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THE CLASS DEFENSE

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THE CLASS DEFENSE

Assaf Hamdani[*] *& Alon Klement*[**]

ABSTRACT

Lawmakers, courts, and legal scholars have long recognized that consolidating the claims of dispersed plaintiffs with similar grievances may promote justice and efficiency. In this Article, we argue that justice and efficiency also mandate that similarly positioned defendants be provided with an adequate procedure for consolidating their claims. We explore the circumstances under which costly litigation and collective action problems will prevent dispersed defendants with plausibly valid defense claims from confronting plaintiffs in court and analyze the troubling fairness and deterrence implications of such failure. We then demonstrate that aggregating claims will rectify the imbalance between the common plaintiff and defendants. To achieve defendant consolidation, we propose to implement what we label as the class defense device. We outline the novel features that will make the class defense both effective and fair—i.e., that will provide class attorneys with proper incentives, adequately protect the due process rights of absentee defendants, and keep to a minimum the omnipresent risk of collusion. Finally, we show that the class defense procedure affords would-be defendants greater protection than its alternatives. Specifically, we demonstrate that the class defense is a superior framework for resolving many disputes—such as lawsuits against credit card and cable companies—that currently take the form of class actions.

Key words: Procedure, litigation, class actions.

JEL classification: K4

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I. INTRODUCTION

The civil liability system provides defendants who are individually sued by a single plaintiff over similar questions of fact or law with inadequate procedural protection. These disperse defendants might have a good defense against the plaintiff's claims. Yet, given costly litigation and collective action problems,[1] each defendant might prefer to settle rather than litigate.[2]

This fundamental shortcoming is underscored by the contemporary crackdown against unauthorized music downloads. The music industry recently embarked upon a vigorous litigation campaign to eradicate the widespread phenomenon of music file swapping. Departing from their practice of targeting peer-to-peer companies such as *Napster*,[3] record companies have filed thousands of copyright infringement lawsuits against individuals who allegedly shared music files.[4]

At first sight, this shift in tactics—suing primary wrongdoers rather than mere facilitators—seems appropriate.[5] Upon closer

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[1] For a comprehensive discussion of the collective action problem and its implications for cooperation within large groups, see generally MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (1971). For a general analysis of costly litigation and its impact on settlement decisions, see, e.g., Richard A. Posner, *An Economic Approach to Legal Procedure and Judicial Administration,* 2 J. LEGAL STUD. 399 (1973); Lucian A. Bebchuk, *Litigation and Settlement under Imperfect Information*, 15 RAND J. ECON. 404 (1984).

[2] This failure constitutes another example of the divergence between the private and social value of litigation. *See generally* Steven Shavell, *The Fundamental Divergence between the Private and the Social Motive to Use the Legal System*, 26 J. LEGAL STUD. 575 (1997); Steven Shavell, *The Level of Litigation: Private Versus Social Optimality of Suit and Settlement,* 19 INT. REV. L. & ECON. 99 (1999).

[3] *See* A&M Records, Inc., v. Napster, Inc., 239 F.3d 1004 (9th Cir. 2001) (upholding a preliminary injunction issued against Napster); In re Aimster Copyright Litigation, 334 F.3d 643 (7th Cir. 2003) (upholding a preliminary injunction issued against Aimster).

[4] As of May 24, 2004, record companies have filed 3,000 lawsuits against users of peer-to-peer networks. *See* CNET NEWS.COM, *RIAA Sues 493 More Music Swappers,* May 24, 2004, *at* http://news.com.com/2100-1027-5219114.html.

[5] Indeed, two prominent copyright scholars have recently applauded this change. *See* Mark A. Lemley & R. Anthony Reese, *Reducing Digital Copyright Infringement Without Restricting Innovation,* 56 STAN. L. REV. 1345, 1351 (2004) (calling for intensifying enforcement against individual defendants). Moreover, the strategy of suing peer-to-peer facilitators has been criticized for producing over-deterrence and stifling innovation. *See* Assaf Hamdani, *Who's Liable for Cyberwrongs?,* 87 CORNELL L. REV. 901 (2002) [hereinafter Hamdani, *Who's Liable*] (analyzing the over-deterrence risk associated with imposing liability on Internet intermediaries); Assaf Hamdani, *Gatekeeper Liability*, 77 S. CAL. L. REV.

inspection, however, the music industry's dragnet turns out to have potentially troubling consequences. Consider a hypothetical defendant who faces a lawsuit for downloading a handful of music files. For simplicity only, assume that the defendant has a valid defense against this lawsuit.[6] Defending against a copyright lawsuit typically costs between $30,000 and $100,000 in legal fees.[7] Record companies, on the other hand, normally offer defendants to settle for $3,000.[8] Under these circumstances, the defendant will undoubtedly prefer settlement to litigation.[9] The upshot will be that although many defendants might have valid defense claims, virtually no music downloader would find it economically sensible to pursue such claims in court.

Somewhat surprisingly, academics and policymakers have thus far overlooked this defendant collective action problem and its implications.[10] This omission is remarkable in light of the considerable attention given to the parallel problem of dispersed plaintiffs, and even more so to its remedy—the class action.[11]

53, 107-108 (2003) [hereinafter Hamdani, *Gatekeeper Liability*] (cautioning against imposing liability on peer-to-peer companies); Lemley & Reese, *id.,* at 1349-1450 (positing that going after suppliers of peer-to-peer technologies would stifle innovation).

[6] Several copyright scholars argue that the fair use defense applies to noncommercial file sharing, especially when the number of songs involved is small. *See* sources cited *infra* note 67.

[7] *See* Jefferson Graham, *'Amnesty' for Song Swappers?,* USA TODAY, Sep. 8, 2003, at D1 (attorney fees for fighting the RIAA in court are could range between $30,000 and $100,000).

[8] *See RIAA Sues 493 More Music Swappers,* CNET NEWS.COM, May 24, 2004, *at* http://news.com.com/2100-1027-5219114.html (the RIAA has settled nearly 400 lawsuits for approximately $3,000 each).

[9] Indeed, there is evidence that defendants either settle or simply fail to appear in court. *See id.; Conn. Man Fined for Downloading Music,* ASSOCIATED PRESS NEWSWIRES, May 13, 2004, *available at http://www.washingtonpost.com/wp-dyn/articles/A23654-2004May13.html* (reporting a fine that was imposed on a file-sharing defendant who failed to appear in court).

[10] The only exception of which we are aware is a recent student note focusing on the limited context of patent litigation. *See* Edward Hsieh, *Mandatory Joinder: An Indirect Method for Improving Patent Quality*, 77 S. CAL. L. REV. 683 (2004). We demonstrate, in contrast, that the failure to assert defense claims is a phenomenon with broad implications that is not limited to patent cases. Moreover, the solution we offer substantially differs from the one that the Note proposes. *See* note 115*, infra.*

[11] Recent examples of scholarly works focusing on various issues arising in the class action context include John C. Coffee, Jr., *Class Action Accountability: Reconciling Exit, Voice and Loyalty In Representative Litigation,* 100 COLUM. L. REV. 370 (2000); Alon Klement, *Who Should Guard the Guardians? A New Approach for Monitoring Class Action Lawyers*, 21 REV. LITIG. 25 (2002); Jill E. Fisch, *Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction*, 102 COLUM. L. REV. 650 (2002); Richard A. Nagareda*, The Preexistence Principle and the Structure of the Class Action*, 103 COLUM. L. REV. 149 (2003).

In a nutshell, class actions are designed to overcome the disincentive of dispersed, similarly positioned plaintiffs to file lawsuits.[12] By consolidating plaintiff claims, class actions render litigation economically viable even for plaintiffs that would not otherwise sue, thereby compensating victims of wrongdoing, bolstering deterrence, and achieving administrative efficiency.[13]

In this Article, we seek to rectify the failure to consider a collective procedure for protecting dispersed defendants. Our core thesis is that the fundamental justification for consolidating plaintiff claims applies with equal force to defendants: In the plaintiff case, the cost of bringing a suit might dissuade victims from suing wrongdoers.[14] In the defendant case, the cost of defending against a lawsuit might lead defendants with good defense claims to default or settle. In both cases, this failure to litigate undermines justice and deterrence; and in both cases, the legal system can restore justice and deterrence by facilitating the consolidation of claims.

This Article seeks to add four key insights to the analysis of representative litigation. First, it explores the circumstances under which dispersed defendants will fail to confront plaintiffs in court and considers the implications of such failure for both fairness and efficiency. Second, the Article demonstrates that consolidating claims will encourage defendants with good defenses to litigate rather than settle. Third, the Article proposes to implement what we label as the *class defense* device in order to attain the goal of defendant consolidation. It outlines the novel features of this procedure, defends it against potential challenges, and identifies issues that merit future research. Finally, this Articles shows that the class defense device is superior to its existing alternatives. Specifically, it demonstrates that the class defense device is a superior framework for resolving many

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[12] *See, e.g.,* Deposit Guaranty National Bank v. Roper, 445 U.S. 326, 338-339 (1980) (noting that the class action may "motivate [plaintiffs] to bring cases that for economic reasons would not be brought otherwise").

[13] *See* Kenneth W. Dam, *Class Actions: Efficiency, Compensation, Deterrence and* Conflict *of Interest*, 4 J. LEGAL STUD. 47, 54-56 (1975) (exploring the deterrence function of class actions); Deborah R. Hensler & Thomas D. Row, Jr., *Beyond "It Just Ain't Worth It": Alternative Strategies for Damage Class Action Reform*, 64-SUM LAW & CONTEMP. PROBS. 137, 137 (2001) (noting that class actions promote deterrence, justice, and administrative efficiency).

[14] The standard justification for class actions focuses on claims for insignificant amounts that would not be filed individually. There are those who argue, however, that class actions are desirable even for larger claims as long as the common defendant enjoys economies of scale. *See, e.g.,* David Rosenberg, *Mandatory-Litigation Class Action: The Only Option for Mass Tort Cases*, 115 HARV. L. REV. 831 (2002) (advocating mandatory class actions based upon this rationale); Note: *Locating Investment Asymmetries and Optimal Deterrence in The Mass Tort Class Action*, 117 HARV. L. REV. 2665 (2004) (exploring the implications of litigation cost asymmetries for mass tort class actions).

disputes—such as lawsuits against credit card and cable companies—that currently take the form of class actions.

In Part II, we begin our analysis by exploring the likely failure of dispersed defendants to litigate their claims. This defendant problem is likely to arise whenever a plaintiff brings separate lawsuits against numerous, similarly positioned defendants. To demonstrate the implications of this failure, we analyze several recent cases in which a powerful plaintiff employing aggressive litigation tactics filed similar lawsuits against thousands of individuals. In addition to the file-sharing example, these cases include: (i) DirecTV's so-called end-user campaign that has produced 24,000 separate lawsuits with questionable merits, and (ii) Leasecomm's fraudulent scheme involving thousands of lawsuits that, although they lacked merit, provided Leasecomm with $24 million in judgments.

These examples not only vividly demonstrate the failure of the existing legal regime to adequately protect dispersed defendants, but also point out that the defendant problem may be particularly vulnerable to abuse. This is because plaintiffs might strategically exacerbate defendants' predicament—by inflating defense costs, for example—to intensify the pressure to settle. Worse, sophisticated wrongdoers might exploit this phenomenon and harness courts to assist them in achieving their illicit goals.

In Part III we turn to consider the proper remedy. Drawing on insights developed in the class action context, we argue that the solution lies in allowing defendants to consolidate their claims. Acting cohesively, members of the defendant group may find litigation economically worthwhile by taking advantage of scale economies. Moreover, pooling defense claims increases the amount at stake, thereby making the representation of defendants a lucrative endeavor for attorneys.[15]

The challenge, therefore, is to devise a doctrinal vehicle for consolidating defense claims. In the plaintiff case, the principal aggregation mechanism is the familiar class action. In this Article, we put forward a tentative proposal for a new device—the *class defense*. We envision a representative procedure driven by attorneys lured by private gains to represent the defendant class.[16] At the same time,

[15] The conventional assumption is that class attorneys are the driving force behind class litigation. *See, e.g.,* John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions,* 86 COLUM. L. REV. 669 (1986); Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1 (1991). *See also* Klement, *supra* note 11, at 27-28 (noting that class representatives have proved to be passive figureheads).

[16] This is the model of the mythical private attorney general. The term "private

courts will monitor the class defense to ensure that absentee defendants are adequately represented. Yet, while it is designed to achieve the same conceptual goal of claim aggregation, the class defense is not merely a mirror reflection of the class action. In the remainder of Part III, therefore, we provide a tentative blueprint of the novel features of the class defense.[17]

The party initiating the class defense will be a plaintiff filing a "standard" lawsuit against a defendant (or separate lawsuits against numerous defendants). Then, an attorney seeking to represent the defendant class will motion the court to certify the lawsuit as a class defense case.[18] Courts will have the power, therefore, to alter the nature of a plaintiff's lawsuit from one against a single defendant to a representative claim that will bind the plaintiff against all defendants and future defendants.

We then consider the principal challenges that must be addressed in order to turn the class defense into an effective and fair procedure. Specifically, we show that the class defense can provide attorneys with sufficient incentives to undertake representation, is consistent with defendant and plaintiff due process rights, and can minimize collusion between plaintiffs and class attorneys.

With respect to incentives, the conventional premise is that providing class attorneys with considerable fees is necessary for an

attorney general" was first coined in Associated Indus. of New York State, Inc. v. Ickes, 134 F.2d 694, 704 (2d Cir. 1943), *vacated as moot by* 320 U.S. 707 (1943). *See also* Jeremy A. Rabkin, *The Secret Life of the Private Attorney General*, 61 LAW & CONTEMP. PROBS. 179, 179-84 (1998) (providing an interesting historical overview of this term).

[17] The class defense should not be confused with the existing procedure of the "defendant class action." The defendant class action is a tool that is available for plaintiffs wishing to enforce their rights against the entire defendant group. The class defense, in contrast, will be available for defendants wishing to improve their litigation position vis-à-vis the plaintiff. *See* Stephen C. Yeazell, *The Past and Future of Defendant and Settlement Classes in Collective Litigation*, 39 ARIZ. L. REV. 687 (1997) (providing an overview of the history of defendant class actions); Robert R. Simpson & Craig Lyle Pera, *Defendant Class Actions*, 32 CONN. L. Rev. 1319 (2000) (discussing the use of defendant class actions in litigation against the gun industry).

[18] Unless stated otherwise, we shall refer throughout the Article to class attorneys and disregard representative defendants. While this omission is motivated principally by convenience, it also reflects the conventional understanding that class representatives often play a nominal role in class litigation. *See, e.g.,* Jean Wegman Burns, *Decorative Figureheads: Eliminating Class Representatives in Class Actions*, 42 HASTINGS L.J. 165, 179-186 (1990-1991) (offering an extreme view under which class action representatives are not necessary to the operation of the class action); Edward H. Cooper, *The (Cloudy) Future of Class Actions*, 40 ARIZ. L. REV. 923, 927 (1998) (recognizing that class representatives often play no client role whatsoever).

effective regime of representative litigation.[19] In class actions, attorneys typically receive a share from the amount that the defendant pays the plaintiff class.[20] In the class defense setting, however, this method is practically unworkable because when the class wins—i.e., when the court determines that the defendants owe nothing to the plaintiff—no money is changing hands.

We thus propose to adopt a universal one-sided fee-shifting rule to provide class attorneys with adequate incentives. Under this rule, the plaintiff will have to pay the fees for the defendant class attorney when the class wins. A class loss at trial, however, will not entitle the plaintiff to recover its fees.

Class litigation is an exception to the fundamental principle that one cannot be bound by a judgment in a litigation in which she is not designated as a party.[21] The class defense, however, might initially raise some distinct due process concerns. First, one might argue that binding absentee defendants poses a threat to their due process rights that is far graver than the threat that class actions pose to absentee plaintiffs.

Second, the class defense might raise novel concerns for *future defendants*—those who engage in the disputed activity but have not been sued yet. Since it is not certain that the plaintiff will ultimately sue all those engaging in the disputed conduct, future defendants might contend that the class defense necessarily makes them worse off. Moreover, future defendants are practically precluded from opting out of the class. This is because by stepping forward and opting out, a future defendant essentially discloses that she engages in disputed conduct, thereby increasing her chances of getting sued individually.[22]

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[19] Peter H. Huang, *A New Options Theory for Risk Multipliers of Attorney's Fees in Federal Civil Rights Litigation,* 73 N.Y.U. L. REV. 1943, 1944 (1998) (noting the importance of providing private practitioners with sufficient fees in order to facilitate civil rights class actions); Lucian A. Bebchuk, *The Questionable Case for Using Auctions to Select Lead Counsel,* 80 WASH. U.L.Q. 889, 894-95 (2002) (arguing that the need to provide class attorneys with sufficient incentives is inconsistent with auctioning the role of class counsel). *See also* Alon Klement & Zvika Neeman, *Incentive Structures for Class Action Lawyers*, 20 J. L. ECON. & ORG. 102 (2004) (proposing an optimal attorney fee regime).

[20] *See* HANOCH DAGAN, THE LAW AND ETHICS OF RESTITUTION 135-136 (offering a normative justification for requiring class members to bear the cost of attorney fees).

[21] *See* Hansberry v. Lee 311 U.S. 32, 41 (1940). For an excellent analysis of courts' attempts to reconcile preclusion analysis with the class action device, see Richard A. Nagareda *, Administering Adequacy in Class Representation,* 82 TEX. L. REV. 287, 295-333 (2003).

[22] The right to opt-out is one of the cornerstones of the monetary class action. *See, e.g., George* Rutherglen, *Future Claims in Mass Tort Cases: Deterrence, Compensation, and Necessity,* 88 VA. L. REV. 1989, 1995 (2002) ("the right to

We will show, however, that none of these due-process concerns undermines the basic case for the class defense. Using both economic and psychological insights, we argue that the risk to absentee defendants is no different than the risk to absentee plaintiffs. We also demonstrate that the class defense does offer future defendants substantial benefits. Finally, we propose to adopt an anonymous opt-out procedure to remove any barriers to opting out by future defendants.

The last issue that we consider is whether the class defense is particularly susceptible to collusion. The class defense, so the argument goes, will highly motivate plaintiffs to collude with potential representative defendants and their attorneys in order to legally bind all members of the defendant class to an adverse judgment or settlement. In other words, powerful plaintiffs might use the class defense procedure against defendants.

The risk of collusion, however, is an inherent byproduct of representative litigation.[23] The sheer specter of collusion, therefore, should not disqualify the class defense procedure. Instead, courts should aim at minimizing this risk by facilitating competition for the class attorney role and carefully considering class certification. We further identify the criteria that should guide courts when deciding whether class certification indeed serves the interests of defendants rather than those of plaintiffs.

Part IV considers whether existing alternatives could achieve the goal of overcoming disincentives to defend without introducing far-reaching reforms into the complex class litigation arena. We show that the class defense procedure outperforms all the existing mechanisms for claim consolidation. Moreover, we demonstrate that the class defense device is a superior framework for resolving many disputes that currently take the form of class actions. Specifically, we show that many existing class actions—especially those concerning wrongful payments to banks, credit card, cable companies, and even the government—are essentially an imperfect byproduct of the existing regime under which defendants lack the ability to consolidate

notice and opt-out has remained at the center of class action litigation at the last three decades").

[23] *See Susan* P. Koniak & George M. Cohen, *Under Cloak of Settlement,* 82 VA. L. REV. 1051 (1996) (advocating the use of lawsuits against class attorneys who arrive at collusive settlements with common defendants in class actions). In fact, the risk of collusion may arise in any litigation setting given the principal-agent relationships between litigants and their counsel. *See generally* Geoffrey P. Miller, *Some Agency Problems in Settlement*, 16 J. LEGAL STUD. 189, 200 (1987); Bruce L. Hay, *The Theory of Fee Regulation in Class Action Settlements*, 46 AM. U.L. REV. 1429, 1437 (1997).

defense claims.

