The Class Defense

Assaf Hamdani & Alon Klement

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 defenses. We explore the circumstances under which litigation costs and collective action problems will prevent dispersed defendants with plausibly valid defenses from confronting plaintiffs in court, and we analyze the troubling implications of this failure to litigate. We then demonstrate that consolidating defense claims would rectify the imbalance between the common plaintiff and defendants. To achieve defendant consolidation, we propose the creation of a new procedural device: the class defense. We outline the qualities that would make the class defense both effective and fair—that is, that would provide class attorneys with proper incentives, adequately protect the due process rights of absentee defendants, and minimize the risk of collusion. Finally, we show that the class defense procedure would afford defendants better protection than many of its alternatives.

INTRODUCTION

This Article highlights a fundamental shortcoming of the legal system, namely, its failure to provide adequate procedural protection to defendants who are individually sued by a single plaintiff over similar questions of fact or law. These dispersed defendants might have plausible defenses against the plaintiff’s claims. Yet, given litigation costs and collective action problems, each defendant might individually prefer to settle rather than to litigate. The failure to litigate in these circumstances undermines the social goals of justice and efficiency.


2. This failure constitutes an 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) [hereinafter Shavell,
This dispersed defendants problem is illustrated by the contemporary crackdown against unauthorized music downloads. The music industry recently embarked on a vigorous litigation campaign to eradicate music file swapping. Departing from their practice of targeting peer-to-peer companies such as Napster, record companies have filed thousands of copyright infringement lawsuits against individuals who allegedly shared music files.

At first blush, this shift in tactics—suing primary wrongdoers rather than mere facilitators—seems appropriate. However, closer inspection reveals that the music industry’s dragnet has potentially troubling consequences. Consider a hypothetical defendant who faces a lawsuit for downloading a handful of music files. For simplicity, assume that the defendant has a valid defense against this lawsuit. Record companies have offered to settle with many defendants for $3,000. On the other hand, the cost of defending against a copyright lawsuit—consisting mostly of attorney fees—is likely to exceed this settlement amount. Under these circumstances, the defendant will likely prefer settlement to litigation.

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3. See In re Aimster Copyright Litig., 334 F.3d 643 (7th Cir. 2003) (upholding a preliminary injunction issued against Aimster); A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004, 1027 (9th Cir. 2001) (upholding, in part, a preliminary injunction issued against Napster).


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 intensified enforcement against individual defendants). Moreover, the strategy of suing peer-to-peer facilitators has been criticized for producing overdeterrence and stifling innovation. See id. at 1349-50 (positing that suing suppliers of peer-to-peer technologies would stifle innovation); Assaf Hamdani, Gatekeeper Liability, 11 S. CAL. L. REV. 53, 107-08 (2003) (cautioning against imposing liability on peer-to-peer companies).

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, e.g., Robert H. Heverly, The Information Semicommons, 18 BERKELEY TECH. L.J. 1127, 1185-88 (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); 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 infringement under U.S. copyright law). But see Cynthia M. Ho, Attacking the Copyright Evildoers in Cyberspace, 55 SMU L. REV. 1561, 1568-70 (2002) (arguing that the notion that noncommercial copying by individuals is legal is a myth).


8. See, e.g., Jefferson Graham, 'Amnesty' for Song Swappers?, USA TODAY, Sept. 8, 2003, at D1 (reporting that attorney fees for fighting the Recording Industry Association of America (RIAA) in court could range between $30,000 and $100,000); Fred von Lohman, Commentary Perspective on Anniversary of RIAA File-Sharing Suits, 20 ENT. L. & FIN. 1 (Oct. 2004) (noting that hiring counsel to defend against the RIAA file-sharing lawsuits costs more than settling).

9. Indeed, evidence suggests that many defendants either settle or simply fail to appear in court. See von Lohman, supra note 8; Associated Press, Conn. Man Fined for Downloading Music (May 13,
she might have a valid defense claim, it would not be economically sensible to pursue it in court.

Somewhat surprisingly, academics and policymakers have generally overlooked this defendant collective action problem and its implications. This omission is remarkable in light of the considerable attention given to the parallel problem of dispersed plaintiffs and its procedural remedy, the class action. In a nutshell, class actions are designed to overcome the disincentive of dispersed, similarly positioned plaintiffs to file lawsuits. By consolidating plaintiff claims, class actions render litigation economically viable for plaintiffs who would not otherwise sue and allow plaintiffs to exploit scale efficiencies. Class actions can therefore compensate victims of wrongdoing, bolster deterrence, and improve administrative efficiency.

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. In the defendant case, the


10. Recently, legal scholars have acknowledged the failure of many defendants in patent litigation to challenge patent validity. See, e.g., Joseph Farrell & Robert P. Merges, Incentives to Challenge and Defend Patents: Why Litigation Won't Reliably Fix Patent Office Errors and Why Administrative Patent Review Might Help, 19 BERKELEY TECH. L.J. 943 (2004) (calling for greater funding for the Patent Office to improve patent review at the application stage); Mark A. Lemley & Carl Shapiro, Probabilistic Patents, 19 J. ECON. PERSP. (forthcoming 2005) (exploring the suboptimal incentives of private parties to challenge patents in courts and considering potential reforms); Joseph Scott Miller, Building a Better Bounty: Litigation-Stage Rewards for Defeating Patents, 19 BERKELEY TECH. L.J. 667 (2004) (proposing a regime of litigation-stage bounties to encourage defendants to challenge patent validity); Edward Hsieh, Note, Mandatory Joinder: An Indirect Method for Improving Patent Quality, 77 S. CAL. L. REV. 683 (2004) (proposing a mandatory joinder solution). We demonstrate 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 differs substantially from the ones that these authors propose. See infra Part II.


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. Rowe, Jr., Beyond "It Just Ain't Worth It": Alternative Strategies for Damage Class Action Reform, 64 LAW & CONTEMP. PROBS. 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. However, class actions are desirable even for larger claims as long as the common defendant enjoys economies of scale that the plaintiffs cannot exploit in the absence of
cost of defending against a lawsuit might lead defendants with legitimate defenses to default or settle. In both cases, the 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.

In Part I, we explore the disincentives for 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 defendants' failure to litigate, 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: (1) DirecTV's so-called end-user campaign that has produced twenty-four thousand separate lawsuits, and (2) Leasecomm's scheme involving thousands of lawsuits with questionable merit that provided Leasecomm with $24 million in judgments.

These examples vividly demonstrate the failure of the existing legal regime to adequately protect dispersed defendants. They also suggest that the defendant problem may be particularly vulnerable to abuse. Specifically, plaintiffs might strategically exacerbate defendants' predicament—by inflating defense costs, for example—to intensify the pressure to settle.

In Part II we consider the proper remedy for this defendant problem. Drawing on insights developed in the class action context, we argue that the solution lies in allowing defendants to consolidate their claims. By acting together and taking advantage of scale economies, members of the defendant group may find litigation economically worthwhile. Moreover, pooling defense claims increases the amount at stake, thereby making the representation of defendants a more 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. As with class actions, the class defense would be a representative procedure driven by consolidation. See generally David Rosenberg, Mandatory-Litigation Class Action: The Only Option for Mass Tort Cases, 115 HARV. L. REV. 831 (2002) (advocating mandatory class actions based on 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).

attorneys lured by private gains to represent the defendant class\textsuperscript{16} and monitored by courts to ensure that absentee defendants are adequately represented. But while it is designed to achieve the same conceptual goal of claim aggregation, the class defense is not a mirror image of the class action. In the remainder of Part II, we provide a tentative blueprint of the novel challenges and features of the class defense.\textsuperscript{17} Specifically, we show that the class defense can provide attorneys with sufficient incentives to undertake representation, operate without violating due process rights, and 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 effective regime of representative litigation.\textsuperscript{18} In class actions, attorneys typically receive a share from the amount that the defendant pays the plaintiff class.\textsuperscript{19} 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 changes 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 would have to pay the fees for the defendant class attorney when the class wins. A class loss at trial, however, would not entitle the plaintiff to recover its fees from the defendant class.

The class defense may raise some distinct due process concerns. To be sure, class litigation is an exception to the fundamental principle that one

\textsuperscript{16} This is the model of the mythical private attorney general. The term "private attorney general" was first coined in \textit{Associated Indus. of N.Y., 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, \textit{The Secret Life of the Private Attorney General}, 61 LAW \& CONTEMP. PROBS. 179, 179-84 (1998) (providing an interesting historical overview of this term).

\textsuperscript{17} The class defense should not be confused with the existing procedure known as the "defendant class action." The defendant class action is a tool available to plaintiffs who wish to enforce their rights against a group of defendants. See generally Robert R. Simpson \& Craig Lyle Pera, \textit{Defendant Class Actions}, 32 CONN. L. REV. 1319 (2000) (discussing the use of defendant class actions in litigation against the gun industry); Stephen C. Yeazell, \textit{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). The class defense, in contrast, would be available to defendants who wish to improve their litigation position vis-à-vis the plaintiff.


\textsuperscript{19} See HANOCH DAGAN, \textit{THE LAW AND ETHICS OF RESTITUTION} 135-36 (2004) (offering a normative justification for requiring class members to bear the cost of attorney fees).
cannot be bound by a judgment in a lawsuit to which one was not a party.\textsuperscript{20} Yet, since absentee defendants may face significant out-of-pocket expenses if the class loses, binding such defendants may pose a threat to their due process rights that is far graver than the threat that class actions pose to absentee plaintiffs. Furthermore, one may argue that the class defense has troubling implications for future defendants—those who engage in the disputed activity but have not yet been sued. 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 could make them worse off. Moreover, future defendants are practically precluded from opting out of the class. By stepping forward and opting out, a future defendant essentially discloses that she engaged in the disputed conduct, thereby increasing her chances of getting sued individually.\textsuperscript{21}

We will show 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 from the risk to absentee plaintiffs in the class action setting. We also demonstrate that the class defense can offer future defendants substantial benefits. Finally, we propose 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 motivate powerful plaintiffs to collude with potential representative defendants and their attorneys in order to use the class defense against defendants.\textsuperscript{22} As we explain, however, the sheer specter of collusion should not disqualify the class defense procedure.\textsuperscript{23} Courts could minimize this risk by


\textsuperscript{21} 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) ("[T]he right to notice and to opt out has remained at the center of class action litigation for the last three decades . . . ").

\textsuperscript{22} 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 only 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, 179-86 (1990) (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).

\textsuperscript{23} The risk of collusion is an inherent byproduct of representative litigation. See Susan P. Koniak & George M. Cohen, Under Cloak of Settlement, 82 Va. L. Rev. 1051, 1056-57 (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. Bruce L. Hay, The Theory of Fee
facilitating competition for the class attorney role and carefully considering class certification.

Part III identifies existing alternatives to the class defense and considers whether these alternatives to the class defense 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 offers a solution that is more comprehensive than the one offered by 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.

I

THE PROBLEM: DISPERSED DEFENDANTS

The core thesis of this Article is that the fundamental justification for consolidating plaintiff claims extends also to defense claims. To develop this argument, we must analyze in depth the case of dispersed, similarly positioned defendants. We do so in this Part, showing that the absence of a mechanism for aggregating defense claims undermines fairness and efficiency.

We begin in Section A 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 in which defendants are numerous and dispersed. Section C briefly reviews three case studies that illustrate both the existence of the dispersed defendants phenomenon and the justice and deterrence concerns that it raises. In Section D, we identify the general conditions under which the problem of numerous defendants is likely to be severe.

A. The Dispersed Plaintiffs Problem and Its Implications

This Section presents the problem facing numerous plaintiffs who were wronged by a single defendant. The analysis will serve as useful background for assessing the parallel case of numerous defendants.

The class action is principally designed to facilitate the filing of suits that would not be filed if victims were to act individually. Since litigation is costly, plaintiffs might refrain from suing wrongdoers in the absence of a mechanism for consolidating their claims. Consider, for example, an investor who purchased one share from a company that recently went public and failed to disclose material information in its prospectus. As a result of this omission, the investor overpaid for the share by $1. Assume that this is a

clear case of fraud and that the investor would surely win in court if she sued the issuer.

If litigation were costless, the investor would 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 litigating the case. Assume that the cost to the investor of bringing a suit and seeing it through would be $100. Under these circumstances, the investor would not sue the issuer because 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 investors with similar claims and that their only option is to file individual suits. Based on the same cost-benefit analysis as above, each investor would decide not to bring a lawsuit against the issuer. As a result, the investors would not be compensated for their losses even though they are entitled to such compensation. Moreover, failing to sue would undermine the deterrence of wrongdoers. The liability system serves a deterrent function by making wrongdoers pay for harms that they cause. When litigation costs prevent victims from filing suits, wrongdoers may not internalize the harm resulting from their conduct. In our example, issuers will have de facto immunity from civil liability for securities fraud, insofar as the cost to investors of litigating exceeds their expected benefit. This would make fraud more attractive to the company at hand as well as to other securities issuers.

Although this plaintiff problem is most salient when plaintiffs’ claims are small, it also has implications for claims that are large enough to litigate. 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 incentive to invest in each lawsuit will reflect its aggregate interest in avoiding liability. In other words, the defendant can

24. We assume that the regime in place follows the conventional U.S. approach under which each party bears its own expenses.

25. See Alon Harel & Alex Stein, Auctioning for Loyalty: Selection and Monitoring of Class Counsel, 22 YALE L. & POL’Y REV. 69, 76 (2004). This is an example of the implications of the divergence between the private and social value of litigation. See generally Shavell, Fundamental Divergence, supra note 2; Shavell, Level of Litigation, supra note 2.

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

27. 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.”). But even large claims may have a negative expected value. That is, the costs of pursuing them may be larger than the expected recovery. This would be the case when the probability of winning is low or litigation costs are high.
utilize scale economies regarding common questions of law and fact. Without the class action device, however, plaintiffs do not enjoy similar economies of scale, as they typically cannot pool their resources due to collective action, communication, and information problems. This asymmetry substantially reduces the value of each individual plaintiff’s claim. As a result, wrongdoing defendants will be sued less often—and face less liability—than they should.

