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#### NOTES TO AUTHORS

Manuscripts submitted for publication should be typewritten on one side of the paper only (use 8½ × 11-inch bond) and double spaced throughout (including footnotes and figure legends). Three copies of the paper should be submitted.

Footnotes should be numbered consecutively throughout and should be typed separately from the body of the text. References cited in the text should be explained in the footnotes and not listed separately. (See recent issues of the *Journal* for reference style.)

Tables and figures should be drawn on sheets separate from the text and clearly labeled. Figures must be professional drawings or photographs, and originals must be available for the Press as camera-ready copy is required for printing.

*Merely etc*

## COMMON LAW AND STATUTE LAW

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### I. INTRODUCTION

THOSE concerned with the economic analysis of law often make a distinction between common law and statute law. Posner, for example, claims that the common law is, by and large, economically efficient (wealth-maximizing) while statute law is more concerned with redistribution, generally toward special interests.<sup>1</sup> He argues that the distinction between the effects of the two types of law is caused by the nature of the arguments allowed in the legislative forum as compared with the judicial forum. Thus, legislators consider the particular individuals involved and the impact on these individuals of the decisions reached; moreover, individuals and groups are allowed to petition the legislators for favors. Judges, on the other hand, are explicitly forbidden from considering the deservings of the individual litigant and must render their decisions on the basis of more objective criteria. The distinction between these processes would, according to Posner, lead to the greater concern with efficiency which he finds in the common law than in statute law. Hayek has also emphasized the difference between common law and statute law, or command, though in his case the basis for the distinction is somewhat less clear than the efficiency-inefficiency dichotomy emphasized by Posner.<sup>2</sup>

More recently, interest in the explanation for common-law efficiency, where such efficiency exists, has shifted from a Posnerian view that efficiency is a result of the wisdom of the judges in reaching decisions to other explanations. In particular, there is now a literature arguing that the

\* University of Georgia. I would like to thank Ellen Jordan, Donald Keenan, Gordon Tullock, and participants at an Emory University Law and Economics Seminar for helpful comments on an earlier version.

<sup>1</sup> Richard A. Posner, *Economic Analysis of Law* (1977) particularly chs. 13 & 19.

<sup>2</sup> Friedrich A. Hayek, *The Constitution of Liberty* (1960), and *Law, Legislation, and Liberty*, Volume 1, *Rules and Order* (1973).

observed efficiency is a result of evolutionary processes in which inefficient rules are more likely to be litigated and overturned than are efficient rules.<sup>3</sup> One of the key results of this literature is that there will be some tendencies for laws to evolve toward efficiency but that this evolution, for various reasons, will not be complete. Since the theories do not predict complete efficiency in all areas of the common law, some who believe that the law is everywhere efficient have rejected the theories. However, one argument of this paper will be that in fact the theories, at least in some of their variants, do have useful descriptive predictions; that is, it will be argued that in fact the law is efficient in those areas where some of the evolutionary theories indicate that it should be efficient and inefficient in areas where the theories would also predict this.

The evolutionary theories which are emphasized here are those of Rubin, Landes and Posner, and Goodman. In the first two, parties with an interest in precedent are likely to litigate inefficient rules (or, in the Landes-Posner variant, efficient but not completely efficient rules) until these rules become efficient. In the Goodman model, those with interest in precedents are likely to spend more on litigation if the current rule is inefficient. In either case, the model is driven toward efficiency by decisions of litigants, and efficiency is achieved if and only if litigants represent the set of future potential parties to disputes involving the rule under consideration. That is, for efficiency to result from these models, parties to particular disputes must represent symmetrically all future interests in such disputes. If this condition is not satisfied, the models indicate that the law will not be driven toward efficiency. Rather, the law will come to favor those parties which do have future interests in cases of the sort under consideration, whether or not it is efficient for such parties to be victorious. Hirshleifer makes essentially the same point when he argues that in order to study forces leading to change in the law it is necessary to determine the factors which make it more or less difficult to mobilize support from members of groups or potential groups with interests in changing the law.

The models discussed above apply to the litigation process. The arguments are that those with stakes in the outcome of the case, and particu-

<sup>3</sup> Paul H. Rubin, *Why Is the Common Law Efficient?* 6 J. Legal Stud. 51 (1977); George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. Legal Stud. 65 (1977); John C. Goodman, *An Economic Theory of the Evolution of the Common Law*, 7 J. Legal Stud. 393 (1978); William M. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 J. Legal Stud. 235 (1979). See also comments and discussion in 8 J. Legal Stud. 2 (1979); Robert Cooter & Lewis Kornhauser, *Can Litigation Improve the Law without the Help of Judges?* 9 J. Legal Stud. 139 (1980); Jack Hirshleifer, *Evolutionary Models in Economics and Law: Cooperation versus Conflict Strategies*, central paper in *Evolutionary Theory in Law and Economics* (Research Law & Econ.) (Paul H. Rubin ed., 1982).

larly in the precedential value of the case, will spend more on litigating and thus be more likely to win. However, Tullock has raised an important point in connection with this analysis.<sup>4</sup> He argues that spending on lobbying by special interest groups with an interest in particular statutes is exactly analogous to spending on litigation by these same interest groups. That is, if spending on litigation drives the common law toward efficiency, spending on lobbying should drive statute law toward efficiency. The fact that we observe (or seem to observe) efficiency in one area but not in the other would then be inconsistent with these theories. We are then either driven back to Posner's wise judge's explanation for the pattern of common-law efficiency or else we must reexamine the evidence about the relative efficiency of common versus statute law.

