior. The small claims case presents a perfect example. A large corporation can bilk many individuals a very small amount, realizing significant gains without fearing that litigation will follow. The very possibility of litigation would change this analysis significantly. Therefore, the threat effects inherent in individual lawsuits produce positive externalities.

Finally, the institutional result of the class action mechanism and related fee provisions is the development of a private group of law enforcers. By enabling litigation, the class action has the structural consequence of dividing law enforcement among public agencies and private attorneys general and of shifting a significant amount of that enforcement to the private sector. This is an important benefit if in fact private enforcement is, as often argued, more efficient than public enforcement. Even if private enforcement generates its own problems (such as the agency costs that inhere in class actions), nonetheless "the sheer diversity of enforcers should generate more innovations than a monopolistic government enforcer would produce." These structural effects are not the immediate purpose of any particular piece of class action litigation, yet they are critical externalities of class suits.

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77 I am indebted to Sam Issacharoff for suggesting that the private attorney general function could be situated in my field of externalities.

Because the settlement, decree, or threat resulting from one individual lawsuit -- and its likely enforcement by a private attorney general -- will often compel a defendant to change its behavior, that lawsuit creates positive externalities. Conventionally, the small claims case is thought to vindicate the interests of the individual class members whose harms are so small individually, yet so large collectively. The externality story defends the class suit not just in terms of the benefits to the litigants themselves, but also in terms of the spillover effects small claims cases will have for society more generally. It is from society’s perspective, not just that of the plaintiffs, that we lament the underproduction of individual small claim lawsuits: we weep not just for them but for us.

V. WHY THE POSITIVE EXTERNALITY APPROACH IS HELPFUL

When the legal system is conceptualized as a market for legal claims, it becomes apparent that the product of the individual lawsuit has the characteristics attributed to public goods: all members of society share the good without depleting it and none can be excluded from doing so. Tragically, therefore, no class member has any incentive to bring the case. This is the collective action dilemma which results in the underproduction of the positive externality. Small claims situations at once pose a collective action problem and a problem of the underproduction of positive externalities.

While the two concepts are closely intertwined, the class action literature has framed class suits, particularly small claim class suits, almost exclusively in the language of collective action. There is little that describes or conceptualizes the problem in terms of externalities. The benefits of adding such a conceptualization to the literature include the following.

First, as I demonstrated in Part III, the collective action moniker is a bit of a misnomer. Those conversant with the collective action literature appreciate that coerced taxation is a response to a collective action problem and can appreciate the dilemma and solution in these terms. However, to a wider audience familiar with the representative nature of class actions, it may seem peculiar or confusing to describe the class action in terms of collective action. The risk of such confusion only grows as the explanation is proffered to a truly lay audience: they at once learn that a class action solves a collective action problem and that class members therefore do nothing. While this sounds like a semantic problem, my sense is that it pervades both popular and legal understandings of class actions; most observers, including lawyers and judges, believe that a class case involves a group of people descending on the courthouse en masse and most fail to appreciate that in fact representative litigation is precisely the opposite. The collective action conceptualization furthers this misunderstanding by implying that because it solves a collection action problem, the class action enables collective action to occur.

Second, the collective action conceptualization suggests that the primary value of the class suit is the benefits to those in the collective that flow from Rule 23’s brilliant resolution of the collective action problem. By contrast, the
positive externality story suggests that what are lost absent litigation are benefits exceeding those provided to the parties themselves. It is true that in a narrow sense the positive externalities of one class member’s lawsuit are the benefits that flow to the other members of the class (those who share the lighthouse). But as I demonstrated in Part IV, the externalities of litigation may be felt by a wider range of citizens than those involved in the current controversy. The lawsuit might develop legal principles, change industry practices, or conserve judicial and social resources. The collective action/externality distinction could be seen as analogous to the compensation/deterrence distinction.79 The collective action story about the small claims case is one about how to secure benefits for those in the collective who have been bilked.80 The externality story is one about how to secure the deterrent effects of litigation. But the externality story can be read even more broadly in that the externalities described in Part IV exceed simple deterrence.

