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A SOLUTION TO THE CHOICE-OF-LAW  
PROBLEM OF DIFFERING STATE LAWS  
IN CLASS ACTIONS: AVERAGE LAW

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# A Solution to the Choice-of-Law Problem of Differing State Laws in Class Actions: Average Law

*Luke McCloud & David Rosenberg\**

*Abstract:* In this essay, we show why and how to apply the average of differing state laws to overcome the choice-of-law impediment currently blocking certification of multi-state federal diversity class actions. Our main contribution is in demonstrating that the actual law governing a defendant's activities involving interstate risk is in every functionally meaningful sense the same regardless of whether it is applied in disaggregated form state-by-state at great cost or in aggregated form on average at far less cost. We refute objections to using the average law approach, including that average law subjects defendants to a law of which they lacked notice at the time of the underlying conduct; fails to accurately reflect and enforce the substantive differences among the governing state laws; and undermines the sovereign lawmaking power of states to enact their distinctive policy preferences. To facilitate use of the average law approach, we also sketch the means for practically implementing the average law solution in different types of class action to determine a defendant's aggregate liability and damages.

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# A Solution to the Choice-of-Law Problem of Differing State Laws in Class Actions: Average Law

## Introduction

The existence of significantly differing state laws currently poses a virtually insuperable obstacle to certification of a multistate, diversity class actions.<sup>1</sup> Interpreting and applying many diverging, not infrequently conflicting state laws – often of all 50 states plus the District of Columbia and U.S. territories – obviously can increase the complexity and cost of resolving numerous claims by class-wide trial. Indeed, though class actions rarely go to trial, it is presumed that a judge could not possibly, let alone practically, instruct the class action jury on the nuances and intricacies of the laws of the fifty states.<sup>2</sup> In general, courts regard the potential management difficulties and diseconomies of this “daunting enterprise” sufficient to tip the balance against class certification.<sup>3</sup> These concerns dominate even when all other indicators point in the direction of certifying the class, including the predominance of common factual questions, availability of formulaic, statistical, or other acceptable methods for estimating and distributing an aggregate damage award on an individual basis, and core policy favoring collectivized enforcement of small-recovery claims.<sup>4</sup>

In this essay, we show that applying the average of the differing state laws can overcome this choice of law impediment to use of class actions, yet without compromising the functioning of the civil liability in any significant way. We define “average law” functionally as the mean recovery value that would result from resolving all classed claims under their respectively governing state laws.<sup>5</sup> Our argument will address practical as well as theoretical questions about use of the “average law” solution.

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<sup>1</sup> Ryan Patrick Phair, *Resolving the “Choice-of-law Problem” in Rule 23(B)(3) Nationwide Class Actions*, 67 U. CHI. L. REV. 835 (2000).

<sup>2</sup> See e.g., *In re American Medical Systems, Inc.*, 75 F.3d 1069, 1085 (6<sup>th</sup> Cir. 1996) (presuming that “[i]f more than a few of the laws of the fifty states differ, the district judge would face an impossible task of instructing a jury on the relevant law”). This presumption is often asserted without substantiation or consideration of the many tools federal district courts can employ, in the event of class action trial, to reduce the costs of applying multiple state laws to efficient levels that preserve the net benefit of class action adjudication. On the array of options and tools available for managing class action and aggregate claim trials, see Federal Judicial Center, *Manual for Complex Litigation* (fourth) (2004).

<sup>3</sup> *In re Zyprexa Products Liability Litigation*, 253 F.R.D. 69, 201-02 (E.D.N.Y. 2008) (denying certification of a class action requiring application of the consumer protection laws of 42 states that “vary on a range of fundamental substantive and procedural issues”).

<sup>4</sup> See e.g., *Zyprexa*, 253 F.R.D. at 201 (rejecting class action treatment of consumer protection claims even though the core common question of fraud predominated non-common questions, class members individually claimed miniscule causally-related loss, and the causally-related loss could be determined statistically with precision for each individual class member as well as for the class as a whole).

<sup>5</sup> As we explain, the natural and usual result of applying differing state laws in any case of interest risk produces the “average law,” in other words, the compound law representing the sum of the relative probabilistically weighted inputs from application of each of the state laws involved. To avoid confusion,

At the outset, we offer a simple stylized example of how the average law solution would work. Suppose a class comprised of two small-recovery claims, each governed by different state laws, one that would impose liability and one that would deny liability. Further assume that the class would be certified but for the costs of applying the varying state laws at class-wide trial to determine the defendant's aggregate liability and damages. In this case, the court could solve the choice of law problem by deriving the average (or mean value) of the two conflicting laws analytically by conceptualizing some appropriately intermediate liability rule or statistically by random sampling. The reliability and comparatively low cost of statistical averaging renders it decidedly preferable to analytical averaging that necessarily requires finding words to express the mean value rule with a tolerable degree of precision.<sup>6</sup> Our analysis proceeds on this preference for statistical over analytical averaging. Nevertheless, assuming their equivalent effectiveness in the example, both methods would produce identical results. Under the average analytically-derived liability rule or statistically-derived norm of probability discounted liability, the defendant would held liable on each claim for 50% of the causally-related loss, which by assumption the court could appropriately distribute among class members.

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we note timeframe related differences in the sense in which we use the phrase “average law.” Our references relate to two basic timeframes: first, *ex ante*, when the prospective defendant contemplates whether and how safely to engage in an activity involving interstate risk, and second, *ex post*, when courts generate settlements and judgments determining the actual defendant's aggregate liability and damages (plus litigation cost) – if any. *Ex ante*, average law is exactly what the prospective defendant knows and internalizes. If potential liability and damages are less than certain to occur, then the compound law the firm takes into account is generally the sum-total of probabilistically weighted state-specific inputs, in other words: the aggregate *expected* liability and damages (plus litigation cost). *Ex post*, however, the compound law is the sum of the “certain” state-specific inputs to the aggregate liability and damages (plus litigation cost). *Ex post*, “average law” in the literal sense exists only as the result of sampling or analytical amalgamation of the differing state laws.

We also emphasize that the average law solution addresses the choice of law problem in the determination of a defendant's aggregate liability. The use of average law does not extend to the distribution of any aggregate recovery among members of the class. As we note, courts have devised many approaches to dealing with the distribution of aggregate recoveries. The average law solution as we develop here is thus designed to function within the conventional class action framework that decouples the determination of aggregate liability from the distribution of aggregate recovery. In short, the average law solution overcomes the choice of law impediment in a case that would otherwise qualify for class action treatment.

<sup>6</sup> Statistical sampling may be used to satisfy courts' demand for an aggregate determination that reflects the sum-total of the value of plaintiffs' respective claims of causally related and legally sanctionable liability and damages. Indeed, to establish causation in cases such as those involving an antitrust violation and securities fraud, courts admit only statistical or econometric analyses as proof of causation, provided of course they find, often only after extensive expert-witness discovery and dispute, that the statistical sampling method and claim-sampling results supply a sufficient basis for extrapolating an “accurate” account of aggregate liability and damages. For an analysis of recent uses of statistical sampling in class action litigation, see Laurens Walker & John Monahan, *Sampling Evidence at the Crossroads*, 80 S. CAL. L. REV. 969 (2007).

We advance the average law solution primarily for use in FRCP Rule 23(b)(3) class action adjudication of mass injury cases arising from interstate risks of commercial activity.<sup>7</sup> “Mass injury case” is defined capaciously to include any civil damage action charging a business defendant with engaging in some standardized activity – such as mass producing a product or service or implementing a centralized policy or set of operating criteria – that exposes some multistate population to a risk of harm. Our analysis therefore applies trans-substantively to any such case, regardless of its formal or conventional classification as tort, contract, property, environmental hazard, competition, employment, financial services, corporate governance, product safety, or consumer protection. Ultimately, our aim in demonstrating the utility of the average law solution is to facilitate the wider and more effective use of the class action, which, as we explain below, provides the best, most socially appropriate means of resolving mass injury cases. We emphasize that use of average law to determine a defendant’s aggregate liability and damages can increase the efficacy of class action generally, but given the existence of other costs unabated by this solution, certification related questions of overall manageability and net social benefit of collectivization will remain for the court to decide in each particular case.

We are not the first to suggest the use of the average law solution. Most notably, the ALI’s newly promulgated *Principles of the Law of Aggregate Litigation*<sup>8</sup> identified average law as one approach to solving the differing law problem in class action, but quickly dismissed it as “foreclosed by the recognition that each body of substantive law derives from a particular sovereign and that courts lack authority to resolve choice-of-law disputes in class actions through amalgamation of the laws of multiple sovereigns.”<sup>9</sup> This argument originated with an opinion by Seventh Circuit Judge Richard Posner ruling the certification of a national products liability class action an abuse of discretion in part because of the district court’s effort to solve the choice of law problem by melding 50 differing state negligence standards into a single class-wide jury charge. Posner famously (and according to *Principles*, “appropriately”) criticized the lower court for subjecting the defendants to class-wide trial under a law that was “no actual law of any jurisdiction,” but rather “a kind of Esperanto instruction.”<sup>10</sup> *Principles* supplements

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<sup>7</sup> Federal Rule of Civil Procedure 23(b)(3) conditions class action certification on the court finding “that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy.” FED. R. CIV. P. 23(b)(3). When determining whether to certify, a court must also assess the desirability and manageability of collectivized litigation. *Id.* The choice of law problem of significantly differing state laws generally leads courts to find class action treatment unwarranted for lack of predominance, superiority, manageability, and overall desirability. *See, e.g.,* *In re American Medical Systems*, 75 F.3d at 1085; *Castano v. American Tobacco Co.*, 84 F.3d 734, 741 (5th Cir. 1996).