In this paper, I provide such a reexamination. In particular, I argue that what appears to be a statute-common law distinction is really something else. It is actually a distinction between law through the beginning of this century and later law. That is, in the early period most law was efficient and most law was common law. In the later period, most law was inefficient and most law was statute law. Observers looking at the law and concluding that common law is more efficient than statute law are then confounding an effect due to time with one due to efficiency. In Part II of this paper I provide some evidence that the relevant distinction is based on time rather than on the type of law. In Part III, I provide an explanation for the change in efficiency of rules based on changes in costs of organizing interest groups. That is, I argue that the movement toward inefficiency, in both statute and common law, is a result of technological change in the costs of organizing interest groups. In Part IV, I apply the analysis to an issue raised by Posner at several points—the issue of class actions. To anticipate my conclusion, I argue that greater reliance on class actions and other methods of judicially aggregating claims has no necessary implication about efficiency. Part V is a summary.

## II. IS COMMON LAW NECESSARILY MORE EFFICIENT THAN STATUTE LAW?

In this section, I briefly examine three bodies of law which are partially statutory and partially common law. The claim is that, at least in these cases, the common law is not necessarily more efficient than statute. The laws considered are property law in the nineteenth century, unconscionability in the twentieth century, and law dealing with monopoly.

<sup>4</sup> Gordon Tullock, *Trials on Trial* (1980); also, discussion by Tullock in *Evolutionary Theory in Law and Economics*, *supra* note 3.

### A. *Statutes in the Nineteenth Century: Property*

Property law is one of the common-law areas viewed by Posner as being essentially economically efficient. However, deeper examination of the basis for contemporary American property law indicates that much of the foundation of this law, including its efficient aspects, rests in nineteenth-century statutes rather than in common law. In fact, the form of contemporary property law is a result of a combination of statute- and common-law rulings, and it is not obvious that either type of ruling has been more efficient than the other.

The three criteria given by Posner for efficiency in property rights are universality, exclusivity, and transferability. Modern American property-rights systems in land fulfill all of these requirements to a substantial extent. However, this system is due to statute as much as to common law. In particular, the basic type of land tenure in the United States, fee simple, does allow free transfer of land. But this form of land tenure was itself imposed by statute rather than by common law.<sup>5</sup> Thus, it was statutes, such as those passed in New York in 1827–28, which simplified the old common-law feudal land tenures. As Friedman says, "Statute and practice worked hand in hand to simplify land remedies."<sup>6</sup>

Other statutory changes dealt with the ability of women to transfer land. A 1787 Massachusetts statute allowed women deserted by their husbands to petition for the right to sell land. Moreover, the change in the status of women from a situation in which "... her legal existence and authority [were] in a degree lost or suspended, during the continuance of the matrimonial union"<sup>7</sup> to a situation in which women could buy and sell land was brought about primarily by the various married women's property acts—statutes—rather than by common-law decisions. Moreover, the institution of "dower," which allowed a wife to claim one third of land owned by the husband, even if the land were sold (thus placing a cloud upon title), was also overturned by statute.<sup>8</sup> Thus, in these cases, transferability of property was greatly increased by statutes, which essentially overturned the old feudal common-law methods of transferring property.

Another feature of efficient property systems is universality. Everything must be owned for efficiency (at least up to the point where enforcement of title is more expensive than the value of ownership). In the

<sup>5</sup> The discussion of land law is largely based on Lawrence M. Friedman, *A History of American Law* (1973). See also Jonathan R. T. Hughes, *The Governmental Habit* (1977).

<sup>6</sup> Friedman, *supra* note 5, at 208.

<sup>7</sup> 2 Kent, *Commentaries* 106 (2d ed. 1832), quoted in Friedman, *supra* note 5, at 184 n. 15.

<sup>8</sup> *Id.* at 376.

case of American land, the relevant fact was that the government owned most of the continent. It was the various homestead acts—statutes—which gave title of government-owned land to private individuals.<sup>9</sup> It was also statutes which created property rights in intellectual capital in the form of patents and copyrights.

It is not claimed that the common law of the nineteenth century was inefficient, nor is it claimed that statutes in this period were always efficient. The point is rather that in many cases both common law and statutes worked "hand in hand" to achieve efficiency, and that our current feelings that statutes are less efficient than common-law rules may be based on current situations rather than on universal principles. To explore this argument further, I now examine briefly some common-law rules in the twentieth century and show that in many cases common-law rules are no more efficient than statutes.