The class action is the key mechanism for addressing the problems associated with 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. Furthermore, increasing the amount at stake renders class representation financially appealing for lawyers. This means that the plaintiff class will file and litigate a suit even when each plaintiff, acting individually, would find litigation economically infeasible. Ideally, class actions compensate deserving plaintiffs and deter wrongdoing defendants.

To be sure, class actions raise a host of dilemmas that have occupied legal academics and policymakers for decades. Our present goal, however, is not to delve into the intricacies of class actions but merely to demonstrate that aggregating plaintiff claims may overcome the disincentives to sue.

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28. See David Rosenberg, Mass Tort Class Actions: What Defendants Have and Plaintiffs Don’t, 37 Harv. J. on Legis. 393, 404-06 (2000) (exploring the link between plaintiffs’ incentives to invest in litigation and defendants’ liability); Rosenberg, supra note 14, at 858-60 (explaining why the absence of a single owner of all plaintiff claims produces high transaction costs and free riding, which inhibit plaintiffs from utilizing scale economies).

29. In addition to addressing plaintiffs’ collective action and cost asymmetry problems, class actions conserve resources by allowing for the efficient resolution of large numbers of similar claims. See Hensler & Row, supra note 13, at 137.

30. See Rosenberg, supra note 14.

31. The conventional deterrence rationale focuses on the impact of class actions on the level of care adopted by potential wrongdoers. See generally Harel & Stein, supra note 25. In many cases, however, victim conduct can also affect the likelihood of harm. See Steven Shavell, Strict Liability Versus Negligence, 9 J. Legal Stud. 1, 6-9 (1980) (exploring optimal liability standards designed to impact both victim and wrongdoer conduct). In these cases, the class action device might also affect victims’ incentives. As we shall see, this would have implications with respect to the class defense as well. See infra Part I.C.3.

B. The Dispersed Defendants Problem and Its Implications

The phenomenon we discussed in the last Section is well known, but the converse—the case of dispersed, similarly positioned defendants—has eluded the attention of academics and policymakers alike. In this Section, we show that disincentives to litigate may arise with respect to defendants as well.

The problem of numerous defendants emerges when unrelated individuals, acting independently, allegedly inflict harm on a single victim who then files separate lawsuits against them. 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 solid defense against the lawsuit. As in the plaintiff case, the failure of defendants with good claims to litigate may undermine both justice and deterrence.

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

Since conducting a patent trial is costly, most defendants will only go to trial if the expected return from doing so exceeds their litigation costs. In other words, if going to trial would cost a defendant more than
$50,000, then the defendant would accept the settlement offer, irrespective of the validity of its claim. Suppose that challenging the patent in court would cost each defendant $1 million. Under these circumstances, each defendant would prefer to settle notwithstanding its legal right to use the technology.

In addition to the unfairness involved in the overpayment of fees, the failure to defend would also undermine the deterrent effect of the liability system. In the plaintiff case, the failure to sue produces under-deterrence of wrongdoers. In the defendant case, in contrast, the failure to defend may over-deter legitimate conduct. The threat of overpaying ex post would impact defendants’ ex ante decisions to engage in conduct that might trigger a lawsuit. Potential defendants would not consider the actual damages they would cause but rather the amount that they would likely pay given their tendency to settle.

Suppose that a start-up has to choose between using Company A’s patented technology or developing a similar technology at the cost of $20,000. As explained above, 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 start-up will prefer to spend $20,000 on developing the equivalent technology. Since the patent is invalid, investing $20,000 in developing an equivalent technology would be socially wasteful. Thus, the prospect of costly litigation would produce not only overpayment by defendants ex post but also overdeterrence of lawful conduct ex ante.

The patent hypothetical highlights some important implications of the defendant case. First, as we demonstrate in the next Section, the plaintiff’s main goal may be to bolster ex ante deterrence, not to receive compensation ex post. Company A, for example, might be more interested in detererring other companies from using its technology than in collecting fees per se. To achieve this deterrence goal, plaintiffs do not have to file lawsuits against all the potential defendants.

Second, the social welfare implications of defendants’ failure to litigate are not limited to the overdeterrence of lawful conduct. Rather, this failure may also result in the under-deterrence of harmful conduct by would-be plaintiffs. Consider Company A’s decision to try to obtain a patent that it knows to be invalid. As long as it can separately sue each alleged

38. See, e.g., Teresa Riordan, Trying to Cash In on Patents, N.Y. TIMES, June 10, 2002, at C2 (reporting that patent experts estimate the average cost of patent litigation to be $2 million); Farrell & Merges, supra note 10, at 948 (“[T]he average patent infringement case now costs roughly $2 million for each party.”).

39. As we explain later, another potential result is under-deterrence of plaintiffs. See infra Part I.C.3.

40. See also Meurer, supra note 34, at 519 (noting that opportunistic patent cases may deter firms from developing new products).
infringer, Company A knows that no defendant will find it economically worthwhile to challenge its patent in court. Thus, Company A will be motivated to seek unjustified patent protection. In other words, defendants’ failure to litigate may produce excessive incentives for filing invalid patent applications.

Most alarmingly, plaintiffs can act strategically to exacerbate the problem confronting each defendant, further diminishing the incentives to go to trial. 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 this is to bring suit in an inconvenient and remote venue. Such venue shopping has, in fact, been used to discourage defendants from litigating, thereby allowing the plaintiff to obtain default judgments. Another way to impose substantial costs on defendants is to obtain provisional relief orders that attach defendants’ property or restrict their economic activity. Although prejudgment remedies are subject to due process restrictions under modern rules of procedure, they may nevertheless be obtained without a considerable investment on the plaintiff’s part.

As we shall explain later, allowing potential defendants to consolidate their claims would rectify the imbalance between plaintiffs and dispersed defendants by enabling the defendant group to exploit economies of scale. Moreover, such consolidation would enhance the incentives of

41. See also Lemley, supra note 35, at 1517-18 (describing the phenomenon of “holdup licensing,” where patent owners seek “to license even clearly bad patents for royalty payments small enough that licensees decide it is not worth going to court”).

42. Note that the problem under which plaintiffs file suits with a negative expected value can arise in a single plaintiff/single defendant setting. See David Rosenberg & Steven Shavell, A Model in Which Suits Are Brought for Their Nuisance Value, 5 INT’L REV. L. & ECON. 3 (1985) (explaining that the ability to extract initial defense costs from defendants might motivate plaintiffs to file suits with nuisance value); Lucian A. Bebchuk, Negative Expected Value Suits, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 551-54 (Peter Newman ed., 1998) [hereinafter NEW PALGRAVE DICTIONARY] (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’L REV. L. & ECON. 261, 265-67 (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 obvious 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 arise only if Company A could enjoy scale economies by litigating common questions of law and fact against multiple defendants and thus reduce its per-case cost below its expected per-case settlement value. Of course, if Company A does not enjoy scale economies but convinces an infringing company that it does, Company A can sue, and the infringer will still settle. This problem, however, is rooted in information issues, not investment asymmetries.

43. See our discussion of the Leasecomm case, infra Part I.C.3.

44. There is a line of precedents establishing various procedural safeguards against provisional remedies’ abuse. For a review of these precedents, see CHARLES A. WRIGHT ET AL., FEDERAL PRACTICE & PROCEDURE § 2934 (1998).

45. See infra Part II.A.
lawyers to represent the defendant group and litigate the case rather than settle. This, in turn, would alleviate both the overdeterrence and underdeterrence problems resulting from the failure of defendants to confront plaintiffs in court.

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 and a single litigant. In both cases, the imbalance could lead individual members of the dispersed group to settle rather than pursue their claims in court, leading to unfair outcomes and undermining deterrence. And in both cases, allowing the parties to consolidate their claims could enable them to exploit scale efficiencies and level the playing field between the group members and their opponent.

C. Case Studies of Dispersed Defendants

The last Section introduced the theoretical scenario in which numerous defendants face a single plaintiff. In this Section, we move away from abstractions and present three contemporary, real-world examples that illustrate both the failure of the legal system to protect dispersed defendants and the grave implications of this failure. The examples cover (1) the music industry’s battle against users of peer-to-peer networks; (2) DirecTV’s aggressive campaign against signal piracy; and (3) Leasecomm’s strategic abuse of the dispersed defendants 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.46 We have no intention of taking a stand in this fierce debate and need not do so for present purposes. 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 overdeterrence—that is, sub-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, and the Internet

has allowed them to distribute these copies at virtually no cost.47 Understandably, these developments have motivated content owners to wage a war to preserve exclusive control over their copyrighted works. The litigation strategy of copyright owners has evolved in several stages.48 They initially targeted the relatively deep-pocketed Internet service providers in an attempt to hold them liable for the misconduct of their users. Defendants included, among others, providers of Internet access and web-hosting services,49 search engines,50 and even Internet auction sites.51 The Digital Millennium Copyright Act of 1998,52 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 networks presented copyright owners with an unprecedented challenge.53 Record labels and movie studios initially sued the providers of peer-to-peer services and software. These efforts were successful in the cases of Napster and Aimster.54 However, this tactic suffered a setback when a federal district court ruled against record companies in Grokster.55

In the aftermath of Grokster, the music industry adopted a new tactic for fighting music downloading. The Recording Industry Association of America (RIAA) launched a vigorous, well-publicized campaign of suing

47. See generally Peter S. Menell, Envisioning Copyright Law’s Digital Future, 46 N.Y.L. SCH. L. REV. 63 (2003) (discussing the impact of these advances on the future of copyright law).
48. The music industry has pursued other measures to preserve its control over copyrighted content. For example, it lobbied for legislation that would require electronic devices to include antipiracy measures. 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 Kelly v. Arriba Soft Corp., 336 F.3d 811 (9th Cir. 2003) (rejecting an infringement lawsuit filed against a search engine that made copyrighted pictures accessible).
51. 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 website).
individual file-swappers for copyright infringement. As of January 10, 2005, the RIAA had filed approximately seven thousand suits against individuals for their use of peer-to-peer networks.

Commentators have applauded this new tactic and even called for enhancing enforcement against individual end users. As our analysis suggests, however, this end-user tactic might be problematic given the absence of a mechanism for consolidating defense claims. To understand why, consider an individual facing a copyright infringement lawsuit for downloading a relatively small number of songs. Suppose that the defendant believes her conduct amounts to fair use and thus does not constitute copyright infringement. Based on newspaper reports of recent settlements, the defendant knows that she can settle for $3,000. 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.

For most individual defendants, $3,000 is a significant sum of money. Yet, this amount pales in comparison to the likely cost of defending against a lawsuit brought by the powerful music industry. Thus, the defendant would reasonably choose to settle, even though she has a valid defense.

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

Consider a teenager who would like to download a handful of music files to help her decide whether to purchase her favorite pop star's new album. Assume again that downloading music files for this purpose amounts to "fair use" and thus does not constitute copyright infringement. The music fan estimates her likelihood of being sued by the record label producing this new album at 10%. In light of the prohibitive cost of defending against

57. See Kirsner, supra note 4.
58. See Lemley & Reese, supra note 5, at 1351 (endorsing criminal prosecutions and increased monetary judgments against individual downloaders).
59. For a discussion of the applicability of the fair use defense, see infra note 65 and accompanying text.
60. See Reuters, RIAA Sues 493 More Music Swappers, supra note 7 (reporting that the RIAA has settled more than four hundred 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 after it was criticized for being misleading. See Matt Hines, RIAA Drops Amnesty Program, CNET NEWS.COM (Apr. 20, 2004), at http://news.com.com/RIAA+drops+amnesty+program/2100-1027_3-5195301.html.
61. See Associated Press, supra note 9.
62. See sources cited supra note 8.
the lawsuit, the teenager expects to settle for $3,000 if she is sued. As a result, she would not download the music files unless her benefit from doing so exceeds $300, which is unlikely. The prospect of costly litigation may discourage not only copyright infringement but also perfectly lawful behavior.

The scenario that we describe is realistic. Contrary to some early statements, the RIAA has not limited its lawsuits to "egregious" cases in which hundreds or thousands of music files have been downloaded or uploaded for others' use. Rather, it appears that some lawsuits target Internet users whose alleged infringement consists of downloading a very small number of music files.

This distinction is important because some copyright lawyers argue that limited consumer downloading falls within the "fair use" defense to copyright infringement. Moreover, those accused of downloading a relatively small number of files—and who are thus more likely to be protected under the fair use defense—are also those who have stronger incentives to settle. Since the magnitude of the sanction for copyright infringement increases with the number of files downloaded, the value of defending against a copyright infringement lawsuit is likely to be smaller for those accused of downloading a relatively small number of files. Thus, courts may not have an opportunity to determine whether this subset of music downloads is legal. This, in turn, increases the threat of overdeterrence.

To summarize, the recent campaign against music file swappers illustrates the quandary presented when a single, powerful plaintiff sues dispersed defendants. Individuals downloading music files may indeed be more appropriate 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. Assuming that some file sharing is protected under the fair use defense, this might over-deter Internet users from sharing music files.

2. DirecTV's End-User Campaign

The RIAA's dragnet seems half-hearted when compared to DirecTV's aggressive battle against signal piracy. This is a story of a just cause—


64. See Associated Press, supra note 9 (reporting the outcome of a lawsuit accusing the defendants of downloading five music files); Associated Press, Woman Fined for Getting Tunes off Internet (May 6, 2004), available at http://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).

65. See supra note 6. Lemley and Reese, for example, envision a system of intensified enforcement only against "high-volume uploaders." See Lemley & Reese, supra note 5, at 1399-1400.

66. If the RIAA allows all defendants to settle for $3,000, then defendants will compare defense costs to the amount of the settlement offer.
fighting illegal signal pirates—that has turned into a controversial litigation campaign that allegedly squeezed relatively high settlement payments even from 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.67

Computer programmers and hardware manufacturers quickly developed techniques to allow unauthorized users to obtain free satellite programming from DirecTV.68 This created a significant piracy problem; analysts estimated that by 2003 there were a million or more households illicitly receiving DirecTV signals.69 Analysts also estimated that DirecTV lost revenues of $1.2 billion per year, a substantial amount compared to the company’s $7.2 billion annual revenue.70

DirecTV adopted various technological measures to eliminate signal piracy. Each measure, however, was quickly countered by software and hardware developments that facilitated free access to the company’s programming.71 DirecTV then adopted a new tactic: filing lawsuits against individuals who illegally received satellite-broadcast programming.72 Apparently because direct evidence of unauthorized signal reception is difficult to obtain, DirecTV decided to sue even when it had no evidence of signal piracy other than the defendant’s purchase of a smart-card device.73 As we shall explain below, this decision was crucial in turning DirecTV’s legitimate battle to enforce its rights into a controversial campaign that might produce unjust results and deter perfectly legal conduct.