<sup>8</sup> AMERICAN LAW INSTITUTE, *PRINCIPLES OF THE LAW OF AGGREGATE LITIGATION* (2010) [hereinafter *PRINCIPLES*].

<sup>9</sup> *PRINCIPLES* § 2.5, Comment. We equate the *PRINCIPLES*’ undefined phrase “amalgamation of the laws” with our definition of the average of the applicable differing state laws.

<sup>10</sup> *In re Rhone-Poulenc Rorer, Inc.*, 51 F.3d 1293, 1300 (7th Cir. 1995).

Posner’s rather formalistic objections with the more functionally intelligible explanation that application of the average rather than the actual differing state laws “risks exposing the defendant to a legal standard for which it did not have notice at the time of the underlying conduct.”<sup>11</sup>

The rejection of the average law solution is profoundly mistaken. It stems from the prevailing view among courts and commentators that the nature of the governing law and businesses’ understanding and response to it at the time of the underlying conduct is the same regardless of whether the contemplated activity involves an intrastate or interstate risk.<sup>12</sup> Our principal contribution is a basic, straightforward point: the average of the differing state laws is in reality the actual law that in fact ultimately governs the choice a business will make and expresses the choice the multiple states involved expect and presumably want the business to make regarding whether and how safely it should engage in activities involving interstate risk.

We develop this main point in Parts I and II. In Part I, we explain that from the ex ante perspective of defendants – “at the time of the underlying conduct” – the average law constitutes the legal standard of primary concern to them and therefore of which they would necessarily have notice, indeed full and detailed knowledge, when they decided to hazard the legal consequences of engaging in activity involving interstate risks. Then, in Part II we address the sovereign law-making power of states and explain that in every functionally significant way the average law is the actual law made by states to determine the liability of defendants for their underlying conduct in multistate mass injury cases. In sum, we show that the average law inherently results from the application of differing state laws in such cases and hence is the “law” that businesses know and live-by in deciding whether and how safely to engage in activities involving interstate risks. We further demonstrate that the contrary position restated and advocated by *Principles* undermines state sovereignty. In denying the reality and legitimacy of average law, and thereby all but eliminating the uniquely essential option to enforce the actual law governing interstate business risk-taking through federal diversity class actions, *Principles* not only dilutes the force of the law states make, but also crimps their power to make that law fully effective.

In Part III, we state the basic reasons why class action is the best, most socially appropriate means of enforcing the state laws governing interstate risk-taking by

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<sup>11</sup> PRINCIPLES § 2.05, Comment b.

<sup>12</sup> Linda J. Silberman, *The Role of Choice of Law in National Class Actions*, 156 U. Pa. L. Rev. 2001, 2022 (2008) (“The reason for the class device is that a coherence of rights and claims *already exists* among potential class members, and it is the existence of those elements that makes the representative suit appropriate. To use the class action as the justification for altering choice of law rules would be to put the cart before the horse and to misunderstand the role of both class actions and choice of law.”); Larry Kramer, *Choice of Law in Complex Litigation*, 71 N.Y.U. L. REV. 547, 572 (1996) (“If choice of law is substantive (in the sense that it defines the parties’ rights), then courts should not alter choice-of-law rules for complex cases...If the reason for consolidating is to make adjudication of the parties’ rights more efficient and effective, then the fact of consolidation itself cannot justify changing those rights. To let it do so is truly to let the tail wag the dog.”).

businesses, and thus why using the average law solution is imperative. We then sketch the means for practically implementing the average law solution in different types of class action. We will conclude in Part IV with a brief summary of the salient arguments for use of the average law solution.

### I. Average Law Is the Actual Law in Multistate Mass Injury Cases

We start by stating the premise for our analysis of the defendants’ “notice” of the “actual law” in multistate mass injury cases. In particular, we define “actual law” – as Holmes did “law in operation” – in terms of consequences or effects of legal norms, processes, and sanctions on peoples’ behavior, including what and how they think, and on their well-being.<sup>13</sup> This definition comports with the approach of *Principles* in its focus on the consequences and effects experienced by defendants in planning and acting “at the time of the underlying conduct” as the relevant real life determinant of what the “actual law” of liability means and “is” as a positive matter. But more fundamentally, *Principles* appears to take the functional approach to the question of whether the applicability of multiple state laws poses a choice of law problem. Thus, *Principles* expressly eschews “formal” differences, mere semantic or conceptual variation, and instead posits the question as a “functional one ... whether those bodies of law are relevantly the same [or dissimilar] in functional content.”<sup>14</sup>

As the context for discussion concerns class actions (and more broadly, aggregate litigation), we also posit that the “underlying conduct” involves the potential for an interstate risk arising from a series of similar transactions or events (e.g., product sales) or a central policy or plan (e.g., decentralized authority to hire and fire employees). Further we assume that the defendant businesses, ex ante, rationally seek to maximize profits and their other valued interests. Specifically regarding threatened civil liability for harms from interstate risks, businesses ex ante seek to maximize their benefit by minimizing the adverse consequences and effects of the governing law. Given the evident reasons for affording businesses the opportunity to make an informed choice about engaging in the underlying conduct, *Principles* thus makes obvious sense to be concerned about whether firms have ex ante notice (actual or reasonably attributable) of the functional content of governing law.

We part ways from *Principles*, however, at the point of its summary conclusions regarding the nature of the governing law of which businesses would have notice ex ante when operating under a regime of differing state laws. *Principles* evidently assumes that businesses would have notice of the functional content of each of the different state laws, but would lack such notice of the average law, of the mean value of the functional content – the consequences and effects – of the differing state laws. But why would businesses have notice of the former but not the latter? From a functional standpoint, the

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<sup>13</sup> On Holmes’s conception of law in terms of its relevant operative consequences and effects, see David Rosenberg, *THE HIDDEN HOLMES: HIS THEORY OF TORTS IN HISTORY* 46-50 (1995).

<sup>14</sup> *PRINCIPLES* § 2.05, Comment d.

question answers itself: businesses know the law they need to know. So *Principles* must take it that if businesses lack notice of the average law it is because they don't need to know it. Although *Principles* does not address the question directly, it suggests this answer in presuming that the nature of the governing law and defendants' ex ante understanding of and response to it is the same for cases involving intrastate risk as it is for cases involving interstate risk. In short, the *Principles* presumes that in interstate risk cases businesses seeking to minimize the adverse legal consequences and effects of a regime of differing state laws need to know only the discrete, separate functional content of each state's law to make an informed choice about whether to engage in the underlying activity with respect to each state. This assumption is misguided.<sup>15</sup>

The law governing the choice to engage in an activity involving interstate risk is the aggregate total or whole of the functional content of all the applicable differing laws. From the ex ante perspective of a business contemplating its liability exposure for activity that can be designed and implemented to involve more or less interstate risk, the functional content of the governing law is the sum of the adverse consequences and effects the business anticipates incurring under each of the applicable differing laws, in other words, the average law. This is a reality dictated by business necessity; only by assessing the total functional content of all of the applicable state laws can a business rationally manage interstate risk to minimize the adverse legal consequence and effects of its choice of underlying conduct. Because the businesses of concern here operate on the basis of centralized policies and generalized designs for the production and marketing of products and services, they normally must take standardized measures across, in, or with respect to all of the potentially affected states to minimize the adverse consequences and effects from operating under a regime of differing state laws.<sup>16</sup> Indeed, the resulting business choices of interstate risk from the production and marketing of products or

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<sup>15</sup> It might be contended that it is impractical for businesses to gain accurate knowledge of the average law ex ante, at the time they decide to engage in underlying conduct. But, as we explain below, the knowledge a business needs to know, ex ante, before making an informed choice to engage in risky conduct, whether it involves a intrastate or interstate hazard, is the functional content of the law in *expected terms*, in other words, foresight of the future adverse legal consequences and effects of choosing this or that course of action. Given that no one can know the future with certainty, accuracy for these purposes is only knowledge of the likelihood of such adverse consequences and effects. More specifically, because a business planning some standardized activity never knows whether and how much harm will occur and to whom, it must and does base its decision on its aggregate *expected* legal sanctions – the anticipated sum of all liability and damages plus all manner of litigation and related costs. Again, unable to predict the future with certainty, the business “knows” the aggregate *expected* legal sanctions only as a distribution of probability weighted litigation outcomes. This explanation holds whether the business seeks to know its aggregate *expected* legal sanctions under a single state law or under many differing state laws, or indeed whether the risk involved is systematic or isolated and sporadic, such as a driver's decision when and how fast to turn left across a lane with oncoming traffic. Average law is simply the sum-total of the aggregate expected legal sanctions under each of the applicable differing state laws. If a business is capable of determining its aggregate expected legal sanctions under each given state law, then it should have no difficulty summing them up to derive its aggregate expected legal sanctions under the average law. That businesses engage in standardized activity is strong evidence that they are capable of “accurately” knowing the functional content of average law ex ante.