### B. *Common Law in the Twentieth Century: Unconscionability*

Many of the inefficient statutes of the twentieth century are those which interfere with freedom of contract. Economists are fond of citing minimum-wage laws and rent-control laws as examples of such inefficient interferences. Other interventions are various product-safety laws which discourage consumers from purchasing particular products if some agency such as the Consumer Product Safety Commission or the National Highway Traffic Safety Administration forbids such purchase. These are examples of statutory interferences with freedom of contract, and also examples of economically inefficient laws.

However, there are many common-law interferences with contract which are equally inefficient. Many of these common-law interferences are cases in which freely agreed upon contractual terms are invalidated because they are held to be "unconscionable."<sup>10</sup> This doctrine, according to Epstein, is partially of common-law creation, and, even when it is based on statutes, Epstein claims that the statutes are so loose that a substantial part of the doctrine occurs because of judicial interpretation. Thus, when contracts are overturned because of unconscionability, we are observing inefficiencies in common-law cases.

I will not examine in detail cases in which unconscionability has been used in court cases to overturn efficient private contractual agreements; Epstein has performed such an examination. He gives several types of

<sup>9</sup> For a discussion of the homestead acts, see Lance E. Davis & Douglass C. North, *Institutional Change and American Economic Growth*, ch. 5 (1971).

<sup>10</sup> The discussion of unconscionability is based on Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 *J. Law & Econ.* 293 (1975).

contracts which have been overturned as being unconscionable and provides reasons as to why such rulings have been inefficient.<sup>11</sup> The types of cases he lists are Add-On clauses, Waiver-of-Defense clauses, Exclusion of Liability for Consequential Damage, Due-on-Sale clauses, and Termination-at-Will clauses. In all cases, reasonable grounds are indicated as to why consumers would be willing to enter into contracts with such clauses, and in all cases courts have overturned these clauses. These rulings by common-law judges are as inefficient as statutory rules which deny consumers other types of contracts, as discussed above. Again, the point of this section has not been to demonstrate that all common-law rules are currently inefficient, but rather to indicate that both statutes and common-law rules are currently likely to be inefficient.

### C. Monopoly

It is sometimes argued that the common law was opposed to monopoly and that monopolies were generally created by statute. If this claim were true, it would be inconsistent with the arguments made here since the evolutionary process would not be expected to operate in such a manner as to remove monopoly. This is because any one consumer of a monopolized product or potential entrant into a monopolized industry would have less of an interest in eliminating the monopoly than the monopolist would have in maintaining his position. Thus, the models of legal evolution which depend on relitigating inefficient rules or on spending being greater by parties with interests in precedent would predict that the common law should favor, not oppose, monopoly. In fact, however, the claim that the common law was opposed to monopolies is probably incorrect. Ekelund and Tollison have argued convincingly that the apparent favor shown by seventeenth- and eighteenth-century common-law courts toward competition in England was actually the result of a conflict over rights to issue monopoly grants between Parliament and the Crown, rather than any attempt to promote competition.<sup>12</sup> Horwitz, in his discussion of the conception of monopoly and competition in nineteenth-century American law, indicates that competition was as likely to come out of granting of additional charters by legislatures as from court rulings, and that judges sometimes gave chartered corporations more monopoly protection than they were given by legislatures.<sup>13</sup> Moreover, of course, the antitrust laws themselves are statutory, rather than common-law, crea-

<sup>11</sup> *Id.* at sec. 4.

<sup>12</sup> Robert B. Ekelund, Jr., & Robert D. Tollison, *Economic Regulation in Mercantile England: Heckscher Revisited*, 18 *Econ. Inquiry* 567 (1980).

<sup>13</sup> Morton J. Horwitz, *The Transformation of American Law*, ch. 4 (1977).

tions. That these statutes currently are enforced in an inefficient manner is not inconsistent with the theory developed here: the major party with an ongoing interest in the enforcement of antitrust laws are the enforcers—the Justice Department and the Federal Trade Commission. These parties would have no particular desire for efficiency; thus, it is not surprising that the law has not evolved toward efficiency.<sup>14</sup>

### III. INTEREST GROUPS IN THE LEGAL PROCESS

Is there an explanation for this change from relative efficiency in both statute and common law in the last century to relative inefficiency in both now? I hypothesize that there is such an explanation which is an implication of forces identified in the Rubin and Goodman models of litigation discussed above. Recall that in these models the important determinant of the outcome of the litigation process is the nature of the litigants. In the Goodman model, the factor which decides the nature of case law is the expenditure by litigants on litigation; more spending is associated with a higher probability of victory. In the Rubin model (and, to a lesser extent, in the Landes-Posner model), the determining factor is the interest of the litigant in the case viewed as precedent. Thus, both of these models have essentially the same implications for efficiency and for the nature of the outcomes. Efficiency results if each party to the litigation represents the entire set of social interests on the same side in future disputes of this type. That is, if the party which has the most to gain from a victory is representative of all gainers and also if the party with the least to gain is representative of all losers, then these models predict that the litigation process will lead to efficient outcomes. Conversely, if the parties are, for whatever reason, not typical of all potential parties involved in such disputes, then there is no presumption that the models will lead to efficiency.