71. Allegedly, DirecTV initially broadcast “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 responded with other innovations. Poulsen, supra note 68.
72. See Darrin Schlegel, DirecTV Dragnet Casting Wide Net, HOUS. CHRONICLE, Jan. 18, 2004, at A1 (reporting that DirecTV initially focused its crackdown on Web-based distributors of illicit receiving technology and only then resorted to suing individuals).
73. Interestingly, DirecTV claims that it will drop its case if it turns out in the pretrial legal process of discovery that a defendant is clearly innocent. See John Accola, DirecTV Casts Wide Net: Clients Fight Back, Claim Company Is on a Witch Hunt, ROCKY MOUNTAIN NEWS, Dec. 13, 2003, at C1 (statement of the company’s assistant general counsel). As we explain in this Article, however, individuals are likely to settle if the cost of such pretrial proceedings exceeds DirecTV’s settlement offer.
DirecTV claims to have filed more than 24,000 lawsuits against end-user defendants, but even this large figure provides an incomplete picture of the company’s anti-piracy efforts. In addition to filing lawsuits, DirecTV has mailed more than 170,000 demand letters to alleged smart-card holders, warning them that the purchase and possession of signal theft equipment subjects them to statutory damages of up to $10,000 per violation. These letters also suggested that the holders surrender their smart cards, commit to refrain from further purchases of such devices, and pay DirecTV for past wrongful conduct.

Most importantly for our purposes, DirecTV has offered to settle with smart-card holders for $3,500. This amount is puzzling since it seems to have no relation to actual litigation prospects. Indeed, some claim that DirecTV set this amount strategically to coerce smart card holders into settlement without even requiring DirecTV to file a suit.

We neither claim that signal piracy is legal nor dispute that it may be detrimental to satellite TV operators. Indeed, 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. Unfortunately, many defendants may have no such guarantees. Since the cost of confronting DirecTV in court likely exceeds $3,500, many individuals who receive a demand letter are likely to settle, regardless of the validity of their legal claim.

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76. Samples of such cease and desist letters can be found at a website dedicated to defending against DirecTV’s campaign. See Electronic Frontier Foundation, DirectTV Defense, at http://www.directvdefense.org/files (last visited Mar. 17, 2005). The first sample letter mentions the $10,000 in damages.
77. Id.
78. See von Lohmann, supra note 75.
79. John Fisher, a former member of the End User Development Group, testified in a wrongful-termination lawsuit against DirecTV that he was told to tell potential defendants that it would be cheaper to settle for $3,500 than to hire an attorney. See Declaration of Plaintiff John Fisher, s. 22, Fisher v. DirecTV, Inc. (YC 048689), available at http://www.overhauser.com/DTV/main.html (last visited Feb. 8, 2005). 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.” Id. Ultimately, the wrongful-termination lawsuit was dismissed on procedural grounds. See Kevin Poulsen, Ex-investigator’s Suit Against DirecTV Dismissed, SECURITY Focus News (June 2, 2004), at http://www.securityfocus.com/news/8815. Once DirecTV filed a lawsuit against a holder, it agreed to settle only for a larger sum. See Schlegel, supra note 72 (reporting this practice and the accusations that it was designed to extract settlements).
80. See, e.g., Schlegel, supra note 72 (reporting that attorneys claim that their fees exceed the $3,500 settlement amount).
81. Since defense costs consist mostly of attorney fees, some individuals have decided to represent themselves in court rather than settle. See id.
If DirecTV pursued only genuine signal thieves, this situation might be substantively (although not procedurally) fair. However, as we explained earlier, DirecTV cannot easily obtain direct evidence of piracy, so it has targeted certain individuals for their mere possession of smart-card devices. The case against many smart card holders, however, is shaky on both legal and factual grounds.

From a legal standpoint, the key question is whether DirecTV has a private right of action against individuals based upon their mere purchase of smart card devices. While several district courts adopted DirecTV's position, others have rejected it and required proof of actual signal interception to hold defendants liable. The Eleventh Circuit, for example, recently held that DirecTV has no right of action against persons for their mere possession of smart card devices.

Beyond the legal issue, devices designed for decrypting DirecTV signals can, as a factual matter, be used for perfectly legal purposes. Signal pirates buy smart cards to repair satellite TV access cards that have been placed in an infinite loop by one of DirecTV's electronic countermeasures. Others, in contrast, use smart card devices for legal purposes, such as encryption system development, audiovisual exhibit management, network security administration, home and computer security, and automotive electronic control.

The potential to use smart cards for multiple purposes demonstrates the troubling implications of the disincentive to defend. Some uses for smart-card devices are not only legal but also could lead to socially valuable innovation. By indiscriminately suing smart card purchasers, DirecTV

82. The Eleventh Circuit described the issue as "whether 18 U.S.C. section 2520(a), as amended in 1986, provides a private right of action against persons who possess devices used to intercept satellite transmissions in violation of 18 U.S.C. section 2512(1)(b) ..." DirecTV, Inc. v. Treworgy, 373 F.3d 1124, 1125 (11th Cir. 2004).
85. Treworgy, 373 F.3d 1124.
has effectively raised the price of each device by as much as $3,500. This could eliminate purchases by individuals whose expected personal benefit from the devices is lower than $3,500 yet whose use could benefit society at large.

To summarize, DirecTV’s “end-user campaign” demonstrates both the fairness and deterrence concerns that arise when dispersed, similarly positioned defendants face a powerful plaintiff. Regardless of whether DirecTV’s end-user campaign has succeeded in deterring signal piracy, it may have punished some individuals who had no intention of using smart card devices for illegal purposes and may have precluded others with lawful goals from purchasing the devices in the first place. As one defense attorney put it, “there are as many people out there getting sued who are not pirating [DirecTV’s] signal as there are pirates. They’re catching a lot of dolphins in that tuna net.”

3. Leasecomm’s Financing Scheme

In the previous two examples, plaintiffs embarked on litigation campaigns to deter what they genuinely believed to be illegal conduct. Our next example, in contrast, illustrates a different pattern. The plaintiff, Leasecomm, allegedly devised a fraudulent scheme to lure people into contracts that they would later fail to satisfy. Most important for our discussion, Leasecomm then sued to enforce the agreements, relying on defendants’ disincentives to defend in court to obtain thousands of judgments totaling $24 million.

We use this case to make two points. First, the problem of dispersed defendants might not only over-deter potential defendants but also under-deter wrongdoers who could then become plaintiffs. Second, plaintiffs can strategically exacerbate defendants’ problems 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 bought these items as part of their purchase of a business opportunity or a profit-making venture. Many of these ventures allegedly turned out to be worthless, get-rich-

87. The market retail price of smart cards seems to be much lower. See, e.g., Poulsen, supra note 86 (reporting a purchase of a smart card for $79). The text assumes that DirecTV files a suit against all purchasers of smart card devices.
88. Id.
quick schemes (such as Internet web malls, multilevel marketing programs, and pyramid schemes). \textsuperscript{90}

Since the monthly payments under the lease corresponded to the price of the complete business package, many customers claimed that they were led to believe that they were entering into a financing agreement for the entire 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 discovered that the business venture was worthless, customers realized that they owed Leasecomm \$4,000 for equipment with a retail value of approximately \$400-$500.\textsuperscript{91}

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, it filed suits against 27,000 customers and secured \$24 million in court judgments. Based on a jurisdiction clause in the lease contract, Leasecomm regularly filed suits in Massachusetts, even though most customers resided in other states.\textsuperscript{92}

Leasecomm's strategy rendered defense expenses for customers prohibitively high, especially when compared to the amounts at stake. The vast majority of customers who were sued in Massachusetts neither appeared in court nor defended, thereby allowing Leasecomm to obtain default judgments.\textsuperscript{93} Even those who were represented by an attorney could not justify extensive investment in legal research or afford witnesses' travel expenses to Massachusetts. Although many customers apparently had valid legal arguments and counterclaims,\textsuperscript{94} few of them found it economically worthwhile to challenge Leasecomm in court.\textsuperscript{95}

To summarize, it appears that Leasecomm carefully designed its collection strategy to take advantage of the collective action problem facing numerous defendants. This example vividly illustrates the potentially grave consequences of the dispersed defendants problem. In the absence of a device for aggregating defense claims, plaintiffs can intentionally enforce unfair and illegal obligations on innocent defendants.

\begin{itemize}
\item \textsuperscript{90.} See FTC Complaint, \textit{supra} note 89.
\item \textsuperscript{91.} \textit{Id}.
\item \textsuperscript{92.} \textit{Id}.
\item \textsuperscript{93.} For testimonials by numerous Leasecomm customers, see ConsumerAffairs.com, Consumer Complaints About Leasecomm, at http://www.consumeraffairs.com/business/leasecomm.html (last visited Feb. 8, 2005).
\item \textsuperscript{94.} FTC Complaint, \textit{supra} note 89 (reviewing the substantive defenses that customers could raise).
\item \textsuperscript{95.} \textit{Id}. (noting that "few of the customers can afford the expense of litigation in a distant forum and most cases have ended in default judgments").
\end{itemize}
D. Social Desirability of Failures to Defend

So far, we have shown that the case of dispersed defendants generally parallels that of dispersed plaintiffs. In both cases, individual members of the dispersed group—whether plaintiffs or defendants—might settle rather than pursue their claims in court given the cost of litigation. One might contend, however, that our analysis has overlooked a crucial difference between the two. Failures to sue create a regime of immunity for wrongdoers; failures to defend, in contrast, essentially create a no-fault liability regime that might 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. In this Section, we explain why this argument is misguided.

A regime in which defendants always settle is essentially a no-fault regime; regardless of their level of fault, all defendants pay damages. This insight casts doubt on the extent to which the dispersed defendants phenomenon raises overdeterrence concerns. After all, law and economics scholars have shown that strict liability can provide defendants with incentives to take adequate precautions, induce optimal activity levels, and be administratively cheaper than negligence or fault-based liability. Thus, it may appear that the no-fault regime imposed on dispersed defendants is desirable.

Indeed, if plaintiffs sue the right defendants for precisely the correct amount of damages, a system that prevents dispersed defendants from challenging plaintiffs in court might approximate an optimal strict liability regime. But this scenario is unrealistic. If they can force defendants to settle, plaintiffs will have no incentive to sue only genuine wrongdoers or to demand only the correct amount of damages. In the absence of fair trials, there is an omnipresent risk of false accusations and other errors. Moreover, even if strict liability is optimal for a particular kind of misconduct, courts often must address questions of fact or law. Courts may need to resolve questions concerning causation, the magnitude of damages, or other legal issues. Even supporters of strict liability will agree that defendants should be accorded an opportunity to defend themselves in court.

98. This is because under strict liability, courts do not need to determine the adequate standard of care or verify whether the defendant satisfied the standard. See Richard A. Epstein, A Theory of Strict Liability, 2 J. Legal Stud. 151, 188 (1973) (noting that under strict liability, "[t]here 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").
99. See generally Louis Kaplow & Steven Shavell, Accuracy in the Assessment of Damages, 39 J.L. & Econ. 191 (1996). Note, however, that many questions of fact or law may be "non-common" and thus provide no basis for consolidating defense claims. In the file-sharing example, issues such as
Consider the DirecTV example. Even if signal piracy is illegal, courts must decide whether the purchase of smart cards is itself unlawful. If all purchasers agree to settle, courts will not address this question and thus they will fail to provide guidance to those considering purchasing such devices.

Finally, even law and economics scholars acknowledge that strict liability is not always desirable. This generally will be the case when an activity externalizes benefits upon third parties. Under a strict liability regime, defendants engaging in such activities will internalize the costs of their conduct but not its benefits. In contrast, a fault-based liability regime can be calibrated to provide potential defendants with optimal incentives even when they cannot capture the full value of their activities.

II
THE CLASS DEFENSE SOLUTION

Part I showed that numerous, dispersed defendants who act individually and face a single plaintiff might have suboptimal litigation incentives. Legal scholars have overlooked this issue and its implications for the effectiveness of the liability system. In this Part, we put forward a tentative proposal for rectifying the problem. We show that enabling defendants to consolidate their claims would generally solve the collective action problem that they face and allow defendants to enjoy scale efficiencies. For plaintiffs, the doctrinal vehicle for consolidating claims is the class action. In this Part, we propose a parallel device for defendants: the class defense.

the identify of the downloader and the number of downloads should not be resolved within a class defense. For a discussion of this point in the class action context, see Randy J. Kozel & David Rosenberg, Solving the Nuisance-Value Settlement Problem: Mandatory Summary Judgment, 90 Va. L. Rev. 1849, 1880-90 (2004).

100. 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).

101. See supra notes 83-86 and accompanying text.


103. For an example involving network externalities, see Neal K. Katyal, Criminal Law in Cyberspace, 149 U. Pa. L. Rev. 1003, 1095-101 (2001) (exploring the impact of strict ISP liability given the network externalities characterizing the Internet). Peer-to-peer file sharing may also involve network externalities. However, the implications of such externalities for the proper liability regime for unauthorized file downloads are beyond the scope of this Article.

104. The most prominent example is liability for harmful speech. Courts have consistently held that strict liability for harmful speech may create an undesirable chilling effect. See New York Times v. Sullivan, 376 U.S. 254 (1964). The economic explanation is that speech is a public good, that is, that speakers do not capture the full social value of their speech. Hence, if speakers pay for all the harm they cause, from a social perspective they might be overly cautious in exercising their right to speak. For a discussion of the optimal liability regime for harmful speech, see Oren Bar-Gill & Assaf Hamdani, Optimal Liability for Libel, 2(1) Contrib. to Econ. Analysis & Pol'y Art. 6 (2003), at http://www.bepress.com/bejeap/contributions/vol2/iss1/art6 (last visited Feb. 8, 2005).
Our analysis in this Part has three objectives: (1) to demonstrate that consolidating claims can eliminate the dispersed defendants problem; (2) to establish the class defense as an effective and fair mechanism for consolidating defense claims; and (3) to provide a tentative outline of the key features of the class defense mechanism.