<sup>16</sup> For a discussion of average law's applicability in situations involving customized, state-specific safety strategies, see *infra* II.B.



services generally correspond with the commands of no particular actual law of any of the states (except by sheer coincidence), but rather will reflect a liability minimizing strategy formulated in response to the average functional content of the differing laws.

More particularly, the major legal determinant (ignoring administrative regulation) of a business's ex ante choice of activity involving interstate risk is its aggregate liability exposure under the governing state laws – the aggregate functional content of the average law. To be sure, the aggregate expected liability equals the sum of the firm's expected liability exposure under each of the applicable laws. But, because it seeks to minimize the total adverse consequences and effects of the governing laws, the business will choose an activity involving interstate risk that is not necessarily the one it would choose if it involved risk limited to any given state (or that could be modulated by customizing the activity on a state by state basis) and hence would be governed exclusively by that state's law (or choice of law rules). In other words, ex ante, the business needs to know the average, the sum-total functional content of all of the applicable state law because that is the actual law that determines the choice of underlying conduct involving interstate risk.

Ex ante, the business can thus be viewed as designing its safety strategy in response to the internalized aggregate expected liability. Essentially, the laws of affected states, like tastes of potential consumers, represent a demand for safety that the firm seeks to efficiently supply. When customizing – incorporating or complying with state-specific requirements – is too costly, the firm will mass produce or standardize safety across all states as it would all customers.

To illustrate assume two states with different laws representing different demands for safety, low ( $l$ ) and high ( $h$ ). This variation in precaution level and related cost is depicted in Figure 1.

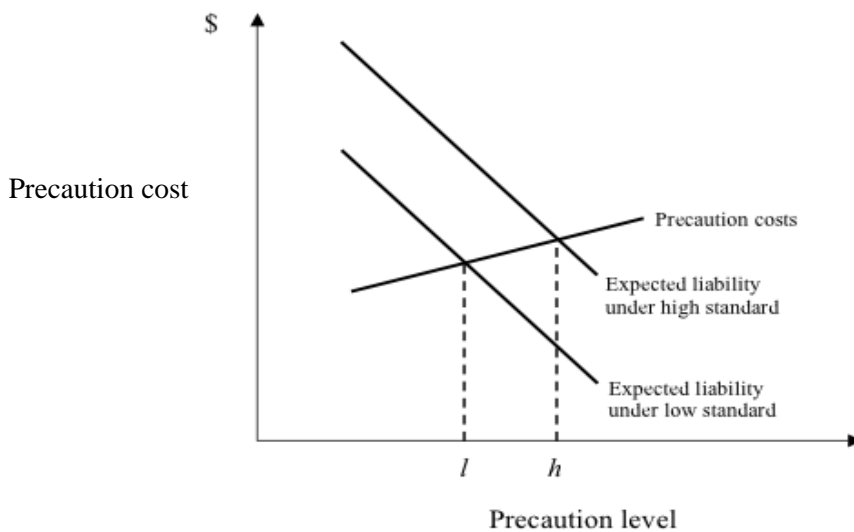


Figure 1

Figure 1 creates an analytic framework for understanding how a business will behave where different states' laws are applied to the choice of product design (or similar choice regarding some other activity) involving interstate risk. The horizontal axis in the figure corresponds to the degree of precaution a manufacturer takes in making and marketing its product (research, safety features, warnings, or whatever). To highlight the risk management dynamics of business decisionmaking in the ex ante time-frame, we assume there is no single precaution that magically eliminates all expected liability under either standard, much less both.<sup>17</sup> Rather, we assume that precautions and their consequences lie on a continuum, lowering the risk and/or magnitude of harm to consumers, and therefore lowering the risk and/or magnitude of legal sanctions for the business. The business's expected liability (per unit sold) under the varying standards of liability is captured by the downward-sloping lines: the more the business invests in precautions, the less its expected liability. The per-unit costs of precautions (expense, delay, etc.) are captured by the upward-sloping line.

Points *l* and *h* on the horizontal axis mark the optimal precaution levels, from the business's point of view, corresponding to each the two given standards of liability. If the low standard governed the entire market, the business's optimal level of precaution would be *l*, because here the precaution cost line intersects with the expected liability line for that standard. Precaution investments beyond that point would cost the business more than it would reap in reduced expected liability. By the same token, if the *high* standard governed the entire market, the optimal precaution level would be *h*. Any lesser investment would yield greater expected liability than the savings in precaution costs.

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<sup>17</sup> Assuming otherwise would not change our analysis or conclusions. For example suppose that the standardized precaution satisfying a high negligence standard in state A costs \$175 to avoid \$200 in liability per unit sold in A and also satisfied a lower negligence standard in state B, compliance with which would cost \$100 per unit to avoid \$200 in liability per unit sold in B. Assume further that the lower, State B precaution would leave the business exposed to \$140 in liability per unit sold in State A. Although compliance with the higher standard would avoid liability in both states, the business might well trade off higher expected liability in State A for some lower cost overall by choosing an intermediate precaution, say one costing \$150 per unit that would satisfy the lower negligence standard in B, but left the firm exposed to liability of \$30 per unit under the higher negligence standard in A. Anticipating the sale of two units respectively subject to the differing negligence standards, the business comes out best by adopting the intermediate precaution and incurring total expected cost of \$330 (\$300 cost of precaution + \$30 expected legal sanction) as compared to its total expected cost from the low precaution of \$340 (\$200 cost of precaution + expected legal sanction of \$140) and from the high precaution of \$350 (\$350 cost of precaution + 0 expected liability). We are of course assuming that precautions customized to comply with the demands of each state's law would involve additional cost rendering that option inferior to adopting any of the standardized precautions.

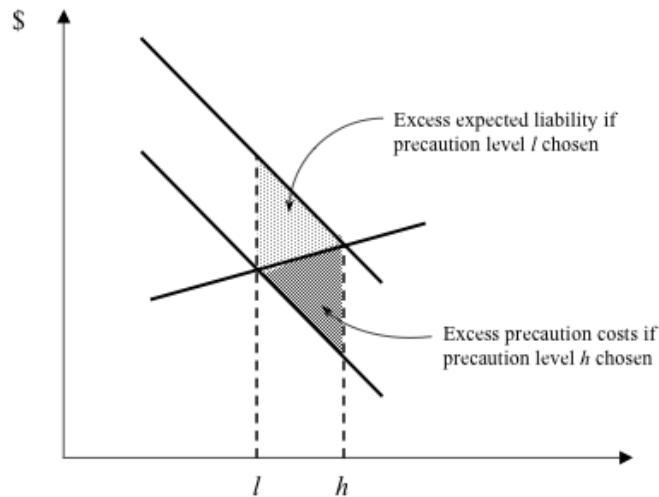


Figure 2

If, however, the two standards coexist in the relevant market, then the business is better off selecting an intermediate precaution level. Let us assume that each standard governs roughly half of the market. Consider Figure 2, which shows what happens when the business chooses one or the other of the standard-specific optima just identified. If the business chooses  $l$ , it faces excess liability in the high-standard regions of the market; this excess is captured by the upper lighter shaded triangle. If the business instead chooses  $h$ , it incurs excess precaution costs in low-standard market regions; this excess is represented by the lower darker shaded triangle. In effect, these two triangles – excess liability and excess precaution costs – measure the losses the business must trade off in selecting a precaution level demanded by the liability standard of one or the other state laws.

Now consider Figure 3, which shows the effect of choosing a precaution level somewhere between the standard-specific optima, in other words, a level of precaution demanded by the liability of none of the applicable state laws. Suppose the business chooses precaution level  $m$ . Compared to the choice of  $h$ , this action generates excess expected liability in high-standard parts of the market, represented by the upper shaded triangle. And compared to the choice of  $l$ , the action generates excess precaution costs in low-standard market regions, represented by the lower shaded triangle. However, the *combined area* of the shaded triangles in Figure 3 is less than *either* of the shaded triangles in Figure 2, as a quick visual inspection will confirm. In other words, the *sum* of excess precaution costs and excess liability is less for the choice of  $m$  than it is for the choice of  $l$  or  $h$ .

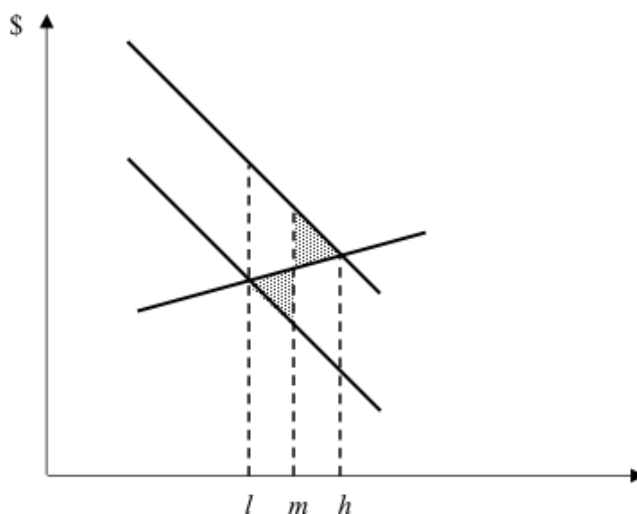


Figure 3

What drives this result, in essence, is that the business wants to be as close as it can to the optimal point for *each* of the state-decreed liability standards, without being “too far” from either. The further the business is from the optimal point for one of the standards, the more important it is to move in the direction of the optimum; by the same token, the closer it is to the optimum, the less it has to lose by moving away from it. We can see this with a glance back at Figure 3: if the business is at *m* and moves leftward, the top triangle (excess liability) grows “faster” than the bottom triangle (excess precaution costs) shrinks; and the further to the left it moves, the more pronounced this asymmetry becomes. Thus, the closer the business is to *l*, the more it has to gain by moving in the direction of *h*, and vice versa. As we have drawn the picture, the solution to the triangle-shrinking problem is to pick a point near the middle. Its precise location would change if we altered the precise shape of the curves. But the central conclusion – that the business will select an intermediate precaution level – would not change.