Since Rubin spent the most time discussing the nature of the litigants and the implication for the outcome of this nature, we will discuss this model in slightly more detail. Rubin identified two possible situations. A party could have a "substantial interest in future cases of this sort" or not. The results of the model were the following: (1) If both parties did have such an ongoing substantial interest, then the common-law litigation process would likely lead to efficiency. This is because an inefficient rule would lead to deadweight losses which could not be bargained away and thus the inefficient rule would be more likely to be litigated. A similar

<sup>14</sup> For discussion of the state of antitrust law emphasizing its current inefficiency, see Robert H. Bork, *The Antitrust Paradox* (1978); and Richard A. Posner, *Antitrust Law* (1976). There is no explanation for the passage of the antitrust laws based on an interest-group perspective, so that, in one sense, we do not really know why these laws were passed.

result would follow from Goodman's model, where the party which expected to benefit from an efficient outcome would spend more on litigation than would the other party and would thus again provide an incentive for efficiency. (2) If neither party had an ongoing interest, then there would be no incentive for litigation at all and the law would remain as is; there would be neither an incentive for efficiency nor one for inefficiency. (3) If one party had an ongoing interest and the other did not, then precedents would come to favor the party with the ongoing interest, independently of efficiency. That is, the party which is "in the market" would spend more on litigation or would continually relitigate until favorable precedents were obtained. If the party which is in the market is the party which should win (from an efficiency standpoint) then the law will evolve toward efficiency; if the party which is in the market should not win, then the law will evolve away from efficiency. That parties with such ongoing interests do tend to win at litigation has been shown by Galanter,<sup>15</sup> who, however, did not discuss the efficiency implications of his work.

On this view, then, disputants who are in the market will tend to litigate until they reach a favorable decision. They may achieve such a decision by spending more on litigation; by relitigating cases whenever issues arise until a favorable decision is reached; by waiting to litigate until a particularly apt case for establishing precedent occurs; and by using other techniques aimed at obtaining favorable precedents, discussed most thoroughly by Galanter. For such parties, the distinction between common law and statute law may not be definitive; when they are unable to obtain favorable decisions at common law (for reasons discussed below) they may simply turn to the legislature and attempt to obtain desirable outcomes there. For any given litigant, however, the decision as to whether to use the courts and achieve favorable common-law rulings or to use the legislature and achieve favorable statutes would be expected to be a purely instrumental decision, depending solely on which type of ruling would be most profitable. This view of the process does not lead to a prediction of greater efficiency in common law than in statute law.

While it is not the purpose of this paper to address the issue of types of rulings which may be sought in each type of arena, a brief discussion of likely distinctions between common law and statute law is in order. This is especially true since the models of legal evolution discussed above have some implications about this issue. In the Rubin model, litigants must decide whether to litigate for favorable precedents based on the costs and benefits of such litigation and on the probability of victory. As the current

<sup>15</sup> Marc Galanter, *Why the 'Haves' Come out Ahead: Speculation on the Limits of Legal Change*, 9 *Law & Soc. Rev.* 95 (1974).

rule becomes more entrenched, the probability of overturning this rule becomes lower, so that the payoff from litigating becomes smaller. Landes and Posner modify this argument by suggesting that litigation of undesirable rules (i.e., rules which the party with the continuing interest does not like) may actually make such rules more firmly entrenched and so is even less likely to occur than in Rubin's model. (Rubin assumes that the precedent will govern or not, while Landes and Posner allow for marginal changes in the probability of a precedent determining a case where the probability is a function of past decisions using this same precedent.) Thus, in either of these models, it is possible to reach a situation where a rule which a party dislikes is so firmly entrenched in the common law that further litigation will be unlikely to change the rule and may even strengthen it. (In the models referred to, the discussion is in terms of efficient and inefficient rules, but the same point applies to any rule which the party with the continuing interest favors.) Parties will then attempt to obtain favorable statutes, rather than favorable court rulings, when the position which they advocate is so far from current strongly entrenched rules that common-law litigation is unlikely to reach a favorable outcome. If, as will be argued below, the structure of litigants was such that in the nineteenth century rules were generally efficient, and if now there are pressures from groups which favor other outcomes, then we would expect greater reliance on statute now since the efficient common-law rules would be difficult to overturn—not because they are efficient, but merely because they are well established.

The claim of this paper is simply that, in the past, costs of organization were sufficiently high to preclude formation of potential interest groups into litigating or lobbying groups, so that the prime actors in the legal process (both statute and common law) were individuals. Conversely, it has now become less expensive to organize interest groups and therefore the recent patterns of law are such as to reflect group interests.<sup>16</sup> There are no necessary theoretical implications from this process for efficiency; whether it leads to efficiency or not is an empirical matter. It is, however, inconsistent to argue, as Posner does, both that group litigation is more efficient than individual litigation and that group lobbying is less efficient; there is no necessary distinction between the two. To illustrate the points made above, three types of law will be considered: cases where there are contractual interests between the parties, cases where there are no con-

<sup>16</sup> Mancur Olson, *The Logic of Collective Action* (1965), defines the concept of "latent" group as a group which it does not pay to form. The argument here is that whether a group is latent or whether it actually forms will depend, at least in part, on the costs of organization; as these costs become lower, some groups which were latent will begin to form.

tractual interests but the parties are symmetrical, and cases where there are no contractual interests and the parties are asymmetrical.