Turning the class defense into a workable alternative will require the resolution of many thorny issues, including, for example, personal jurisdiction and the collateral effects of the class defense on those who opt out. We do not intend to provide a detailed blueprint of the class defense in this Article. Rather, our objective is to highlight the novel difficulties that might confront this mechanism and to identify tentative solutions.

Before proceeding, we would like to emphasize that the class defense should not be confused with the existing procedure known as the defendant class action. Although similar in name, the two mechanisms serve entirely different purposes. The paradigmatic defendant class action involves a plaintiff seeking adjudication of claims containing questions of law or fact that are common to a class of defendants. In this setting, it is the plaintiff who names the representative defendant and asks the court to certify the lawsuit as a class action. 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. The defendant class action thus serves 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 create parity between a single plaintiff and a group of similarly positioned defendants.

Part II.A reviews the advantages associated with consolidating defense claims. Part II.B elaborates on the challenge of providing class defense attorneys appropriate incentives. Part II.C discusses due process concerns. Part II.D analyzes the risk of collusion in class defense cases. Part II.E concludes by outlining the main procedural features of the class defense.

105. In a defendant class action, "[o]ne or more members of a class may sue or be sued as representative parties." Fed. R. Civ. P. 23 (emphasis added).
106. For the history of the defendant class action, see Note, Certification of Defendant Classes under Rule 23(b)(2), 84 Colum. L. Rev. 1371, 1380-83 (1984); Yeazell, supra note 17.
107. 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." Yeazell, supra note 17, at 700.
108. See Note, Defendant Class Actions, 91 Harv. L. Rev. 630, 630 n.3 (1978).
A. Benefits from Consolidation: Scale Economies and Marketability

Allowing defendants to consolidate their claims will encourage them to stand up to plaintiffs in court.\footnote{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 consolidation in class actions, see Dam, supra note 13; Geoffrey Miller, Class Actions, in NEW PALGRAVE DICTIONARY, supra note 42, at 257-58; Charles Silver, Class Actions—Representative Proceedings, in ENCYCLOPEDIA OF LAW AND ECONOMICS 194, 201-09 (B. Bouckaert & G. De Geest eds., 2000).} 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, we will focus on three key advantages that aggregation offers defendants: 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 to lawyers.

The class defense overcomes the disincentive to confront lawsuits by allowing dispersed defendants to exploit economies of scale otherwise available only to the plaintiff.\footnote{For analyses of the economies of scale available to defendants in class actions, see Bruce L. Hay & David Rosenberg, “Sweetheart” and “Blackmail” Settlements in Class Actions: Reality and Remedy, 75 NOTRE DAME L. REV. 1377, 1383-89 (2000) (arguing that when claims are litigated separately, plaintiffs are overburdened by litigation costs, artificially strengthening the defendants’ positions); David Rosenberg, Class Actions for Mass Torts: Doing Individual Justice by Collective Means, 62 IND. L.J. 561, 564-65 (1987) (calling for expanded use of class actions in mass-tort cases, where defendants can spread their litigation costs over the entire class of claims while individual plaintiffs cannot); David Rosenberg, The Causal Connection in Mass Exposure Cases: A “Public Law” Vision of the Tort System, 97 HARV. L. REV. 849, 902-05 (1984) [hereinafter Rosenberg, Public Law Vision] (“Defendants can generally exploit ‘private law’ process to achieve many of the economies of scale afforded by aggregative procedure.”); Rosenberg, supra note 28, at 397-400 (“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.”).} To illustrate, consider the following scenario, which is a highly simplified version of the signal-piracy case. Assume that DirecTV files one hundred lawsuits against smart card holders. DirecTV offers to settle with each defendant for $3,500; for each defendant, the cost of mounting a decent defense is $100,000. Assume that holding a smart card is perfectly legal. Acting individually, each defendant in this situation normally would prefer to settle. However, if the defendants can consolidate their defenses and face DirecTV in court as a cohesive group, they may choose to litigate. More specifically, defendants will litigate rather than settle if consolidation sufficiently reduces the per-defendant cost of litigation.

Consolidation will reduce per-defendant litigation costs when it allows defendants to take advantage of economies of scale. Many DirecTV lawsuits raise a common legal issue—which the mere purchase of a smart card device is illegal.\footnote{See supra text accompanying notes 83-86.} The cost of researching and litigating this issue is unlikely to increase significantly with the number of defendants.
Suppose, for example, that the cost for the entire defendant class to litigate this issue remains $100,000. Under this assumption, the defendant group will defend rather than settle. Assuming that each defendant bears equally the cost of defense, the expected value of litigation is now $2,500. Each defendant would bear $1,000 in litigation costs to save $3,500 in settlements.

In addition to encouraging defendants to defend by letting them exploit economies of scale, consolidation also helps to create some balance between plaintiffs and defendants. Plaintiffs typically enjoy economies of scale because they can spread litigation costs over their entire pool of defendants. The plaintiffs in all our featured examples—RIAA, DirecTV, and Leasecomm—filed boilerplate complaints and thus did not incur significant costs in filing additional suits. The class defense would allow members of the dispersed defendant group to exploit similar scale advantages.

Although the consolidated defense has a positive expected value, it can still fail to resolve the dispersed defendants problem. The benefits of consolidation are public goods: all members of the defendant class share them, they are nonexcludable (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). 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 consolidation without contributing effort and money.

The consolidation mechanism must overcome this free rider problem. The class defense can achieve this goal by adopting a representational approach under which relevant defendants need not actively consent to their inclusion in the class.

112. 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-defendant remains $100,000 regardless of group size, then the aggregate defense cost will be $10 million ($100,000 for each defendant in a group of 100 defendants) whereas the expected benefit will be $350,000.

113. In fact, if DirecTV knows it is bound to lose against the class of defendants, it would not pursue litigation to begin with. Thus, the mere opportunity to consolidate defenses may deter meritless lawsuits.

114. A similar point is made in Hsieh, supra note 10, at 692-93.

115. Economists define public goods as goods that are nonexcludable and nondepletable. See, e.g., ANDREU MAS-COLELL ET AL., MICROECONOMIC THEORY 359-60 (1995); JOSEPH E. STIGLITZ, ECONOMICS OF THE PUBLIC SECTOR 79-80 (3d ed. 2000). See also Farrell & Merges, supra note 10, at 952 (explaining why a successful challenge to patent validity is a public good).

116. A free rider problem may be characterized as a situation in which an action that would best serve the goals of all group members would conflict with the private interest of any individual group member who is supposed to perform it. On the free rider problem within large groups, see OLSON, supra note 1, at 9-16.

117. For a discussion of the representational model of class actions—and its competitor, the joinder model—see Diane P. Hutchinson, Class Actions: Joinder or Representational Device?, 1983
Finally, the class defense renders the representation of defendants more attractive to potential attorneys. When the expected value of either prosecuting or defending against a lawsuit is negative, it is unlikely that private attorneys will agree to undertake representation on a contingent basis.\textsuperscript{118} Consolidation makes representation more attractive to lawyers by turning multiple defenses with negative expected values into a pool of defenses with a 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—that is, the conventional assumption that private lawyers in pursuit of private gain are those who initiate class proceedings that serve the public interest. We will elaborate on the incentives of class defense attorneys in the next Section.

\textbf{B. Incentivizing Class Defense Attorneys}

As the experience with class actions shows, class attorneys would play a key role in class defenses:\textsuperscript{119} they would identify lawsuits in which class certification may be appropriate and petition the court for class certification. To fulfill this important role, however, class attorneys must be provided with appropriate incentives.\textsuperscript{120}

The principal vehicle for incentivizing class attorneys is their fee.\textsuperscript{121} Unlike attorneys in ordinary litigation, class attorneys have no clients to hire them, monitor their litigation and settlement decisions, or pay their fees. Although courts may (to some extent) perform the first two tasks,\textsuperscript{122} the payment of fees is more complex and requires careful institutional design. The conventional wisdom is that class attorney fees should be

\textsuperscript{118} See Rosenberg, Public Law Vision, supra note 110, at 889-92 (contending that a claim cannot gain access to the court system unless it is marketable to plaintiffs' attorneys).

\textsuperscript{119} See Macey & Miller, supra note 15, at 3 (positing that plaintiffs' 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").

\textsuperscript{120} See generally John C. Coffee, Jr., Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working, 42 Md. L. Rev. 215 (1983) (arguing that the incentives provided to class attorneys are both inadequate and counterproductive in terms of the social interests that private law enforcement is intended to serve); Coffee, supra note 15 (explaining the behavior of plaintiffs' attorneys who specialize in class and derivative litigation in terms of the incentives and organizational problems that they face).

\textsuperscript{121} See Bebchuk, supra note 18, at 894-96 (stressing the importance of providing class attorneys with sufficient fees).

\textsuperscript{122} See Fed. R. Civ. P. 23(c) (certification of a class action); id. at 23(d) (monitoring of litigation); Fed. R. Civ. P. 23(e) (consideration of settlement, voluntary dismissal, or compromise); Fed. R. Civ. P. 23(g) (appointment of class counsel).
structured to align the interests of attorneys with those of the class they represent, thus providing attorneys with appropriate incentives. To achieve this outcome, we must identify an appropriate source and structure for the fees.

There are two main approaches to awarding attorney fees in class actions: the "common fund" doctrine and fee shifting. As we shall explain, however, only the fee-shifting method is workable for class defenses.

1. Common Fund: Why It Would Fail in the Class Defense Context

Under the common fund doctrine, a class attorney who creates, increases, or preserves a monetary benefit that extends to all class members is entitled to reimbursement for her costs and a reasonable fee. This amounts to a contingent fee based on a share of the common fund recovered at trial or in a settlement. If the defendant wins, the class attorney receives nothing; but if the class prevails or the parties settle, the attorney receives a fee designed to compensate her for her costs and the risk of non-recovery in the event of a loss. The common fund doctrine not only serves the equitable goal of preventing unjust enrichment by class members

123. A proper fee structure should align the interests of the class and the attorney and motivate the attorney to file and litigate the class action. For a detailed analysis of this issue, see Klement & Neeman, supra note 18.

124. See ALBA CONTE, 1 ATTORNEY FEE AWARDS § 2.1 (2d ed. 1993); 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) [hereinafter THIRD CIRCUIT TASK FORCE]. The common fund doctrine was designed to prevent the unjust situation in which class members enjoy an uncontracted-for benefit conferred by class representatives and their lawyers without being obliged to pay reasonable fees and expenses. See Cent. R.R. & Banking v. Pettus, 113 U.S. 116, 126-27 (1884).

125. The contingent fee takes one of two forms: a percentage fee or a "lodestar" hourly contingent fee. For a review and comparison of these forms, see CONTE, supra note 124, §§ 2.02-2.07; DERFNER & WOLF, supra note 124, § 15.01; THIRD CIRCUIT TASK FORCE, supra note 124, at 242-46; ALAN HIRSCHE & DIANE SHEEHEY, AWARDING ATTORNEYS' FEES AND MANAGING FEE LITIGATION 63-71 (1994); MANUAL FOR COMPLEX LITIGATION FOURTH § 14.1 (2004). 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).

126. See Janet Cooper Alexander, Contingent Fees and Class Actions, 47 DePaul L. Rev. 347, 349-50 (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, 562-67 (1992), that risk enhancement should not be allowed in statutory fee-shifting cases. Views differ about the application of this holding to common fund cases. See, e.g., Goldberger v. Integrated Res., Inc., 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 Ga., 34 F.3d 560 (7th Cir. 1994) (same); In re Washington Pub. Power Supply, 19 F.3d 1291 (9th Cir. 1994) (same); In re Bolar Pharm. Co. Sec. Litig., 800 F. Supp. 1091, 1095-96 (E.D.N.Y. 1992) (stating that the application of Dague's holding to common fund cases would not defeat the purpose of the equitable fund doctrine).
ex post but also provides attorneys with incentives to pursue class actions ex ante.\textsuperscript{127}

Collection of attorney fees in the typical monetary class action is rather simple. The attorney is only entitled to a fee once the class has prevailed and a common fund has been created. The fee is paid by the defendant and deducted from this fund.

The common fund doctrine is theoretically available in class defenses as well. But while this doctrine is effective in class actions, collection problems will make it unworkable in the class defense context. 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—they will not have to pay damages to the plaintiff. There is therefore no inherent reason the class attorney cannot share in this benefit under the common fund doctrine.\textsuperscript{128} The problem, however, is that no money changes hands when the class wins. The fund created by the class attorney is the amount \textit{not} paid by defendants. Thus, applying the common fund doctrine would require a class attorney to collect her fees from each defendant. The transaction costs associated with collecting such fees are likely to be high.\textsuperscript{129} Applying the common fund doctrine would therefore diminish attorneys’ incentives to undertake class defense representation.\textsuperscript{130}

2. \textit{Fee Shifting: The Solution to Incentivizing Class Defense Attorneys}

Since the common fund doctrine is impracticable, we propose to incentivize class defense attorneys with a one-sided fee-shifting rule. Under this rule, the plaintiff would pay the fees of the defendant class attorney if the class prevailed at trial or the parties settled. If the class lost, the class attorney would not receive any fees, and the plaintiff would not be entitled to recover its attorney fees either.

This proposal would mark a departure from the “American Rule,” which dictates that each litigant bear her own legal costs regardless of the

\textsuperscript{127} For an analysis of these two objectives of attorney fee awards in class actions, see Charles Silver, \textit{ARestitutionary Theory of Attorneys’ Fees in Class Actions}, 76 CORNELL L. REV. 656 (1991).

\textsuperscript{128} The common fund doctrine has been extended to allow for attorney fee awards even when no fund is created. See \textit{Sprague v. Ticonic Nat’l Bank}, 303 U.S. 161, 166-67 (1939) (allowing counsel fees even though the common benefit was created through precedent established in an individual proceeding); \textit{Conte, supra} note 124, § 2.01.