The basic logic of this model holds regardless of how many state specified-liability standards there are, and regardless of how they are distributed in the market. We have assumed, for simplicity of exposition, that the two state-specified liability standards govern equal shares of the market. If, instead, one state-specified standard governs a disproportionate share, the solution to the business’s problem is a kind of weighted average favoring but not precisely corresponding with that state’s law. Likewise, if there are multiple state-specified liability standards in force, the business’s problem becomes one of finding an appropriate intermediate point among, but only by coincidence corresponding with any one of them.

## II. Potential Objections to the Average Law Solution

The foregoing argument that businesses *ex ante* need and therefore acquire knowledge of the average law as the ultimate determinate of their choice to engage in

activities involving interstate risk should suffice to answer the complaint that the use of the average law solution results in courts applying a law that corresponds to no actual law. The previous showing makes clear that application of the average law indeed applies all of the actual, differing state laws involved. To be sure the functional content – consequences and effects – of any given law is not ultimately brought to bear on the defendant in the discrete, direct, and one-to-one way as it would be in a case of intrastate risk. But in a case of interstate risk, the only law that is ultimately brought to bear on the defendant in a discrete, direct, and one-to-one way is the average law, which is comprised of and enforces the real applicable state laws. In other words, *ex ante* a business estimates the legal sanctions it will incur from application of each of the governing state laws separately to each potential claim, but if it is to make an informed, rational choice about engaging in an activity involving interstate risk, the firm would as it must go further to minimize total adverse legal consequences and effects. It will *add up* the expected state-specific outcomes to determine the total expected legal sanction, the aggregate expected costs of liability, damages, and litigation of action – that is, to determine the average law.

This showing should also meet two related concerns raised in some court opinions and commentary. The first is that application of the average law does not accurately replicate the outcomes of liability and damages that would result from application of the constituent laws separately. Significant discrepancy between applying differing laws on average and separately could detrimentally affect social welfare by distorting deterrence and compensation outcomes and possibly by unduly increasing the related risk-bearing costs for businesses. The second views the application of average law as derogating from the lawmaking sovereignty and autonomy of affected states. In particular, the concern is that applying average law will impede states from furthering their respective governmental interests and relatedly discourage them from serving as “little laboratories” of regulatory diversity, competition, and innovation. There is no substance to either of these objections to the average law solution.

#### A. Accuracy

A good illustration of the accuracy objection is Judge Frank Easterbrook’s opinion in the Firestone Tire-Ford Explorer mass tort case involving thousands of claims alleging increased roll-over risk due to design and warning defects regarding the Firestone tires with which Ford equipped most of its Explorer SUVs.<sup>18</sup> Plaintiffs were seeking class action treatment of their small-recovery claims for refund of the tire purchase-price on the ground that the manufacturers’ failure to disclose the tire defects constituted a deceptive trade practice in violation of governing state consumer protection laws. Consistent with the trend described above, Easterbrook ruled that using class action would be inappropriate because of great differences among the governing state laws. Rejecting plaintiffs’ choice-of-law argument that the forum law governed all claims, Easterbrook found that proper choice-of-law analysis required application of the differing consumer protection laws of 50 states and the District of Columbia to resolve the

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<sup>18</sup> *In re Bridgestone/Firestone, Inc., Tires Product Liability Litigation*, 288 F.3d 1012 (7th Cir. 2002).

pertinent subgroup of claims each law governed.<sup>19</sup> According to Easterbrook, statistical sampling could not solve this choice of law problem. On his view of the proposed sampling models, none could efficiently resolve the great heterogeneity among claims except by deriving a general average law that would ignore or suppress significant variables, and thus would skew the estimate of the actual, sanctionable loss and damages incurred by the class as a whole and expose the defendants to excessive legal sanctions.<sup>20</sup> The practical, and in Easterbrook’s view it seems, the best means for gaining “the information needed for accurate evaluation of mass tort claims” is the “decentralized process of multiple trials, involving different juries, and different standards of liability in different jurisdictions’.”<sup>21</sup>

The key to understanding the error in Easterbrook’s argument is that, as we have shown above, average law reproduces the results of applying each of the relevant state laws separately. Thus, regardless of the mode of applying the differing state laws – on average or separately – the aggregate outcomes for purposes of deterrence and compensation will be identical. The choice between the two modes is not a matter of indifference, for as we show in Part III, rejecting the average law solution curtails use of multistate federal diversity class actions, and thus deprives states of the most effective means of enforcing their laws aimed at preventing and compensating harm from socially inappropriate interstate risk-taking by businesses and consequently decreases the well-being of everyone exposed to such hazards.

For compensation purposes, we can illustrate the point with the example of two claims each governed respectively by the differing laws of States A and B. Assume that the State A claim would recover \$100 and the state B claim would recover \$200.<sup>22</sup> Compare the two modes of applying the differing state laws to determine the defendant’s aggregate liability and damages: first, separate application of each state law, which given the objection to averaging is deemed “accurate” and denominated the baseline mode; and second application of the average or mean value of the two laws. The baseline mode of separate application of the two laws would result in recoveries (by settlement or judgment) of \$100 and \$200 respectively and \$300 in the aggregate. Using a reliable statistical method of sampling would result in an average or mean value of \$150 that

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<sup>19</sup> *Id.* at 1016. Easterbrook also pointed out numerous factual variations, noting that instead of one tire design, there were 67 different sets of design specifications and that related to each set were myriad consumer-specific issues, for example, each consumer’s intended and actual use of the tires and reliance on the allegedly misleading warnings. *Id.* at 1019.

<sup>20</sup> *Id.* at 1020. Although a general average could impose excess or deficient aggregate liability and damages, Easterbrook, without explanation, seems to presume the former result. *See also McLaughlin v. American Tobacco Company*, 522 F.3d 215 (2d Cir. 2008).

<sup>21</sup> *Bridgestone/Firestone*, 288 F.3d at 1020 (quoting *In re Rhone-Poulenc Rorer, Inc.*, 51 F.3d 1293, 1299 (7th Cir. 1995)). Easterbrook fails to mention that the small-recovery claims involved were unlikely to be economically viable as separate actions in the “decentralized process.”

<sup>22</sup> Here and in all subsequent numerical examples, it is assumed that differences in dollar valuations of claims and outcomes arise exclusively from differences among state laws and their respective functional content in terms of consequences and effects.

when applied to each claim produces aggregate liability and damages of \$300, the same amount as the baseline mode produced.

For deterrence purposes, the focus is on the defendant's ex ante expectation of aggregate liability and damages. The "accuracy" required for deterrence purposes is concerned only with whether the threat and imposition of aggregate liability and damages is determined in a way and amount that will lead the prospective defendant (and plaintiff) to "internalize" the socially appropriate level of aggregate *expected* liability and damages in the ex ante time-frame, the period prior to the risk-taking decision in question. Because it is virtually always the case that the prospective defendant knows and responds to the sum-total of its future aggregate liability and damages only as a distribution of probability weighted outcomes, the threat and imposition of liability that comports with that statistical expectation is all that accuracy for deterrence purposes requires. Under the baseline mode of separately applying the differing state laws, the defendant would internalize ex ante aggregate *expected* liability of \$300 with some probability. Here we have assumed that result would occur with certainty; but if the probability of the \$300 recovery was less than 100%, then the prospective defendant would treat that outcome as one of the distribution of probability weighted outcomes and add the others to derive the aggregate *expected* liability and damages that ultimately motivates the investment in precautions. Applying average law produces the identical deterrence result. Essentially, applying the average law generates the "accurate" deterrence result ex ante because it compels the prospective defendant to internalize the entire distribution of probability weighted outcomes in contemplating a risky venture and the investment in precautions it should make.

To illustrate, suppose a firm is contemplating taking a risk that would result in sanctionable loss to and related claims by A of \$100, B of \$200, and C of \$300.<sup>23</sup> Assume the firm would take optimal precautions that would avoid the risk altogether if it expected to incur aggregate liability and damages of \$600. Suppose further the firm anticipates that the courts would employ one of two methods of determining its aggregate liability and damages: (1) trying or settling each claim separately or (2) using statistical sampling to reliably estimate aggregate liability and damages as actually and individually incurred by all plaintiffs.