We conclude our analysis by briefly examining additional alternatives, including gatekeeper liability, liability insurance, and government intervention. All these alternatives, we argue, are inferior to the class defense device.

II. THE PROBLEM: DISPERSED DEFENDANTS

The core thesis of this Article is that the fundamental justification for consolidating plaintiff claims extends also to defense claims. In this Part, we analyze in depth the case of dispersed, similarly positioned defendants. We show that the absence of mechanism for aggregating defense claims might circumvent fairness and efficiency.

First, we set the background by outlining the familiar, paradigmatic scenario in which numerous plaintiffs face a single defendant. Then, in section B, we uncover the parallel—yet unfamiliar—case when defendants are numerous and dispersed. Section C briefly reviews three case studies that illustrate both the existence of the phenomenon and the justice and deterrence concerns that it raises. In section D, we identify the conditions under which the problem of numerous defendants is likely to be particularly severe.

A. Dispersed Plaintiffs

This Article argues that the scenario of numerous, dispersed defendants is analogous to the paradigmatic scenario underlying the class action mechanism—the case of numerous, dispersed plaintiffs. This section presents the problem facing numerous plaintiffs who were wronged by a single defendant. This analysis will serve as a useful backdrop against which the remainder of this Part will assess the parallel case of numerous defendants.

The class action device is principally designed to facilitate the filing of suits that would not be filed were plaintiffs to act individually.[24] This, in turn, not only ensures that victims are compensated, but also provides wrongdoers with adequate incentives to refrain from causing harm.[25]

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[24] *See supra* note 12. Class actions may also be used to overcome cost-asymmetries between dispersed defendants and the plaintiffs. *See infra* text accompanying notes 29-31. Another justification for class actions is that they conserve resources by allowing efficient resolution of large number of similar claims. *See* Hensler & Row, *supra* note 13, at 137.

[25] The conventional deterrence rationale focuses on the impact of class actions on the level of care adopted by potential wrongdoers. *See* Alon Harel & Alex Stein, *Auctioning for Loyalty: Selecting and Monitoring Class Counsel*, 22 YALE L. & POL'Y REV. 69, 76 (2004). In many cases, however, victim conduct can also affect

Since litigation is costly, plaintiffs might refrain from suing wrongdoers in the absence of a mechanism for consolidating their claims. Consider the example of an investor who purchased one share from a company that recently went public while failing to disclose material information in its prospectus. As a result of this omission, the investor overpaid for the share by an amount of $1. Assume that this is a clear case of fraud and, therefore, investors will surely win in court if they sue the issuer.

If litigation were costless, the investor would undoubtedly file a suit and receive $1 in damages. In the real world, however, litigation is costly. Accordingly, victims will sue wrongdoers only if the expected recovery exceeds the cost of filing the suit.[26] Assume that the cost for the investor of bringing a suit and litigating the case is $100. Under these circumstances, the investor will not sue the issuer since the expected recovery is smaller than the cost. In other words, the suit has a negative expected value for the investor.

Now assume that there are numerous victims with similar claims, and that each victim has to file a suit separately. Based upon a similar cost-benefit analysis, each victim will decide not to bring a lawsuit against the issuer.

The upshot will be the wrongdoer will escape liability for its misconduct. This means that victims will not be compensated for their losses although there might be no doubt, as in our example, that they are entitled to such compensation. The failure to sue, however, would also undermine the deterrence of wrongdoers.[27]

The liability system serves a deterrent function by making wrongdoers pay for harms that they cause.[28] When victims refrain from filing suits due to their costs, wrongdoers do not internalize the

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the likelihood of harm. *See* Steven Shavell, *Strict Liability v. Negligence,* 9 J. LEGAL STUD. 1, 6 (1980) (exploring optimal liability standards designed to impact both victim and wrongdoer conduct). In these cases, the class action device might also affect victim incentives. As we shall see, this would have implications with respect to the class defense as well. *See* Part II.C.3, *infra* (discussing the likely impact of aggregating defense claims on plaintiff conduct).

[26] We assume that the regime in place follows the conventional U.S. approach under which each party bears its own expenses. On the implications of fee-shifting rules in this context, see our analysis in Part III.B *infra*.

[27] *See* Harel & Stein, *supra* note 25, at 76. This is another example of the implications of the divergence between the private and social value of litigation. *See generally* Steven Shavell, *The Fundamental Divergence between the Private and the Social Motive to Use the Legal System*, 26 J. LEGAL STUD. 575 (1997); Steven Shavell, *The Level of Litigation: Private Versus Social Optimality of Suit and Settlement,* 19 INT. REV. L. & ECON. 99 (1999).

[28] *See, e.g.,* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 180 (5th ed. 1998) (noting that potential injurers will not take precautions unless the legal system steps in and holds them liable in damages should an accident occur).

harm resulting from their conduct. In our example, if investors do not sue, issuers will have a de-facto immunity from civil liability for securities fraud. This, in turn, would make fraud more attractive for issuers.

Although this plaintiff problem is most salient when plaintiffs' claims are small,[29] it has similar implications for large claims as well. When numerous plaintiffs face a single defendant in separate proceedings, the defendant normally has a superior litigation position vis-à-vis each plaintiff. Because it can spread its litigation investment across all cases, the defendant's incentives to invest in each lawsuit will therefore reflect its aggregate interest in avoiding liability. In other words, the defendant can utilize scale economies regarding common questions of law and fact. Plaintiffs, in contrast, do not enjoy similar economies of scale, as they typically cannot pool their resources due to collective action, communication and information problems.[30] This asymmetry substantially reduces the value of each individual claim. As a result, wrongdoers face a lower liability than they optimally should.[31]

The class action is the key mechanism for addressing the problem of numerous plaintiffs. By allowing plaintiffs to aggregate their common claims against the wrongdoer, the class action allows the plaintiff group to exploit economies of scale as well.[32] Furthermore, increasing the amount at stake renders class representation financially appealing for lawyers. This in turn means that the plaintiff class will file and litigate a suit even when each plaintiff, acting individually, would find litigation economically infeasible.

To be sure, class actions raise a host of dilemmas that have occupied legal academics and policymakers in recent decades.[33] Our

[29] Overcoming disincentives to pursue small claims is the classic justification for class actions. *See* Harry Kalven, Jr. & Maurice Rosenfield, *The Contemporary Function of the Class Suit*, 8 U. CHI. L. REV. 684, 684 (1941) ("The type of injury which tends to affect simultaneously the interest of many people is also apt to involve immensely complex facts and intricate law, and redress for it is likely to involve expense totally disproportionate to any of the individual claims.").

[30] *See* David Rosenberg, *Mass Tort Class Actions: What Defendants Have and Plaintiffs Don't,* 37 HARV. J. ON LEGIS. 393, 404-406 (2000) (exploring the link between plaintiff incentives to invest in litigation and defendants' liability).

[31] *See* text accompanying notes 109-112, *infra.*

[32] *Id.*

[33] Current dilemmas with which policymakers and scholars try to grapple include the proper method for selecting class counsel, the role of the mandatory class action, and the appropriate treatment of coupon settlements. *See* Harel & Stein, *supra* note 24 (analyzing the auction method for selecting class counsel); Richard A. Nagareda, *Autonomy, Peace, and Put Options in the Mass Tort Class Action*, 115 HARV. L. REV. 747 (2002) (discussing mandatory class actions); David Rosenberg, *Mandatory-Litigation Class Action: The Only Option for Mass Tort Cases*, 115 HARV. L. REV. 831 (2002) (same); A. Mitchell Polinksy & Daniel L Rubinfeld,

present goal, however, is merely to demonstrate that aggregating plaintiff claims overcomes their disincentives to sue.

B. Dispersed Defendants

The phenomenon we discussed in the previous section is widely familiar. But the mirror phenomenon—the case of dispersed, similarly positioned defendants—has thus far eluded the attention of academics and policymakers alike. In this section, therefore, we show that disincentives to litigate may often arise with respect to defendants as well.

The problem of numerous defendants arises when unrelated individuals, acting separately, inflict (or are being accused of inflicting) harm on a single victim, who decides to file separate suits against the alleged wrongdoers.[34] Although the defendants have acted separately, their conduct involves common questions of fact or law. Thus, if the defendants were to aggregate their cases, they could exploit economies of scale. In the absence of consolidation, however, defendants might prefer to settle even when they have a good defense against the lawsuit. Like in the plaintiff case, the failure of defendants to litigate circumvents both justice and deterrence.

To illustrate, consider the following hypothetical.[35] Company A holds a patent on a technology that many other firms use without paying royalties. Company A decides to sue for patent infringement the firms that employ its technology. Company A also offers each firm to settle for $50,000 in licensing fees. For simplicity, assume also that the patent granted to Company A is invalid.[36]

Remedies for Price Overcharges: The Deadweight Loss of Coupons and Discounts (Stanford Law & Econ. Working Paper No. 271, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=471001 (discussing the use of coupons).

[34] In contrast, the problem of numerous plaintiffs arises when a wrongdoer inflicts harm on a group of unrelated victims.

[3535] For claims that owners of intellectual property rights indeed follow the litigation path that we describe in our hypothetical, see Michael J. Meurer, *Controlling Opportunistic and Anti-Competitive Intellectual Property Litigation*, 44 B.C. L. REV 509, 516-521 (2003) (reviewing several cases in which intellectual property owners have litigated opportunistically); Amit Asaravala, *Dodgy Patents Rile Tech Industry,* WIRED NEWS, Apr. 5, 2004, *at* http://www.wired.com/news/business/0,1367,62930,00.html (reporting that many companies often give in and pay licensing fees for invalid patents given the cost of litigation). For a proposed solution in the patent context, see Hsieh, *supra* note 10, at 692-693 (advocating the use of a mandatory joinder).

[36] The Patent and Trademark office has recently come under heavy criticism for allowing invalid patents to slip through the system. *See, e.g.*, Julie E. Cohen, *Reverse Engineering and the Rise of Electronic Vigilantism: Intellectual Property Implications of "Lock-Out" Programs*, 68 S. CAL. L. REV. 1091, 1177-80 (1995); John R. Thomas, *Collusion and Collective Action in the Patent System: A Proposal*

Since conducting a patent trial is costly,[37] each defendant will go to trial only if the expected savings from doing so exceed its litigation costs. Otherwise, defendants will decide to accept Company A's settlement offer. Suppose that challenging the patent in court will cost each defendant $1 million.[38] Under these circumstances, each defendant will prefer to settle notwithstanding its legal right to use the technology.

Users of the patented technology will therefore overpay licensing fees to Company A. From society's perspective, however, the implications of this phenomenon are not limited to the unfairness involved in the over-payment of fees. Rather, the failure to defend would also undermine the deterrent effect of the liability system.

In the plaintiff case, the failure to sue undermines the deterrence of wrongdoers. In the defendant case, in contrast, the likely outcome of the failure to defend is over-deterrence of legitimate conduct.[39] This is because the overpayment by defendants ex post would impact decisions ex ante whether to engage in conduct that might subsequently trigger a lawsuit. Potential defendants would take into account not the amount of damages in principle, but the amount that they would likely pay given their tendency to settle.

Returning to our example, suppose that a startup has to choose between using Company A's patented technology or developing a similar technology at the cost of $20,000. From society's perspective, the startup should undoubtedly employ Company A's technology. Since the patent is invalid, investing $20,000 in developing an equivalent technology will be a social waste.

As explained above, however, users of the patented technology will likely settle for $50,000 when Company A sues—regardless of the patent's validity. Assuming that Company A sues all those who use its technology, the startup will prefer to spend $20,000 on developing the equivalent technology. Thus, the prospect of costly litigation will result not only in overpayment by defendants ex post,

for Patent Bounties, 2001 U. ILL. L. REV. 305, 316-22. For a position defending the current practices of the Patent and Trademark Office, see Mark A. Lemley, *Rational Ignorance at the Patent Office,* 95 NW. U. L. REV. 1495, 1496-97 (contending that ex-post review by courts might be cheaper than ex ante review by the patent office).

[37] Note that litigation might be costly for both defendants and the plaintiff. Like the defendant in class actions, however, the plaintiff in our example will be able to spread the cost of its investment in litigation—legal research and attorney fees for example—across the numerous cases that it intends to file. In other words, the plaintiff will enjoy economies of scale in conducting its litigation campaign.

[38] *See, for example,* Teresa Riordan, *Trying to Cash In on Patents*, June 10, 2002, N.Y. TIMES, at C2 (reporting that patent experts estimate the cost of patent litigation to be $2 million).

[39] As we explain below, another potential result is under-deterrence of plaintiffs. *See* Part II.C.3, *infra.*

but also in their over-deterrence ex ante.[40]

The patent hypothetical highlights some novel implications of the defendant case. First, as we demonstrate in the next section, the plaintiff's main goal is often bolstering ex ante deterrence rather than receiving compensation ex post. Company A, for example, might be principally interested in deterring other companies from using its technology rather than collecting fees per se.

Second, the social welfare implications of defendants' failure to litigate are not limited to the over-deterrence of potential defendants. Rather, this failure may also result in the under-deterrence of would-be plaintiffs. Consider Company A's decision whether to obtain a patent that it knows to be invalid. As long as it can separately sue each alleged infringer, Company A knows that no defendant will find it worthwhile to challenge its patent in court. Company A thus will be motivated to seek unjustified patent protection.[41] Hence, defendants' failure to litigate produces excessive incentives for filing invalid patent applications.[42]

Most alarmingly, plaintiffs can act strategically to exacerbate the problem confronting each plaintiff in order to ensure that defendants have no incentive to challenge them in court. Without a substantial investment, plaintiffs can inflate each defendant's litigation costs, thereby transforming an otherwise viable defense into one with a negative expected value.

One obvious technique for doing so is suing defendants in an inconvenient and remote venue. Such venue shopping has in fact been

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[40] *See also* Meurer, *supra* note 35, at 519 (noting that opportunistic patent cases may deter firms from developing new products).

[41] *See also* Lemley, *supra* note 37, at 1517-18 (describing the phenomenon of "holdup licensing"—where patent owners are "seeking to license even clearly bad patents for royalty payments small enough that licensees decide it is not worth going to court").

[42] Note that plaintiffs' negative expected value problem can arise in a single plaintiff—single defendant setting. *See* Lucian A. Bebchuk, *Negative Expected Value Suits*, in PETER NEWMAN, (ED.), THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 551-554 (1998) (surveying the literature on the plaintiff's negative expected value problem and its sources)*;* Alon Klement, *Threats to Sue and Cost Divisibility Under Asymmetric Information*, 23 INT. REV. L. & ECON. 261 (2003) (demonstrating that the negative expected value problem persists when defendants hold private information). In contrast, defendants' negative value from defense would arise only when a single plaintiff sues numerous defendants, thereby creating investment asymmetries. Returning to our patent example, if only one company were to use Company A's technology, then there would be no reason to expect the parties' litigation costs to differ. But then, Company A would not file a suit that would cost it $1 million only to recover a $50,000 settlement. A problem would therefore arise only if Company A could enjoy scale economies litigating common questions of law and fact against multiple defendants, thus managing to reduce its per-litigation cost below its expected settlement value.

used to discourage defendants from litigating, thereby allowing the plaintiff to obtain default judgments.[43] Yet another way for imposing substantial costs on defendants is to obtain provisional relief orders attaching defendants' property or restricting their economic activity. Although prejudgment remedies are subject to due process restrictions under modern rules of procedure,[44] they may nevertheless be obtained without requiring a considerable investment on the plaintiff's part.

As we shall explain later,[45] allowing potential defendants to consolidate their claims will rectify the imbalance between plaintiffs and dispersed defendants by enabling the defendant group to exploit economies of scale. Moreover, such consolidation will enhance the incentives of lawyers to represent the defendant group and litigate the case rather than settle. This, in turn, will alleviate and perhaps eliminate both the over-deterrence and the under-deterrence problems resulting from the failure of defendants to confront plaintiffs in court.[46]

To summarize, the problem of numerous defendants is the mirror image of the problem of numerous plaintiffs. In both cases, there is an imbalance between a dispersed group of parties, on the one hand, and a single litigant, on the other hand. In both cases, the imbalance could lead members of the dispersed group acting individually to settle rather than pursue their claims in court, thereby undermining the deterrent effect of the liability system. In both cases, allowing the parties to consolidate their claims enables them to exploit scale efficiencies thus restoring the balance between the group and their opponent.

C. Case Studies

This Part has thus far introduced the paradigmatic case in which numerous defendants face a single plaintiff. In this section, we present three contemporary examples that illustrate both the failure of the legal system to protect dispersed defendants and the grave implications of this failure: the music industry's battle against users of peer-to-peer networks, DirecTV's aggressive campaign against signal piracy, and how a single company strategically abused the defendant

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[43] *See* our discussion of the Leasecomm case, Part II.C.3, *infra*.

[44] There is a line of precedents establishing various procedural safeguards against provisional remedies' abuse. State laws that had failed to provide for notice and an opportunity to be heard before implementing a pre-judgment remedy were often held unconstitutional. For a review of these precedents, see, e.g., CHARLES A. WRIGHT, ARTHUR R. MILLER, & MARY K. KANE, 11A FED. PRAC. & PROC. CIV. 2ND §2934.

[45] *See* Part III.A, *infra.*

[46] Another advantage is that allowing aggregation can solve liquidity problems that might prevent defendants from pursuing their case in court.

problem to defraud thousands of consumers.

1. Music File Sharing

There is an ongoing controversy among academics and policymakers concerning the proper means for protecting copyright in cyberspace.[47] We have no intention of taking a stand in this fierce debate. Rather, our goal in this section is to use the battle against music file sharing to demonstrate that suing dispersed defendants separately could result in over-deterrence, *i.e*., less than optimal use of peer-to-peer networks.

In recent years, technological advances have made it possible for individuals to make nearly perfect copies of digital works, while the Internet has allowed them to distribute these copies at virtually no cost.[48] These developments have understandably motivated content owners to wage a war in order to preserve their exclusive control over their copyrighted content.

The litigation strategy of copyright owners has evolved in several stages.[49] They initially targeted the relatively big-pocketed Internet service providers in an attempt to hold them liable for the misconduct of their users. Defendants included, among others, the providers of Internet access and web-hosting services,[50] search engines,[51] and even

[47] *See, e.g*., R. Anthony Reese, *Copyright and Internet Music Transmissions: Existing Law, Major Controversies, Possible Solutions*, 55 U. MIAMI L. REV. 237 (2001); Raymond Shih Ray Ku, *The Creative Destruction of Copyright: Napster and the New Economics of Digital Technology*, 69 U. CHI. L. REV. 263 (2002) (calling for the use of levies to regulate music distribution online); Neil W. Netanel, *Impose a Noncommercial Use Levy to Allow Free Peer-to-Peer File Sharing,* 17 HARV. J. L & TECH. 1 (2003) (advocating the use of levies rather than liability to compensate copyright owners); Lydia Pallas Loren, *Untangling the Web of Music Copyrights*, 53 CASE W. RES. L. REV. 673 (2003).

[48] *See generally* Peter S. Mennel, *Envisioning Copyright Law's Digital Future,* 46 N.Y.L. SCH. L. REV. 63 (2003) (discussing the impact of these changes on the future of copyright law).

[49] The music industry has implemented various other measures to preserve its control over copyrighted content. For example, the music industry lobbied for legislation that would require electronic devices to include anti-piracy devices. *See* John Borland, *Antipiracy Bill Finally Sees Senate*, CNET NEWS.COM, Mar. 21, 2002, *at* http://news.com.com/2100-1023-866337.html.

[50] *See, e.g.,* Religious Tech Center v. Netcom On-Line Communication, 907 F. Supp. 1361, 1377 (N.D. Cal. 1995) (lawsuit for copyright infringement against the provider of web-hosting services); in April 2000, the rock group Metallica sued Yale University as the provider of Internet access to its students using Napster's services. Immediately afterwards, Yale decided to block the access of its students to Napster. *See* John Borland, *Yale Drops Napster After Legal Pressure,* CNET NEWS.COM, Apr. 19, 2000, *at* http://news.cnet.com/news/0-1005-200-1719530.html?tag=st.ne.1005 (reporting Yale's response to a lawsuit filed against it by Metallica for providing Internet access to Napster users).