\textsuperscript{129} The problem would be less acute if the plaintiff obtained partial victory and moved to collect damages from class members. In this case, the class attorney’s fee could 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 on the plaintiff’s recovery, and that would create severe conflict of interest problems.

\textsuperscript{130} Allowing class attorneys to collect from class members could also enhance incentives for collusion between plaintiffs and class attorneys. Plaintiffs would artificially inflate their initial demand and settle for a smaller amount. This in turn would increase the fees payable by class members.
trial's outcome.\textsuperscript{131} This departure would probably require explicit congres-
sional authorization\textsuperscript{132} and might even discourage some plaintiffs with
valid claims from filing lawsuits.\textsuperscript{133} However, the one-sided fee-shifting
rule is not a newcomer to class litigation. With respect to attorney fees,
class defenses are analogous to non-monetary class actions, such as class
actions seeking injunctive or declaratory relief.\textsuperscript{134} In these types of cases,
the class attorney renders a valuable service but the benefit that the attor-
ney produces does not take the form of a tangible monetary fund.

To overcome this problem, class actions for injunctive and declaratory
relief often employ a one-sided fee-shifting rule to compensate class attor-
neys.\textsuperscript{135} Indeed, such a rule is embedded in more than 150 fee-shifting stat-
utes that span class actions in antitrust, environmental protection, civil
rights, and many other areas.\textsuperscript{136}

Analogizing class defenses to non-pecuniary class actions is helpful
on another matter as well, namely, the valuation difficulties associated with
setting class attorney fees. Class attorney fees are based on the benefit the
attorney produces for the class. Measuring that benefit would be difficult in
class defense cases. Courts would be forced to determine the extent to
which the attorney relieved class members of their potential liability. This
would require rough estimates of actual liability and the hypothetical liabil-
ity that would have been imposed had the attorney not represented the class

\textsuperscript{131} See Alyeska Pipeline Co. v. Wilderness Soc'y, 421 U.S. 240, 247 (1975) ("In the United
States, the prevailing litigant is ordinarily not entitled to collect a reasonable attorneys' fee from the
loser."). The "English Rule," in contrast, requires the losing party to bear the legal costs of the
prevailing party. There is an ongoing debate concerning which rule is more efficient, how each rule
affects the rate of filing and settlements, and which rule facilitates better access to justice. See
Symposium: Attorney Fee Shifting, 47 LAW & CONTEMP. PROBS. 1 (1984); Symposium on Fee Shifting,
71 CHI.-KENT L. REV. 415 (1995); see also Avery W. Katz, Indemnity of Legal Fees, in
ENCYCLOPEDIA OF LAW AND ECONOMICS, supra note 109, at 63 (reviewing the literature comparing the
American and English fee-shifting rules). Generally speaking, no definite conclusions have
materialized. See James W. Hughes & Edward A. Snyder, Allocation of Litigation Costs: American and
English Rules, in NEW PALGRAVE DICTIONARY, supra note 42, at 55 ("The theory of the English rule
does not produce unambiguous predictions about its effect on claim disposition.").

\textsuperscript{132} See Alyeska Pipeline Co., 421 U.S. at 247-57 (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).

\textsuperscript{133} A one-sided fee-shifting rule increases the expected cost of trial for a losing plaintiff. When
plaintiffs cannot predict the outcome of litigation with certainty, such a rule would discourage not only
frivolous suits, but also those with merit. One way to mitigate the chilling effect of the one-sided fee-
shifting rule on meritorious suits would be to take into account the margin by which the defendants
won, that is, how strong the court perceives the case to be at the end of the trial. For a general analysis
of such fee-shifting rules, see Lucian Arye Bebchuk & Howard F. Chang, An Analysis of Fee Shifting
Based on the Margin of Victory: On Frivolous Suits, Meritorious Suits, and the Role of Rule 11, 25 J.
LEGAL STUD. 371 (1996).

\textsuperscript{134} Monetary class actions are usually filed under FED. R. CIV. P. 23(b)(1) or 23(b)(3). Injunctive
and declaratory relief class actions, on the other hand, fit under FED. R. CIV. P. 23(b)(2). See ALBA

\textsuperscript{135} See MANUAL FOR COMPLEX LITIGATION FOURTH, supra note 125, § 4.11.

\textsuperscript{136} For a list of these statutes, see CONTE, supra note 124, § 28.1.
(or had the class not been certified). While this would undoubtedly be a complicated task, it is not conceptually different from the valuation issues that arise in non-pecuniary class actions. In such cases, the losing defendant provides class members with some benefit other than a cash payment.\textsuperscript{137} The benefit may take the form of a discount on future purchases, periodic medical examinations, or a distribution of stocks and options. Valuing that benefit is "inevitably problematic."\textsuperscript{138} Still, courts manage to do it,\textsuperscript{139} just as they decide whether a settlement is "fair, reasonable, and adequate."\textsuperscript{140} There is no reason why courts could not undertake the same task in class defense cases.

3. Attorney Compensation and 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. We have therefore focused on the reforms necessary to make the class defense compatible with this private attorney general framework. But this market-based model does not capture all of 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.\textsuperscript{141} While these organizations rely to some extent on fee-shifting statutes for their funding,\textsuperscript{142} 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.

To the extent that the interests of such groups overlap with the interests of a defendant class, these groups might offer another way to initiate the class defense device. To be sure, such groups might assist individual

\begin{footnotesize}
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\item \textsuperscript{137} For a comprehensive discussion of these settlements, see Geoffrey P. Miller & Lori S. Singer, \textit{Nonpecuniary Class Action Settlements}, 60 LAW & CONTEMP. PROBS. 97 (1997).
\item \textsuperscript{138} Id. at 107-12 (showing how plaintiffs' attorneys and defense counsel can manipulate nonpecuniary settlements to inflate their valuation); see also Christopher R. Leslie, \textit{A Market Based Approach to Coupon Settlements in Antitrust and Consumer Class Action Litigation}, 49 UCLA L. REV. 991, 1050-51 (2001) (showing why coupon settlements are difficult to evaluate, thus allowing class attorneys to increase their net contingency fee); Roberta Romano, \textit{The Shareholder Suit: Litigation Without Foundation?}, 7 J.L. ECON. & Org. 55, 61 (1991) (noting that nonpecuniary settlements present severe valuation difficulties).
\item \textsuperscript{139} Class actions that conclude with nonmonetary remedies are common. See Miller & Singer, \textit{ supra} note 137, at 134 tbl.A5 (finding that in a sample of 127 class action settlement notices published in the \textit{New York Times} between January 1993 and September 1997, about 20% were nonpecuniary settlements).
\item \textsuperscript{140} \textit{Fed. R. Civ. P. 23(e)}.
\item \textsuperscript{141} \textit{See Deborah R. Hensler et al., Class Action Dilemmas: Pursuing Public Goals for Private Gain} 71 (2000) (noting that organizations such as the ACLU, the NAACP, and NOW bring class actions but often lack sufficient resources to engage in extensive litigation).
\item \textsuperscript{142} \textit{See Roy D. Simon, Jr., Fee Sharing Between Lawyers and Public Interest Groups}, 98 YALE L.J. 1069 (1989) (discussing fee sharing between public interest groups and their lawyers in fee-shifting class actions).
\end{itemize}
\end{footnotesize}
defendants even in the absence of a mechanism for aggregating defense claims. For instance, in the file-sharing example, the Electronic Frontier Foundation (EFF) assisted several defendants in challenging the music industry through various stages of litigation. The EFF has also set up a designated website to assist defendants sued by DirecTV. The class defense mechanism could provide such organizations with additional funding so that they could assist defendants more effectively. For example, the fee-shifting arrangements that we propose may prompt public interest organizations to reallocate some of their limited resources to class defense cases.

C. Due Process Concerns

Class litigation is an exception to the fundamental principle that one cannot be bound by a judgment rendered in a lawsuit to which one was not a party. The Supreme Court has held that, for this exception to apply, the class action procedure must fairly ensure the protection of absentee class members' interests. Moreover, the class action must guarantee all class members "adequate representation" to satisfy the Fourteenth Amendment's due process requirements.

Both the class action and the class defense seek to advance justice and efficiency; both procedures also include mechanisms for ensuring the adequacy of representation. Thus, there is no obvious reason to suppose that class defenses present unique due process concerns. 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 address three such challenges to consolidating defense claims. First, we discuss the argument that the due process rights of defendants deserve greater protection than those afforded to plaintiffs. Then, we consider the due process concerns of future defendants. Finally, we discuss the impact of the class defense on plaintiffs' rights.

143. For a list of cases, see http://www.eff.org/share (last visited Feb. 8, 2005).
144. See http://www.directdefense.org (last visited Feb. 8, 2005).
145. For a recent work demonstrating the direct relationships between public interest organizations' sources of funding and their litigation portfolio in the employment law context, see Christine Jolls, The Role and Functioning of Public-Interest Legal Organizations in the Enforcement of the Employment Laws (Harvard L. & Econ. Discussion Paper No. 498, 2004).
147. Id. at 42-43.
148. Id. at 42-43. For a comprehensive analysis of the adequate representation concept, see Nagareda, supra note 20.
149. See infra text accompanying notes 189-91 (discussing adequate representation in the class defense context).
1. Class Defendants and Class Plaintiffs

The first potential due process argument is that the stakes of plaintiffs and defendants are qualitatively different. Absentee class action plaintiffs merely lose their right to some hypothetical benefit if the class action fails. Absentee members of the defendant class, on the other hand, may face significant out-of-pocket expenses if the class loses. Thus, allowing absentee defendants to be bound by the outcome of the class defense is arguably inconsistent with due process principles.

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

On purely economic grounds, distinguishing between plaintiffs and defendants is clearly unjustified. The position of a plaintiff with a claim against a defendant for $100 is no different from the position of the defendant who is being sued for $100. For either party, losing at trial would cause a harm worth $100. The defendant’s out-of-pocket cost is economically equivalent to the plaintiff’s opportunity cost.

One might argue, however, that this narrow economic perspective overlooks the established body of psychological research showing that people view gains and losses differently. Specifically, individuals tend to value losses more heavily than gains of the same magnitude. This reasoning suggests that, since the class defense creates a risk of loss for defendants, defendants should be entitled to broader due process protections.

However, even if individuals view gains and losses from litigation differently, the policy implications that should be drawn in the class defense context are unclear. For example, if losses indeed loom large, then dispersed defendants are more likely to settle. This strengthens the

150. See Hutchinson, supra note 117, at 504-06 (arguing that, for due process purposes, there is no difference between defendant and plaintiff class members as long as courts ensure adequacy of representation).

151. One could argue that gain and loss should be treated differently due to wealth effects, that is, the phenomenon of decreasing marginal utility of wealth. This claim should be rejected for two reasons. First, since the gains and losses we discuss are small, wealth effects are likely to be negligible. See generally Robert D. Willig, Consumer’s Surplus Without Apology, 66 AM. ECON. REV. 589 (1976) (showing that the difference between the maximum an individual is willing to pay for a good and the minimum compensation demanded for the same good is negligible). Second, this reasoning is incompatible with common understandings of procedural due process rights, which do not depend on an individual’s wealth.

152. 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).

153. See Russell Korobkin, The Endowment Effect and Legal Analysis, 97 NW. U. L. REV. 1227, 1230 (2003) (positing that drawing the policy implications of the endowment effect—the tendency of people to value goods more when they own them than when they do not—requires care and nuance because the phenomenon is highly context dependent).
justification for a class defense that will afford such defendants the opportunity to avoid this loss.\footnote{154}

Moreover, psychological studies of attitudes toward gain and loss also indicate that people's preferences may vary based on reference points and the manner of framing the relevant choices.\footnote{155} In our context, this means that the intuitive depiction of defendants as standing to lose and plaintiffs as standing to gain is not necessarily correct. For instance, whether defendants in a class defense stand to gain or lose depends on the manner of framing their situation. Defendants whose reference point is a virtually certain loss in individual litigation may perceive the class defense as an opportunity for gain. Similarly, plaintiffs who lack sufficient resources to individually pursue their valid claims may perceive their failure to sue as a certain loss.\footnote{156} Indeed, there seems to be no difference between a mass tort plaintiff who owes thousands of dollars in medical bills but cannot recover from an alleged tortfeasor and a defendant charged the same costs as a result of an unsuccessful class defense proceeding.\footnote{157} If their respective classes lose at trial, both the defendant and the plaintiff would have a standing debt they must pay from their own resources. To summarize, we believe that the prevalence of different attitudes towards gains and losses cannot justify providing absentee class defendants with greater protection than that afforded to absentee class plaintiffs.

Finally, one might argue that the Supreme Court has explicitly acknowledged the fundamental difference between plaintiffs and defendants in the class action setting. In \textit{Phillips Petroleum v. Shutts},\footnote{158} the Court drew a distinction between absentee class plaintiffs and absentee defendants for purposes of personal jurisdiction. Specifically, the Court held that the burdens placed by a State upon an absent class plaintiff are not of the same order or magnitude as those it places upon an absent defendant.\footnote{159} Thus, the argument goes, the \textit{Shutts} holding mandates that absentee defendants receive enhanced due process protection.

\footnote{154. Loss aversion also implies that individuals prefer probabilistic large losses to certain small losses. See Kahneman \& Tversky, \textit{supra} note 152, at 278. This, in turn, implies that class defense certification is justified only when the probability of being sued is sufficiently high. See \textit{infra} Part II.C.}


\footnote{156. See Cass R. Sunstein \& Richard H. Thaler, \textit{Libertarian Paternalism Is Not an Ozymoron}, 70 \textit{U. CHI. L. REV.} 1159, 1161 (2003) ("[T]he design features of both legal and organizational rules have surprisingly powerful influences on people's choices.").}

\footnote{157. See Korobkin, \textit{supra} note 153, 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).}

\footnote{158. 472 U.S. 797 (1985).}

\footnote{159. \textit{Id.} at 807-11. Thus, the Court concluded that absentee plaintiffs need not possess "minimum contacts" with the forum state for it to establish personal jurisdiction over them. For an explanation of the "minimum contact" requirement for personal jurisdiction, see generally \textit{International Shoe Co. v. Washington}, 326 U.S. 310 (1945).}
We do not believe that the Shutts holding distinguished absentee defendants from absentee plaintiffs on due process grounds. Rather, it established the general principle that, in the due process calculus, procedural protections in class proceedings may substitute for actual participation or consent. The Court did not address the due process concerns of absentee defendants in a class; rather, it addressed the rights of the common defendant in a class action. The rights of absentee members of the plaintiff class are protected by mechanisms such as opt-out rights and the requirement of adequate representation. In contrast, a common defendant in a class action does not enjoy such protection. Therefore, the best interpretation of Shutts is that the Court distinguished between plaintiffs and defendants because representation was available to plaintiffs but not to defendants.