Threatening the firm with the outcomes from trial or settlement of each claim would give it the proper incentive to invest optimally in avoiding the risk because, ex ante, it would internalize aggregate expected liability of \$600 (\$100 from claim A + \$200 from claim B + \$300 from claim C). The same aggregate expected liability of \$600 can be derived by using statistical sampling to ascertain the liability and damages attributable to the average claim, here \$200, and extrapolating that amount to all claims for an aggregate assessment of liability and damages of \$600. Both the multi-claim trial and

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<sup>23</sup> The dollar figures attached to these civil damage claims represent the sum total effect of all state law related variables of any type, degree, and significance, accounting for their uncertainty and offsetting of one another, on the plaintiffs' respective probable recovery at trial and cost of litigation to secure this prospect.

average law methods thus internalize to the prospective defendant the same, presumed to be the appropriate, level of aggregate expected liability and damages by virtue of threatening liability for the sum-total of liability and damages for each of the aggregated claims separately determined or statistically estimated.

## B. Sovereign Lawmaking

Another charge lodged against average law is that it displaces the laws and hence overrides the lawmaking authority of the several states. In the context of federal diversity cases, this criticism invokes Holmes's injunction that the "common law is not a brooding omnipresence in the sky, but the articulate voice of some sovereign [state] that can be identified."<sup>24</sup> By negating state law and its animating policy aims and preferences, application of average law also jeopardizes the benefits of "federalism" to the extent it dilutes the incentives of states to serve as "little laboratories" of experimentation and innovation. As Judge Easterbrook warned, in somewhat strident terms,

"It is hard to adopt the central-planner model [presumably including the average law solution] without violence not only to Rule 23 but also to principles of federalism. Differences across states may be costly for courts and litigants alike, but they are a fundamental aspect of our federal republic and must not be overridden in a quest to clear the queue in court. ... Tempting as it is to alter doctrine in order to facilitate class treatment, judges must resist so that all parties' legal rights may be respected. "<sup>25</sup>

This argument reproduces the erroneous conflation of cases of intrastate risk with cases of interstate risk. Our previous showing that average law is the necessary and inevitable result of enforcing multiple state laws in cases of interstate risk warrants dismissal of these objections as insubstantial. In the benchmark process, the functional and real import of separate application of each state law to resolve its share of claims – beyond the enormous cost involved – boils down simply to the contribution of a probabilistically weighted input to the overall distribution of probabilistically weighted inputs from application of all other state laws to their respective shares of claims. Of course, states are free in that process to craft their laws to implement their respective autonomously chosen interests and preferences, and to develop new approaches to solving some social problem, even one with interstate dimensions. And to the extent that the laws apply to cases of intrastate risk, the distinctive functional content of each law will be expressed discretely, directly, and fully within each state's jurisdictional reach (that is, as far as the state's choice of law rules authorize its application). But, when the laws are applied in cases of interstate risk, the distinctive functional content of each law will receive only marginal expression as one among a series of probabilistically weighted

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<sup>24</sup> *Southern Pacific Company v. Jensen*, 244 U.S. 205, 222 (1917) (Holmes, J., dissenting).

<sup>25</sup> *In re Bridgestone/Firestone, Inc.*, 288 F.3d 1012, 1020 (7th Cir. 2002). See also Linda S. Mullenix, *Mass Tort Litigation and the Dilemma of Federalization*, 44 DEPAUL L. REV. 755, 781 (1995); Robert A. Sedler, *The Complex Litigation Project's Proposal for Federally-Mandated Choice-of-Law in Mass Tort Cases: Another Assault on State Sovereignty*, 54 LA. L. REV. 1085 (1994).



inputs from applying other states' laws that comprise the aggregate expected liability businesses internalize ex ante and the sum total of the judgments and settlements courts generate ex post. The functional and real import of applying the several states' laws to resolve interstate mass injury claims remains unaffected by average law. In short, average law represents no different – no greater or lesser threat – to states' sovereign and creative powers of lawmaking than does the benchmark process.

Three additional points should be noted. First, the benefit of states serving as “little laboratories” is overstated in the context of enforcing civil liability to deter business from engaging in unreasonably risky multistate ventures. Given competing interests of states, the potential for some states to free-ride on the innovations of another is likely to discourage states from optimally investing in new approaches that can be freely copied. A more basic constraint on innovating laws applicable to interstate business ventures is that a given state gains only a fractional share of the benefits from innovation while it would probably have to pay the full cost of developing the new approach. For example, suppose a change of law costing \$50 to develop would produce a nationwide benefit of \$100, but the innovating state would gain only \$10. It is doubtful that the state would invest much if anything in developing the new approach and if it did invest say \$5, the resulting innovation probably would not have much if any significant value to other states.

Second, federalism is plainly not a license for unfettered state lawmaking sovereignty. There are many basic and applied constitutional norms constraining the courts of one state from making or applying law to gain advantage over or at the expense of one or more of the other states. The problem is most acute in the civil liability context when a state court presides over a mass injury case in which the defendant is an out-of-state business. Notably, the court might increase the business's liability exposure to favor forum state plaintiffs. While the business anticipating such action might raise prices of its products and services to forum state customers in advance of litigation to offset such law-gauging, because of the relatively low cost of interstate arbitrage, the firm will rarely be able to price discriminate so as to charge the full cost to such buyers. Hence the business will likely increase the price across the board, compelling buyers in other states to bear some of the burden and thus to subsidize gains from heightened liability for forum state buyers.

Federal diversity jurisdiction operates as one constraint against a forum state court engaging in such opportunistic biasing of the law to favor the interests of forum state litigants or citizens generally. By enabling out of state parties to avoid the exercise of state court jurisdiction, federal diversity jurisdiction substantially limits the opportunity for state courts to manipulate the formulation or application of state law in the course of adjudicating ongoing cases. This negative role of diversity jurisdiction and resulting benefits for non-forum parties are well-known. But, less well recognized is its more positive role and benefits for the federal system of multistate lawmaking, in particular in regard to cases involving interstate risks. Essentially, as a hedge against states gaming the system, federal diversity jurisdiction provides a strong degree of assurance to all states that none of them will be able to steal a march on the others in terms of

manipulating the law at their expense. Because distrust and costs engendered by the potential for gaming generally ends up making all states and their citizens worse off, it would be sensible for the states to agree to refrain from taking advantage of one another. However, such an agreement would not be legally enforceable outside of an interstate compact or a state engaging in self-dealing of a sufficiently egregious nature as to warrant constitutional rebuke. Diversity jurisdiction fills some of this legal gap. It should be readily apparent that the effectiveness of diversity jurisdiction in this respect as well as in its more negative role is promoted by adopting the average law solution to facilitate expanded and more efficient use of federal diversity class actions.

Finally, the analysis throughout has assumed that the firm subject to average law would adopt a standardizing safety strategy. This might raise concerns that average law requires this choice of safety strategy and therefore might distort businesses' incentives by motivating them to adopt customized safety strategies for no economic purpose other than escaping the increased probability of class action. There is no reason for such concern. Application of average law will not affect the business decision to employ a standardized or customized safety strategy.

The focus on standardizing safety strategies was simply to further the evaluation of using average law to overcome the differing state law problem in class actions, and class actions are conventionally considered appropriate for similar claims. To this end, we have tried to limit the differences among claims to varying state laws. The utility of an average law approach does not in any degree depend on the firm's choice between standardizing and customizing safety strategies. To state the point directly and in terms of our basic argument, use of average law to determine a defendant's aggregate liability and damages replicates the functional consequences and effects that would obtain under the benchmark process of applying the differing laws separately state-by-state.

To see this, consider a defendant business that operates two trucks as part of its business and faces the prospect of two claims, a claim for \$100 arising from a traffic accident involving use of one truck in state A and claim for \$300 arising from an accident involving use of the other truck in state B. Assume that the strict liability rules of A and B differ significantly (e.g., state A caps non-pecuniary damages while state B does not) and the choice of law rule of each state would apply the law of the place of accident. Also assume that the difference in the claimed amounts reflect differences between the state laws and not in the amounts of loss suffered by plaintiffs. If these claims were resolved by the benchmark process, applying the state-specified law to each claim, the firm would anticipate the outcomes from resolving both claims to sum up to aggregate liability of \$400. Under the average law approach, the firm's liability for each accident is simply the average of the two potential liability values, or \$200. The firm therefore anticipates and internalizes aggregate liability and damages from paying \$200 per claim of \$400, precisely the same as it would in the benchmark process.

Now consider the firm's incentives for precautions under the two adjudicative regimes, the benchmark process and application of the average law. For this purpose assume that if the firm does not spend reasonably on precautions, \$50 for the state A

truck and \$150 for the state B truck, the harm caused by and related liability level for each vehicle would double – from \$100 to \$200 from the former truck and from \$300 to \$600 from the latter truck. As a rational profit maximizing enterprise, the firm seeks to minimize its total expected law-related accident costs. If the claims are resolved in the benchmark process, the firm minimizes total expected accident costs at \$600 by taking reasonable precautions totaling \$200, allocating this amount on a customized basis: \$50 to the state A truck and \$150 to the state B truck. If it invested less than that amount, for example \$0 for both vehicles, the firm would bear total expected accident costs of \$800. Suppose the firm customized the allocation by investing \$50 for the state A truck and \$0 for the state B truck, then its total expected accident costs would be \$750 (\$50 in precautions for the State A truck + \$100 in liability and damages from the state A truck + \$600 in liability and damages from the state B truck).