Third, the externality approach re-frames the discussion of the general shortcoming of class actions. Conventionally, these are described in agency cost terms as the strike suit and the sell-out: the former is a case with no merit settled too high, while the latter is a case with merit settled too low.81 From a market externality perspective, the strike suit is a transaction that should not have taken place, the overproduction of positive externalities, a lighthouse built in a landlocked territory. By contrast, the sell-out creates not too many, but too few positive externalities; it is a shore-based lighthouse but one lacking a bulb. These agency costs of representative litigation remain, but their effects are broadened. Not only are the class-members harmed by the strike suit or sell-out, but because externality production is skewed, so too is society generally. It is true that the externality story does not provide a solution for these agency costs. But its broader focus helps amplify the need for one.

Finally, most generally, the positive externality story about the small claims case lines up the rationale for this type of class action with the rationale for the other existing types of class cases. Federal class action law currently encompasses five distinct categories of class cases: 1) those involving the risk of “incompatible standards” for the defendant;82 2) those involving limited funds;83

79 See also Scott, supra note 59, passim (contrasting a “conflict resolution model” of civil adjudication that focuses on compensating plaintiff losses with a “behavior modification model” that focuses on deterring defendants).

80 As I noted above, see supra note 8, many collective action scholars are indifferent as to whether compensation or deterrence is the goal; their focus is on the class mechanism as the means of overcoming the collective action problem. Nonetheless, their private law interests tend to emphasize individual compensation not deterrence. Id.


82 FED. R. CIV. P. 23(b)(1)(A).
3) Those involving injunctive relief; 84 4) Those involving money damages where claims are small; 85 and 5) Those involving money damages where claims are not small. 86 As noted earlier, I elsewhere argue that the essential organizing principle of all five types of class cases recognized by Rule 23 is that they each resolve problems concerning the spillover effects of individual lawsuits. 87 Thus, for example, I have already described how limited fund cases internalize the externalities created when, in a race to the courthouse, an individual litigant depletes the defendant’s resources and harms her similarly situated would-be litigants. 88 In a not dissimilar fashion, in large mass tort situations such as asbestos, the court system may be swamped with individual claims. 89 These claims deplete the resources society has allotted to adjudication and thus have negative externalities on the ability of the legal system to accomplish its social function. In short, the different types of representative litigation all share one common characteristic: they each respond to a particular problem created by a distinct failing of individualist procedure. All class suits are necessitated not by collective action problems specifically, but by the more general notion of externalities. Each form of the class case addresses a particular type of positive or negative externality problem in individualist procedure. Conceptualizing small claims cases in externalities terms helps make their relationship to other forms of class cases clearer.

VI. CONCLUSION

The legal claims that formed the basis of Phillips Petroleum Co. v. Shutts 90 were meritorious, yet of relatively modest value. Generally, these were negative value claims that would not have been litigated individually because the costs of doing so outweighed the benefits to individual litigants. Phillips Petroleum could well have walked away without liability. Conventionally, scholars describe this situation as posing a collective action problem and demonstrate how the class action mechanism works to solve that problem.

83 Id. at 23(b)(1)(B).
84 Id. at 23(b)(2).
85 Id. at 23(b)(3).
86 Id. Many courts and commentators believe that large claim cases should not or do not fit within Rule 23. See Rubenstein, Transactional Model, supra note 21, at 394-395 & nn 110-111; id. at 400 & n.136.
87 See supra note 57 (citing Rubenstein, A General Theory of the Class Suit).
88 See supra notes 57-58 and accompanying text.
89 Bone, supra note 45, at 265 n.73.
In this Article, I have discussed the problem of negative value claims in a different language. The fact that parties will not pursue these claims is, I argue, an example of the underproduction of positive externalities. Put simply: were individuals to litigate their small claims, these lawsuits would produce collateral social benefits. The class action mechanism helps produce these benefits by internalizing a benefit (to class counsel) that consequently enables the lawsuits to be brought.

I argue that the addition of this analysis to the scholarly literature serves several functions. Among these is that it illuminates how little collective action really took place in Shuts, how relatively unimportant the compensatory aspects of the case are compared to its other social functions, and how Shuts is more like other types of class cases than generally presumed.

This last point is particularly important for in the two decades since the Supreme Court decided Shuts, class action practice has exploded. Despite a variety of attempts to shut them down, ranging from disapproving Supreme Court decisions to a variety of Congressional enactments, class action lawsuits appear unlikely to die. The externality story of the small claims case sets the groundwork for a more general understanding of the common feature of class suits.