Notwithstanding its initial appeal, the claim that absentee defendants risk greater harms than absentee plaintiffs is misguided. We thus see no justification for providing class defendants with due process protections beyond those currently provided to class plaintiffs.

2. Implications of the Class Defense for Future Defendants

The defendant class would presumably include alleged wrongdoers who have not been individually sued. In the file-sharing case, for example, the defendant class would include all of those who have a lawsuit pending against them as well as all other Internet users who have engaged in file-sharing activities over a certain period. We shall refer to members of this latter group of defendant class members as future defendants. In many cases, future defendants would probably outnumber current defendants.

a. Potential Drawbacks for Future Defendants

The presence of a significant number of future defendants triggers two potential objections to the class defense device. First, turning a regular lawsuit into a class defense 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 simple. Without class certification, future defendants are not a party to any lawsuit. Moreover, it

160. 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, 607-12 (1987). But see Conte & Newberg, supra note 134, § 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.”).

161. From the defendant’s 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 after the Shutts decision. See cases cited by Conte & Newberg, supra note 134, § 4.52.
is not certain that the plaintiff will ultimately sue each future defendant. Accordingly, future defendants might prefer to adopt a wait-and-see approach and deal with the plaintiff only if, and when, it sues them. Put differently, there is arguably no symmetry between class plaintiffs and class 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, since their individual claims are worthless anyway due to their negative expected value. Future defendants, in contrast, might be worse off with a class defense. If the class loses, they will be liable to the plaintiff (which has not sued all of them prior to certification); if the class wins, they merely acquire immunity against liability which they have not yet been asked to bear.

This highlights another problematic feature of the class defense. In theory, membership in the defendant class is not mandatory: future defendants could simply opt out of the class. Future defendants, however, would often find the opt-out route to be impractical, because opting out would disclose their identities to the plaintiff and make public the fact that they engaged in the disputed conduct. This would invite the plaintiff to file lawsuits against those who opt out.162

The barriers to opting out pose a major challenge to the legitimacy of the class defense as the opt-out option is important in preserving due process rights. Indeed, the right of class members to exclude themselves from the class is one of the tenets of the modern monetary class action.163 Furthermore, many proposals for reform aim to strengthen opt-out rights and extend them to injunctive and declaratory relief class actions as well.164

162. Opting out would require future defendants to expend resources learning about the existence of a class defense and sending the opt-out notice. Note, however, that these costs apply equally to plaintiffs in class actions. See Samuel Issacharoff, Preclusion, Due Process, and the Right to Opt Out of Class Actions, 77 NOTRE DAME L. REV. 1057, 1062 (2002) (arguing that the right to opt out is important even when it does not offer class plaintiffs a meaningful opportunity to exit).

163. See Shuts, 472 U.S. at 811-13 (holding that 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 Issacharoff, supra note 162, at 1064-66 (citing scholars who support the view that “Shuts invites an expansion of the due process rationale to permit binding class members to preclusive resolution of their individually-defined [sic] damages claims only if they have been afforded the right to opt out.”); Rutherglen, supra note 21, at 1995 (“[T]he right to notice and to opt out has remained at the center of class action litigation for the last three decades . . . .”).

164. Fed. R. Civ. P. 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 419-22 (proposing a delayed opt-out procedure); see generally Nagareda, supra note 32 (calling for maximizing the opportunity for class members to opt out in return for conceding punitive damages).
b. Protecting Future Defendants

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 Section, we explain why these concerns do not pose an insurmountable challenge to our proposal.

i. How the Class Defense Benefits Future Defendants

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

The class defense strengthens future defendants’ ex post litigation position in two ways. First, it supplies defendants holding plausibly valid defenses with a mechanism for effectively challenging the plaintiff in court. Consider again the file-sharing example. Users who share files face some probability of being sued. If this probability is sufficiently high, then they will prefer the advantages of the class defense to confronting the plaintiff in an individual proceeding in which they will be compelled to settle, regardless of their cases’ merit.165

Furthermore, risk-averse future defendants who are aware of the possibility of a lawsuit may benefit from the class defense even if it fails to reduce their expected liability.166 Without the class defense, for example, a file-swapper who expects to be sued with 20% probability faces an all-or-nothing risk. If she is sued, she will settle for $3,000; if she gets lucky, she will not be sued and therefore pay nothing. Such a risk-averse future defendant would prefer a global settlement that requires her to pay $600 (twenty percent of $3,000) to the risk of an individual lawsuit. Although this $600 is equivalent to her expected liability without the class defense, the class defense eliminates the risk associated with the wait-and-see approach.

Second, the mere existence of the class defense mechanism discourages plaintiffs from embarking on litigation campaigns designed solely to exploit the vulnerability of dispersed defendants and 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 that might coerce dispersed defendants into settling even when they have plausibly valid defenses.

165. If each individual’s probability of being sued is low, then courts should carefully consider whether the case should be certified as a class defense. See infra text accompanying notes 192-93.
166. For a formal definition of risk aversion, see Mas-Colell et al., supra note 115, at 185-94.
The class defense also allows future defendants 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 noncommercial file sharing is legal would change 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 increase their level of activity as a result—but also to those who refrained from engaging in the disputed activity in light of the potential liability.

Moreover, the 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 is 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 can neither know whether they will suffer harm nor predict the magnitude of any harm they might suffer. Future defendants, in contrast, generally know that they have engaged in the disputed activity. Furthermore, risk-averse future plaintiffs will prefer full compensation for losses that they actually suffer to an aggregate settlement based on the average loss within the plaintiff group. Such plaintiffs will thus prefer to pursue their claims only after they can determine the magnitude of their loss. As explained above, risk-averse future defendants will often prefer collective settlement to an all-or-nothing litigation risk.

Despite the challenges that future plaintiffs face, courts have not ruled out the possibility of binding them in class actions. To be sure, the Supreme Court has imposed significant restrictions on the use of class action settlements to resolve future plaintiffs’ rights. Nevertheless, it has

167. 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 whose identity and whose “existence or magnitude of his injuries have yet been established”).

168. Damages based on the average loss within the plaintiff group leave future plaintiffs with the risk that their actual future loss will be greater than the amount of damages they receive. Future plaintiffs who are risk averse will dislike this damages measure because it increases the risk that they will suffer a loss for which they will not be compensated. This point is clearly explained in David Rosenberg, Individual Justice and Collectivizing Risk-Based Claims in Mass-Exposure Cases, 71 N.Y.U.L. Rev. 210, 247 n.91 (1996).

169. Note that this argument applies only to plaintiffs who cannot determine, at the time of settlement, the precise magnitude of their future losses. Thus, the analysis here does not undermine our general position that the risk to defendants in a class defense is not conceptually different from the risk faced by class action plaintiffs.


171. See, e.g., Ortiz v. Fibreboard Corp., 527 U.S. 815, 856-61 (1999) ("[A] class divided between holders of present and future claims . . . requires division into homogeneous subclasses . . . with separate representation to eliminate conflicting interests of counsel."); Amchem Prod. v. Windsor, 521
stopped short of holding that such settlements violate future plaintiffs' rights per se. Instead, the Court has left open the possibility of including future plaintiffs in mass tort settlements as long as they are afforded procedural guarantees against collusion and abuse. As shown in this Section, representative litigation is more problematic for future plaintiffs in mass tort cases than for class defendants. Thus, if due process concerns do not preclude the use of class actions to bind future plaintiffs in mass tort cases, then these concerns should not prevent the use of the class defense to bind future defendants.

### ii. Enabling Future Defendants to Opt Out

As for the opt-out issue, future defendants may indeed determine that opting out of class defenses is too costly. However, the implications of this barrier should not be overstated. First, recent research concerning class actions shows that only a very small percentage of class members opt out. The highest mean opt-out rate, 4.6%, is for mass tort cases. In consumer class actions, the mean opt-out rate is less than 0.2%. There is no reason to believe that future defendants in class defense cases would exhibit a greater tendency to opt-out.

Second, the disincentive to opt out could be mitigated by allowing future defendants wishing to be excluded from the class to opt out without substantially increasing their risk of being sued individually. We thus propose to make the opt-out procedure anonymous. Under our proposal, members who wish to exclude themselves from the defendant class would notify courts, which would hold an opt-out registry for each class defense. The identity of those who opted out would not be disclosed to the plaintiff. If the plaintiff wanted to commence collection procedures against individual class members after winning the lawsuit against the class, he would have to submit their names and locations to the registry and confirm that they are not listed there, that is, that they are indeed members of the class.

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172. See Warshauer, supra note 170, at 1276-77 (noting that both Amchem and Ortiz were decided on class certification grounds and that neither decision addressed the principle of whether class actions are adequate for future plaintiffs).

173. See Amchem, 521 U.S. at 612 (refraining from deciding the issue of future plaintiffs' standing to sue); Ortiz, 527 U.S. at 831 (same). But see Hazard, supra note 167, at 1913 (arguing that the Ortiz decision practically precludes the use of FED. R. CIV. P. 23 to resolve future claims in mass-tort injury cases).


175. Id.

176. Id.
Furthermore, a plaintiff who sues a defendant who opted out would not be allowed to use the defendant’s opt-out notice as proof of her liability.\textsuperscript{177}

Third, the power to opt out is not as essential to due process protections as one might think. The ability to opt out is not required in Rule 23(b)(1) and (2) class actions but only in monetary, Rule 23(b)(3) class actions.\textsuperscript{178} Some commentators go even further and advocate abolishing the opt-out procedure in monetary class actions as well.\textsuperscript{179}

Finally, even in the absence of a class defense, future defendants may find themselves bound by adverse precedents set in prior, individual proceedings. In this regard, future defendants are clearly better off under the class defense. Either way, future defendants are bound when the plaintiff wins. But an individual suit neither requires notice to absentee defendants nor provides them with a choice not to be bound by any precedent that might be set by the outcome of the suit. Furthermore, the litigation incentives of the defendant in the prior individual suit would only reflect her personal interests, and her litigation performance would not be subject to any monitoring by the court. The class defense would guarantee future defendants better representation.

3. \textit{Implications of the Class Defense for 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 any meaningful benefits.

For plaintiffs, the downsides of the class defense are obvious. Class defense litigation likely would be costlier than a regular lawsuit, and if the plaintiff lost at trial, he would be precluded from suing all similarly

\textsuperscript{177} Our discussion assumes that opting out would disclose information that might be used by a plaintiff in a future civil lawsuit against the person opting out. In some cases, however, the disputed activity could make defendants civilly and criminally liable. Were opting out to disclose information that would assist the government in a future criminal case, class defendants would be further discouraged from opting out. The question then becomes whether removing the barrier to opting out is a sufficient justification for making the information contained in the opt-out registry privileged for criminal purposes as well. For a thorough discussion of a similar question in the context of internal audits conducted by corporations in order to detect environmental violations, see David A. Dana, \textit{The Perverse Incentives of Environmental Audit Immunity}, 81 Iowa L. Rev. 969 (1996).

\textsuperscript{178} See supra note 164.

\textsuperscript{179} See, e.g., Robert G. Bone, \textit{Rule 23 Redux: Empowering the Federal Class Action}, 14 Rev. Litig. 79, 105-06 (1994) (calling for a flexible approach to litigant autonomy that justifies binding absentees in some situations even without a chance to opt out); David Rosenberg, \textit{supra} note 14, at 862-66 (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); David Rosenberg, \textit{Adding a Second Opt-Out to Rule 23(b)(3) Class Actions: Cost Without Benefit}, 2003 U. Chi. Legal Forum 19, 35-36.
positioned future defendants. In addition, under our one-sided fee-shifting proposal, a losing plaintiff would have to pay the fees of the class attorney. A victorious plaintiff, on the other hand, would not be reimbursed for his legal fees.

The upside of the class defense for plaintiffs is unclear. In theory, successful plaintiffs would enjoy significant cost savings, since they would not have to sue each defendant separately to establish their claims. In practice, however, plaintiffs would have to engage in a costly process to collect judgments from each defendant. Plaintiffs would first have to uncover the identity of class members. Members of the defendant class, however, are unlikely to cooperate with a victorious plaintiff. For example, defendant class members might contest their involvement in the disputed activity and thus their membership in the class. Plaintiffs would then have to file separate lawsuits in order to collect from such class members. While they would not have to re-establish the legal basis for their claims, plaintiffs would have to prove the relevant facts in court. Thus, from a practical perspective, the class defense is unlikely to offer plaintiffs significant benefits.

Although aggregating defense claims may cut against plaintiffs’ interests, this is hardly a justification for rejecting the class defense device. As previously discussed, the imbalance between powerful plaintiffs and dispersed defendants undermines the social goals of justice and efficiency. By definition, restoring the balance would weaken the plaintiffs’ superior position. In other words, given that the initial balance of power is skewed in favor of plaintiffs, enhancing defendants’ power at the expense of plaintiffs is desirable.

Notice also 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 prefer to confront plaintiffs separately. Yet, no one seriously suggests that the adverse impact on defendants justifies abolishing the class action device. This is true notwithstanding claims that class actions may allow plaintiffs to blackmail defendants by filing frivolous suits and threatening them with risky all-or-nothing verdicts.

180. The prospect of further litigation raises another point. Dispersed defendants who face plaintiffs in a trial over the issue of class membership also might be pressured to settle even if they have plausibly valid defense claims. This problem, however, cannot be addressed through the class defense mechanism unless the dispute over class membership itself involves a common question of fact. In the absence of a common question, consolidating defendants would not provide them with economies of scale.