[51] *See* Kelly v. Arriba Soft Corp., 336 F.3d 811 (9th Cir. 2003) (rejecting an

Internet auction sites.[52] The Digital Millennium Copyright Act of 1998,[53] which generally grants Internet service providers immunity from legal liability, has to a large extent rendered this strategy ineffective.

The introduction of peer-to-peer ("p2p") networks presented copyright owners with an unprecedented challenge.[54] Record labels and movie studios initially responded by suing the providers of p2p services and software. These efforts turned out to be successful in the cases of *Napster* and *Aimster*.[55] This tactic suffered a setback, however, when a federal district court ruled against record companies in the *Grokster* case.[56]

In the aftermath of *Grokster*, the music industry adopted a new tactic for fighting music downloads. The Recording Industry Association of America ("RIAA") has launched a vigorous, well-publicized campaign of suing individual file-swappers for copyright infringement.[57] As of May 30, 2004, the RIAA has filed approximately 3,000 suits charging individual with copyright infringement for their use of p2p networks.[58]

Commentators have applauded this new tactic and even called for enhancing enforcement against individual end-users.[59] As our analysis

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infringement lawsuit filed against a search engine that made copyrighted pictures accessible).

[52] *See* Hendrickson v. eBay, 165 F. Supp. 2d 1082 (C.D. Cal. 2001) (finding that eBay is not liable for infringing items posted for sale on its web site).

[53] 17 U.S.C. § 1201 (2003).

[54] *See also* Tim Wu, *When Code Isn't Law,* 89 VA. L. REV. 679, 722-726 (2003) (exploring the link between the widespread use of p2p networks and the social norms against copyright violations on the Internet).

[55] *See* A&M Records, Inc., v. Napster, Inc., 239 F.3d 1004 (9th Cir. 2001); In re Aimster Copyright Litigation, 334 F.3d 643 (7th Cir. 2003) (upholding a preliminary injunction issued against Aimster). *See also* John Borland, *Record Companies Settle with Israeli P2P Company,* CNET NEWS.COM, Jul. 20, 2004 (reporting a settlement between the RIAA and the file-swapping company iMesh). There is also a pending lawsuit for vicarious copyright infringement against the venture capital firm that funded Napster. *See* Amy Harmon, *Universal Sues Bertelsmann Over Ties to Napster,* N.Y. TIMES, May 13, 2003, at C6.

[56] *See* MGM Studios, Inc. v. Grokster, Ltd., 259 F. Supp. 2d. 1029 (C.D. Cal. 2003). This decision was recently upheld by the Ninth Circuit. *See* John Borland, *Judges Rule File-Sharing Software Legal,* CNET NEWS.COM, Aug. 19, 2004, *at news.com.com/Judges+rule+file-sharing+software+legal/2100-1032_3-5316570.html?tag=nefd.lede.* For a comprehensive analysis of this series of cases, see Lemley & Reese, *supra* note 5, at 1356-66.

[57] *See* John Schwartz*, Record Industry Warns 204 Before Suing on Swapping,* N.Y. TIMES*,* Oct. 18, 2003, at B1.

[58] *See* CNET NEWS.COM, *RIAA Sues 493 More Music Swappers,* May 24, 2004, *at* http://news.com.com/2100-1027-5219114.html (last visited August 31,2004).

[59] *See generally* Lemley & Reese, *supra* note 5, at 1351 (endorsing criminal prosecutions of individual downloaders as well as increasing monetary judgments against such defendants).

suggests, however, this end-user tactic might be problematic given the absence of a mechanism for consolidating defense claims.[60]

To understand why, consider an individual facing a copyright infringement lawsuit for downloading a relatively small number of songs.[61] Suppose that the defendant's conduct amounts to "fair use" and thus does not constitute copyright infringement.[62] Based on reading newspaper reports of recent settlements, the defendant knows that she can settle for an amount of $3,000. [63] She also knows that there are several cases in which courts imposed a fine of $750 per downloaded song on defendants who neither answered the complaint nor appeared in court for the hearing.[64]

The amount of $3,000 is rather significant for most individual defendants. Yet, this amount pales in comparison to the likely cost of defending against a lawsuit brought by the powerful music industry. Estimates for the cost of defending these lawsuits range between $30,000 and $100,000.[65] Given these costs, the defendant would clearly choose not to defend against the lawsuit notwithstanding her valid defense.

The pressure to settle affects not only those who were unfortunate enough to be sued by the RIAA, but also all those who might consider downloading music files. The ex post settlement decisions of defendants impact the ex ante decisions of Internet users whether to download music. Hence, when defendants settle even when they may have a good defense, there is a considerable risk of excessively deterring music downloads by Internet users.

Consider the case of a teenager who would like to use a p2p service to download a handful of music files in order to decide

[60] Note that in some cases RIAA aggregated claims for identification of defendants. Not necessarily in a convenient forum.

[61] As we discuss below, the RIAA indeed files suits against people who downloaded only a handful of songs. *See infra* text accompanying note 66.

[62] We discuss the applicability of the fair use defense below. *See infra* text accompanying notes 67-68.

[63] *See* CNET NEWS.COM, *RIAA Sues 493 More Music Swappers,* May 24, 2004, *at* http://news.com.com/2100-1027-5219114.html (reporting that the RIAA has settled nearly 400 lawsuits for approximately $3,000 each). During the early stages of its campaign, the RIAA had a formal amnesty program under which file-sharers were required to settle for $3,000. The RIAA pulled the plug on the program since it was criticized as being misleading. *See* Matt Hines, *RIAA Drops Amnesty Program,* CNET NEWS.COM, Apr. 24, 2004, *at http://news.com.com/RIAA+drops+amnesty+program/2100-1027_3-195301.html*.

[64] *See Conn. Man Fined for Downloading Music,* ASSOCIATED PRESS NEWSWIRES, May 13, 2004, *available at http://www.washingtonpost.com/wp-dyn/articles/A23654-2004May13.html* (last visited August 31, 2004) (reporting a fine of over $4,000 that was imposed on a defendant that had been accused of downloading 5 music files but failed to appear in court).

[65] *See* Graham, *supra* note 7.

whether to purchase the new album of her favorite pop star. Assume again that downloading music files for this purpose amounts to "fair use" and thus does not constitute copyright infringement. The music fan expects to be sued by the record label producing this new album. In light of the prohibitive cost of defending against the lawsuit, the teenager expects to settle for $3,000. The upshot is that the teenager will download the music files only when his benefit from doing so exceeds $3,000. In other words, the prospect of costly litigation discourages not only copyright infringement, but also perfectly lawful behavior.

We would like to stress that the scenario we describe is a realistic one. Contrary to some early statements, the RIAA has not limited its lawsuits to "egregious" cases of those who have uploaded hundreds or thousands of music files for others to download. Rather, it appears that many lawsuits target Internet users whose alleged infringement comprises of downloading a very small number of music files.[66]

This distinction is especially important as some copyright lawyers argue that consumer downloading falls within the "fair use" defense to copyright infringement.[67] Moreover, those accused of downloading a relatively small number of files are more likely to settle given the asymmetry between defense costs and the value of litigation. The implication is that courts will not have the opportunity to determine whether this subset of music downloads is legal. This, in turn, renders the threat of over-deterrence a realistic concern.[68]

To summarize, the recent campaign against music file swappers underscores the risk associated with the scenario of numerous

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[66] *See Connecticut Man Fined for Downloading Music,* ASSOCIATED PRESS NEWSWIRES, May 13, 2004, *available at* www.washingtonpost.com/wp-dyn/articles/A23654-2004May13.html (reporting the outcome of a lawsuit accusing the defendants of downloading 5 music files); *Woman Fined for Getting Tunes off the Internet,* REUTERS NEWSWIRES, *available at* www.usatoday.com/tech/webguide/music/2004-05-06-downloader-fined_x.htm (reporting a suit against a woman for downloading a small number of files).

[67] *See, e.g.,* Jessica Litman, *War Stories*, 20 CARDOZO ARTS & ENT. L.J. 337, 341-42 (2002) (positing that it is unclear whether personal copying by individual users constitutes copyright infringement under US copyright law); Robert H. Heverly, *The Information Semicommons*, 18 BERKELEY TECH. L.J. 1127, 1185-1188 (2003) (arguing that file-sharing might be protected under the fair use defense); Lemley & Reese, *supra* note 5, at 1399-1400 (noting that, unlike uploaders, downloaders might have legitimate reasons for downloading content). *But see* Cynthia M. Ho, *Attacking the Copyright Evildoers in Cyberspace*, 55 SMU L. REV. 1561, 1568-1570 (2002) (arguing that the notion under which noncommercial copying by individuals is legal is a myth).

[68] Lemley & Reese, for example, envision a system of intensified enforcement only against "high-volume uploaders." *See* Lemley & Reese, *supra* note 5, at 1399-1400.

defendants. Individuals downloading music files may indeed be better targets of litigation than the companies that develop file-sharing technologies. Yet, in the absence of a device that would enable them to consolidate their defense claims, defendants are likely to settle even when their behavior is perfectly legal. This, in turn, might overly deter Internet users from sharing files online.

2. DirecTV's End-User Campaign

The RIAA's dragnet seems to be laid-back when compared to DirecTV's aggressive battle against signal piracy. This is a story of a just cause—fighting illegal signal pirates—that has turned into an indiscriminate litigation campaign, squeezing relatively high settlement payments even from possibly innocent individuals.

DirecTV provides television programming using satellite technology. To enjoy DirecTV's programs, a consumer must obtain a satellite dish, an integrated receiver/decoder ("IRD"), and an access card or "smart card." To prevent unauthorized signal reception and program viewing, DirecTV encrypts transmissions of its television programming. The smart card enables the subscriber's IRD to decrypt the signals to permit program viewing in accordance with the subscriber's authorized subscription package.[69]

Computer programmers and hardware manufacturers quickly developed techniques to allow unauthorized users to obtain free satellite programming from DirecTV.[70] This created a significant piracy problem for DirecTV. By 2003, analysts estimated that there were a million or more households illicitly receiving DirecTV signals. Analysts also estimated lost revenues at $1.2 billion per-year, a substantial amount compared to the company's $7.2 billion annual revenues.[71]

DirecTV therefore declared war on the pirate community. The company initially adopted various technological measures to eliminate signal piracy.[72] Each measure, however, was quickly countered by software and hardware developments that facilitated free

[69] *See* Declan McCullagh, *DirecTV Secrets Allegedly Pilfered,* CNET NEWS.COM, Jan. 2, 2003, *at* http://news.com.com/2100-1023-979001.html (last visited August 31, 2004).

[70] *See* Kevin Poulsen, *DirecTV Zaps Hackers*, SECURITY FOCUS NEWS, Jan. 25 2001, *at* www.securityfocus.com/news/143 (last visited August 31, 2004).

[71] *See* Dorothy Pomerantz, *Staling the Show*, FORBES, May 29, 2003; Jennifer Lee, *Student Arrested DirecTV Piracy Case*, N.Y. TIMES, Jan. 3, 2003, at C4.

[72] DirecTV initially broadcasted "search and destroy" programs that looked for hacked codes and damaged the software in any card that had them. When hackers countered this technology by making the cards "read only," DirecTV has moved to employ electronic countermeasures (ECMs) to deny programming to illegally modified access cards. *See* Poulsen, *supra* note 70.

access to satellite programming. Notably, in an effort to produce cards that would be harder to decode, DirecTV redesigned its access cards four times within less than five years, but without much success.[73]

Absent effective technological solutions, DirecTV resorted to legal measures to combat the escalating illicit viewer problem. DirecTV deployed various legal strategies—such as targeting middlemen and working with federal undercover operations—that also failed to substantially reduce the use of illicit equipment.

By mid-2001, DirecTV had adopted a new tactic: filing lawsuits against individuals who illegally received satellite-broadcast programming. Yet, because direct evidence of unauthorized signal reception is virtually impossible to obtain, DirecTV decided to sue based upon the mere purchase of smart card devices. As we shall explain below, this decision is crucial in turning DirecTV's legitimate battle to enforce its rights into a campaign that might produce unjust results and deter perfectly legal conduct.

According to DirecTV, it has filed more than 24,000 lawsuits against end-user defendants.[74] This datum, however, provides only a limited picture of the impressive scope of DirecTV's dragnet.

DirecTV collected more than 100,000 names and addresses of potential smart card holders. The company then sent out thousands of letters warning holders that the purchase and possession of signal theft equipment subjects them to statutory damages of up to $10,000 per violation.[75] These letters then suggested that the purchaser surrender the smart card devices, commit to refrain from further purchase of similar devices, and pay DirecTV for past wrongful conduct. DirecTV even set up a special department—called the End User Development Group—dedicated to contacting alleged smart card purchasers and inducing them to settle.

Most important for our purposes, DirecTV offered smart card holders to settle for $3,500. This amount is puzzling since it seems to have no relation to actual litigation prospects. Indeed, there are those who claim that DirecTV set this amount strategically to achieve three advantages: (i) to coerce smart card holders into settlement without even requiring DirecTV to file a suit,[76] (ii) to cover its attorney fees,

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[73] *See* Poulsen, *supra* note 70.

[74] *See* www.hackhu.com (last visited August 31, 2004) (a DirecTV web site designated for its end-user campaign).

[75] Samples of such cease and desist letters can be found at a web site designated to defending against DirecTV's campaign. *See* directvdefense.org/files (last visited August 30, 2004).

[76] Moreover, once it had filed a lawsuit against a holder, DirecTV agreed to settle only for a larger amount. *See* Darrin Schlegel, *DirecTV Dragnet Casting Wide Net*, HOUST. CHRONICLE, Jan. 18, 2004, at A1 (reporting this practice and the

and (iii) to produce sufficient deterrence against future purchases of smart card devices.[77] For example, in his wrongful termination lawsuit against DirecTV, a former member of the End User Development Group testified that he was told to tell potential defendants that it would be cheaper to settle for $3,500 than to hire an attorney.[78]

We neither claim that signal piracy is legal nor dispute that it may be detrimental to satellite TV operators. As long as defendants are guaranteed access to court and a fair procedure, there is no apparent reason to object to the filing of numerous anti-piracy lawsuits. There is reason to believe, however, that this is not the case concerning the "end-user campaign." Here, individuals who receive a warning letter are likely to settle since the cost of confronting DirecTV in court exceeds $3,500.[79]

This outcome could seem substantially (although not procedurally) adequate were DirecTV to pursue only genuine signal thieves. Regrettably, this description does not apply to DirecTV's campaign. As we explained earlier, DirecTV decided to target individuals for their mere possession of a smart card device. The case against smart card holders, however, is shaky on both factual and legal grounds.

Factually, devices designed for decrypting DirecTV signals can also be used for perfectly legal purposes. One example is the device known as "unlooper" in piracy circles. Signal pirates buy the unlooper to repair a satellite TV access card that has been placed in an infinite loop by one of DirecTV's electronic countermeasures. Others, in contrast, have used it to enhance the capabilities of their (lawful) smart card programmer. Other legal uses of this card include encryption system development, audiovisual exhibit management, network security administration, home and computer security and automotive electronic control.[80]

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accusations that it has been designed to extract settlements).

[77] *See* Declaration of Plaintiff John Fisher, s. 22, Fisher v. DirecTV (YC 048689), *available at* http://www.overhauser.com/DTV/main.html (last visited August 31, 2004). Fisher also testified that "[A]t no time did … other DirecTV officials present any justification or explanation for the $3,500 figure and it certainly was not tied to any actual financial loss that was ever explained to me."

[78] *Id.* The lawsuit was ultimately dismissed on procedural grounds. *See* Kevin Poulsen, *Ex-investigator's Suit against DirecTV Dismissed,* SECURITY FOCUS NEWS, Jun. 2 2004, *at http://www.securityfocus.com/news/8815.*

[79] *See* Schlegel, *supra* note 76 (reporting that attorneys claim that their fees exceed this settlement amount). Since defense costs consist mostly of attorney fees, some individuals have decided to represent themselves in court rather than settle. *See id.*

[80] See Amicus Curiae Brief filed by the Electronic Frontier Foundation in DirecTV, Inc. v. Treworgy, 373 F.3d 1124 (11th Cir. 2004) (2:03-CV-428-29SPC), *available at* directvdefense.org/files/Treworgy_Amicus_Brief.pdf (last visited August 30,

Most importantly, from a legal standpoint, it is doubtful whether the mere purchase of smart card devices is unlawful. While several district courts adopted DirecTV's position,[81] others have rejected it and required proof of actual signal interception to hold defendants liable.[82] The Eleventh Circuit, for example, has recently held that DirecTV has no right of action against persons for their mere possession of smart card devices.[83] Whatever the correct statutory interpretation turns out to be, the question whether the mere purchase of a smart card is actionable evidently merits judicial consideration.

The potential for dual use of smart cards demonstrates the undesirable implications of the disincentive to defend. Some uses for smart card devices are not only legal, but also feature a potential for socially valuable innovation. By indiscriminately suing all smart card purchasers, DirecTV has practically raised the price of each device to $3,500 (compared to its retail price of approximately $100). This in turn would likely eliminate most purchases by individuals whose benefit from the devices is lower than $3,500, yet whose use could benefit society at large.

To summarize, this case demonstrates both the fairness and deterrence concerns arising when dispersed, similarly positioned defendants face a powerful plaintiff. The proclaimed goal of this "end-user campaign" was to "send out an unequivocal message that users also can't escape "vigorous pursuit"."[84] DirecTV's litigation threat has evidently been credible as it has exploited economies of scale—it filed about 24,000 boilerplate suits based upon similar factual patterns and involving nearly identical questions of law.

It is questionable whether DirecTV's end-user campaign has succeeded in deterring signal piracy. But it has certainly punished

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2004); Kevin Poulsen, *DirecTV Dragnet Snares Innocent Techies*, SECURITY FOCUS, Jul. 17,2003, *at* http://securityfocus.com/news/6402 (last visited August 30, 2004).

[81] *See, e.g.*, DirecTV v. Tasche, 316 F. Supp. 2d 783, 788-89 (E.D. Wis. 2004); Dillon, 2004 WL 906104, at *2-3 (N.D. Ill. Apr. 27 2004); DirecTV v. Kitzmiller, 2004 WL 692230, at *4 (E.D. Pa. Mar 31, 2004); Oceanic Cablevision, Inc. v. M.D. Elec., 771 F. Supp. 1019, 1027 (D. Neb. 1991).

[82] *See* DirecTV, Inc. v. Regall, 2004 U.S. Dist. LEXIS 14725 (E.D. Wis. Jul. 28 2004) ("most courts have held that the plain language of § 2520(a) permits suits only against defendants who unlawfully intercept, disclose or use electronic communications and not against persons who merely possess a pirate device"). *See also* DirecTV v. Alter, 2004 WL 1427108, at 2 (N.D. Ill. Jun. 23, 2004); DirecTV v. Bertram, 296 F. Supp. 2d 1021, 1024 (D. Minn. 2003); DirecTV v. Beecher, 296 F. Supp. 2d 937, 941 (S.D. Ind. 2003); DirecTV v. Hosey, 289 F. Supp. 2d 1259, 1263-64 (D. Kan. 2003); DirecTV v. Cardona, 275 F. Supp. 2d 1357, 1367 (M.D. Fla. 2003).

[83] *See* DirecTV, Inc. v. Treworgy, 373 F.3d 1124 (11th Cir. 2004).