Average law produces exactly the same customizing results. Facing the same aggregate expected liability and damages under average law as it would in the benchmark process, the firm would adopt the same customizing safety strategy to minimize total expected accident costs. If, for example, the firm invested \$0 in precautions for both trucks, average law would confront the firm with total expected accident costs of \$800 ( $\frac{1}{2} \times (\$400 + \$1200)$ ). Suppose the firm customized the allocation by investing \$50 for the state A truck and \$0 for the state B truck, then its total expected accident costs would be \$750 under average law (\$50 in precautions for the State A truck +  $\frac{1}{2} (\$200 + \$1200)$ ) just the same as it would be in the benchmark process. Thus, applying average law generates the same deterrence effects as would the benchmark process.

### III. Practical Applications of Average Law in Class Action

In this part we discuss the practical implementation of the average law solution. In general, we posit that determination of a defendant's aggregate (class-wide or sub-classed) liability or aggregated liability and damages is severable (decoupled) from the distribution of damages among class members and that class action treatment would be warranted but for the presence of significantly differing state law. Specifically, our analysis considers the extent to which the benefit of using average law to solve the differing state law problem in the aggregate liability stage is offset by the costs of applying the differing laws at the individual distribution stage. Our aim is not to provide a comprehensive primer on the question, but rather only to indicate the illustrative types of cases and conditions that would most likely accommodate and facilitate use of average law in class action. Preliminarily we explain the need for class action to correct a structural bias in the system of civil liability that distorts the deterrence and compensation outcomes of mass injury litigations and hence the need for using the average law solution to the maximum feasible degree.

#### A. Special Need for Class Action and Hence for Average Law

Collective actions are conventionally viewed as increasing the efficient enforcement of common law claims for damages. The benefits are enhanced compensation and deterrence, though the latter is rarely given sustained consideration by

courts or commentators. For high-recovery claims, greater efficiency is seen as a function of the similarities among claims that enable courts and parties to capitalize on the scale efficiency from adjudicating and litigating questions of common import. Making a “once-and-for-all” investment on those questions, and spreading the cost across all claims, avoids the expense of courts and parties having needlessly to repeat their efforts to resolve multiple, similar claims in separate actions. By spreading the collective or common question investment on discovery, experts, litigation of summary judgment and other dispositive motions, and the like, class action yields great savings in processing costs, usually put in terms of absolute reductions in expenditures by the court and parties. For small-recovery cases, the greater efficiency of class action is seen as a function of aggregation itself. Indeed, according to the Supreme Court, it is the “core” purpose of the class action to solve the problem of the unmarketability of small-recovery claims to plaintiff-attorneys by “aggregating the relatively paltry potential recoveries into something worth someone’s (usually and attorney’s) labor.”<sup>26</sup>

The conventional view generally fails to recognize a key further benefit of collectivization applicable to both large- and small-recovery class actions. The generally unnoticed benefit arises from the scale efficiencies of class action in correcting a systemic bias of resolving similar claims in the separate action process that distorts outcomes on average and consequently undermines the compensation as well as the deterrence value of civil liability. Specifically, collectivization corrects this systemic bias by affording the plaintiff-side the same opportunity as defendants naturally have in the separate action process to exploit scale efficiencies in the prosecution of similar claims.

As noted above, lower cost is the well-known return from the scale efficiencies fostered by class actions. But scale efficiencies in litigation produce another important, though little recognized benefit in providing the parties, particularly, as discussed below, the plaintiff-side with incentives to make qualitatively superior investments in developing relevant information needed by the court to render socially appropriate decisions.

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<sup>26</sup> See *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 617 (1997). Strictly speaking this explanation is not complete. For if the cost of prosecuting each aggregate claim remained constant, the claims aggregated or otherwise would remain unmarketable to plaintiff-attorneys despite the increased amount at stake. The key to their market value in the aggregate is the scale efficiency of spreading litigative investments on the common elements across all claims. However, collectivizing small-stake claims does not lower the cost of duplicative effort. This is because there is none to avoid. In the absence of collectivization, small-stake, unmarketable claims would simply die on the vine. Thus collectivization results in processing costs (not of a duplicative-effort nature) for the court and defendant that they would not incur otherwise. However, in justifying collective processing of these claims, courts and commentators simply recite as absolute benefits vindicating “rights” and compensating losses, without ever even alluding to the added cost. Typically left out of the equation is the most important offsetting benefit from small-recovery class actions: deterrence of socially inappropriate risk-taking.

The reference in *Amchem* to “small recovery” is also somewhat misleading. Recoveries can be small even when the alleged loss is large. Risk and other litigation costs can reduce the expected recovery to a pittance regardless of the amount at stake. Indeed, this is true for most “solo actions.” Unless a plaintiff-attorney anticipates acquiring a relatively sizable market share of mass injury claims and/or free-riding on some other attorney’s workproduct, he or she would be unlikely to invest in the litigation.

To illustrate, assume that 10 customers sue a bank for engaging in a deceptive trade practice that results in each losing \$1000. Assume that each plaintiff proceeds by separate action and invests \$250 to prove fraud by the defendant with a 60% probability of succeeding at trial. On this basis, each expects to recover \$600 at a cost of \$250, and hence to net \$350 and thereby to subject the defendant to aggregate expected liability and damages of \$6000. However, if the fraud question is common to all claims and a single investment of \$250 would result in a 60% probability of recovery for all, the collectivization for a once-for-all investment would still result in the defendant facing aggregate liability of \$6000, but by reducing per-claim cost, increases each plaintiff's net recovery to by \$225 to \$575.

Now assume that the plaintiff could increase the probability of winning at trial from 60% to 90% by increasing the investment from \$250 to \$1000. Of course, in the separate action process, no individual plaintiff would spend an additional \$750 to raise the expected recovery by \$300 ( $90\% \times \$1000 - 60\% \times \$1000$ ). However, the investment might well be worthwhile if a single once-for-all investment of \$1000, spread across all claims, raised the probability of winning at trial to 90% for all. Then each plaintiff would bear the added marginal cost of \$75 over the collective action investment of \$25 ( $\$1000/10 - \$250/10$ ) for an increase in the marginal recovery per claim of \$225 ( $\$900 - \$100 - \$575$ ). Defendant's aggregate expected liability and damages would also increase correspondingly to \$9000.

We focused the example on the comparative advantage for plaintiffs in a collective action versus separate actions for the reason that in confronting plaintiffs suing separately, defendants naturally and automatically have incentives to invest optimally in their side of the case. The defendant owns the aggregate stake in mounting an effective aggregate defense on common elements against all claims. This gives the defendant an asymmetric advantage over each plaintiff, who owns only a fractional stake in the common elements of the aggregate claim. Indeed, the defendant's superior litigation position when similar claims are litigated separately grows ever stronger with each additional separately filed claim. All else equal, the defendant's expected payoff from its defense investment doubles when there are two separately prosecuted actions, triples when there are three, and so forth. The consequence of this asymmetric investment advantage is to skew outcomes on average in the defendant's favor, undermining both deterrence and compensation objectives.

For an example, assume that the 60% probability of success results given the investment of \$250 by each plaintiff to establish and \$250 by the defendant to refute the fraud accusation. The key here is that the defendant can spread the defense cost across all claims to skew the outcome of settlement. Given roughly equivalent bargaining power (symmetry in information about the value of the claim in litigation and in risk-bearing cost) and assuming the parties agree on the \$600 expected recovery from trial, then settlement of each bank fraud claim will reflect the difference in the parties' respective costs of going to trial. The stark comparison here is between the \$250 cost of going to trial for each plaintiff and the \$25 ( $\$250/10$ ) cost of going to trial for the defendant against each plaintiff as spread across all claims. One would expect the

resulting settlement on each claim to come in around \$487.50, representing the mean of the sum of each plaintiff's expected net recovery (the lowest demand), \$350 (\$600 - \$250), and the defendant's expected gross payout (the highest offer), \$625 (\$600 + \$25).

The adverse consequences for deterrence and compensation objectives due to the defendant's asymmetric investment advantage should be evident on the quality dimension. To illustrate, assume in the separate action process that if the defendant invests \$1000 rather than \$250 while the individual plaintiff invests \$250 the probability of plaintiff recovering at trial will drop from 60% to 20%. In other words, the defendant's marginal cost in each claim increases by \$75 ( $\$1000/10 - \$250/10$ ) but is outweighed by the marginal benefit of \$400, the decrease in each plaintiff's expected recovery from \$600 to \$200.