#### A. *Contractual Interests*

As long as courts are willing to enforce mutually agreeable contracts the form of the law dealing with cases where there are contractual interests is almost irrelevant. If the law should be inefficient in some context, some costs will be imposed since parties will be forced to add extra provisions in their contract. However, if courts will enforce these provisions, the additional costs of inefficient principles of contract law will be relatively unimportant. As an example, consider landlord-tenant law. As evolved in the nineteenth and early twentieth centuries, this body of law seemed to favor landlords.<sup>17</sup> However, there are contractual agreements between parties. Therefore, economic theory would suggest that the parties to the agreements would derive the most efficient terms since any gains from efficiency would easily be capitalized into the price; that is, if there were profitable changes in the terms of the contracts the parties would be able to internalize these potential gains. Moreover, there is some evidence of the efficiency of this branch of law. Hirsch has studied empirically the effects of statutory changes in landlord-tenant laws which have essentially mandated warranties of implied fitness in housing, and he concludes that these changes have led to deadweight losses borne by consumers.<sup>18</sup> Peltzman's demonstration that laws mandating increased safety in automobiles have not saved any lives is also evidence about the efficiency of relatively unregulated markets where there are contractual agreements between parties.<sup>19</sup> Thus, in situations where the parties have contractual agreements, theory would indicate that the contractually agreed upon terms would be efficient, and the evidence which we have is consistent with this theoretical prediction.

#### B. *No Contract, Symmetric Interests*

In cases of this sort, the evolutionary models would predict efficiency in the law. That is, if parties have symmetric interests in cases and precedents there should be incentives to litigate inefficient rules (or to spend

<sup>17</sup> For a discussion of the state of landlord-tenant law and its recent changes, see, for example, Richard H. Chused, *A Modern Approach to Property: Cases—Notes—Materials*, ch. 3 (1978).

<sup>18</sup> Werner Z. Hirsch, *Law and Economics*, ch. 3 (1979).

<sup>19</sup> Sam Peltzman, *The Effects of Automobile Safety Regulation*, 83 *J. Pol. Econ.* 677 (1975).

more on such litigation when the rule is inefficient), so that we would expect rules in such cases to evolve toward efficiency. Moreover, in such cases, if the rules do not evolve toward efficiency there would be substantial deadweight losses imposed, since the absence of a contract between parties indicates that transaction costs would be sufficiently high so that parties would be unable to negotiate around the law. Two examples of situations in which there are symmetric interests but no contracts are automobile accidents and business torts.

In the case of automobile accidents, it is clear that individuals have no incentive to litigate since no individual expects to be in many accidents. However, almost all automobile drivers have insurance. Insurance companies would expect to be involved in numerous cases, and thus would have interests in precedents. Moreover, any one insurance company would expect to be on either side of any given type of case in the future (i.e., a company which insures the plaintiff in one case would expect with equal probability to insure the defendant in future cases of the same sort), and in this situation the models predict convergence toward efficiency in precedent. This situation is interesting since there are those who claim that litigation costs are so large in the case of automobile accidents that other forms of insurance, such as "no-fault" insurance would be better.<sup>20</sup> Recently, Elisabeth Landes has studied the effect of adoption of no-fault insurance on accident rates and has found that this policy leads to significantly increased accident rates.<sup>21</sup> While this evidence does not prove that the liability system in effect before the adoption of no-fault was efficient, it does at least suggest that one alternative proposed by many was probably less efficient than the system evolved by the common law, presumably driven by insurance companies with symmetric interests in precedents.

Another area in which there are no contractual relationships but in which we would expect symmetric interests and therefore efficient precedents is the area of business torts. Here, the wrongs at interest are those committed by one business against another. Since both parties are business firms, we would expect both to be interested in future cases of the sort under dispute; moreover, we would expect either party in one case to be equally likely to be on the other side in future cases. Thus, the theory would predict the same sort of evolution toward efficiency in this situation

<sup>20</sup> See, for example, Jeffrey O'Connell, *Elective No-Fault Liability Insurance for All Kinds of Accidents: A Proposal*, 1973 *Ins. L. J.* 495, reprinted in *The Economics of Legal Relationships* 296 (Henry G. Manne ed. 1975).

<sup>21</sup> Elisabeth M. Landes, *Insurance, Liability, and Accidents: A Theoretical and Empirical Investigation of the Effect of No-Fault Accidents* 25 *J. Law & Econ.* 49 (1982).

as in the situation involving automobile accidents. One example of business torts which have been subjected to economic analysis is the law of false advertising. Here, except for "passing off" (mislabeling products), the common law allowed virtually no relief for one business when another misrepresented its product. Many commentators felt that this law was inefficient, and the Lanham Act, a statute, was passed in order to give firms greater grounds for redress. Jordan and Rubin studied the impact of this law by examining all cases in which a claim was made under the Lanham Act. The conclusion of this exhaustive study of cases was that the statute made virtually no difference.<sup>22</sup> That is, in almost all cases the Lanham Act claim merely replaced a potential common-law claim for passing off; where the Lanham Act claim did not replace the common-law claim (a trivially small number of cases) there was no gain in efficiency from the Lanham Act claim.