[84] *See* Andy Pasztor, *DirecTV Takes Aim at Illicit Consumers*, WALL ST. J., July 31 2001, at A3.

some tech geeks who had no intention of using smart card devices illegally, and precluded others with lawful purposes from purchasing similar devices. As one defense attorney put it, "the problem that I have is that there are as many people out there getting sued who are not pirating their signal as there are pirates. They're catching a lot of dolphins in that tuna net."[85]

3. Leasecomm's Financing Scheme

In the previous two examples, plaintiffs embarked upon litigation campaigns in order to deter what they genuinely believed to be illegal conduct. Our next example, in contrast, illustrates a different operational pattern. The plaintiff, Leasecomm, has devised fraudulent schemes designed to lure innocent people into taking financial obligations they would later fail to satisfy. Leasecomm then relied on defendants' disincentives to challenge it in court to obtain judgments for substantial amounts—$24 million to be precise—against its victims.[86]

We use this case to make two points. First, that the problem of dispersed defendants might not only overdeter potential defendants, but also under-deter wrongdoers. Second, that plaintiffs can strategically exacerbate the defendant problem by inflating defense costs.

Since 1997, Leasecomm, a Massachusetts based corporation, has provided financing to individuals and small businesses through contracts it termed "leases." The contracts purported to lease items such as point-of-sale credit card swiping machines ("POS machines") and Internet-based, online payment systems ("virtual terminals"). Customers, however, bought these items as part of their purchase of a business opportunity or a profit-making venture. These ventures were often worthless get-rich-quick schemes (e.g. Internet web malls, multilevel marketing programs, and pyramid schemes) that customers were duped into buying by deceptive sellers.

Since the monthly payments under the lease corresponded with the full price of the business venture package, customers were led to believe that they were entering into a financing agreement for the entire business venture. In fact, however, the lease applied only to the POS machine, the virtual terminal, or some other item that was merely an incidental part of the business venture. When they

[85] *See* Poulsen, *supra* note 80.

[86] Our discussion of the Leasecomm affair is based upon the complaint submitted by the FTC and the stipulated final judgment against Leasecomm. Both documents can be found at www.ftc.go/rp/leasecomm (last visited Aug. 18, 2004). *See also* David Ho, *Accused Company Will Cancel Court Judgments: FTC Says Leasecomm Cheated Customers,* WASH. POST, May 30, 2003, at E4.

discovered that the business venture that they had purchased was worthless, customers also realized that they owed Leasecomm $4,000 for the lease of an equipment with a retail value of approximately $400-$500.

Naturally, most defrauded customers defaulted on their lease payments. Leasecomm, however, adopted a very aggressive litigation strategy to secure its revenues: between 1997 and 2000, Leasecomm filed suits against 27,000 customers, and secured $24 million in court judgments. Leasecomm also made sure that defense costs would be prohibitive for most customers: Based on a jurisdiction clause in the lease contract, Leasecomm regularly filed suits in Massachusetts, notwithstanding the fact that most customers resided in other states.

This strategy has rendered defense expenses for customers prohibitively high compared to the relatively low amounts at stake. The vast majority of customers that were sued in Massachusetts neither appeared in court nor defended, thereby allowing Leasecomm to obtain default judgments.[87] Even those who were represented by an attorney could neither justify extensive investment in legal research nor afford witnesses' travel expenses to Massachusetts. Thus, although customers evidently had valid legal arguments and counterclaims, virtually no customer found it economically worthwhile to challenge Leasecomm in court.

This example vividly illustrates the potentially grave consequences of the dispersed defendants' problem. In the Leasecomm case, a wrongdoer carefully designed fraudulent schemes to take advantage of the collective action problem facing numerous defendants. Put differently, in the absence of a device for aggregating defense claims, plaintiffs can enforce unfair and illegal obligations over innocent defendants.

D. Is Failure to Defend Socially Desirable?

So far, we have shown that the case of dispersed defendants generally parallels that of dispersed plaintiffs. One might contend, however, that our analysis has overlooked a crucial difference between plaintiffs and defendants. Failure to sue creates a regime of immunity for wrongdoers; failure to defend, in contrast, creates a regime of no-fault liability that might turn out to be optimal in many cases. Thus, the argument goes, the phenomenon of numerous, dispersed defendants is not necessarily a cause for concern. Rather, it can produce desirable incentives while conserving judicial resources.

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[87] For testimonials by numerous Leasecomm customers, see www.consumeraffairs.com/business/leasecomm.html (last visited August 30, 2004).

In this section, we explain why this argument is misguided. First, we explore the no-fault regime arising when defendants fail to confront plaintiffs. Then, we explain why this regime is likely undesirable.

1. No-Fault Liability

In the case of plaintiffs, the failure to bring suits produces a regime under which wrongdoers are not liable for misconduct. Without liability, wrongdoers have little incentive to refrain from inflicting harm.[88] Thus, it is easy to see how the numerous plaintiffs' scenario undermines the deterrent power of the liability system.

For defendants, however, the dynamics is somewhat different. A regime under which defendants settle is essentially a no-fault regime in the sense that defendants always, regardless of their level of fault, pay damages. The settlement amount normally would not exceed the amount of damages that courts would have imposed had the case been decided in favor of plaintiffs.[89] Put differently, defendants would pay the same amount they would have paid under a regime of strict, or no-fault, liability.

This insight casts doubts on the extent to which the phenomenon of dispersed defendants raises over-deterrence concerns. After all, legal economists have shown that strict liability provides defendants with incentives to take adequate precaution.[90] Moreover, the accepted wisdom among law-and-economics scholars is that strict liability tends to be superior to other forms of liability because it induces defendants to adopt optimal activity levels,[91] and is administratively cheaper to apply than negligence or fault-based liability.[92] If strict liability is indeed optimal, so the argument goes, the no-fault regime

[88] *See supra* note 28.

[89] Defendants would not agree to any settlement amount that exceeds the expected damages award (assuming this is what the courts will make them pay if they fail to defend). If the settlement offer is too high, defendants would simply fail to appear in court and have the court set the amount of damages. For general models analyzing settlement decisions, see Robert D. Cooter & Daniel L. Rubinfeld, *Economic Analysis of Legal Disputes and Their Resolution,* 27 J. ECON. LIT. 1087 (1989); Steven Shavell, *Suit, Settlement, and Trial: A Theoretical Analysis under Alternative Methods for Allocating Legal Costs,* 11 J. LEGAL STUD. 55 (1982).

[90] *See, e.g.,* STEVEN SHAVELL, ECONOMIC ANALYSIS OF ACCIDENT LAW 6-7 (1987).

[91] *See* Shavell, *supra* note 25, at 2-3; Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes,* 72 N.Y.U. L. REV. 687 (1997).

[92] This is because under strict liability courts do not need to determine the adequate standard of care nor verify whether the defendant satisfied that standard. *See, e.g.,* Richard A. Epstein, *A Theory of Strict Liability*, 2 J. LEG. STUD. 151, 188 (1973) (under strict liability, "there is no need to ask the hard question of which branch of government is best able to make cost-benefit determinations, because the matter is left in private hands").

imposed on dispersed defendants should be considered desirable as well.

To illustrate the logic underlying this argument, let us return to the file-sharing example. Lacking incentives to defend, file swappers will essentially face a regime of no-fault liability for copyright infringement. But this, the argument goes, is consistent with the current regime of strict liability for copyright infringement.[93] Put differently, the absence of a device for aggregating defense claims arguably has no adverse implications in the file-sharing context.

In the remainder of this section, we argue that the de-facto regime of no-fault liability that governs numerous, dispersed defendants is often undesirable even when, as a matter of principle, strict liability is optimal.

2. The Value of Adjudication

The claim that the phenomenon of numerous defendants poses no risks implicitly assumes that having courts adjudicate disputes involving such defendants is unnecessary—*i.e.*, that all defendants are guilty anyway. This premise, however, is clearly incorrect.

We will begin with the assumption that strict liability is indeed optimal for a particular misconduct. A strict-liability regime, however, often requires courts to address preliminary questions of fact or law. Even those who find strict liability to be optimal would agree that holding defendants liable without resolving such questions would be undesirable.[94]

First, courts need to resolve causation and damages issues. Courts must determine that it is the defendant who has caused the harm alleged by the plaintiff; they also need to specify the magnitude of the harm that the defendant's actions caused.[95] Moreover, in the absence of a fair trial, there would be an omnipresent risk of false accusations and other errors.

Consider again the file-sharing example. For our purposes, we can assume that strict liability is the optimal standard for copyright

[93] *See* Lipton v. Nature Co., 71 F.3d 464 (2d Cir. 1995); 4 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 13.08 at 13-204 (2003) (good-faith mistakes and ignorance do not constitute a defense to a finding of direct infringement, though they might affect remedies). *See also* Dane S. Ciolino & Erin A. Donelon, *Questioning Strict Liability in Copyright*, 54 RUTGERS L. REV. 351 (2002) (arguing that strict liability is neither justified nor necessary in copyright law).

[94] *See generally* Louis Kaplow & Steven Shavell, *Accuracy in the Determination of Liability*, 37 J. L. & ECON 1 (1994) (exploring the deterrence implications of errors in imposing liability).

[95] *See* Louis Kaplow & Steven Shavell, *Accuracy in the Assessment of Damages*, 39 J. L. & ECON 191 (1996).

infringement. This, however, does not imply that there is no value to having a trial. Rather, courts need to resolve basic questions of fact—such as whether the defendant downloaded copyrighted music files, and whether the plaintiff is the lawful copyright owner. Indeed, several lawsuits filed by the music industry turned out to address the wrong person.[96] Likewise, in order to determine the proper amount of damages, courts will need to determine the number of files that the defendant had downloaded.

Courts may also face questions of law under strict liability. In the DirecTV example, even if signal piracy itself is indisputably illegal, courts have to interpret the relevant statute to determine whether the mere purchase of signal unscrambling devices is unlawful.[97] If all purchasers agree to settle, however, courts will lack the opportunity to address this question, thereby failing to provide guidance to all those who might consider purchasing a smart card device.

The defendant problem may also raise over-deterrence concerns when it effectively turns a desirable fault-based regime into a non-desirable no-fault regime.

Even from a law-and-economics perspective, there may be cases in which strict liability is not optimal. This generally will be the case when there are externalities involved.[98] Potential defendants often engage in activities that confer benefits upon third parties who do not pay potential defendants for such benefits. In such cases, strict liability will make defendants internalize the costs of their conduct, but not its benefits.[99] Strict liability will thus have a chilling effect on defendants' activity. A fault-based regime, in contrast, can be calibrated so as to motivate potential defendants to act optimally even when they cannot capture full value of their activity.

The most prominent example is liability for harmful speech.[100]

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[96] *See, e.g.,* John Schwartz, *She Says She's No Music Pirate. No Snoop Fan Either,* N. Y. TIMES, Sept. 25, 2003, at C1 (reporting the dismissal of a suit that was filed by the RIAA against the wrong person).

[97] *See supra* text accompanying notes 81-83.

[98] *See generally* Keith N. Hylton, *A Missing Markets Theory Of Tort Law*, 90 NW. U.L. REV. 977 (1996). Strict liability may turn out to be suboptimal for other reasons as well. *See, e.g.,* Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. LEGAL STUD. 833 (1994) (showing that strict corporate liability might distort compliance incentives).

[99] For examples, see Neal K. Katyal, *Criminal Law in Cyberspace,* 149 U. PA. L. REV. 1003, 1095-1101 (2001) (addressing network externalities associated with ISP liability); Hamdani, *Who's Liable*, *supra* note 5 (exploring externalities associated with imposing strict liability on third parties).

[100] *See* Oren Bar-Gill & Assaf Hamdani, *Optimal Liability for Libel*, CONTRIBUTIONS TO ECONOMIC ANALYSIS & POLICY: Vol. 2: No. 1, Article 6 (2003), *at* http://www.bepress.com/bejeap/contributions/vol2/iss1/art6 (last visited August 31, 2004).

Courts have consistently held that strict liability for harmful speech may create an undesirable chilling effect.[101] The economic explanation is that speech is a public good, *i.e*., that speakers do not capture the full social value of their speech. Hence, if speakers pay for all the harm they cause, they might be overly cautious in exercising their right to speak

Music file-sharing illustrates this concern as well. An important question that underlies a certain subset of the file-swapping cases is whether the conduct of the defendants falls within the fair use defense to copyright infringement.[102] A key justification for the fair use doctrine is that users of a copyrighted work may be unable to pay the price of permission if they cannot charge for the public benefit that they produce.[103] Yet, if file swappers always prefer settlement to litigation, they would have to pay the music industry even if they are entitled to the fair use defense, thereby rendering this valuable defense inapplicable.

To conclude, there are many cases in which the deterrent goal of the legal system will be undermined if individual defendants are not allowed to aggregate their cases. This section showed that the defendant problem is a source of concern notwithstanding the conventional economic wisdom that strict liability is optimal. Even if strict liability is optimal in a given context, it does not follow that the dispersed defendants' problem could be safely disregarded.

Legal scholarship has thus far overlooked the difficulties associated with the case of numerous, similarly positioned defendants. In this Part, we have shown that the case in which a single plaintiff brings separate suits against a dispersed group of individuals creates an imbalance that resembles the symmetric case of numerous plaintiffs holding small claims against a single defendant. This litigation imbalance might have significant implication for the extent to which the liability system produces the desirable level of deterrence. In the reminder of this Article, we explore potential remedies to this problem.

III. THE CLASS DEFENSE SOLUTION

Part II has shown that dispersed defendants acting individually might face suboptimal litigation incentives. In this Part, we put forward a tentative proposal for rectifying this problem. We show that allowing defendants to consolidate their claims would likely

[101] *See* New York Times v. Sullivan, 376 U.S. 254 (1964).
[102] *See* text accompanying notes 66-67 *supra.*
[103] See Wendy Gordon, *Fair Use as Market Failure: A Structural and Economic Analysis of the Betamax Case and Its Predecessors*, 82 COLUM. L. REV. 1600, 1630-1631 (1982).

solve the defendant problem—it would allow defendants to enjoy scale efficiencies, thereby rendering their expected value from litigation positive. In the plaintiff context, the doctrinal vehicle for aggregating claims is the class action. In this Part, we propose to adopt a parallel device, which we shall label the *class defense* mechanism.

Our analysis in this Part has three objectives: first, to demonstrate that aggregating defense claims can eliminate the problem; second, to establish the class defense as an effective and fair mechanism for consolidating defense claim; and finally, to provide a tentative outline of the key features of the class defense procedure.

Turning class defenses into a workable alternative requires the resolution of many thorny issues, such as personal jurisdiction, for example. We have no intention of providing here a detailed blueprint of class defenses. Rather, our objective is merely to highlight the novel difficulties that might confront this mechanism and point out tentative solutions.

Before proceeding, we would like to emphasize that the procedure we propose should not be confused with the existing procedure known as the *defendant class action*.[104] Although similar in name, the two mechanisms serve entirely different goals. The paradigmatic setting for defendant class actions is one where a plaintiff seeks adjudication of claims consisting of common questions of law or fact against a class of defendants.[105] In this setting, it is the plaintiff who names the representative defendant and motions the court to certify the lawsuit as a class action.[106] As far as we know, there has been no case in which a defendant requested that she be certified as a representative of a class of defendants.[107]

The defendant class action has thus served plaintiffs rather than defendants. The purpose of the class defense, in contrast, is to protect defendants. As we shall explain, it is a defendant-initiated procedure designed to balance defendants' litigation position vis-à-vis a single plaintiff.

This Part proceeds as follows. Section A introduces the conceptual framework for the class defense mechanism. Section B examines incentive problems. Section C discusses due process

[104] Federal Rules of Civil Procedure (FRCP) Rule 23, reads "One or more members of a class may sue or *be sued* as representative parties…"

[105] For the history of the defendant class action, see Note, *Certification of Defendant Classes under Rule 23(b)(2)*, 84 COLUM. L. REV. 1371, 1380-1383 (1984); Yeazell, *supra* note 17.

[106] One commentator has defined the defendant class action as a procedural device in which a group finds itself involved in representative litigation at the instance of its opponent. See Yeazell, *supra* note 17, at 700.

[107] *See* Note, *Defendant Class Actions*, 91 HARV. L. REV. 630, fn. 3 (1978).

concerns. Section D analyzes the risk of collusion in class defense cases. Section E concludes by outlining the main procedural features of the class defense.

A. Consolidation, Scale Economies, and Marketability

Allowing defendants to consolidate their claims will encourage them to stand up to plaintiffs in court.[108] We believe that aggregation is best achieved by employing the class defense device. We shall elaborate on the mechanics of the class defense below. At this stage, however, it would suffice to mention that the class defense is designed for aggregating defense claims. Aggregation, in turn, offers defendants three related advantages: first, it allows defendants to exploit economies of scale; second, it overcomes the collective action problem that prevents defendants from cooperating; and third, it renders their defense marketable for lawyers.

Class defenses overcome disincentives to confront lawsuits by allowing dispersed defendants to exploit economies of scale otherwise available only to the plaintiff.[109] To illustrate, consider the following scenario, which is a highly simplified version of the signal piracy case. Assume that DirecTV files 10,000 lawsuits against smart card holders. DirecTV offers each defendant to settle for $3,500; for each defendant, the cost of mounting a decent defense is $100,000. For simplicity, assume that holding a smart card is perfectly legal. Acting

[108] Our analysis in this section draws upon the insights of the literature addressing class actions. For a general overview of the advantages and disadvantages of aggregation in class actions, see Dam, *supra* note 13; Geoffrey Miller, *Class Actions*, in PETER NEWMAN, (ED.), THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW Vol.1 pp.257-258 (1998); Charles Silver, *Class Actions–Representative Proceedings*, in B. BOUCKAERT AND G, DE GEEST (EDS.), ENCYCLOPEDIA OF LAW AND ECONOMICS 194, 201-209 (1999).

[109] For analyses of the economies of scale available to defendants in class actions, see David Rosenberg, *The Causal Connection in Mass Exposure Cases: A "Public Law" Vision of the Tort System*, 97 HARV. L. REV. 851, 902-905 (1984) (defendants can generally exploit "private law" process to achieve many of the economies of scale afforded by aggregative procedure) (hereinafter "Rosenberg, *Public Law Vision*"); David Rosenberg, *Class Actions for Mass Torts: Doing Individual Justice by Collective Means*, 62 IND. L.J. 561, 564-65 (1987) (calling for expanding the use of class actions in mass tort cases, where defendants can spread their litigation cost over the entire class of claims while individual plaintiffs cannot); David Rosenberg, *Mass Tort Class Actions: What Defendants Have and Plaintiffs Don't,* 37 HARV. J. ON LEGIS.393, 397-400 (2000) ("aggregating the classable claims arising from a mass tort event enables litigants to exploit economies of scale by investing once-and-for-all in the common questions and spreading the cost of the investment across all claims"); Bruce L. Hay and David Rosenberg, *"Sweetheart" And "Blackmail" Settlements in Class Actions: Reality and Remedy,* 75 NOTRE DAME L. REV. 1377, 1383-1389 (2000) (arguing that when claims are litigated separately, the plaintiffs are overburdened by litigation costs, leading to an artificially strengthened defendant's position).

individually, however, each defendant would naturally prefer to settle.

Now assume that defendants can consolidate their claims and face DirecTV in court as a cohesive group. Will the defendant group choose to litigate? Consolidation does not always ensure that the defendant group will vigorously defend against meritless lawsuits. Rather, consolidation will encourage defendants to litigate only when it reduces the cost-per-defendant of mounting a defense.

In the DirecTV lawsuits, the principal issue at stake is whether the mere purchase of a smart card device is illegal.[110] The cost of researching and litigating this issue is unlikely to increase significantly with the number of defendants. For example, assume that the cost for the entire defendant class of vigorously litigating this issue remains $100,000. Under this assumption, the defendant group will clearly find it worthwhile to defend.[111] Assuming that each defendant bears equally the cost of defense, the expected value of litigation is now $2,500, as defendants would bear $1,000 litigation costs to save the $3,500 settlements. In fact, if DirecTV knows it is bound to lose against the class defense, it would not pursue litigation to begin with.

Technically, therefore, consolidation overcomes disincentives to defend by allowing defendants to exploit economies of scale.[112] Consolidation also creates some balance between the plaintiffs and defendants. Plaintiffs typically enjoy economies of scale because they can spread litigation costs over their entire defendant pool. The plaintiffs in all our featured examples—Leasecomm, DirecTV and the RIAA—filed boilerplate lawsuits and thus did not incur significant costs for adding an additional person to their defendant list. The class defense will allow members of the dispersed defendant group to exploit similar scale advantages.