181. See, e.g., Castano v. Am. Tobacco Co., 84 F.3d 734, 746 (5th Cir. 1996) ("[C]lass 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 could face a $25 billion verdict and would therefore be under intense pressure to settle). For a critical analysis of the
D. Collusion in the Class Defense Setting

While designed to empower similarly positioned defendants with valid claims, there is a risk that the class defense procedure could turn against defendants. Plaintiffs would have strong incentives to collude with representative defendants and their attorneys to bind all members of the defendant class to an adverse judgment or settlement. For purposes of this Article, we divide such collusive arrangements into two groups. First, plaintiffs who prefer to face all defendants collectively would try to create the impression that consolidation would serve defendant interests. They would therefore collude with defendants to file and certify a class defense. Second, plaintiffs and class attorneys might reach collusive settlements. In this Section, we explain why neither form of collusion poses an insurmountable challenge to the class defense procedure.

1. The Double-Edged Sword Problem

Class actions can be used strategically to serve defendant interests. Defendants who fear the prospect of an endless flow of individual claims often support class actions because they offer a collective and final determination of their liability and put an end to their public relations troubles. These defendants are often well positioned to select friendly class attorneys who would file class actions resulting in settlement conditions that favor defendant interests. Indeed, some commentators have cautioned against “reverse auctions” in which defendants use competition among plaintiffs’ attorneys to achieve favorable settlement terms.

At first sight, the class defense presents an even greater threat of such collusion than class actions. First, plaintiffs might have stronger incentives than class action defendants to seek aggregation. Defendants in class actions are mainly motivated by their desire for predictability and finality. Some plaintiffs, in contrast, might perceive the class defense as an attractive, cheap vehicle for generating revenues by securing judgments that would bind a large group of defendants. They could employ the class defense to compel a large group of defendants to pay the plaintiffs money they could not otherwise collect. Those defendants would then be

claim that defendants are systemically victimized by class action “blackmail,” see Hay & Rosenberg, supra note 110, at 1393 (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); Charles Silver, “We’re Scared to Death”: Class Certification and Blackmail, 78 N.Y.U. L. REV. 1357 (2003).


prevented from challenging the lawfulness of the payments in court. Aggregation of defendants, so the argument goes, is like a double-edged sword. It may serve defendants by helping them overcome disadvantages during individual litigation, but it also may harm defendants by dragging them into litigation they would not otherwise face.

While the risk of collusion cannot be eliminated, it can be contained within the class defense framework. First, we show that the practical implications of this problem are rather limited. Then, we explore the means that courts could deploy to minimize it.

As a practical matter, the "double-edged sword" risk is not as significant as it first appears. Even without class defenses, plaintiffs have the power, and thus the opportunity, to bind a group of defendants by initiating a defendant class action. The risk, therefore, is not that the class defense would substantially enhance plaintiffs' incentives to benefit themselves by aggregating defendants; plaintiffs who cannot enforce their rights in individual proceedings can certify their lawsuits as a defendant class action. Rather, the concern is that such plaintiffs would increase their chances of securing class certification by creating the impression that consolidation would benefit defendants.

The challenge, therefore, is to distinguish class proceedings that would serve defendant interests from those that would profit the plaintiff. While this would not necessarily be an easy task, it is one with which courts are familiar. Courts always consider the interests at stake prior to certification in any class proceeding.\(^{184}\)

Finally, several measures could minimize the risk that plaintiffs will use the class defense against defendants. Courts would have to encourage competition for the positions of class representatives and attorneys. This would make it more difficult for plaintiffs to influence the selection process. More generally, courts would have to use discretion in certifying the class action, selecting the class attorney, and awarding the fee. These are the best tools for minimizing collusive behavior in class litigation.

2. **The Risk of Sweetheart Deals**

Preventing collusive settlements between the defendant and the class counsel is one of the greatest challenges facing class action courts. Collusive settlements are often agreed to before a case is ever filed, and

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\(^{184}\) For example, courts face this type of problem in mass-tort class actions. Large individual claims would often be viable even without their aggregation in a class action. See, e.g., Nagareda, supra note 32, at 751 (noting that, given their size, most mass-tort claims could have been filed under the "general" tort system). 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.
courts are then requested to certify a class action for the sole purpose of settlement.\textsuperscript{185}

In addition to reverse auctioning, collusive settlements can take two other forms.\textsuperscript{186} First, the defendant and the class attorney can inflate the purported value of the settlement to induce the court to approve it. This can happen with, for example, non-monetary settlements, settlements that define the represented class very broadly but impose difficult-to-satisfy conditions for collection, and settlements that allow for the reversion of unclaimed funds to the defendant.

Second, the defendant can make side payments to the class attorney in return for a reduction in compensation for class members in the proposed settlement. The side payment often takes the form of favorable settlements filed by the class attorney against the defendant. Since they take place outside of the class proceedings, such settlements are not subject to the court's discretion.\textsuperscript{187}

The class defense is susceptible to these collusive practices. However, the question is whether the risk in the class defense context is inherently greater than in class actions. This would be the case if the class defense (1) enhanced incentives to collude, or (2) diminished the ability of courts to prevent collusive arrangements. Neither of these scenarios seems likely.

Because valuing class benefits is difficult, plaintiffs and class attorneys may be able to boost the purported benefit by asking for inflated damages or by increasing the size of the class, all without raising judicial suspicion. Such valuation difficulties, however, also characterize non-monetary class actions and non-pecuniary settlements. Class defenses would be no more difficult for courts to manage than such class actions. As in the class action context, plaintiffs and class attorneys could be required to disclose all agreements and proceedings related to the class defense.

\textsuperscript{185} 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 \textsc{Amendments to Federal Rules, Preliminary Draft of Proposed Amendments to the Federal Rules of Appellate, Civil, and Criminal Procedure}, 167 F.R.D. 523, 535 (1996). This proposal was vehemently opposed. See, e.g., Letter from Steering Committee to Oppose Proposed Rule 23, May 28, 1996, in \textsc{2 Working Papers of the Advisory Committee on Civil Rules on Proposed Amendments to Civil Rule 23}, at 1-10 (1997), available at http://www.uscourts.gov/rules/WorkingPapers-Vol2.pdf (arguing that the proposed amendment would invite collusion between defendants and class attorneys); see also \textsc{Symposium, Settlement Class Actions}, 80 \textsc{Cornell L. Rev.} 811 (1995) (discussing the implications of settlement class actions).

\textsuperscript{186} See \textsc{Klement, supra} note 11, at 42-43 (documenting the various types of collusion); \textsc{Silver, supra} note 109, at 213-14 (reviewing sweetheart settlements in class actions).

\textsuperscript{187} See \textsc{Coffee, supra} note 183, at 1373-84 (defining these methods as "new collusion" that differs from the non-monetary "old" collusive settlements); \textsc{Konik & Cohen, supra} note 23, at 1047-48, 1057-64, 1086-114 (describing similar allegations against class counsel in \textsc{Georgine v. Amchem Products}). 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 \textsc{Fed. R. Civ. P. 23(e)(2)}. 
This would ensure close monitoring of both sides by the court to help set an appropriate attorney fee. The risk of collusion does not pose an insurmountable challenge to the class defense.

E. Class Defense: A Tentative Outline

We conclude our analysis of the class defense with a brief outline of its main procedural features. We will not offer a full account of the doctrinal nuances and practical considerations that would be associated with implementing this mechanism. Deploying the class defense would require courts and lawmakers to address doctrinal issues such as personal jurisdiction, proper venue, subject-matter jurisdiction, and limitations periods; such important topics are best left for another time. This discussion focuses solely on the fundamental features of the class defense.

In a typical class action, the initiating party is the class representative who files the suit and then seeks its certification. In a class defense, however, a plaintiff would first file a regular lawsuit against a defendant, and this defendant could then ask the court to turn the case into a class defense. In other words, the defendant would seek to represent an entire class of defendants who have also been sued or who are at risk of being sued for similar acts. The class defense would authorize the court, upon the defendant's request, to alter the nature of the plaintiff's lawsuit. Although he intended to pursue an individual claim, the plaintiff could be implicated in a representative lawsuit that could bind him against all class members.

Class defense courts also would have to ensure that class members are adequately represented. As discussed above, there is a risk that plaintiffs would attempt to select a defendant who would cater to their interests to represent the class. To alleviate this problem, courts should allow other defendants or attorneys to compete for class representation. This could be achieved by employing the mechanisms devised for this purpose in the class action context. 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.

188. Note that some of these issues have been addressed in the parallel case of defendant class actions. See Robert E. Holo, Defendant Class Actions: The Failure of Rule 23 and a Proposed Solution, 38 UCLA L. REV. 223, 241-45 (1990); Note, Statutes of Limitation and Defendant Class Actions, 82 MICH. L. REV. 347 (1983).

189. See supra Part II.C.


191. 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 occurs because, unlike class actions, the class defense requires defendants to wait to be sued. Hence, there is no risk of a race to file.
Courts would have to decide whether to certify the lawsuit as a class defense. The relevant considerations for class certification should generally be no different in the class defense setting than in class actions. For example, courts would have to determine whether there are common questions of fact or law that justify claim aggregation. As we have explained, however, cases might exist in which plaintiffs would collude with putative class attorneys to secure class certification in order to compel a large group of defendants to pay the plaintiffs money they could not otherwise collect. Courts should, therefore, carefully examine compliance with class certification requirements to prevent such an abuse. For example, a court considering the superiority requirement of a “Rule 23(b)(3) class defense” might take into account the probability that the plaintiff will ultimately sue defendants separately. If the probability of being sued individually is sufficiently high, then it is less likely that class certification is sought merely to provide plaintiffs with an illicit benefit.

Due process requires that potential class members be given notice of the pending class certification and an opportunity to opt out. As previously explained, future defendants lack incentives to step forward and identify themselves as members of the defendant class. Thus, the class defense notification procedures should rely on public notice rather than personal notice.

The procedural posture of the class defense raises a novel issue that does not arise in class actions. Since the plaintiff would formally initiate the lawsuit, he would have the power to withdraw the lawsuit at any time. This creates a risk that plaintiffs would try to exploit their litigation advantage by suing individuals separately and then, once an attorney files a motion for class defense certification, simply withdraw the lawsuit.

To alleviate this risk, courts should allow the plaintiff to withdraw at any time; however, if the withdrawal takes place after the defendant class had been certified, it should prevent the plaintiff 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

192. See supra Part II.D.
193. To make class certification less likely in cases where there is no collusion, plaintiffs might attempt to create the impression that their probability of suing defendants individually is small. Courts should thus examine this question very carefully.
194. See supra Part II.C.
195. A Rule 23(b)(3) class action is the only type of certified class action that requires individual notice. Other types of class action notices, as well as notices of settlement, may be given by publication. See Conte & Newberg, supra note 134, § 8:34.
the plaintiff. Withdrawal of the suit before class certification should be allowed and should not produce a binding preclusive effect for the benefit of all absentee defendants. The plaintiff would, however, have to reimburse the defendant and her attorney for all costs incurred in connection with class defense certification.\textsuperscript{196}

Finally, courts would have to fulfill some of the responsibilities that they assume in class actions. Courts would 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 raise any unique concerns in these respects beyond the ones we have already discussed.

Whether class defenses may be certified under the current Rule 23 is beyond the scope of this Article. Nevertheless, it bears mentioning that, although Rule 23 was not designed as a defensive mechanism, its language does not preclude such a use. To qualify as a class action, a lawsuit must satisfy the requirements enumerated in Rule 23(a), fit into one of the categories specified in Rule 23(b), and satisfy the conditions of that category. Each of the three examples discussed in Part I—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 Rule 23(a) requirements of numerosity, 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, implementing the class defense may not require far-reaching procedural reforms.\textsuperscript{197}

In this Part, we argued that the class defense procedure could successfully achieve the goal of defendant aggregation. We would like to stress, however, that the procedure we outlined is not necessarily the only viable solution to the problem of dispersed defendants. In theory, policymakers could devise other institutions or doctrines for consolidating defense claims. As long as they incorporate the features necessary for effectively overcoming the defendant collective-action problem—such as proper fees for class attorneys and adequate opt-out procedures—such mechanisms

\textsuperscript{196} The situation we describe is similar to class actions that become moot due to the defendant’s voluntary change in conduct. Whether such a change in conduct renders the plaintiff a “prevailing party” for purposes of fee-shifting statutes was answered negatively in \textit{Buckhannon Bd. & Care Home, Inc. v. W. Va. Dep’t of Health and Human Res.}, 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, \textit{Taking Out the Adversary: The Assault on Progressive Public-Interest Lawyers}, 91 \textit{CALIF. L. REV.} 209, 243-45 (2003).

\textsuperscript{197} For example, restrictions on the plaintiff’s withdrawal from the lawsuit could be implemented under Rules 23(e) and 41. Recall, however, that statutory authorization probably would be required to implement the proposed fee-shifting rule. \textit{See supra} Part II.B.2.
could be effective regardless of their doctrinal label. Thus, the class defense may also be configured as a 23(b)(2) class action seeking declaratory relief. Members of a defendant group who anticipate a lawsuit may preempt the plaintiff by filing a class action seeking a declaration that their conduct is legal. This tactic could function as a class defense by allowing would-be defendants to enjoy the benefits of consolidation. This approach, however, is currently subject to doctrinal constraints that undermine its effectiveness. 198

III
ALTERNATIVES TO THE CLASS DEFENSE

In the previous Parts, we 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 its necessity. Before introducing this novel device into the already complex class litigation arena, policymakers should consider whether any existing doctrines can address the same problem.

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

Our objectives in surveying these alternative mechanisms are twofold: first, to shed new light on these mechanisms and their potential for solving the dispersed defendants problem; and second, to show that all existing alternatives fall short of offering a satisfactory solution to the problem.