Only collective adjudication of all claims, effectively as a single case, will overcome the defendant's asymmetric investment advantage and resulting superior litigation power, and hence eliminate the systemic bias that undermines the deterrence and compensation objectives of civil liability. Now assume a point of equilibrium that has each side investing \$1000 for a probability of success for plaintiffs of 75%. Given that the plaintiff-side has the same opportunity as the defendant to spread the trial costs of \$1000 across all claims, each plaintiff can expect net recovery from trial of \$650 ( $\$750 - \$1000/10$ ) and \$750 from settlement. The enhanced deterrence results are clear in either case as class action judgment or settlement both subject the defendant to aggregate liability and damages of \$7500.<sup>27</sup>

## B. Cases and Conditions Best Suited for Use of Average Law

To start with, we see no litigation scenario that would categorically render the average law solution impractical to use. Its application fits well within the bounds of Rule 23 and standard class action doctrine and practice. Rule 23(d) provides broad authority for courts to manage class action trials by requiring the determination of a defendant's aggregate liability and damages separately and decoupled from proceedings to distribute any aggregate recovery among class members.<sup>28</sup> That authority also empowers courts to allow or even require proof of the defendant's aggregate liability and damages by statistical means based on a reliably representative sample of the classed claims.<sup>29</sup>

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<sup>27</sup> For further elaboration of this argument for collectivizations, see David Rosenberg, *Mass Tort Class Actions: What Defendants Have and Plaintiffs Don't*, 37 HARV. J. ON LEGIS. 393 (2000).

<sup>28</sup> See e.g., *Boeing Co. v. Van Gemert*, 444 U.S. 472 (1980); *Carnegie v. Household International, Inc.*, 376 F.3d 656 (7th Cir. 2004); *In re Monumental Life Insurance Company*, 343 F.3d 331, 341-42 (5th Cir. 2003); *Allapattah Services, Inc. v. Exxon Corp.*, 157 F.Supp. 2d 1291 (S.D. Fla. 2001); *Barber v. Kimbrell's, Inc.*, 424 F. Supp. 42 (W.D. N.C. 1976), *aff'd in part, rev'd in part on other grounds*, 577 F.2d 216 (4th Cir. 1978); PRINCIPLES §§ 2.07–2.08.

<sup>29</sup> See e.g., *In re Hydrogen Peroxide Antitrust Litigation*, 552 F.3d 305 (3<sup>rd</sup> Cir. 2009); *Dukes v. Wal-Mart, Inc.*, 474 F.3d 1214 (9th Cir. 2007); *Zyprexa*, *infra*; *Long v. Trans World Airlines, Inc.*, 761 F. Supp. 1320 (N.D. Ill. 1991); F.R. Evid. Rules 703 and 1006; 3 ALBA CONTE & HERBERT NEWBERG, *NEWBERG ON CLASS ACTIONS* § 10:3 (4th ed. 2002).

Determination of aggregate liability and damages by class action generally reduces costs of litigation and adjudication.<sup>30</sup> More fundamentally, decoupling the determination of aggregate liability and damages from the distribution of any aggregate damage award furthers the social objective of optimal recovery for purposes not only of compensating losses from sanctionable harm, but also to deter businesses from creating unreasonably dangerous interstate risks. Indeed, this division of functions is crucial to promoting and prioritizing optimal deterrence because decoupling avoids burdening or even restricting pursuit of the deterrence goal with the high and often prohibitive cost of resolving the non-common questions that determine whether and how much to payout on individual claims. Optimal deterrence does not depend on how aggregate damages are distributed, but rather is generally achieved by threatening and holding the defendant liable for damages equal to the aggregate sanctionable loss. Once aggregate liability and damages are established and assessed, the job of optimal deterrence is done. How damages are distributed among class members – whether averaged, allotted by need, apportioned according to some other criterion, or not distributed at all – is generally (with the exception of its effect on plaintiff incentives) irrelevant to achieving deterrence.

In short, applying average law to overcome the choice of law impediment to class action certification is appropriate whenever the court finds it necessary, useful, or simply practical to determine the defendant's aggregate liability and damages separately from undertaking the distribution of any class-wide recovery. To illustrate how courts can derive and apply the average law statistically to determine the defendant's aggregate liability and damages we employ an uncomplicated, inexpensive method of sampling and hold all relevant features of the case constant except for the variation of state law. This method produces a representative sample simply by randomly drawing claims from the pool of all claims and the defendant's aggregate liability, resolving the selected claims in the normal course by judgment or settlement, calculating the average of the resulting recoveries, and then multiplying the average recovery by the total number of claims in the pool.<sup>31</sup> Assume, for example, that 3 individual claims each involving identical loss of

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<sup>30</sup> Obviously, if the defendant succeeds on any element of the aggregate case of liability or damages, there is never any need to undertake adjudication of the non-common issues of law and fact particularly in assessing and distributing damages among class members. And when the plaintiff class succeeds, the decoupled process avoids the costs of resolving class members' claims by needlessly relitigating common factual questions and to some extent applying state-specific legal requirements. In high-recovery cases, these savings accrue inevitably as class members' claims are worth litigating by individual separate civil actions.

<sup>31</sup> The sampling method we employ can be used to derive the defendant's aggregate liability and damages without compromising the normal functioning of the civil liability system regardless of the number, type, and degree of litigation relevant differences – legal, factual, and otherwise – among claims and regardless of whether they are formally aggregate by class action or consolidation. This method is developed in David Rosenberg, *A New Sampling Method for Resolving Differing Claims against a Defendant* (unpublished manuscript, available from the author). It has been proposed for use to facilitate regulatory enforcement by administrative agencies. Cf. Robert J. Jackson & David Rosenberg, *A New Model of Administrative Enforcement*, 93 VA. L. REV. 1983 (2007).

\$100 are respectively governed by 3 differing state laws, A that would deny liability, B that would impose 50% liability, and C that would impose 100% liability. Suppose that the claims under laws A and C are randomly selected and resolved, yielding an average recovery of \$50 (A \$0 liability + C \$100 liability / 2). The defendant's aggregate liability and damages would thus equal \$150 (3 x \$50). Note that this is the same aggregate liability the defendant would incur if all three claims were resolved under the law governing each (A \$0 liability + B \$50 liability + C \$100 = \$150).

Of course, with more state law variables and with greater variability of functional content among them the sample size will likely increase. However, in the reality of numerous classed claims, often numbering in the tens or hundreds of thousands, the sample will usually comprise a minute fraction of the total number of claims in the pool. In a large set of claims, sampling even 5 or 10 claims would greatly reduce the variance from the mean value.<sup>32</sup> As the total number of claims increases, the percentage of sampled claims decreases and correspondingly, so will the percentage of extra expenditures attributable to the sampled cases. Thus, if a sample of 50 claims would reasonably minimize deviation of the aggregate result from aggregate mean value, then the extra expenditure per claim is \$100; when there are 1000 claims the sample size constitutes 5% of the total and the extra-cost per claim is \$5; if there are 10,000 claims, the sample percentage drops to .5% of the total and the extra-cost per claim falls to \$0.50.

When class-wide causally-related loss from the defendant's allegedly sanctionable conduct can be estimated without sampling claims, then in some cases courts might lower the cost of sampling to derive and apply the average law by limiting its role to providing the basis for determining a statistically proportioned award aggregate damages.<sup>33</sup> Thus, in the above example of three differing state laws respectively governing one of three claims each involving \$100 in causally-related loss, suppose that the court could reliably

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<sup>32</sup> For example, assume multiple plaintiffs whose claims could have three possible trial outcomes: 0, 10, or 20, each with a probability of 1/3. (The outcome of 0 corresponds to losing; 10 to winning with low damages; and 20 to winning with relatively high damages). If one trial determines the payoff for each plaintiff, then all face the following distribution of outcomes: 0 with probability 1/3, 10 with probability 1/3, 20 with probability of 1/3. If two trials determine the payoff for each plaintiff, there are 9 possible outcomes, each with probability 1/9th: (0,0), (0,10) (0,20), (10,0), (10,10), (10, 20), (20,0), (20, 10), (20,20). Corresponding to these 9 outcomes is an average over the two trials for each outcome: 0 (the average of 0 and 0), 5, 10, 5, 10, 15, 10, 15, 20. Note that there are 2 ways that 5 can be the average, 3 ways that 10 can be the average, etc. So the probabilities of the possible averages are these: 0 probability of 1/9; 5 probability of 2/9; 10 probability of 1/3; 15 probability of 2/9; 20 probability of 1/9. Comparing this distribution of payoffs to the distribution if you have one trial, note that the probability of extremes of 0 and 20 falls from 1/3 in one trial to 1/9<sup>th</sup> in two trials. Also, in one trial there are no possibilities of 5 and 15, but here there are in two trials. So what is happening is that probabilities near the mean of 10 are becoming more likely and the extreme results less likely. Three trials would generate 27 outcomes ((0,0,0), (0,0,10), (0,0,20), (0,10, 0), (0,10,10), (0,10, 20), ...etc.), each with a probability of 1/27, and further greatly increasing probabilities near the mean and decreasing the likelihood of the extreme outcomes.

<sup>33</sup> See e.g., *Zyprexa*, 253 F.R.D. 69.



estimate the total of such loss, \$300, from the defendant's records or other non-claim related data. It may be advantageous in such a case for the role of average law in determining aggregate damages to be limited to providing the basis for proportionally discounting the total causally-related loss by the average probability of liability. In the example, the sampling of the differing state laws yields average probability of liability of 50% ( $0 + 50\% + 100\% / 3$ ) and hence aggregate damages equal to 50% of the total causally-related loss or \$150.