Sheer consolidation, however, can also fail to resolve the dispersed defendants' problem. Although the consolidated defense has a positive expected value, its benefits are public goods: all members of the defendant class share them, they are non-excludable (no member can be prevented from enjoying them), and their use is non-rivalrous (enjoyment of the benefits by one member does not diminish the possible utility of the defense for others).[113] Like in any

[110] *See supra* text accompanying notes 81-83.

[111] In contrast, if consolidating claims has no impact on the per-defendant cost of defense, then acting as a group will not enhance incentives to defend. In the DirecTV example, if the cost per-plaintiff remains at $100,000 regardless of group size, then the aggregate cost will be $1 million whereas the expected benefit will be $350,000.

[112] This point is also made, although less elaborately, in Hsieh, *supra* note 10, at 692-693.

[113] Economists define public goods as goods that are non-excludable and non-

other case of public goods, it is therefore unlikely that all individual defendants would cooperate and agree to act as a group. Instead, each member of the putative defendant group would have an incentive to enjoy the benefit of aggregation without contributing effort and money.

The consolidation mechanism must therefore overcome this free riding problem.[114] The class defense will achieve this goal by adopting a representational approach under which there is no requirement that all members of the class actively consent to their inclusion in the defendant group.[115]

Finally, the class defense also renders the representation of defendants more attractive for potential attorneys. When a suit, or a defense claim, has a negative expected value, it is unlikely that private attorneys will agree to undertake representation.[116] Consolidation makes defense claims more marketable for lawyers by turning a single defense claim with a negative expected value into a pool of claims with positive expected value, thereby increasing the expected gain for attorneys undertaking class representation. This is important given the prevalence of the private-attorney general paradigm—i.e., the conventional assumption that private lawyers in pursuit of private gain are those who initiate class proceedings that serve the public interest.[117]

B. Incentives

As the experience with respect to class actions shows, class

depletable. *See, e.g.,* ANDREW MAS-COLELL ET. AL, MICROECONOMIC THEORY 359-260 (1995); Joseph E. Stiglitz, ECONOMICS OF THE PUBLIC SECTOR (3rd. ed.) 79-80 (1999).

[114] A free riding problem may be characterized as a situation where an action that would best serve the goals of all group members would be against the private interest of any group member who is supposed to perform it. On the free-riding problem within large groups, see OLSON, *supra* note 1, at 9-16.

[115] For a discussion of the competing models of class actions—the joinder model and the representational model, see Diane P. Wood, *Class Actions: Joinder or Representational Device*?, 1983 SUP. CT. REV. 459 (1983) (arguing that the representational model is superior to the joinder model). This also explain why our solution is superior to the joinder mechanism that was recently proposed as a solution to the problem in the patent context. *See* Hsieh, *supra* note 10, at 692-693 (advocating the use of a mandatory joinder). Moreover, a mandatory joinder device grants too much power to plaintiffs and leaves no room for initiative by class attorneys.

[116] See Rosenberg, *Public Law Vision*, *supra* note 109, at 889-892 (contending that a claim cannot gain access to the court system unless it is marketable to plaintiff attorneys).

[117] We discuss in detail the mechanism for providing class defense attorneys with adequate incentives in the next section.

attorneys will play a key role in the class defense arena:[118] it is class attorneys who will identify potential lawsuits where they could seek class certification. To fulfill this important role, however, class attorneys must be provided with appropriate incentives.[119] The principal vehicle for incentivizing class attorneys is their fee.[120] As we explain in this section, providing class defense attorneys with sufficient incentives might be too costly under the current legal landscape. This, however, does not imply that class defenses are not a viable alternative. Rather, as we shall argue, the solution will have to be a more liberal use of fee-shifting arrangements.

1. Common Fund

Unlike attorneys in ordinary litigation, class attorneys have no clients that hire them, monitor their litigation and settlement decisions, and pay their fees. Although courts may (to some extent) take the client role in performing the first two tasks,[121] the conventional wisdom is that class attorney fees should be designed so as to provide them with appropriate incentives.[122] Thus, for the class defense mechanism to function properly, it is important to identify a source for class attorney fees.

Clearly, there is no practicable way for attorneys to collect their fees directly from each class member. Requiring class attorneys to collect their fees from class members will diminish their incentive to pursue class litigation. In class actions, there are two main sources for class attorney fees: the common fund doctrine and fee shifting. As we shall immediately explain, only the fee-shifting method is workable in the class defense context.

Under the common fund doctrine, a class attorney who creates,

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[118] *See* Macey & Miller, *supra* note 15, at 3 (positing that plaintiff attorneys function essentially as entrepreneurs who bear a substantial amount of the litigation risk and exercise nearly plenary control over all important decisions in the lawsuit).

[119] *See* John C. Coffee Jr., *Rescuing the Private Attorney General: Why The Model of the Lawyers as Bounty Hunters Is Not Working,* 42 MD. L. REV. 215 (1982) (arguing that the incentives provided to class attorneys are both inadequate and counterproductive in terms of the social interests which private enforcement of law is intended to serve); Coffee, *supra* note 15 (explaining the behavior of plaintiff attorneys who specialize in class and derivative litigation in terms of the incentives and organizational problems that they currently face).

[120] *See also* Bebchuk, *supra* note 19, at 894-95 (arguing that the need to provide class attorneys with sufficient fees is inconsistent with auctioning the role of class counsel).

[121] See Rule 23(c)(certification of a class action and appointment of the class attorney); Rule 23(d) (monitoring of litigation); and Rule 23(e) (consideration of settlement, voluntary dismissal or compromise).

[122] A proper fee structure should seek better alignment of the interests of the class and the attorney and motivate the attorney to file and litigate the class action. For a detailed analysis, see Klement & Neeman, *supra* note 19.

increases, or preserves a monetary benefit that extends to all members of the class is entitled to reimbursements for her costs and a reasonable fee.[123] The class attorney thus receives a contingent fee based upon a share of the common fund recovered at trial or in a settlement.[124] If the defendant wins, the class attorney receives nothing; if the class prevails or if the parties settle, the attorney receives a fee that is designed to compensate her for both her costs and the risk of non-payment in case the class loses.[125] The common fund doctrine serves not only the equitable goal of avoiding unjust enrichment by class members ex-post, but also the objective of providing class attorneys incentives to pursue the class action *ex-ante*.[126]

In class actions, collection of attorney fees is rather simple. The attorney is entitled to a fee only once a common fund is created. The fee in turn is paid by the defendant and deducted out of this fund. The

[123] See ALBA CONTE, 1 ATTORNEY FEE AWARDS (2nd ed. 1993) §2.1; MARY FRANCIS DERFNER & ARTHUR D. WOLF, 1 COURT AWARDED ATTORNEY FEES §2.02[1] (2003); COURT AWARDED ATTORNEY FEES: REPORT OF THE THIRD CIRCUIT TASK FORCE, 108 F.R.D. 237, 241 (1986). The common fund doctrine is an equitable doctrine, whose main objective was to prevent an unjust situation where class members would enjoy an uncontracted-for benefit conferred by class representatives and their lawyers, without being obliged to pay their reasonable fees and expenses. *See* Central Railroad & Banking v. Pettus, 113 U.S. 116, 126-127 (1884).

[124] The contingent fee may take one of two possible forms: a percentage fee or a 'lodestar' hourly contingent fee. For a review and comparison of these two methods, see CONTE, *id.* at §§2.02-2.07; DERFNER & WOLF, ***id.*** at §15.01; THIRD CIRCUIT TASK FORCE, ***id.*** at 242-246; MANUAL FOR COMPLEX LITIGATION FOURTH §14.1 (2004); ALAN HIRSCH & DIANE SHEEHEY, AWARDING ATTORNEYS' FEES AND MANAGING FEE LITIGATION 63-71 (1994). For an empirical examination of the two methods, see William J. Link, *The Courts and the Market: An Economic Analysis of Contingent Fees in Class-Action Litigation*, 19 J. LEGAL STUD. 247 (1990); William J. Link, *The Courts and the Plaintiffs' Bar: Awarding the Attorney's Fee in Class Action Litigation*, 23 J. LEGAL STUD. 185 (1994).

[125] See Janet Cooper Alexander, *Contingent Fees and Class* Actions, 47 DEPAUL L. REV. 347, 349-350 (1998) (finding the "no win no pay" principle and the proportionality of the fee to recovery to be the two main characteristics of class action attorney fees). The Supreme Court held in *City of Burlington v. Dague*, 505 U.S 557, 562-567 (1992) that no risk enhancement should be allowed in statutory fee shifting cases. Views about application of this holding to common fund cases differ. *See, for example,* Berg v. Gackenbach (In re Bolar), 800 F. Supp. 1091, 1095-1096 (E.D.N.Y. 1992) (the application of *Dague*'s holding to common fund cases would not defeat the purpose of the equitable fund doctrine); Goldberger v. Integrated Res., 209 F. 3d 43, 52-55 (2d Cir. 2000) (allowing, in principle, for a contingency multiplier in common fund class actions); Florin v. Nationsbank of Georgia, 34 F. 3d 560 (7th Cir. 1994) (same); In re Washington Public Power Supply, 19 F. 3d. 1291 (9th Cir. 1994) (same).

[126] For an analysis of the two objectives of attorney fee awards in class actions, see Charles Silver, *A Restitutionary Theory of Attorney's Fees in Class Actions*, 76 CORNELL L. REV. 656 (1991).

common fund doctrine, however, is likely unworkable in the class defense context due to collection problems.

Consider the case of class victory. By removing the threat of liability, the class attorney confers a monetary benefit upon all members of the defendant class. Thus, there is no innate reason for preventing the class attorney from sharing in this benefit under the common fund doctrine.[127] The problem is, however, that there is no money changing hands in this case. Rather, the fund created by the class attorney is the amount *not paid* by defendants. Thus, applying the common fund doctrine will require class attorneys to collect their fees from each defendant. As we explained above, however, this requirement is impractical.

In theory, the problem is less acute if the plaintiff obtains partial victory and moves to collect damages from class members. In such a case, the class attorney's fee may be collected at the same time that the plaintiff collects from defendants, making collection less costly. Still, this would make the defense attorney's fee contingent upon the plaintiff's recovery. This will not only create severe conflict-of-interest problems, but also result in a relatively complex collection procedure.

This nature of the benefit produced by the class defense attorney thus practically precludes the common fund doctrine from applying to class defenses.

2. Fee Shifting

Since the common fund doctrine is impracticable, we propose to incentivize class attorneys with a one-sided fee-shifting rule. Under this rule, the plaintiff will pay the fees of the defendant class attorney when the class prevails at trial or the parties settle. If the class loses, on the other hand, the plaintiff will not be entitled to recover its attorney fees.

The regime we propose would mark a departure from the principle underlying U.S. civil procedure. Under the general "American Rule," each litigant bears her own legal costs regardless of the trial's outcome.[128] The "English Rule," in contrast, requires the losing party to bear the legal costs of the prevailing party. There has been an ongoing debate concerning which rule is more efficient, how

[127] The common fund doctrine was extended to allow for attorney fee awards even when no fund was created. *See* Sprague v. Ticonic Nat'l Bank, 303 U.S. 161, 166-167 (1938) (allowing counsel fees although the common benefit was created through stare decisis, in an individual proceeding); CONTE, *supra* note 123, at §2.01.

[128] *See* Alyeska Pipeline Co. v. Wilderness Soc'y, 421 U.S. 240, 247 (1975) (stating that "[i]n the United States, the prevailing litigant is ordinarily not entitled to collect a reasonable attorneys' fee from the loser").

each rule affects the rate of filing and settlements, and which rule facilitates better access to justice.[129] Generally speaking, no definite conclusions have been materialized.[130] Whatever rule turns out to be generally superior, it is clear for our purposes that a fee-shifting rule is necessary for providing class attorneys with adequate incentives.

Moreover, although adopting it would probably require explicit Congressional authorization,[131] the one-sided fee-shifting rule is not a newcomer to the class litigation arena. In context of attorney fees, class defenses are analogous to non-monetary class actions, such as class actions seeking injunctive or declaratory relief.[132] In these types of class actions the class attorney renders a valuable service to the class. The class benefit, however, does not take the form of a tangible monetary fund. Thus, like in the class defense case, the common fund doctrine is impractical with respect to non-monetary class actions.

To overcome this problem, injunctive and declaratory relief class actions often deploy a one-sided fee-shifting rule to compensate class attorneys. Such a rule is indeed practiced under explicit congressional authorization in over 150 fee-shifting statutes that span actions in antitrust, environmental protection, civil rights and many other types of claims.[133]

This analogy to nonpecuniary class actions is helpful on another matter as well. Class attorney fees are based upon the benefit that the attorney produces for the class. In monetary class actions, measuring that benefit is a straightforward task: it equals the amount of the damages paid to the class. In class defense cases, in contrast, a court wishing to measure this benefit will have to determine the extent to

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[129] At least two symposia address the topic of attorney fee shifting. *See Symposium on Fee Shifting*, 71 CHI.-KENT L. REV. 415 (1995); and *Symposium: Attorney Fee Shifting* 47 LAW & CONTEMP. PROBS. 1 (1984). For a review of the literature comparing the English and the American fee shifting rules, see Avery W. Katz, *Indemnity of Legal Fees*, in B. BOUCKAERT AND G, DE GEEST (EDS.) ENCYCLOPEDIA OF LAW AND ECONOMICS 63 (1999).

[130] *See* James W. Hughes & Edward A. Snyder, *Allocation of Litigation Costs: American and English Rules*, in PETER NEWMAN, (ED.), THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW, Vol. 1, 55 (1998) ("The theory of the English rule does not produce unambiguous predictions about its effect on claim disposition").

[131] *See* Alyeska Pipeline Co. v. Wilderness Soc'y, 421 U.S. 240, 247–57 (1975) (rejecting a general "private attorney general" theory that would allow courts to shift a prevailing party's fees to the losing party absent specific statutory authorization).

[132] Monetary class actions are usually filed under FRCP Rule 23(b)(1) or 23(b)(3). Injunctive and declaratory relief class actions, on the other hand, fit under Rule 23(b)(2). *See* ALBA CONTE & HERBERT B. NEWBERG, NEWBERG ON CLASS ACTIONS §4.11 (4th ed.).

[133] *See* MANUAL FOR COMPLEX LITIGATION FOURTH §4.11 (2004). For a list of these statutes see CONTE, *supra* note 123, at §28.1.

which the attorney work has relieved members of the class of their liability. In other words, courts will have to rely on rough estimates, comparing actual liability with the hypothetical liability that would have been imposed had the attorney not represented the class (or had the class not been certified). This is undoubtedly a complicated task compared to the simple measure of class benefit in class actions.

Valuation issues, however, often arise even in the class action setting. When the class recovery is nonpecuniary, the defendant provides class members some benefit other than cash payment.[134] This benefit may take the form of a discount on future purchases, periodic medical examinations and monitoring, or a distribution of stocks and options. Valuing the benefit that class members derive from a settlement of this type is inevitably problematic.[135] Still, class actions ending in non-pecuniary settlements are common.[136] Courts do find it possible to estimate their value—both to decide whether the settlement is fair, reasonable and adequate,[137] and to award attorney fees.[138] There seems to be no reason why courts would not be able to undertake the same task in class defense cases.

3. Public Interest Organizations

So far, we have assumed that private attorneys motivated by the prospect of private gain will be the sole driving force behind the class defense device.[139] We have thus focused on the necessary reforms for making the class defense compatible with this private attorney general framework.

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[134] For a comprehensive discussion of these settlements, see Geoffrey P. Miller & Lori S. Singer, *Nonpecuniary Class Action Settlements*, 60 LAW & CONTEMP. PROBS. 97 (1997).

[135] *See* Miller & Singer, *id.* at 107-112 (showing how plaintiff attorneys and defense counsel can manipulate a nonpecuniary settlement in order to unrealistically inflate its valuation); Christopher R. Leslie, *A Market Based Approach to Coupon Settlements in Antitrust and Consumer Class Action Litigation*, 49 UCLA L. REV. 991, 1050-1051 (2001) (showing why coupon settlements are difficult to evaluate, thus allowing class attorneys to increase their net contingency fee); Roberta Romano, *The Shareholder Suit: Litigation without Foundation,* 7 J. L. ECON. & ORG. 55, 61 (1991) (noting that nonpecuniary settlements present severe valuation difficulties).

[136] See Miller & Singer, *supra* note 134, at 134 Table 4 (Finding that in a sample of 127 class action settlement notices published in the *New York Times* between January 1993 and September 1997, about 20% were non-pecuniary settlements).

[137] Rule 23(e).

[138] Rule 23(h).

[139] A good illustration of the fundamental role of the private-gain-for-public-good paradigm in class actions is the title of RAND's Institute of Civil Justice empirical research: "Class Action Dilemmas: Pursuing Public Goals for Private Gain." *See* DEBORAH R. HENSLER ET. AL., CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAIN (2000).

But this market-based model does not capture all the actors in the class litigation arena. In many cases, the plaintiff class is represented by a public-interest organization. This is often the case with respect to civil rights class litigation, and certain consumer and tort class actions.[140] To some extent, these organizations rely on fee-shifting statutes for their funding.[141] But they also have other sources of income. Thus, public-interest organizations might litigate class actions even when they are not fully reimbursed for their costs.

Assuming that the public interest of such groups overlaps with the interest of members of the defendant class, these groups might offer a complementary mechanism for initiating the class defense device. To be sure, such public interest groups might assist individual defendants even in the absence of a mechanism for aggregating defense claims. In the file-sharing example, the Electronic Frontier Foundation ("EFF") has assisted several defendants in challenging the music industry through various stages of litigation.[142] The EFF has also set up a designated web site to assist defendants sued by DirecTV.[143] Although such activism exists even under the current rules that do not support defendant aggregation, it is clear that the class defense mechanism would provide such organizations with the financial means for assisting defendants more effectively.

C. Due Process

Class litigation is an exception to the fundamental principle that one cannot be bound *in personam* to a judgment rendered in a litigation to which she was not a party.[144] The Supreme Court held that a judgment rendered in a class action constitutes *res judicata* with respect to absentee class members only if the procedure fairly ensures the protection of their interests, and that the class action must guarantee all class members "adequate representation" if it is to satisfy Article Fourteen due process requirements.[145]

Both the class action and the class defense advance the important social goals of efficiency and justice; and both include mechanisms for ensuring the adequacy of representation. Thus, there is no

[140] See Hensler et. al., *id.* at 71 (noting that organizations such as the American Civil Liberties Union, NAACP and National Organization for Women bring class actions, yet often lack sufficient resources to engage in extensive class action litigation).
[141] For a discussion of fee sharing between public interest groups and their lawyers in fee-shifting class actions, see Roy D. Simon Jr., *Fee Sharing Between Lawyers and Public Interest Groups*, 98 YALE L. J. 1069 (1989).
[142] For a list of cases, see www.eff.org/share (last visited August 30, 2004).
[143] *See* www.directvdfense.org (last visited August 30, 2004).
[144] *See* Hansberry v. Lee 311 U.S. 32, 41 (1940).
[145] *Id*. at 42-43. For a comprehensive analysis of the adequate representation concept, see Nagareda, *supra* note 21.

apparent reason for distinguishing between the due process implications of the two devices.

Nevertheless, one might argue that the strain on due process under the class defense is significantly heavier than under the class action. In this section, we present—and dismiss—three such challenges to consolidating defense claims. First, we discuss the argument that the due process rights of defendants deserve greater protection than that afforded to plaintiffs. Then, we consider the due process concerns of future defendants. Finally, we discuss the impact of the class defense on plaintiff rights.

1. Comparing Plaintiffs and Defendants

The first potential due-process critique is that the stakes of plaintiffs and defendants are qualitatively different. Class action plaintiffs, so the argument may go, merely risk losing their prospect of receiving some hypothetical benefit. Members of the defendant class, on the other hand, face the risk of bearing significant out-of-pocket expenses if the class loses. Thus, allowing defendants to be bound by the outcome of the class defense is inconsistent with due process principles.