### C. *Asymmetric Interests, No Contract*

In this case, there is no presumption that the law will have any connection with efficiency. As is generally true, we assume that each party attempts to maximize its own self-interest. However, in this case there is no connection between self-interest and efficiency; that is, there is no presumption that maximizing self-interest will lead to efficient outcomes. An example of this situation is Brenner's discussion of nineteenth-century nuisance law.<sup>23</sup> At the beginning of the nineteenth century, nuisance law seems to have been efficient in that remedies were easily available when one party imposed nuisance on another. This is consistent with the theory, since in general parties to nuisance actions at that time were symmetric. That is, they were generally landowners with similar rights and therefore similar interests. The ease with which litigants could obtain injunctions was probably efficient since low transactions costs between parties meant that negotiation could occur and rights could flow to their highest valued uses.

By the end of the nineteenth century, polluters were generally industrial firms and victims were either individuals or landowners. In this case, the polluter would have a more substantial interest in being able to pollute than any one individual would have in stopping the pollution. Given this situation, the theory would indicate that precedents would come to favor the party with the ongoing interest—the industrial polluter. In fact, this

<sup>22</sup> Ellen R. Jordan & Paul H. Rubin, *An Economic Analysis of the Law of False Advertising*, 8 J. Legal Stud. 527 (1979).

<sup>23</sup> Joel Franklin Brenner, *Nuisance Law and the Industrial Revolution*, 3 J. Legal Stud. 403 (1974).

seems to be what did occur. Moreover, though there were some statutes passed aimed at alleviating problems of pollution, it appears that in fact these statutes had little effect, again as the model would predict. Whether the situation in industrializing England was efficient or not is difficult to say; Brenner indicates that citizens might have been willing to tolerate the pollution in return for the benefits of industrialization. However, it does seem consistent with the argument proposed here that the party with the ongoing interest was the party to prevail in obtaining favorable court rulings and also favorable legislation (or the lack of effective unfavorable legislation).

Thus, the evidence cited above is consistent with the claim that precedents will come to favor parties with ongoing interests. Precedents will also be efficient if parties with ongoing interests are symmetrically distributed on both sides of particular cases, but the efficiency is a by-product of the litigation process aimed at maximizing the wealth of the litigants. If costs of organizing groups should change, the types of litigants observed should also change. This would then be expected to lead to changes in both common-law decisions and statutes.

In fact, this does seem to be what has occurred. In statute-law areas, it is clear that organized interest groups are able to influence legislatures in significant ways; Kau and Rubin provide substantial amounts of empirical evidence on this point.<sup>24</sup> Moreover, some of the major groups influencing legislation are labor unions, though they are not the only such group. Unions seem to influence legislation in several ways. First, it is common for representatives from districts with many union members to vote in ways favorable to union interests. Second, unions contribute money to candidates who vote in ways which are desirable from the union standpoint. Third, candidates who receive contributions from unions are likely to change their voting in ways which support union desires. Moreover, with respect to the issues of interest in this paper, it is true that unions as important organized political groups did not exist before 1935, the year of the first passage of the National Labor Relations Act. Thus, in the area of statute law, we find that it has been fairly recent changes which have created interest groups with substantial lobbying ability.

In the case of common law, the evidence is less firm. However, it does seem likely that many recent inefficient common-law rulings have not been achieved by a process of two-party litigation; rather, in many of the cases some third party or set of third parties has been involved. Many of the recent rulings affect poor persons who would not themselves be able to hire counsel; in many of these cases counsel has been provided by

<sup>24</sup> James B. Kau & Paul H. Rubin, *Congressmen, Constituents, and Contributors* (1982).

government agencies or volunteers with interests beyond the case at hand. For example, we find six cases listed by Epstein in his discussion of unconscionability. In four of these cases the court record identifies amici briefs, indicating that the parties to the disputes were not the sole parties involved in the litigation. (The cases in which amici briefs were filed were *William v. Walker-Thomas*; *Unico v. Owen*; *Tucker v. Lassen Savings and Loan Association*, and *Coast Bank v. Minderhout*.) Epstein also discusses the issue of termination-at-will clauses in franchise contracts, where one important party has been automobile dealers' associations. As Macaulay demonstrates, these associations have been active both as litigants and as lobbyists.<sup>25</sup>

Thus, we observe that changes in both statute law and common law can be explained at least in part by changes in the nature of litigants and lobbyists, and that these changes are caused by increased activity of groups in attempting to change the law. These changes themselves have probably been caused by various technological changes in the cost of organizing: increased urbanization leading to reduced communication costs, increased literacy, telephone and television, perhaps increased mobility caused by automobiles. These changes in costs of communicating and organizing have then led to formation of groups for lobbying and litigating, with consequent results in changing the law.<sup>26</sup>

There is no a priori reason why this process of increased group activity in seeking legislation should be inefficient. In fact, we may identify at least one area in which there were probably net gains from such increased activity. This is the area of environmental legislation. While the form of environmental laws, which mandate particular standards rather than simply charging polluters fees based on the amounts of pollution, has generally not been efficient, and while many such laws have probably gone beyond the point where marginal cost equals marginal benefit, it is nonetheless probably true that, net, such laws have increased welfare. This is because, as discussed above in the example of nineteenth-century nuisance law, polluters probably had a more substantial ongoing interest in their rights to pollute than those suffering from pollution had in their

<sup>25</sup> Stewart Macaulay, *Law and the Balance of Power: The Automobile Manufacturers and Their Dealers* (1966).