To statistically identify and distinguish the effect of a defendant's alleged sanctionable conduct on different subgroups in the class, courts generally use more complex modes of sampling to determine a defendant's aggregate liability and damages (or aggregate liability alone).<sup>34</sup> In contrast to the simple mode described above, the modes of sampling courts conventionally employ entail far greater cost due to the complexity and hence technical expertise required for their reliable implementation. For purposes of assuring the necessary degree of reliability, conventional sampling depends on adequate collection and review of claim data, identification and control of claim variables, often by resort to regression analyses, and using this information for sorting and stratifying claims into subgroups of appropriate size, structure, and homogeneous composition.

The comparative advantage of using a conventional versus the simpler method of sampling does not turn on their relative reliability in determining aggregate liability and damages. Despite all of the additional effort and expense, conventional modes of sampling produce exactly the same aggregate results as the simpler mode described above. Rather their comparative advantage depends on the degree to which differences in state law relating to the prima facie case of liability and damages, or defenses such as statutes of limitations and comparative negligence may require costly individualized determinations in the course of distributing the aggregate recovery (if any) among class members. Thus, in some cases conventional sampling might well prove more cost effective because it can do double duty, determining aggregate liability and damages at the same time it establishes the categories and criteria needed to facilitate distribution of the aggregate recovery.<sup>35</sup>

Notwithstanding its potential limitations, the simpler method should suffice for most mass injury cases that qualify for diversity class action treatment today. Under currently prevailing class action policy and doctrine, certification is only afforded to small-recovery claims. Typically, the distribution of aggregate damages in small-recovery class actions can be affected without considering the extent that differences in the governing state laws might translate into variations in individual recoveries. The main reason is that the amounts at stake are too small for any state law inquiry to be

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<sup>34</sup> See e.g., *New Motor Vehicles Canadian Export Antitrust Litigation*, 552 F.3d 6 (1st Cir. 2008); Michael J. Saks & Peter David Blanck, *Justice Improved: The Unrecognized Benefits of Aggregation and Sampling in the Trial of Mass Torts*, 44 STAN. L. REV. 815, 841 (1992); see also Walker & Monahan, *supra* note 5. REV. 969 (2007).

<sup>35</sup> See e.g., *Hilao v. Marcos*, 103 F.3d 767 (9th Cir. 1996).

worthwhile, at least not in any fine grained way. Distributions therefore proceed on an equal, pro rata, or very roughly scaled basis, or by means of some formulaic, claim-form submissions, statistical estimation, or other more or less “mechanically” constructed and implementable schema.<sup>36</sup>

Given the generally high cost of litigating a mass injury claim, some fraction of cases will warrant certification because the “small-recovery” involved renders individual claims unmarketable, even though the amount at stake runs into the tens of thousands of dollars. In such cases, a court might find it worthwhile to determine whether and to what extent state laws differ as to the conditions for individual recovery by class members. For example, the consumer protection laws of some states might require proof of individual reliance on a seller’s fraudulent misrepresentations, while other laws may presume reliance based on statistical analysis of price and sales fluctuations or on more intuitive projections of reasonable consumer behavior. And, of course, there may be cases in which class action treatment is afforded to large-recovery claims that are economically viable to be prosecuted as separate actions under the respectively governing state laws.

However, the prospect of having to apply differing state laws in the distribution phase of the class action generally should not and usually does not preclude certification. The nature of the management task in distributing damages is functionally distinct from that which the courts currently refuse to undertake in determining the defendant’s aggregate liability and damages by class-wide trial. In distributing damages on an individual basis the court would not have to devise a way of organizing a trial and instructing the single jury to apply multiple differing state laws governing liability and damages in rendering *class-wide* judgment – the management difficulties that have brought class action litigation to a virtual standstill. In short, applying average law to determine the defendant’s aggregate liability and damage solves this management problem, leaving for the damage distribution stage only traditional, commonplace choice of law issues and application of differing state laws that federal diversity suits present every day.

More fundamentally, allowing the costs of distributing aggregate damages to preclude class action treatment would mean forgoing pursuit of the law enforcement objective of deterring businesses from creating socially inappropriate interstate risks, regardless of how widespread and harmful the wrongdoing and how effective, efficient, and reliable the determination of the defendant’s legal responsibility for it. Moreover, to apply such a rule would mean that the more widespread the wrongdoing, the more numerous the victims and state laws, the more differential the harmful and legal impact, the less likely would be the availability of the class action to enforce the law. The need to avoid these perverse results has generally motivated courts to reject the equation of right and remedy, and in particular to overcome the difficulty of assessing individual damages by “find[ing] some way in which damages can be awarded where a wrong has

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<sup>36</sup> See e.g., *In the Matter of Monumental Life Insurance Company*, 343 F.3d 331; *Zyprexa*, 253 F.R.D. 69; 3 ALBA CONTE & HERBERT NEWBERG, *NEWBERG ON CLASS ACTIONS* §§ 10:7 – 10:9 (4th ed. 2002).

been done.”<sup>37</sup> This policy has animated courts to innovate processes for assessing and dispensing individual damages in large-recovery and other cases involving stakes worth litigating on their own.<sup>38</sup> Innovation is most often exercised to preserve class action treatment for small-recovery claims.<sup>39</sup> As Judge Richard Posner explained, where the “*realistic* alternative to a class action is . . . zero individual suits a class action has to be unwieldy indeed before it can be pronounced an inferior alternative – no matter how massive the fraud or other wrongdoing that will go unpunished if class treatment is denied – to no litigation at all.”<sup>40</sup>

#### IV. Conclusion

In this Essay, we argue in favor of using the average law to overcome the choice of law impediment to certification of multistate mass injury class actions. We show that the mainstream consensus to the contrary is misguided in positing that average law is not the actual law of any state’s making and that prospective defendants have no notice of such law *ex ante*. Our main contribution is demonstrating that applying the average law is equivalent to the sum and substance of the traditional, benchmark approach of applying *all of the actual state laws* separately. In essence, under both approaches each state’s law is expressed as one probabilistically weighted input to the overall distribution of probabilistically weighted inputs from application of all other state laws to their respective shares of claims.

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<sup>37</sup> *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 265-66 (1946).

<sup>38</sup> In large-recovery class actions, and as noted, in many small-recovery class actions, class members may find it worthwhile to litigate non-common questions of state law at the damage distribution stage. Anticipating substantial litigation in this stage, courts have at hand the further option of decertifying the class after determining aggregate liability and damages and providing notice to class members concerning how they may proceed to prove damages under the state laws governing their respective claims by filing individual state or federal actions against a court-appointed trustee of a fund comprised of the aggregate damage award. See *In re Visa Check/Master Money Antitrust Litigation*, 280 F.3d 124, 141 (2d Cir. 2001). Any residuary amount in the fund would be distributed according to standard doctrines of *cy pres*, fluid recovery, and escheat. 3 ALBA CONTE & HERBERT NEWBERG, *NEWBERG ON CLASS ACTIONS* §§ 10:15 – 10:19 (4th ed. 2002).

<sup>39</sup> Exercising their Rule 23 authority, courts have devised a number of “imaginative solutions” to manage the individual distribution of damages including trial of individual damage issues before separate juries. The most effective solutions essentially create an “offer of judgment” scheme. See e.g., *Langley v. Coughlin*, 715 F.Supp. 522 (S.D.N.Y. 1989). Pursuant to court-appointment, a judge magistrate or special master would develop criteria, processes, and/or categories of prescribed payoff amounts. Class members could then elect to participate in the claim-resolution scheme or to “opt-out” and seek individual damages based on the state law governing their respective claims. Those who elect to participate could object to any feature of the scheme, but would ultimately be bound by the court’s judgment prescribing the scheme’s terms and finding them reasonable. In the absence of some systemic deficiency in the structure or substance of the scheme, the rate and volume of opt-out litigation will likely be quite small. Claims that probably were not worth prosecuting for the total recovery will surely be less so for the marginal recovery.

<sup>40</sup> *Carnegie v. Household International, Inc.*, 376 F.3d 656 (7<sup>th</sup> Cir. 2004).

This is the inevitable nature of the law governing business activities involving interstate risks. As such, businesses know and internalize the legal force of this compound law ex ante in deciding the extent of their risk-taking, whether the choice is to adopt a standardized or customized safety strategy. And, of course, it is the actual law made by the several states involved to govern such interstate business risk-taking. The common objections to the use of average law are thus without substance. Applying average law “accurately” reproduces the aggregate outcome for both deterrence and compensation purposes as would the benchmark approach. It follows that applying average law poses no greater (or lesser) threat to state sovereignty than does the benchmark process.

Despite the equivalence of applying the differing state laws separately and applying the average of those differing laws as a unity, all is not equal. Rejecting the average law solution curtails use of multistate federal diversity class actions, and thus deprives states of the most effective means of enforcing their laws aimed at preventing and compensating harm from socially inappropriate interstate risk-taking by businesses and consequently decreases the well-being of everyone exposed to such hazards. Collectivized adjudication is necessary to overcome the mass injury defendant’s asymmetric investment advantage. The average law solution can achieve this benefit irrespective of the type of case under consideration, and its use comports with the strictures of Rule 23 and standard class action practice.

We have also suggested ways in which an average law approach could be practically implemented. In the majority of cases, the average law could be determined using a simple, low cost method of statistical sampling. Indeed, we believe average law would be appropriate and feasible to use in any case where a court foresees benefits from decoupling the determination of a defendant’s aggregate liability from the distribution of any class-wide recovery.