Notwithstanding its intuitive appeal, we believe this objection to be misguided on economic, psychological, and doctrinal grounds.

On purely economic grounds, the attempt to distinguish between plaintiffs and defendants is clearly unjustified. Economically, the position of a victim who has a claim against a wrongdoer for $100 is no different from the position of a defendant who allegedly owes $100 to the plaintiff.[146] In both cases, losing at trial would cause a damage of $100. In other words, the defendant's out-of-pocket cost is economically equivalent to the plaintiff's opportunity cost.[147]

One might argue, however, that this narrow economic perspective overlooks the established body of psychological studies showing that people view gains and losses differently. Specifically, individuals tend to value losses more heavily than gains of the same

[146] *See* Wood, *supra* note 115, at 505-506 (arguing that, for due process purposes, there is no difference between defendant and plaintiff class members as long as courts ensure adequacy of representation).

[147] One may claim that gain and loss should be treated differently due to wealth effects—i.e., the phenomenon of decreasing marginal utility from wealth. This claim should be rejected, however, for two reasons. First, since the gains and losses we discuss are small, wealth effects are likely to be negligible. *See* Robert D. Willig, *Consumer Surplus without Apology*, 66 AM. ECON. REV. 589 (1976) (showing that the difference between an individual's maximum willingness to pay for a good and minimum compensation demanded for the same entitlement is negligible). Second, this reasoning is incompatible with common understanding of procedural due process rights, which do not depend on an individual's wealth.

magnitude.[148] Under this argument, since the class defense creates a risk of loss for defendants, defendants should be entitled to broader due process protections.

Even if individuals view gains and losses from litigation differently, it is not clear what are the policy implications that should be drawn in the class defense context.[149] For example, if losses indeed loom large then the more likely are dispersed defendants to settle (like in the examples of DirecTV and Leasecomm), the more justified will be a class defense that will allow them the opportunity to avoid this loss.[150]

Moreover, the psychological studies that establish peoples' different attitudes toward gain and loss also indicate that peoples' preferences may vary based upon reference points and the manner of framing the relevant choices.[151] In our context, defendants whose reference point is the virtually certain loss in individual litigation may perceive the class defense option as an opportunity for gain. Similarly, plaintiffs who had to finance their losses through debt may perceive their inability to individually pursue litigation as a certain loss.[152] Indeed, there seems to be no difference between a mass tort plaintiff that owes thousands of dollars on medical bills but is unable to recover his costs from an alleged tortfeasor and a defendant charged the same costs as a result of an unsuccessful class defense proceeding.[153] Like the plaintiff, the defendant has a standing debt he must pay out of his own resources as a consequence of the class losing at trial.

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[148] *See* Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263, 279 (1979) ("The aggravation that one experiences in losing a sum of money appears to be greater than the pleasure associated with gaining the same amount"). The technical term for this phenomenon is *loss aversion*. It is related to another phenomenon known as the *endowment effect*. *See* Daniel Kahneman et. al., *The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5 J. ECON. PERSP. 193, 194 (1991).

[149] See Russell Korobkin, *The Endowment Effect and Legal Analysis*, 97 NW. U. L. REV. 1227, 1230 (2003) (positing that applying the endowment effect to legal policy questions requires care and nuance).

[150] Loss aversion also implies that individuals prefer probabilistic large losses to certain small losses. *See* Kahneman & Tversky, *supra* note 148, at 278. This, in turn, implies class defense certification is justified only when the probability of being sued is sufficiently high. *See* Part III.E *infra*.

[151] *See* Daniel Kahneman & Amos Tversky, *Choices, Values and Frames*, 39 AMERICAN PSYCHOLOGIST 341, 343-344 (1984).

[152] *See* Cass R. Sunstein & Richard H. Thaler*, Libertarian Paternalism Is Not an Oxymoron*, 70 U. CHI. L. REV. 1159, 1161 (2003) ("The design features of both legal and organizational rules have surprisingly powerful influences on people's choices.").

[153] *See also* Korobkin, *supra* note 149, at 1227 (finding that each individual determines the value that she places on an entitlement independently of external situational characteristics, which are subject to change).

Finally, as a matter of doctrine, one might argue that the Supreme Court has explicitly acknowledged the fundamental difference between plaintiffs and defendants in the class action setting. In *Phillips Petroleum v. Shutts*,[154] the Supreme Court drew a distinction between absent class plaintiffs and absent defendants for purposes of personal jurisdiction. Specifically, the Court held that "the burdens placed by a State upon an absent class-action plaintiff are not of the same order or magnitude as those it places upon an absent defendant."[155]

We believe such a reading of *Shutts* is misguided. The *Shutts* holding does not distinguish the class defense from the class action on due process grounds. On the contrary, this decision establishes the principle that procedural protections in class proceedings may substitute for actual participation or consent in the due process calculus.[156] The Court did not address due process concerns of absent defendants in a class defense, but those of a joint defendant in a class action. The Court's distinction was therefore based on the representation of plaintiffs in the class action that is unavailable for the individual defendant in an ordinary non-class suit.[157]

Notwithstanding its initial appeal, therefore, we find the claim that the potential harm to absentee defendants is intrinsically greater than to absentee defendants to be misguided. We thus see no justification for providing class defendants with due process protections beyond those currently provided to plaintiffs.

2. Future Defendants and Opting Out

The defendant class would presumably include alleged wrongdoers who have not been individually sued. We shall refer to these members of the defendant class as *future defendants*. In the

[154] 472 U.S. 797 (1985).

[155] *Id.* at 807-811. Thus, the court concluded that absentee plaintiffs need not possess "minimum contacts" with the forum state in order for it to establish personal jurisdiction over them. For the "minimum contact" requirement for personal jurisdiction, see International Shoe Co. v. Washington, 326 U.S. 310 (1945).

[156] For a contrary interpretation in the context of plaintiff-initiated defendant class actions see Diane P. Wood, *Adjudicatory Jurisdiction and Class Actions*, 62 Ind. L. J. 597, 607-612 (1987). *But see* CONTE & NEWBERG, *supra* note 132 at §4.52 ("Because a class action, involving either a plaintiff or defendant class, is a representative action on behalf of absent class members, personal jurisdiction over all class members is not required to reach a binding judgment as to the common issues decided in the class action").

[157] From the defendant perspective, the threat posed by the class defense is likely smaller than that of the defendant class action, which is initiated by plaintiffs. Notably, plaintiff-initiated defendant class actions have been allowed even in the aftermath of the *Shutts* decision. *See* cases cited by CONTE & NEWBERG, *supra* note 132, at §4.52.

file-sharing case, for example, the defendant class will include all those who were unfortunate enough to have a lawsuit pending against them. The defendant class, however, will also include all Internet users who have engaged in file-sharing activities over a certain period. In fact, it is likely that members of the latter group will far outnumber current defendants.

The significant presence of future defendants triggers two potential objections to the class defense device: first, turning a regular lawsuit into a class defense case always makes future defendants worse off; second, the opt-out mechanism is practically unavailable to members of the defendant class.

The intuition underlying the first objection is quite simple. Without class certification, future defendants are not a party to the initial lawsuit. Moreover, it is not certain that the plaintiff will ultimately sue each future defendant. Accordingly, future defendants might prefer to adopt a wait-and-see approach—*i.e.*, to deal with the plaintiff only if, and when, it sues them.

In other words, there is arguably no symmetry between class plaintiffs and future defendants. Plaintiffs are clearly better off with class actions: If the class wins or settles, they will benefit from a favorable resolution of the class action; if the class loses, they will suffer no harm as their individual claims are worthless anyway due to their negative expected value. Future defendants, in contrast, might be worse off: If the class loses, they will be liable to the plaintiff (which has not sued them prior to certification); if the class wins, they merely acquire immunity against liability which most of them have not been asked to bear yet.

This highlights another problematic feature of the class defense. In theory, membership in the defendant class is not mandatory: any future defendant can simply opt-out of the class.[158] Practically, however, future defendants would often find the opt-out route to be prohibitively expensive. This is because opting out discloses to the plaintiff the identity of the future defendant and makes public the fact that she engages in the disputed conduct. This in turn will practically invite the plaintiff to file a suit against such future defendant.

To illustrate, consider again the file-sharing example. Assume that a music fan that has downloaded several music files learns about a motion to certify a lawsuit filed by the RIAA as a class defense case and wishes to opt-out. By stepping forward and opting out, however, he would reveal both his identity and, more importantly, the fact that he has downloaded music files. This in turn would increase the

[158] Exercising the opt-out option requires future defendants to expend resources on finding out about the existence of a class defense and sending out the opt-out notice. These costs, however, apply equally to plaintiffs in class actions.

chances that he would ultimately be sued.

This barrier to opting out poses a major challenge to the class defense device given the importance of the opt-out option in preserving due process rights. Both courts and legal academics view class members' right to exclude themselves from the class as one of the tenets of the modern monetary class action.[159] Furthermore, many proposals for reform focus on strengthening opt-out rights and extending them to injunctive and declaratory relief class actions as well.[160]

The discussion thus far raises important points concerning the impact of the class defense on the due process rights of future defendants. In the remainder of this subsection, we explain why these concerns do not pose an insurmountable challenge to this institution.

To begin, contrary to the claim that the class defense necessarily makes future defendants worse off, we believe that the class defense procedure provides future defendants with substantial benefits concerning both their litigation position ex post and their engagement in the underlying activity ax ante.

The class defense strengthens future defendants' ex post litigation position in two ways. First, it supplies defendants holding plausibly valid defense claim with a mechanism for effectively challenging the plaintiff in court. Consider again the file-sharing example. Users who share files are likely to be sued with some probability. If this

[159] *See* Phillips Petroleum v. Shutts, 472 U.S. 797, 811-813 (1985) (in a claim for money damages, personal jurisdiction over absent class members requires that they be given an opportunity to opt out). This holding was extended to cases involving both injunctive relief and monetary damages in *Brown v. Ticor Title Insurance*, 982 F. 2d 386, 392 (9th Cir. 1992). *See also* George Rutherglen, *Future Claims in Mass Tort Cases: Deterrence, Compensation, and Necessity,* 88 VA. L. REV. 1989, 1995 (2002) ("the right to notice and opt-out has remained at the center of class action litigation at the last three decades"); Samuel Issacharoff, *Preclusion, Due Process, and the Right to Opt Out of Class Actions*, 77 NOTRE DAME L. REV. 1057, 1064-1066 (2002) (citing scholars who support the view that "Shutts invites an expansion of the due process rationale to permit binding class members to preclusive resolution of their individually-defined damages claims only if they have been afforded the right to opt out").

[160] Rule 23(c)(2)(A) currently allows courts to direct appropriate notice to the class in Rule 23(b)(1) or (2) class actions. Still, following Rule 23(c)(2)(B), notice and opt-out are mandatory only in Rule 23(b)(3) class actions. For proposals to require notice and opt-out in all class actions and settlements, see Mark C. Weber, *A Consent-Based Approach to Class Action Settlement: Improving Amchem Products, Inc. v. Windsor,* 59 OHIO ST. L. J. 1155, 1193 (1998) (contending that class members must generally be allowed the option to reject a class settlement and exclude themselves from the class at the time of the settlement); Coffee, *supra* note 11, at 419-422 (proposing a delayed opt-out procedure); Nagareda, *supra* note 33 (calling for maximizing the opportunity for class members to opt out in return for conceding punitive damages).

probability is sufficiently high, then they will prefer the advantages of the class defense to facing the plaintiff in an individual proceeding—where they will likely be compelled to settle regardless of merits.[161]

Furthermore, risk-averse future defendants will benefit from the class defense even if it fails to reduce their expected liability.[162] Without the class defense, for example, a file-swapper who expects to be sued with 20% probability is facing an all-or-nothing risk. If she is sued, she will likely settle for $3,000; if she gets lucky, she will not be sued and therefore pay nothing. Such a risk-averse future defendant will prefer a global settlement that will require her to pay $600 (20% of $3,000) with certainty to the risk of an individual lawsuit.

Second, the sheer existence of the class defense mechanism discourages plaintiffs from embarking upon litigation campaigns designed solely to exploit the vulnerability of dispersed defendants in order to extract settlement payments. In other words, in the absence of an effective device for aggregating defense claims, plaintiffs will be more likely to bring numerous individual suits.

The class defense also affords future plaintiffs the ability to engage in the disputed activity without the threat of lawsuits. A victorious class defense reduces the expected cost of engaging in the relevant activity. In the file-sharing example, a binding decision under which file sharing is legal would turn file swapping from a potentially expensive activity to a risk-free hobby. In fact, a successful class defense offers this benefit not only to future defendants—who might merely increase their level of activityas a result—but also to all those who refrained from engaging in the disputed activity in light of the pending threat of liability.

Moreover, a claim that the class defense has distinctly alarming due process implications should be evaluated against the backdrop of the existing class action rules. In this context, it would be helpful to compare future defendants to future plaintiffs. The position of future plaintiffs in class actions seems to be worse than that of future defendants. First, future plaintiffs typically cannot know whether they will suffer harm nor predict the magnitude of the harm that they might suffer.[163] Future defendants, in contrast, know that they have engaged in the disputed activity. Furthermore, risk-averse future plaintiffs will prefer full compensation for losses they actually

[161] If each individual's probability of being sued is low then the class defense should not be certified. *See* our discussion of class certification, *infra* Part III.E.

[162] For a formal definition of risk aversion, see MAS-COLELL ET. AL, *supra* note 114, at 185-194.

[163] *See* Geoffrey C. Hazard, Jr., *The Futures Problem*, 148 U. PA L. REV. 1901, 1911 (2000) (describing the future claimant in the mass-tort context as a plaintiff that "neither his identity nor the existence or magnitude of his injuries have yet been established").

suffer—if it materializes—to an aggregate settlement based upon the average loss within the plaintiff group.[164] As explained above, risk-averse future defendants will often prefer collective settlement to an all-or-nothing litigation risk.

Yet, courts have not ruled out the possibility of binding future claimants in class actions.[165] To be sure, the Supreme Court has imposed significant restrictions on the use of settlement class actions for resolving future plaintiffs' rights.[166] Nevertheless it has stopped short of holding that such settlements violate future plaintiffs' rights per-se. Instead, it has left open the possibility of including future plaintiffs in mass tort settlements, as long as they are afforded sufficient procedural guarantees against collusion and abuse.[167]

As for the opt-out issue: The existing legal rules might indeed create a barrier to opting out from class defenses. But the implications of this barrier should not be overstated. First, the experience with respect to class actions shows that only a very small percentage of class members opt-out.[168] The highest opt-out rate is for mass tort cases where the mean rate is 4.6 percent. In consumer class actions, in contrast, the mean opt-out rate is less than 0.2 percent. There is no reason to believe that future defendants in class defense cases would exhibit greater willingness to opt-out.

Second, the opt-out barrier could rather easily be removed by devising mechanisms to mitigate the exposure of future defendants wishing to be excluded from the class. We propose, for example, to make the opting-out procedure *anonymous*. Under our proposal, members wishing to exclude themselves from the defendant class will

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[164] This point is clearly explained in David Rosenberg, *Aggregation and Individual Justice and Collectivizing Risk-Based Claims in Mass-Exposure Cases*, 71 N.Y.U. L. REV. 210, 247-248, note 91 (1996). *See also* Louis Kaplow & Steven Shavell, *Accuracy in the Assessment of Damages,* 39 J. L. & ECON. 191 (1996).

[165] For a recent overview of courts' treatment of future plaintiffs in mass-tort class actions, see Samantha Y. Warshauer, Note: *When Futures Fight Back: For Long-Latency Injury Claimants in Mass Tort Class Actions, Are Asymptomatic Subclasses the Cure to the Disease?,* 72 FORDHAM L. REV. 1213*, 1236*-64 (2004).

[166] *See* Amchem Products v. Windsor, 521 U.S. 591, 617-627 (1997) (refusing to certify a class action since the settling parties failed to provide for structural assurances of fair and adequate representation for future plaintiffs); Ortiz v. Fibreboard Corp., 527 U.S. 815, 856-861 (1998).

[167] *See* Amchem Products v. Windsor, *id.* at 612 ((refraining from deciding the issue of future plaintiffs' standing to sue); *Ortiz v. Fibreboard Corp.*, *id.* at 831 (same). *But see* Hazard Jr., *supra* note 163, at 1913 (arguing that the Ortiz decision practically precludes the use of Rule 23 to resolve future claims in mass torts injury cases).

[168] *See generally* Theodore Eisenberg & Geoffrey P. Miller, *The Role of Opt-Outs and Objectors in Class Action Litigation: Theoretical and Empirical Issues*, New York University Law and Economics Research Paper, *available at* www.ssrn.com (finding that, on average, less than one percent of members of opt out).

notify courts, which will hold an opt-out registry for each class defense. At the same time, however, the identity of those who opted out will not be disclosed to the plaintiff. If the plaintiff wants to proceed against individual defendants after winning the class defense, it will have to submit their names and location to the registry and confirm that they are not listed there. Furthermore, individual defendants' opt-out notice will not be allowed as evidence for their liability.

Third, note that opt-out is not required in Rule 23(b)(1) and (2) class actions but only in monetary, Rule 23(b)(3) class actions.[169] Some commentators even go further to advocate abolishing the opt-out procedure in monetary class actions as well.[170]

Finally, even in the absence of a class defense, future defendants may find themselves bound by prior "individual" proceedings under *stare decisis* principles. Future defendants, however, are clearly better off under the class defense alternative. If the plaintiff prevails, both alternatives would have similar adverse implications for future defendants. Yet, an individual suit neither requires notice to absent defendants nor provides any opt-out rights. Furthermore, the litigation incentives of the defendant in the prior individual suit would typically reflect her personal interest only, and her litigation performance would not be subject to any monitoring by the court. The class defense, therefore, would guarantee future defendants better representation.

3. Common Plaintiffs

So far, we have focused on the impact of the class defense on the due process rights of defendants and future defendants. Plaintiffs, however, might also raise fairness objections to the class defense device. Specifically, plaintiffs might argue that forcing them to be a party to a representative proceeding subjects them to significant burdens without offering them any meaningful benefits.

For the plaintiff, the downside of the class defense is quite obvious. Class defense litigation is likely to be costlier for the plaintiff than a regular lawsuit. Furthermore, if it loses at trial, the plaintiff will be precluded from suing all similarly positioned

[169] *See supra* note 160.

[170] *See* David Rosenberg, *Response: Mandatory-Litigation Class Action: The Only Option for Mass Tort Cases*, 115 HARV. L. REV. 831 (positing that courts should aggregate all potential and actual claims arising from mass tort events into a single mandatory-litigation class action, allowing no class member to exit); Robert G. Bone, Rule *23 Redux: Empowering the Federal Class Action,* 14 REV. LITIG. 79, 105-106 (1994) (calling for a flexible approach to litigant autonomy that justifies binding absentees in some situations even without a chance to opt out).

defendants and future defendants. Finally, under our one-sided fee-shifting proposal, a losing plaintiff will have to pay the fees of the class attorney. If it wins, on the other hand, the plaintiff will not be reimbursed for its legal fees.

On the upside, the precise impact of the class defense on plaintiffs is less clear. As a matter of law, the class defense provides victorious plaintiffs with significant cost-savings, as they will not have to sue each defendant separately to re-establish their claims. As a practical matter, however, plaintiffs will have to uncover the identity of members of the class and then engage in a costly process to collect from each defendant the judgment amount.

Aggregating defense claims might indeed undermine plaintiff interests. DirecTV, for example, would surely be worse off if it were to face all smart card holders as a group rather than each defendant individually. This, however, is hardly a justification for rejecting the class defense device. On the contrary, we have argued that the imbalance between powerful plaintiffs and dispersed defendants undermines the social goals of justice and deterrence. By definition, restoring the balance would weaken the plaintiff's superior position. In other words, given the premise that the initial balance of power is skewed in favor of plaintiffs, enhancing defendant power at the expense of plaintiffs is desirable.