<sup>26</sup> While we would generally expect such organized groups to favor the economic interests of their members, this is not necessarily the only purpose for which groups form. For example, Kau & Rubin, *supra* note 24, show that one type of group which seems to have had influence on legislation is the so-called public interest lobby, lobbying groups with primarily ideological interests. That study in general supports the view that ideological, as well as economic, interests may be influential in passing legislation. The original analysis of the (increasing) role of ideology in economic legislation is in Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* (3d ed. 1950).

right to be free of pollution. Therefore, when organization costs were high, polluters probably dominated the law in an inefficient manner. This would be a case where interests were asymmetric and there was no contractual arrangement between the parties and in which there would therefore be no expectation of efficiency. It is also possible that some recent "deregulation" in industries such as air transportation, motor-carrier transportation, and communication has been brought about by increased organizational ability of customers of these industries. Because the regulation which has been repealed generally served to cartelize the regulated industries, such deregulation has provided clear economic benefits.

It might seem that the natural way in which to model the process discussed above would be in terms of cooperative game theory since we are dealing with a situation in which coalitions form (i.e., in which individuals can form binding agreements) for the purpose of changing laws. A result of this theory is that in a world with no transactions costs the outcome will be Pareto optimal. However, this result depends crucially on the absence of transactions costs (as does the Coase theorem). If transactions costs (costs of forming binding agreements, negotiating their terms, etc.) exist, the results of the theory do not go through. Moreover, the situation here is one in which costs of forming coalitions differ as between different types of individuals. It is easier (cheaper), for example, for workers to form a coalition among themselves than for workers and consumers of their products to form coalitions. Arrow and Hahn discuss this situation, and their conclusion is that "... if the costs of bargaining are not uniform for different coalitions, then indeed quite different results may prevail. . . . No real theory of this type has been developed, however."<sup>27</sup> Thus, the situation discussed in this paper is one in which formal models are not yet available and, moreover, one which has resisted formal modeling.

#### IV. CLASS ACTIONS

At several points, Posner argues for class-action suits as alternatives in areas which are now regulated by statute or by direct government regulation.<sup>28</sup> His claim is that such suits would be more efficient than the current rules. These suits would allow individuals (or attorneys; the agent is irrelevant) to aggregate small claims which are not individually worth pursuing and thus have enough at stake to make prosecution of a case worthwhile. If, for example, many consumers each lose a small amount

<sup>27</sup> Kenneth J. Arrow & F. H. Hahn, *General Competitive Analysis* 186 (1971).

<sup>28</sup> Note 1 *supra*.

from a fraudulent claim about a product, no one consumer will have incentive to sue for redress, and thus firms may find it profitable to make such claims. One solution to this problem has been the Federal Trade Commission, which, however, has not been very effective in stopping this behavior.<sup>29</sup> An alternative solution would be a class action representing all defrauded consumers, so that, in aggregate, the claim would be worth pursuing and thus there would be costs imposed on firms which made such claims. Similar arguments could be applied to other areas of behavior where regulation has replaced litigation; class actions would probably be a good substitute for the Environmental Protection Agency.

The inefficiency in not allowing class actions as discussed by Posner is inconsistent with the claim that the law is economically efficient because judges preferred efficient law. If this were so the judges should have been able to allow the optimal amount of class-action suits. That is, it is difficult to see why judges would not have been convinced by arguments relating to aggregation of small claims and have allowed class actions in cases where efficiency arguments could have been made for such claims. From the perspective advanced here, however, it is not difficult to see why even efficient class-action suits would not have been allowed under common-law rules. While the class, had it been organized, would have been able to outspend opponents in litigating (if the class interest were the efficient interest), the cost of organizing the class and of overcoming free-rider problems may well have been too high in general for the class to form and litigate. Thus, the judicial distaste for class litigation is simply a result of the process discussed above: there was no party with sufficient stakes to invest in litigating until rules favoring classes came into being, and hence precedents evolved to oppose class litigation. The inefficiency in this area of law is explicable in terms of the interests of parties with substantial interests in litigating for favorable precedents. There was no such litigant with an interest in class actions.