A. Pay Now, Sue Later

Counterintuitively, the monetary class action is one alternative to the class defense. Many types of class actions are essentially a practical response to the problem of numerous defendants. One’s status as a plaintiff or defendant is often a matter of choice, since people can either wait to be sued or preemptively sue to preserve their rights. The current legal regime, however, does not offer dispersed defendants a mechanism for consolidating their claims. Thus, potential defendants can enjoy the scale efficiencies of consolidation if they approach a dispute as plaintiffs by following what we call the “pay now, sue later” strategy. They can make payments and

then wait for a class action to recover the amount that they overpaid. The "pay now, sue later" strategy is common in consumer class actions.\textsuperscript{199}

To illustrate the functional equivalence of class actions and class defenses, consider a dispute over the right of a cable company to charge late fees. Assume that the cable company requires its dispersed clients to make a relatively small payment, say $5.\textsuperscript{200} For simplicity, assume that the cable company has no legal right to demand such a payment. Since the amounts involved are trivial, no subscriber has an incentive to refuse to pay and invite a lawsuit by the cable company or other adverse consequences, such as negative credit reports. If subscribers could consolidate their claims, litigation might be worthwhile. However, this is not an option given the existing legal landscape.\textsuperscript{201}

Knowing that they cannot single-handedly prevail over the cable company in court, subscribers will likely follow the "pay now, sue later" strategy. They will pay the $5 and then participate in a subsequent class action on behalf of all subscribers to recover their fees.\textsuperscript{202} Once the subscribers become plaintiffs, they can exploit the collective procedures and scale economies offered by the class action device.

Given the functional equivalence of class actions and class defenses, one might argue that there is no need to introduce our far-reaching proposal. After all, class actions could secure claim aggregation without involving one-sided fee-shifting rules and the valuation issues associated with the class defense. We believe, however, that the "pay now, sue later" strategy is not a satisfactory alternative to the class defense for two reasons: first, it is not universally applicable; and second, it does not afford class members full recovery. The class defense would offer 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 only effective 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. In cases in which the initial payment resulted from litigation or the threat thereof, this condition might not hold. Consider the file-sharing and DirecTV examples. In both cases, many defendants paid

\textsuperscript{199} See Hensler et al., supra note 141, at 54-56 (reporting that two thirds of all consumer class actions filed between 1995 and 1996 resulting in reported judicial opinions involved either allegations of improperly calculated or excessive fees or more general allegations of "fraudulent business practices").

\textsuperscript{200} The example is based on Selnick v. Sacramento Cable, No. 541907 (Cal. Super. Ct. 1996), reported in Hensler et al., supra note 141, at 211-23.

\textsuperscript{201} As previously explained, collective action problems will prevent members of the group from cooperating in the absence of a consolidation procedure. See supra Part III.A.

\textsuperscript{202} This discussion does not propose that subscribers pay with the conscious hope of being reimbursed in a subsequent class action. Rather, it describes a pattern of conduct that characterizes many wrongful payment cases.
the plaintiffs as part of a settlement or as a consequence of their failure to appear in court. Res judicata principles will likely prevent these defendants from joining a plaintiff class seeking recovery of those payments. In circumstances like these, plaintiffs who follow the “pay now, sue later” approach might lose their right to seek repayment. Furthermore, defendants would likely be barred from joining a future class action if they settled before they were actually sued. Having consented to settle in the face of a legitimate litigation threat, they would be unable to claim undue coercion or duress and would therefore be bound by their agreement.203

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

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

Second, the “pay now, sue later” strategy forces plaintiffs to be the defendant’s creditors. Put differently, it shifts to members of the group the credit risk associated with the defendant, who may turn out to be bankrupt by the time the litigation is complete.

To summarize, the “pay now, sue later” strategy might fail to eliminate the overdeterrence of would-be defendants. To the extent that the protection granted under the class action alternative is imperfect, potential defendants might perceive the disputed activity as too costly. Shifting to a class defense regime would reduce the expected cost of engaging in that activity.

B. Non-mutual Collateral Estoppel

Under the doctrine of collateral estoppel (also called issue preclusion), a party may not re-litigate an issue of fact or law that was litigated and was essential to the judgment rendered.204 Courts have traditionally applied this doctrine only to litigants who were parties to the original proceeding or

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203. 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, No. CV 03-5972 AHM (RZx) (C.D. Cal. 2003), and Blanchard v. DirecTV, No. B168901 (Cal. Ct. App. 2004). Both decisions are available at DirecTV’s website, http://www.hackhu.com. Note, however, that under certain circumstances agreements entered into by potential defendants who agree to pay under the threat of unmeritorious litigation could be unenforceable on duress grounds. John P. Dawson, Duress Through Civil Litigation (pt. 1), 45 MICH. L. REV. 571, 579 (1947).

204. See Restatement (Second) of Judgments § 27 (1982).
were in privity with those parties. 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.

The modern approach, in contrast, recognizes some non-mutual collateral effects of prior judgments. Under this approach, a plaintiff may be bound by an adverse decision in an individual lawsuit to which she was not a party. The plaintiff, however, will not enjoy any preclusive effects of a beneficial finding in such a lawsuit. This is the defensive non-mutual collateral estoppel rule. Although the rule’s effectiveness may be limited if several cases have been litigated and produced inconsistent results, it is nevertheless possible for the first individual defendant to win her case and bind the plaintiff against all other defendants.

At first glance, this seems to imply that class defense certification would run contrary to the interests of dispersed defendants. Without class certification, dispersed defendants could enjoy a preclusive effect if they prevailed, but they would not be bound by an adverse judgment.

This conclusion overlooks the fundamental problem underlying the dispersed defendants scenario, namely, the lack of incentives to assert defense claims. In the absence of a consolidation procedure, each defendant would settle rather than incur the costs of litigation. With no one to contest the plaintiff in court, collateral estoppel would not be established. Thus, the non-mutual collateral estoppel rule does not provide defendants with effective protection.

Non-mutual collateral estoppel might actually diminish the defendant’s incentives to litigate. Because of this rule, the plaintiff would have more at stake in an individual case; one loss could preclude him from recovering against any defendant. Thus, the plaintiff would invest larger

205. See Tice v. Am. Airlines, 162 F.3d 966 (7th Cir. 1998) (analyzing the requirements of “privity” necessary to establish a preclusive effect on non-parties).


208. This is one reason why plaintiffs seek certification of defendant class actions, since a class action helps the plaintiff restore mutuality between the preclusive effects of favorable and adverse judgments.

209. See Restatement (Second) of Judgments § 29(4) cmt. f; Brainerd Currie, Mutuality of Collateral Estoppel: Limits of the Bernhard Doctrine, 9 Stan. L. Rev. 281, 289 (1957).

resources in litigation, which would translate into a higher probability of plaintiff victory in each case. Contesting lawsuits in court would, therefore, become even 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 in 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 in a class defense.211

In principle, non-mutual collateral estoppel does improve the bargaining position of individual defendants. The collateral effects of a potential loss at trial would encourage the common plaintiff facing a defendant with a promising defense to give up his individual claim. This, however, would be the case only if the individual defendant invests sufficient resources to establish her defense. Since she cannot gain more than the revocation of her liability, the defendant may not find it in her best interest to invest such resources. Moreover, the settlement leverage of individual defendants is limited, because the plaintiff can drop the case to avoid estoppel effects at any time.212 Without imposing a credible threat of litigation, the defendant’s bargaining power would not be affected by the non-mutual collateral estoppel rule.

Similar problems will characterize any other doctrine that extends the outcome of prior litigation to all future defendants without aggregating them in one proceeding.

C. Gatekeepers, Insurance, and Government Intervention

In this Section, we consider three additional mechanisms that may rectify the problem of dispersed defendants: third party liability, liability

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211. See Craig R. Callen & David D. Kadue, To Bury Mutualty, 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 defendants 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) ("[N]onmutuality 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."). See also David Rosenberg, Estoppel vs. Standard Claims Market (Harvard Law & Econ. Discussion Paper No. 392, 2002) (showing that the main advantage of class actions over collateral estoppel is their aptitude in neutralizing the common litigant's scale advantages).

212. The individual defendant’s situation should be distinguished from that of the individual plaintiff’s 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 he may squeeze 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 to do so would expose the defendant to the same collateral effects she 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.
insurance, and government intervention. Each mechanism may offer a reasonable alternative to formal consolidation of defense claims. Unfortunately, these alternatives are not universally applicable, and they can introduce costs and distortions.

The first alternative imposes liability on third parties, or gatekeepers.\textsuperscript{213} Intuitively, when gatekeepers profit from a sufficiently large number of alleged wrongdoers, they will be better motivated than individual defendants to pursue plausible defense claims. The file-sharing example nicely illustrates this facet of gatekeeper liability. Consider the litigation incentives of a company that develops file-sharing software—Aimster, for example—and is sued for contributory and vicarious copyright infringement based on its users' file-swapping activities. The stakes are much larger for Aimster than for 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 revenue. In other words, when deciding whether to litigate or settle, Aimster will take into account the interests of many users and potential users of its services. In terms of providing litigation incentives, this 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, because it might distort the market for gatekeeper services and produce overdeterrence.\textsuperscript{214} In the peer-to-peer setting, imposing liability on software companies like Aimster could stifle technological innovation and excessively restrict legitimate speech.\textsuperscript{215} Second, there is not always a gatekeeper to sue. In the Leasecomm case, for instance, no gatekeeper existed upon whom liability could be pinned. Even when there is a gatekeeper, it will often enjoy immunity from liability.\textsuperscript{216}

Liability insurance may constitute yet another device for achieving effective aggregation of defense claims. The intuition here largely follows the principles underlying the gatekeeper alternative. Assuming it provides coverage to a large number of defendants, an insurance company would

\textsuperscript{213} For a comprehensive analysis of the conditions under which gatekeeper liability is optimal, see generally Hamdani, supra note 5; Reiner Kraakman, Gatekeepers: The Anatomy of a Third Party Enforcement Strategy, 2 J.L. ECON. & ORG. 53 (1986).


\textsuperscript{215} See Lemley & Reese, supra note 5, at 1349-50.

\textsuperscript{216} For example, the Ninth Circuit recently upheld a ruling under which Grokster is not liable for the infringing activities of end users. See supra note 55.
have a substantial stake in the outcome of litigation. Thus, the insurance company may find it worthwhile to confront a plaintiff in court.

The problem with this rationale is that individual defendants normally only purchase liability insurance for specific activities, such as driving. Even if they wanted general liability insurance, insurance companies may not be willing to sell it, given adverse selection and moral hazard problems. Assuming insurance companies did provide such insurance, there would still be a collective action problem among those who did not purchase it. For these reasons, policymakers cannot rely on insurance companies to protect dispersed defendants.

Finally, as with other cases of market failure, the government could intervene in disputes between plaintiffs and dispersed defendants. After all, the FTC ultimately compelled Leasecomm to forgo the collection of its $24 million in judgments.

Government intervention may mitigate the defendant problem in principle. In practice, however, government agencies exhibit many shortcomings, including resource limitations and susceptibility to interest groups. Indeed, it is well established that class litigation is necessary to supplement the limited capacity of the government to engage in public enforcement of plaintiff interests. There is therefore no reason to question the need for class litigation in the defendant context as well.

None of the mechanisms presented in this Section offer a universal remedy to the problem of dispersed defendants. This should come as no surprise, since the same mechanisms have not solved the parallel problem of dispersed plaintiffs.

CONCLUSION

Lawmakers, courts, and legal scholars have long recognized that consolidating the claims of dispersed plaintiffs with similar grievances

217. Insurance companies would not be able to screen out those insureds who are more prone to liability (an adverse selection problem). Even careful insureds would have insufficient incentives to take care, satisfy their contractual obligations, and seriously fulfill any other legal obligations if their potential liability is insured (a moral hazard problem). For a comprehensive analysis of liability insurance and its incentive effects, see Shavell, supra note 96, at 210-27.

218. Theoretically, it is possible for an ex post insurance market to develop. In this market, defendants would insure themselves against 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 context of mass-tort litigation, see David Rosenberg, Deregulating Insurance Subrogation: Towards an Ex Ante Market in Tort Claims (John M. Olin Ctr. for L., Econ. & Bus., Discussion Paper No. 395, 2002). Such a market has not developed in any of the examples discussed in this Article.


220. See generally Gary S. Becker & George J. Stigler, Law Enforcement, Malfeasance, and Compensation of Enforcers, 3 J. LEGAL STUD. 1 (1974); see also Hensler & Rowe, supra note 13, at 137 (noting that class actions can supplement regulatory enforcement by administrative agencies).
promotes justice and efficiency; without the class action device, numerous victims of a single wrongdoer would often fail to pursue their rights with the socially desirable level of vigor. This, in turn, would not only deny victims their rightful compensation, but would also encourage wrongdoers to disregard the social harms they produce.

In this Article, we have shown that justice and efficiency mandate that similarly positioned defendants also be provided with an adequate procedure for consolidating their claims. The creation of the class defense device would serve this purpose. This Article outlined the novel features necessary to make this device both effective and fair—that is, those features that would provide class attorneys with proper incentives, adequately protect the due process rights of absentee defendants, and minimize the risk of abuse.

Our proposal is consistent with a modern understanding of the nature of civil litigation. It is well established that the implications of civil litigation often transcend the stakes of private parties to a dispute. As we have demonstrated, this objective can be met not only when plaintiffs are dispersed, but also when defendants are dispersed. The proposed class defense mechanism would provide courts with the opportunity to address important social issues when they arise in a dispute between a single plaintiff and numerous defendants.

The need for a class defense mechanism will likely increase in the near future. As the DirecTV and RIAA cases demonstrate, the dispersed defendants scenario is often the byproduct of technological developments, such as the introduction of peer-to-peer technology, that enable similarly situated individuals to harm—or allegedly harm—the interests of a single victim. Parallels exist between this phenomenon and the advent of mass production, which led to an increase in mass tort class actions. Therefore, the rapid pace of technological innovation will enhance the need for a defense consolidation procedure. This growing need, coupled with the justice and efficiency rationales already offered for the class defense, strongly suggests that courts and policymakers should seriously consider our proposal.

221. See generally Abram 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"). Indeed, legal academics often rely upon this "public law" paradigm of civil litigation to justify class actions. See Rosenberg, Public Law Vision, supra note 110, at 905-11.

222. 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).