Notice that the defendant in a class action could raise similar objections, since consolidating plaintiffs takes away its cost advantages. Indeed, many defendants in class actions would surely prefer to confront each plaintiff separately. No one seriously suggests that the adverse impact on defendants justifies abolishing the class action device altogether. Furthermore, class actions might allow plaintiffs to blackmail defendants by filing frivolous suits and threatening them with risky all-or-nothing verdicts.[171] This risk, however, is less likely in the case of plaintiffs in class defenses. Whereas plaintiffs initiate class actions, class defendants only respond to lawsuits filed against them. A plaintiff wishing to avoid the

[171] *See*, *e.g.*, Castano v. Am. Tobacco Co., 84 F.3d 734, 746 (5th Cir. 1996) ("class certification creates insurmountable pressure on defendants to settle, whereas individual trials would not…. These settlements have been referred to as judicial blackmail"); In re Rhone-Poulenc Rorer, Inc., 51 F.3d 1293, 1298 (7th Cir. 1995) (decertifying a class action because defendants may easily be facing a $25 billion verdict and they would therefore be under intense pressure to settle). For a critical analysis of the claim that defendants are systemically victimized by class action "blackmail," see Charles Silver, *"We're Scared to Death": Class Certification and Blackmail*, 78 N.Y.U. L. REV. 1357 (2003). *See also* Bruce L. Hay & David Rosenberg, *"Sweetheart" and "Blackmail" Settlements in Class Actions: Reality and Remedy*, 75 NOTRE DAME L. REV. 1377, 1391-1392 (2000) (claiming that blackmail settlements are not inherent to the class action procedure, and therefore the justification for class actions is not undermined by the prospect of extortion).

aggregate proceeding may therefore refrain from filing individual lawsuits. If it decides to pursue those lawsuits, there is no reason why they should not be litigated on level grounds.

D. Collusion

1. The Two-Edged Sword Problem

This Article's thesis is that aggregation will empower similarly positioned defendants with valid defense claims to litigate rather than settle. There is a risk, however, that the class defense procedure will be turned against defendants. Plaintiffs, so the argument goes, will have strong incentives to collude with potential representative defendants and their attorneys in order to legally bind all members of the defendant class to an adverse judgment or settlement.

To be sure, class actions are also vulnerable to this form of collusion. Defendants who fear the prospect of an endless flow of individual claims (as in the asbestos litigation example) often seek a collective and final determination of their liability. Although they lack the power to initiate a class action, defendants are certainly positioned to select their preferable class attorney and impose settlement conditions that favor their interests. Some commentators have even documented "reverse auctions," where defendants have used competition among plaintiff attorneys to get their most favorable terms in settlement.[172]

One might argue, however, that the class defense substantially enhances plaintiff incentives to collude. Aggregation of defendants, so the argument goes, is like a two-edged sword. It may serve defendants if they are disadvantaged in individual litigation; it may harm them, however, if their disparity shields them against individual lawsuits. In the class action, the sole advantage for a defendant of initiating a class action is achieving certainty and closure of its future liability, yet not necessarily diminishing it.[173] Here, in contrast, the plaintiff—which has the formal power to initiate litigation—could employ the class defense to compel a large group of defendants to pay it money it could not collect otherwise while precluding these defendants from challenging such payment in court.

While this collusion problem cannot be eliminated, we argue that it can be reasonably contained within the class defense framework.

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[172] Professor John Coffee first coined the term "reverse auction" in the class action context. *See* John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 COLUM. L. REV. 1343, 1372-1373 (1995).

[173] *See* e.g. Francis E. McGovern, *The Defensive Use of General Class Actions in Mass Torts*, 29 ARIZ. L. REV. 595 (1997) (analyzing the strategic use of class actions by defendants who seek closure of their mass tort liability).

First, we show that the practical implications of this problem are rather limited. Then, we explore the means that courts can deploy to minimize its risks.

Practically, the 'two-edged sword' risk is not as significant as it may first appear. This is because even without class defenses, plaintiffs currently have the power—and thus the opportunity—to bind a group of defendants by initiating a *defendant* class action.[174] The risk, therefore, is not that the class defense will substantially enhance plaintiffs' incentives to improve their position by aggregating defendants—a plaintiff that finds it difficult to enforce its rights in individual proceedings already has a strong interest in certifying its lawsuit as a defendant class action. Rather, the concern is that such plaintiffs would seek to increase their chances of securing class certification by creating the impression that consolidation would benefit defendants—*i.e*., by having defendants motion the court for class certification.

The challenge, therefore, is distinguishing class proceedings that serve defendant interests from those that profit the plaintiff. But class certification is always a zero sum game. Putative class members (whether plaintiffs or defendants) prefer certification when individual proceedings are uneconomical. Joint defendants or plaintiffs prefer it when individual claims or defenses, respectively, are feasible but will create a costly burden. Identifying which party benefits from certification has always been a (not necessarily easy) task for the court when it decides whether to certify the class action.

Moreover, it should be emphasized that courts already face a similar problem in mass-tort class actions. These consist of large individual claims that would often be viable even without their aggregation in a class action. A class action may therefore adversely affect plaintiffs who suffered a sufficiently large harm and whose cases are sufficiently strong to justify the filing of individual lawsuits.[175] In other words, the class action may not only serve plaintiffs, but may also harm them.

Finally, as explained in detail in the next section, we propose several specific measures to minimize the risk of turning the class defense against defendants. First, to certify a case as a class defense case, courts will have to examine the likelihood that the plaintiff will actually file numerous lawsuits against members of the putative

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[174] *See* text accompanying notes 104-107, *supra.*

[175] Indeed, the main argument against the *Georgine* (later *Amchem*) settlement was that plaintiffs could pursue their claims individually, and that class aggregation has only served the defendants' (and the class attorneys') interests. *See* Susan P. Koniak, *Feasting While the Widow Weeps: Georgine v. Amchem Products, Inc.*, 80 CORNELL L. REV. 1045 (1995).

defendant class. Second, courts will have to encourage competition for the positions of class representatives and attorneys. This would make it more difficult for plaintiffs to select a "convenient" counsel to represent the defendant class. More generally, proper use of the court's discretion in certifying the class action, selecting the class attorney, and awarding her fee are the best tools for minimizing collusive behavior in class litigation, whether defendant or plaintiff initiated.

2. Sweetheart Deals

One of the omnipresent challenges facing class action courts is preventing collusive settlements between the defendant and the class counsel. Collusive settlements are typically agreed upon before filing, and courts are requested to certify a class action for the sole purpose of settlement.[176]

In addition to reverse auctioning, collusive settlements can take two forms.[177] First, the defendant and the class attorney might artificially inflate the purported value of the settlement in order to induce the court to approve it. Examples include non-monetary settlements, settlements that define the represented class very broadly, yet impose difficult-to-satisfy conditions for collection by class members, and settlements allowing for the reversion of unclaimed funds to the defendant.

In the second category, the defendant and the class counsel arrive at undisclosed agreements under which the defendant makes side payments to the class attorney in return for the attorneys' acquiescence to reducing the amount of compensation for class members in the proposed settlement. The side payment often takes the form of favorable settlements of other lawsuits—filed by the class attorney independently of the class action—against the defendant. Since they take place outside the class proceedings, such inventory settlements are not subject to the court's discretion. Accordingly,

[176] In 1996, the Advisory Committee on Civil Rules proposed a new rule that would authorize certification of a (b)(3) class for settlement purposes, although the same class would not be certified for purposes of litigation. *See* 167 F.R.D. 535. This proposal was vehemently objected. *See, for example,* a letter by 129 law professors to the Standing Committee on Rules of Practice and Procedure, May 28, 1996, in WORKING PAPERS OF THE ADVISORY COMMITTEE ON CIVIL RULES ON PROPOSED AMENDMENTS TO CIVIL RULE 23, VOL. 2, *available at* www.uscourts.gov/rules/WorkingPapers-Vol2.pdf (last visited August 31, 2004) (arguing that the proposed amendment would invite collusion between defendants and class attorneys). *See also* Symposium, *Settlement Class Actions*, 80 CORNELL L. REV. 811 (1995) (discussing the implications of settlement class actions).

[177] *See* Klement, *supra* note 11, at 42-43 (documenting the various types of collusion); Silver, *supra* note 108, at 213-14 (reviewing sweetheart settlements in class actions).

they might guarantee the attorney disproportional compensation.[178]

The class defense device is also susceptible to these types of collusive practices. The question, however, is whether the risk in the class defense case is greater than in class actions. This will be the case if (i) the class defense enhances incentives to collude, or (ii) courts are less equipped to prevent collusive arrangements. There seems to be little reason to believe that either is likely.

To be sure, given the inherent difficulty of valuing the benefit of class settlements,[179] class attorneys and plaintiffs might be tempted to inflate the purported benefit of a settlement by asking for an inflated damages amount or by increasing the size of the class. Valuation difficulties, however, also characterize nonmonetary class actions and nonpecuniary settlements. Nothing in the nature of the class defense makes it more difficult for courts to manage than such class actions.

The answers to the risk of collusive settlement in class defenses should, therefore, be similar to the ones given in class actions. Namely, requiring plaintiffs and class attorneys to disclose all related agreements and proceedings, ensuring close monitoring of both sides by the court, and seeking proper design of the class attorney fee. The risk of collusion does not seem to pose an insurmountable challenge to the viability of the class defense procedure.

E. Class Defense: A Tentative Outline

We conclude our analysis of the class defense mechanism with a brief outline of its main procedural features. Our analysis will not offer a full account of the doctrinal nuances and practical considerations associated with implementing class defenses. Deploying the class defense device would undoubtedly require courts and lawmakers to address doctrinal issues, such as personal jurisdiction, proper venue, subject matter jurisdiction, and limitations periods.[180] Given space constraints, we leave these important topics outside the scope of this Article. Instead, we offer an account of the

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[178] *See* Coffee, *supra* note 172, at 1373-1384 (defining these methods as the "new collusion" as opposed to the non-monetary "old" collusive settlements); Koniak, *supra* note 175, at 1047-48, 1057-64, 1086-114 (describing similar allegations against class counsel in *Georgine v. Amchem Products*). Indeed, in response to this collusive practice, Rule 23 was revised to require the parties to a class settlement to file a statement identifying any agreement made in connection with the proposed settlement. *See* Rule 23(e)(2).

[179] *See* Part III.C.2, *supra*.

[180] Note that some of these issues have been addressed in the parallel case of defendant class actions. Robert E. Holo, *Defendant Class Actions: The Failure of Rule 23 and A Proposed Solution*, 38 UCLA L. REV. 223, 241-245 (1990) (tolling of statute of limitations and personal jurisdiction); Note, *Statutes of Limitations and Defendant Class Actions*, 82 MICH. L. REV. 347 (1984) (statute of limitations).

fundamental features of the class defense.

The party initiating the class action is the putative class representative who files a suit and seeks its certification as a class action. The class defense device, by contrast, will operate somewhat differently. First, the plaintiff will file a "regular" lawsuit against a defendant (or separate lawsuits against a group of defendants). Then, the defendant will ask the court to turn the case into a class defense case. In other words, the defendant will seek to represent an entire class of defendants who have been similarly sued, or are at risk of being sued for similar acts. The class defense thus authorizes the court, upon the defendant's request, to alter the nature of the plaintiff's lawsuit. Although it intended the lawsuit to be pursued as a single claim against an individual defendant, the plaintiff might become implicated in a representative litigation that can bind the plaintiff against all class members.[181]

As we discussed in detail above,[182] there is a risk that plaintiffs will select the defendant most convenient for their needs to represent the class. To alleviate this risk, courts should allow other defendants or attorneys to compete for class representation. This can be achieved by employing the mechanisms devised for this purpose in the class action context.[183] At the same time, to motivate defendants to step forward and seek class certification, the initial defendant should enjoy some priority in the selection of class representative. This priority, however, ought not be absolute.[184]

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[181] The class defense may also be configured as a class action seeking declaratory relief. Members of the defendant group who anticipate a lawsuit may preempt the plaintiff by filing a class action seeking a declaration that their conduct is legal. Formally a class action, this tactic could in principle function as a class defense allowing would-be defendants to enjoy the benefits of consolidation. This tactic, however, is presently subject to doctrinal constraints that undermine its effectiveness as a means for protecting prospective defendants. *See* WRIGHT, MILLER & KANE, 10B FED. PRAC. & PROC. CIV. 3rd § 2765; 12 MOORE'S FEDERAL PRACTICE, §57.22. For a proposed use of declaratory judgments to counter anti-competitive intellectual property litigation, see Meurer, *supra* note 35, at 528-529.

[182] *See* Part III.D, *supra*.

[183] Most recently, courts have experimented with the use of auctions to select the class representative in class actions filed under the Private Securities Litigation Reform Act of 1995. For a comprehensive assessment of this procedure, see THIRD CIRCUIT TASK FORCE REPORT ON THE SELECTION OF CLASS COUNSEL (2002).

[184] Notice, however, that granting priority to the first defendant who files for class defense status is less problematic than granting priority to the first plaintiff who files a class action. This is because, unlike plaintiffs, the class defense requires defendants to wait to be sued. Hence, there is no risk of a race to file. On the significance of the race to file in the class action context, see James D. Cox, *Making Securities Fraud Class Actions Virtuous,* 39 ARIZ. L. REV. 497, 515-516 (1997). The race-to-file concern has led to legislation of the lead plaintiff provisions in the Private Securities Litigation Reform Act of 1995. *See* Section 27(a)(3)(B)(iii) of the Securities Act of 1933 (codified at 15 U.S.C. § 77z-

Courts will have to decide whether to certify the lawsuit as a class defense. As we have shown,[185] there might be cases in which plaintiffs—and not defendants—would benefit from having their lawsuit certified as a class defense. Courts, therefore, will have to ensure that class certification indeed serves the interest of the putative defendant class rather than that of the plaintiff. A key consideration in the court's decision should be the probability that the plaintiff will ultimately sue individual defendants. The class defense should only be certified if that probability is sufficiently high. In other words, courts should grant certification only if the probability of being sued is such that a potential defendant would prefer to join the class.

Due process requires that potential class members be given a notice of the pending class certification and afforded the opportunity to opt out. As we explained earlier,[186] defendants lack incentives to step forward and be identified as potential defendants. We believe, therefore, that the class defenses should rely upon a public notice rather than a personal one.[187]

The procedural posture of the class defense raises a novel question that does not exist in class actions. Since the plaintiff is the party that formally initiates the lawsuit, it has the power to withdraw the lawsuit at its will. This creates a risk that plaintiffs will try to exploit their litigation advantage by suing individuals separately. However, once an attorney files a motion for class defense certification, the plaintiff will simply withdraw its lawsuit.

To alleviate this risk, we propose to set a policy under which the plaintiff can withdraw at any stage of the trial. However, if the plaintiff decides to withdraw the lawsuit after the defendant class has been certified, it will be prevented from filing similar suits in the future. In other words, for *res judicata* purposes withdrawing a lawsuit after the class has been certified would be equivalent to a verdict against the plaintiff. As for withdrawal of the suit before class certification, we believe it should be allowed and cannot produce a binding preclusive effect for the benefit of all absent defendants. Nevertheless, the plaintiff will have to disburse the defendant and her attorney for their costs, including all costs incurred in connection with

1(a)(3)(B)(iii)(bb) (1994 & Supp. V 1999)) and Section 21D(a)(3)(B)(iii) of the Securities Exchange Act of 1934 (codified at 15 U.S.C. § 78u-4(a)(3)(B)(iii) (1994 & Supp. V 1999)).

[185] *See* Part III.D.1, *supra.*

[186] *See* Part III.C.2, *supra.*

[187] Rule 23(b)(3) class action is the only type of certified class action requiring individual notice of the pendency of the action. Other types of class action notices, as well as notice of settlement, may be given by publication. *See* CONTE & NEWBERG, *supra* note 132, at §8:34.

class defense certification.[188]

Finally, courts will have to fulfill some of the tasks that they currently undertake with respect to class actions. For example, courts will have to examine proposed settlements, determine class attorney fees, and set the required procedures for implementation of any judgment or settlement. The class defense does not seem to feature any unique concern in these respects beyond the ones we have already mentioned.

Whether class defenses may be certified under current Rule 23 is beyond the scope of this Article. Nevertheless, we would like to conclude this Part by briefly commenting that although it is doubtful whether Rule 23 was designed to be used as a defensive mechanism, its language does not preclude such a use.

To be maintainable as a class action, a lawsuit must satisfy the prerequisites enumerated by Rule 23(a), fit in one of the categories specified in Rule 23(b), and satisfy the conditions of such category. Each of the three examples we discussed in part II—the suits brought by the RIAA, DirecTV, and Leasecomm—features questions of law and fact common to all class members and thus could satisfy the four Rule 23(a) prerequisites of numerousity, commonality, typicality and adequate representation. As for the specific class certification category, it seems that all examples could qualify as a "(b)(3) class defense." Since pursuing defense claims individually is practically impossible, the examples satisfy the conditions of predominance and superiority. Hence, despite its conceptual novelty, the class defense may very well not require far-reaching procedural reforms for its actual implementation.

IV. ALTERNATIVE DEVICES

In the previous Parts, we have identified the problem confronting dispersed defendants and demonstrated that the class defense procedure could provide a viable solution. Showing that the class defense works, however, is not the same as showing that it is necessary. Before introducing this novel device into the already complex class litigation arena, policymakers should consider whether

[188] The situation is similar in class actions that become mute due to the defendant's voluntary change in conduct. The question whether such change in conduct renders the plaintiff a "prevailing party" for purposes of fee shifting statutes was answered in negative in *Buckhannon Board and Care Home, Inc., v. West Virginia Dep. Of Health and Human Resources,* 532 U.S. 598 (2001). This decision eliminated the so-called "catalyst theory" used by many courts, according to which plaintiffs were awarded attorney fees in such circumstances. For a critique of this holding, see David Luban, *Taking Out the Adversary: The Assault on Progressive Public-Interest Lawyers,* 91 CAL. L. REV. 209, 243-245 (2001).

any existing doctrines could address the defendant problem.

In this Part, we identify several existing alternatives to class defenses and explore the extent to which they overcome the defendant problem. We begin with a somewhat surprising candidate—monetary class actions. Then, we discuss the doctrine of non-mutual collateral estoppel. We conclude by addressing various other alternatives, such as liability insurance, gatekeeper liability, and public enforcement.

Our objective in surveying these alternative mechanisms is twofold. First, although all these mechanisms are quite familiar, our analysis sheds a new light on their role in overcoming the defendant problem. Second, we show that all of the existing alternatives fall short of offering a satisfactory solution to the problem.

A. Pay Now, Sue Later

Counter-intuitively, the first alternative to the class defense is the monetary class action. In this section, we show that class actions can serve as a substitute to class defenses. We then argue, however, that class actions are inferior to class defenses as a mechanism for addressing the defendant problem. Moreover, we speculate that an effective class defense regime would turn many of the disputes that currently take the class action form into class defense cases.

Upon a close inspection, many types of class actions could be viewed as a practical response to the problem of numerous defendants. This is because one's status as a plaintiff or defendant is often a matter of choice. As the present regime does not offer defendants the option of consolidating their defense claims, potential defendants often prefer to approach the dispute as plaintiffs. In other words, potential defendants will often follow what we label as the "pay now, sue later" strategy—they will make payments and then wait for a class action to recover the amount that they overpaid.

The pay-now-sue-later strategy is normally found in class actions seeking to recover unlawful payments made by the plaintiffs to the defendant. Examples include lawsuit alleging improper charges by credit card companies, banks, insurance companies, airline and other travel industry charges, and cable companies.[189]

To illustrate the functional equivalence of class actions and class defenses, consider a fairly common dispute concerning the right of a cable company to charge late fees. The cable company essentially requires a dispersed group of individuals—its clients—to make a

[189] Recent empirical findings show that this type of class actions accounted for between 20 to 32 percent (depending on the data source) of all consumer class actions filed in 1995-1996. *See* HENSLER ET. AL., *supra* note 139, at 54-56.

relatively small payment, say $5.[190] For simplicity, assume that the cable company has no right to demand such payment.