But is Posner correct in arguing for broadened scope for such suits? Clearly, in some areas his claim would be correct. We have already mentioned pollution and small frauds. However, in other cases the argument would be just as clearly incorrect. In particular, if class actions were generally allowed we would expect the same types of agents to litigate as now lobby for statutes. That is, to the extent that the legal system allows class interests to litigate the common-law system approaches the statutory system, and the sort of inefficient legislation which has been statutorily established in recent years would instead occur through common-law

<sup>29</sup> Richard A. Posner, *The Federal Trade Commission*, 37 U. Chi. L. Rev. 47 (1969); Jordan & Rubin, *supra* note 22.

means. For example, it is not impossible that some low-paid workers, with unions filing amici briefs, would have litigated the issue of wages, arguing that wages below some minimum were "unconscionable," and hence passed a minimum-wage law by litigation rather than by statute. If this seems impossible, consider only that many of the regulatory laws passed since the 1930s were possible only because the Supreme Court reversed its earlier position and no longer overturned legislation on the basis of "substantive due process."<sup>30</sup> It presumably would have been possible to achieve the same result through legislation in the form of a constitutional amendment, but in fact the litigation process was sufficient. Posner errs in looking at particular areas in which class litigation would be efficient without considering the totality of situations in which such litigation would be expected to occur. When all such situations are considered, the presumption in favor of class actions is weakened.

There is another implication of increased class actions. As we allow one set of interests to form and litigate (or lobby) we may expect that other interests would be formed to counterlitigate. This is merely an example of what Posner and Tullock have discussed as "rent seeking."<sup>31</sup> If, for example, we allow all victims of pollution to sue for redress, we may at some point expect all polluters to form a lobbying or litigating group and oppose such litigation. Indeed, we may be observing such behavior now: the existence of pro-market, or business-oriented, legal foundations may be an example of counterlitigation. An example is the National Right to Work Legal Defense Foundation. This is a litigating group founded explicitly to counter the effects of labor unions in litigating in certain areas having to do with compulsory unionism. The issue of which side in these various disputes should win (in terms of efficiency) is not of interest here. What is of interest is the apparent proliferation of litigating groups which serve merely to counter each other's power. In fact, the same thing may be happening in the area of lobbying; recent growth in business political action committees may merely be a counter to the previous growth of labor union political activity.<sup>32</sup> Where the process will end will depend on relative costs of organizing for political and legal activity, and it is impossible to make any predictions about the potential efficiency or inefficiency of the result of this process. However, it is certain that the process itself is wasteful, as are all rent-seeking competitions.

<sup>30</sup> See, for example, Bernard H. Siegan, *Economic Liberties and the Constitution* (1980).

<sup>31</sup> Richard A. Posner, *The Social Costs of Monopoly and Regulation*, 83 J. Pol. Econ. 807 (1975); Gordon Tullock, *The Transitional Gains Trap*, 6 Bell J. Econ. 671 (1975).

<sup>32</sup> For a discussion of political action committees, see Edwin M. Epstein, *The Emergence of Political Action Committees*, in *Political Finance* (Herbert Alexander ed., 1979).

In the limit, of course, if *all* potential interest groups formed and perfectly sought their own interests, efficiency would be achieved. However, this would require that all consumers organized as a lobbying group, and moreover that this group had sufficient information to seek those property-rights definitions which were truly in their interest (which does not seem to be true of the "consumer"-oriented interest groups which have been formed so far). This would require not only costless organization but also costless information. Absent these requirements, some but not all groups will form, and there is no presumption about the ultimate implications of the process for efficiency.

#### V. SUMMARY

Many scholars draw sharp distinctions between statute and common law. It is argued in this paper that this distinction is often overdrawn. It does appear that common law is preferable to statute, but this appearance is more a function of the time at which each type of rule dominated the legal system. Common law was important in the nineteenth and early twentieth centuries, when there were independent forces for efficiency; statute law has dominated since about the 1930s, when other forces which had no implications in favor of efficiency have prevailed. In particular, it is argued that the distinction is due to the nature of groups which have been able to form. In the early period, those favoring particular rules were mainly individuals; in more recent times, various groups have been able to form and lobby for legislation or litigate for common-law rules. So far, the inefficiency effects of the formation of these groups have probably outweighed their effects leading toward efficiency, but this is not necessarily true for all time. It is quite possible that as other groups form there may be some movement toward efficiency. It may be argued that the environmental legislation of recent years, while incorrectly drafted, may nonetheless have created a bias toward efficiency on net. It may also be that the recent deregulation in some industries is due to similar forces. It is not necessarily correct to argue, as does Posner, that class actions would be a movement toward efficiency; but it is not clear that they would not be such a move. All that is correct is that as more and more groups form and attempt to counter each other there will be deadweight losses from the rent-seeking process itself.<sup>33</sup>

<sup>33</sup> John C. Goodman, *supra* note 3, discusses several reasons why the common law might no longer be expected to be more efficient than statute law. However, part of the argument of this paper is that the factors which have changed common law have also changed statute law. Therefore, there is no particular reason to expect statute law to be preferable to common law either.

Finally, a word about policy. Posner's argument for class-action suits is a policy argument; that is, Posner is arguing that it would be good policy to allow broadened scope for such suits. The claim made in this paper is that the nature of litigation which is allowed is an endogenous factor within the system, determined ultimately by the technology of organization. To the extent that this is correct those groups will form for which costs of formation are less than benefits, and exhortations toward judges to change policy in various ways will have relatively little effect.