Since the amounts involved are trivial, each subscriber has no incentive to challenge the validity of such payments; subscribers as a group, however, might benefit from consolidating their cases. Yet, given the existing legal landscape, subscribers cannot effectively consolidate their claims as long as their status is that of defendants. In other words, subscribers cannot refuse to pay and then get sued because then they will lack the ability to act cohesively.[191]

Knowing that they cannot single-handedly confront the cable company in court, members of the group will likely follow the pay-now-sue-later strategy. In other words, they will pay the $5. The advantage of this strategy is that, once they become plaintiffs, members of the group can exploit the economies of scale afforded by the class action device. Thus, subscribers' best course of action is to pay the late fees with the hope that a plaintiff attorney will subsequently file a class action seeking recovery of the late fees.[192]

Given the functional equivalence of class actions and class defenses, one might argue that there is no need to introduce far-reaching reforms, such as the class defense.

We believe, however, that the pay-now-sue-later strategy is an inferior alternative to the class defense for two reasons: first, it is not universally applicable; second, it does not afford members of the class full recovery. Thus, formally establishing class defenses would afford better protection to many individuals who currently, knowingly or not, follow the pay-now-sue-later strategy.

To begin, the pay-now-sue-later strategy is effective only when potential defendants (who then become members of the plaintiff class) can make the initial payment without losing their right to challenge its validity in a future lawsuit. This would normally be the case only where there is some prior contractual relationship that requires group members to make regular payments.

In many cases, however, the initial payment is the outcome of litigation or the threat thereof. Thus, those who follow the pay-now-sue-later approach would lose their right to seek repayment. Consider the file-sharing and DirecTV examples. In both cases, the defendants

[190] The example is based on *Selnick v. Sacramento Cable*, No. 541907 (Cal. Supr. Ct. 1996), reported in HENSLER ET. AL., *supra* note 139, at 211-223.

[191] As we explained earlier, collective action problems will prevent members of the group from cooperating in the absence of a procedure of representative litigation. *See supra* Part III.A.

[192] Note that we do not argue that each subscriber pays with the subjective hope of a subsequent class action. Rather, we describe a pattern of conduct that characterizes many wrongful payment cases.

pay to the plaintiffs as part of a settlement or as a result of failing to show up in court. Thus, res judicata principles will prevent these defendants from subsequently joining a plaintiff class seeking recovery of these amounts.

Furthermore, defendants will be barred from joining any future class action even if they settled before they were actually sued. Having consented to settle in the face of an allegedly legitimate litigation threat they will be unable to claim undue coercion or duress and would therefore be bound by their agreement.[193]

Even when there is no formal obstacle to suing for payments that have already been made, the class defense would provide members of the group with superior protection. This is because the pay-now-sue-later strategy suffers from two principal distortions.

First, this strategy motivates class attorneys to wait until the harm to the plaintiff group is large enough. This is because attorney fees are based on the amount recovered by the class, and the recovery is larger when a larger amount has been overpaid. To be sure, this distortion is constrained by race-to-file considerations.[194] The important point, however, is that the class defense will not produce such a distortion.

Second, the pay-now-sue-later alternative forces plaintiffs to be the defendant's creditors. Put differently, this strategy shifts to members of the group the credit risk associated with the defendant who may turn out to be judgment-proof. Moreover, members of the group are not necessarily reimbursed for the time value of money.

Third, this strategy will fail to eliminate the risk of over-deterrence of would-be defendants. To the extent that the protection granted to them under the class action alternative is imperfect, potential defendants might perceive the disputed activity to be too costly. Shifting to a class defense regime, in contrast, will reduce the expected cost of engaging in that activity.

To summarize, class actions are currently deployed in scenarios that essentially involve a conflict between dispersed defendants and a single plaintiffs. For the reasons we offered in this Part, however, the class action is inferior to the class defense in protecting defendant interests. Thus, it is likely that a well-functioning class defense regime will turn many existing class actions into class defense cases.

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[193] Two class actions were filed against DirecTV for its end-user campaign. Both were dismissed on grounds similar to those described in the text. *See Sosa v. DirecTV*, and *Blanchard v. DirecTV*. Both decisions are available at DirecTV's site, www.hackhu.com. *See also* Kevin Poulsen, *Former Anti-piracy 'Bag Man' Turns on DirecTV,* SECURITY FOCUS NEWS, Apr. 16, 2004, *at* www.securityfocus.com/news/8472.

[194] *See supra* note 184.

B. Non-mutual Collateral Estoppel

Under the doctrine of collateral estoppel (also called issue preclusion), a party may not relitigate any issue of fact or law that was actually litigated and determined and was essential to the judgment rendered.[195] Courts have traditionally applied this doctrine only between litigants who were both parties to the original proceeding or were in privity with those parties.[196] Non-parties could neither be bound by a court's adverse decision nor claim the benefits of a favorable decision. The underlying principle was that of mutuality—because one could not have been bound by a proceeding to which she was not a party, she could not bind others who did participate in that proceeding.[197]

The modern approach, in contrast, recognizes the non-mutual collateral effects of prior judgments.[198] Under this approach, a plaintiff may be bound by an adverse decision in an individual lawsuit. The plaintiff, however, will not enjoy any preclusive effects of a contrary finding in such a lawsuit. This became to be known as the *defensive* non-mutual collateral estoppel rule.[199] Although non-mutual preclusion may be limited if several cases have already been litigated and produced inconsistent results,[200] it is still possible for the first individual defendant to win her case and bind the plaintiff against all other defendants.

At first blush, this seems to imply that class defense certification is against the interest of dispersed defendants. Without class certification, dispersed defendants can enjoy a similar preclusive effect if they prevail, but they will not bound by an adverse

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[195] *See* RESTATEMENT (SECOND) OF JUDGMENTS §27 (1982).

[196] *See* Tice v. American Airlines, 162 F. 3d 966 (7th Cir. 1998) (analyzing the requirements of "privity" necessary to establish a preclusive effect over non-parties).

[197] See ROBERT C. CASAD & KEVIN M. CLERMONT, RES JUDICATA: A HANDBOOK ON THEORY, DOCTRINE AND PRACTICE 169-174 (2001).

[198] The first case to allow non-mutual use of collateral estoppel was *Bernhard v. Bank of America Nat. Trust & Savings Assn.*, 122 P. 2d 892 (Cal. 1942). The Supreme Court has adopted the non-mutual defensive collateral estoppel in *Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation,* 402 U.S. 313 (1971). Non-mutuality was further extender to allow an offensive use by plaintiffs against a joint defendant in *Parklane Hosiery Co. Inc. v. Shore*, 439 U.S. 322 (1979).

[199] In fact, this is one reason why plaintiffs seek certification of defendant class actions, as a class action helps the plaintiff restore mutuality between the preclusive effects of favorable and adverse judgments.

[200] See RESTATEMENT (SECOND) OF JUDGMENTS §29(4), comment f (1982); Brainerd Currie, *Mutuality of Collateral Estoppel: Limits of the Bernhard Doctrine*, 9 STAN. L. REV. 281, 289 (1957).

judgment.[201]

This conclusion, however, overlooks the fundamental problem underlying the dispersed defendants' scenario, namely, the lack of incentives to assert defense claims. In the absence of proper incentives, each defendant will settle rather than incur the cost of defense. With no one to contest the plaintiff in court, no collateral estoppel can be established. Thus, the non-mutual collateral estoppel rule does not provide defendants with an effective protection.

The non-mutual collateral estoppel rule might actually diminish defendant incentives to litigate. Since the plaintiff has more to lose if it loses an individual case, it will invest larger resources in litigation. This will translate into a higher probability of plaintiff victory in each individual case. As a result, contesting lawsuits in court will become less appealing for each individual defendant.

Even if a defendant were to defend, the non-mutual collateral estoppel rule would not level the scales as far as litigation investment is concerned. The incentives of such a defendant to invest in litigation would be limited to her personal stake at the outcome of the case. As a consequence, the probability that the defendant will prevail under the non-mutual collateral estoppel rule is lower than the respective probability in a class defense.[202]

In principle, the non-mutual collateral estoppel rule does improve the bargaining position of individual defendants. A common plaintiff facing a defendant with a promising defense case will be more willing to give up the individual claim to avoid the collateral effects of a loss on trial. This, however, will be the case only if the individual defendant finds it worthwhile to invest sufficient resources in establishing her defense. Yet, since the individual defendant cannot gain more than revocation of her liability, she would usually find it in her interest to pay the plaintiff's claim and avoid litigation. Moreover, the settlement leverage of individual defendants is limited since the plaintiff can at any time drop the case to avoid estoppel

[201] See Note, *A Probabilistic Analysis of the Doctrine of Mutuality of Collateral Estoppel*, 76 MICH. L. REV. 612 (1978); Note, *Exposing the Extortion Gap: An Economic Analysis of the Rules of Collateral Estoppel*, 105 HARV. L. REV. 1940 (1992).

[202] *See* Craig R. Callen & David D. Kadue, *To Bury Mutuality, Not To Praise It: An Analysis of Collateral Estoppel After Parklane Hosiery Co. v. Shore*, 31 HASTINGS L.J. 755, 773 (arguing that a plaintiff facing many defendant will be highly motivated to commit resources for litigation, thereby disadvantaging defendants); Bruce L. Hay, *Some Settlement Effects of Preclusion*, 1993 U. ILL. L. REV. 21, 47-48 (1993) ("nonmutuality may leave plaintiffs who sue sequentially worse off than they would be under mutuality. If the plaintiffs' chances of success in court are investment-sensitive and the cases settle in the order they are expected to go to trial, aggregate settlement recoveries under nonmutuality may be below what they would be under mutuality").

effects.[203] Without having a credible threat of litigating her defense, the defendant's bargaining power against the plaintiff would not be affected by the non-mutual collateral estoppel rule.[204]

Similar problems will characterize any other doctrine that extends the outcome of prior litigation to all future defendants without aggregating them in one proceeding. Thus, the doctrine of stare decisis (or precedent)—binding both the plaintiff and defendants to the court's ruling on questions of law—also keeps intact the imbalance between the parties. In fact, stare decisis will exacerbate the defendant problem even more than non-mutual preclusion. It will intensify plaintiff incentives to invest in each lawsuit since both its loss and its victory might have a binding effect. At the same time, this doctrine will leave the individual defendant similarly under-motivated to invest in litigation since, as a one-time player, she will derive no benefit from the precedential effect of the case.[205]

C. Gatekeepers, Insurance, and Government Intervention

In this section, we consider three additional mechanisms that could rectify the problem of dispersed defendants: third party liability, liability insurance, and government intervention. As we shall explain, each mechanism may offer a reasonable alternative to formal consolidation of defense claims. Unfortunately, however, these alternatives are not universally applicable. Moreover, each mechanism often introduces costs and distortions of its own.

The first alternative is imposing liability on third parties, or gatekeepers.[206] The intuition here is that when gatekeepers interact

[203] The individual defendant's situation should thus be distinguished from the individual plaintiff's respective situation in the symmetric setting of multiple plaintiffs facing a common defendant. Unlike the individual defendant, the individual plaintiff enjoys remarkable settlement leverage, as the amount she may squeeze out from the defendant is potentially as high as its aggregate liability. Since the plaintiff controls the case, the common defendant cannot simply drop the case because by doing so it may be exposed to the same collateral effects it intends to avoid. Individual defendants, in contrast, do not enjoy the same settlement leverage because the common plaintiff may drop any individual case to avoid non-mutual collateral estoppel.

[204] Notice that this would not necessarily be the case where multiple plaintiffs face a single defendant. Since each plaintiff can extract a settlement higher than her individual claim, her incentive to invest in it may be enhanced due to the non-mutual collateral estoppel rule. Thus, the plaintiff may seek litigation only to 'squeeze' as much rent from the defendant, at the expense of future plaintiffs.

[205] *See* Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 L. & SOC'Y. REV. 95 (1974) (describing the inherent advantages enjoyed by repeat players in litigation, including their ability to bring about favorable precedents).

[206] For a comprehensive analysis of the conditions under which gatekeeper liability is optimal, see Reinier Kraakman, *Gatekeepers: The Anatomy of a Third Party*

with a sufficiently large number of alleged wrongdoers, they will be better motivated than each individual defendant to pursue plausible defense claims.

The file-sharing example nicely illustrates this byproduct of gatekeeper liability. Consider the litigation incentives of a company that develops file-sharing software—*Aimster* for example—that is sued for contributory and vicarious copyright infringement based upon its users' file-swapping activities. For *Aimster*, the stakes are evidently much larger than those of an individual file swapper. If it loses, the company will have to pay damages that reflect the file-swapping activities of its entire user pool; it also stands to lose its main source of revenues. In other words, when deciding whether to litigate or settle, a gatekeeper defendant will take into account the interests of many users and potential users of its services. This, in turn, would have an effect similar to aggregating defense claims.

Targeting gatekeepers rather than individual wrongdoers may substantially mitigate the problem of numerous defendants. This alternative, however, is imperfect for two reasons. First, gatekeeper liability is socially costly: it might distort the market for gatekeeper services and produce over-deterrence.[207] In the p2p setting, for example, academics have argued that imposing liability on software companies like *Napster* stifles technological innovation and excessively restricts legitimate speech.[208] Second, both practically and legally, the plaintiff can often sue only the alleged primary wrongdoers. Not in all cases there is someone that serves as a gatekeeper—consider the Leasecomm case for instance; and even when a party may technically qualify as a gatekeeper, it will often enjoy immunity against liability.[209]

Liability insurance may constitute yet another device for achieving effective aggregation of defense claims. The intuition here largely follows that underlying the gatekeeper alternative. Assuming it provides coverage to a large number of defendants, an insurance company would have a substantial stake in the outcome of litigation. To minimize its exposure, the insurance company would confront the plaintiff in court if necessary.

Individual defendants, however, normally do not purchase

Enforcement Strategy, 2 J.L. ECON. & ORG. 53 (1986); Hamdani, *Gatekeeper Liability, supra* note 5.

[207] *See generally* Hamdani, *Gatekeeper Liability, supra* note 5 (analyzing market distortions under gatekeeper liability); Hamdani, *Who's Liable, supra* note 5, at 905-906 (contending that third- party liability might produce over-deterrence).

[208] *See* Lemley & Reese, *supra* note 5, at 1349-1450.

[209] For example, the Ninth Circuit has recently upheld a ruling under which *Grokster* is not liable for the infringing activities of people using its software. *See* sources cited in note 56, *supra*.

liability insurance unless for specific activities such as driving. It seems unlikely that insurance companies would be willing to provide comprehensive, not activity specific, liability insurance given adverse selection and moral hazard problems that would render such insurance highly costly.[210] But even if insurance companies were to provide such insurance, the problem of those who have not purchased it would nevertheless require solution. Thus, we typically cannot rely on insurance companies for protecting numerous defendants against plaintiffs.[211]

Finally, like in other cases of market failure, the government could intervene in the dispute between plaintiffs and defendants. After all, in the Leasecomm case it was the FTC who had eventually filed a complaint that made Leasecomm forgo collection on $24 million in judgments.[212] Thus, whenever there is an imbalance between a powerful plaintiff and dispersed defendants, the government could simply intervene to protect defendants.

Again, government intervention can mitigate the problem in principle. Government agencies, however, exhibit their own shortcomings, including limited resources and being susceptible to the influence of pressure groups.[213] In fact, it is well established that class litigation is necessary to supplement the limited capacity of the government to engage in public enforcement.[214] There is therefore no reason to believe otherwise in the class defense context.

To conclude, this section has considered existing mechanisms

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[210] Insurance companies would not be able to screen among insureds that are more prone to liability (an adverse selection problem). Even careful insureds would have insufficient incentives to take care, satisfy their contractual obligations, or seriously fulfill any other of their legal obligations if their potential liability is insured (a moral hazard problem). For a comprehensive analysis of liability insurance and its incentive effects *see* STEVEN SHAVELL, ECONOMIC ANALYSIS OF ACCIDENT LAW, 210-227 (1987).

[211] Theoretically, it is still possible for an *ex-post* insurance market to develop. In this market, defendants would insure themselves against their potential liability after being sued. Such insurance would be possible because de-facto aggregation of similar claims by insurance companies would render these claims less costly for them than for individual defendants. For a similar proposal in the symmetric context of mass tort litigation, see David Rosenberg, *Deregulating Insurance Subrogation: Towards an Ex-Ante Market in Tort Claims*, Discussion Paper No. 395, John M. Olin Center for Law, Economics & Business, Harvard Law School (2002). Such a market, however, has not developed in any of the examples discussed in this paper.

[212] *See FTC News Release*: *Business Opportunity Lender Settles FTC's Charges*, *at* www.ftc.gov/opa/2003/05/leasecomm.htm .

[213] *See* lobbying achievements of the RIAA.

[214] *See* Gary S. Becker & George J. Stigler, *Law Enforcement, Malfeasance, and Compensation of Enforcers*, 3 J. LEGAL STUD. 1 (1974); Hensler & Rowe, *supra* note ***, at 137 (noting that class actions can supplement regulatory enforcement by administrative agencies).

that can redress the imbalance between numerous, similarly positioned defendants and plaintiffs. Assuming it applies, each mechanism can offer a reasonably effective local solution. We have shown, however, that none of these mechanisms can presently offer a universal remedy to the problem of numerous defendants. This should come at no surprise, as none of these mechanisms has been proved sufficient for solving the parallel problem of numerous plaintiffs.

V. CONCLUSION

Lawmakers, courts, and legal scholars have long recognized that consolidating the claims of dispersed plaintiffs with similar grievances may promote both justice and efficiency: Without the class action device, numerous victims of a single wrongdoer will often fail to pursue their rights with the socially desirable level of vigor. This, in turn, will not only deny victims their rightful compensation, but also encourage wrongdoers to disregard social harms they produce.

In this Article, we have shown that justice and efficiency also mandate that similarly positioned defendants be provided with an adequate procedure for consolidating their claims. Thus, we have put forward a proposal for the *class defense* device. Specifically, the Article has outlined the novel features that will make this device both effective and fair—*i.e*., that will ensure that it provides class attorneys with proper incentives, adequately protects the due process rights of absentee defendants, and keeps to a minimum the omnipresent risk of abuse.

Our proposal is consistent with modern understanding of the nature of civil litigation. It is well established that the implications of civil litigation often transcend the stakes of the private parties to the dispute.[215] Indeed, legal academics often rely upon this "public law" paradigm of civil litigation to justify class actions.[216] As we have demonstrated, the procedural posture that a dispute might take is not indicative of the social significance of the issues at stake— *i.e*., issues with far-reaching implications arise not only when plaintiffs are dispersed. The class defense mechanism will provide courts with the opportunity to address such questions even when they arise in a dispute between a single plaintiff and numerous defendants.

Moreover, there is reason to believe that the need for class

[215] *See generally* Abraham Chayse, *The Role of the Judge in Public Law Litigation,* 89 HARV. L. REV. 1281, 1284 (1976) (contending that the object of federal civil litigation is often the "vindication of constitutional or statutory policies").
[216] *See* Rosenberg, *supra* note 109, at 905-921.

defense will only increase in the near future. As both the DirecTV and the RIAA cases demonstrate, the scenario in which numerous individuals allegedly harm a single plaintiff is often the byproduct of technological developments, such as the introduction of p2p technology, that facilitate activities whereby dispersed actors can harm the interests of a single victim. The advent of mass production has led to an increase in mass torts class actions.[217] We speculate, therefore, that the present rapid pace of technological innovation will likewise enhance the need for class defenses.

[217] *See, e.g.,* Elizabeth J. Cabraser, *Enforcing the Social Compact through Representative Litigation*, 33 CONN. L. REV. 1239, 1254 (2001) (exploring the relationship between the expansion in mass production and the growth of class litigation).