
ASBESTOS AND MASS TORTS WITH FRAUDULENT VICTIMS

Keith N. Hylton*

Abstract: Deterrence and compensation goals should be distinguished, and compensation priorities should change in response to the deterrence goal. This has immediate implications for the problem of handling marginal and fraudulent claims in asbestos litigation. Where the deterrence goals come to the forefront, for example in instances of reckless exposure, it may be desirable for courts to require defendants to pay damages that are not transferred to any claimants. Where the deterrence goals are less compelling, as in instances of ordinary negligence, the importance of weeding out marginal and fraudulent claims becomes paramount. I consider optimal penalties for attorneys who bundle fraudulent claims.

I. INTRODUCTION

The asbestos crisis, from the perspective of those who have not studied it carefully, has looked something like a massive black hole that swallows up large chunks of the lives of the lawyers, judges, and scholars who have come within its gravitational field. It seems to raise unique issues and to require the development of special procedures. Looking on it from a distance, one wonders whether there are general lessons to be gleaned from the crisis.

Of possible theoretical approaches, there are three that have been applied to the asbestos crisis. One is the justice approach, which as the name suggests involves a search for justice in asbestos litigation.¹ Justice is an elusive concept in litigation, and especially in the case of asbestos. Would a search for justice involve specifying compensation amounts that victims should receive, or the specification of fair procedures? Aggregate

* Honorable Paul J. Liacos Professor of Law, Boston University, knhylton@bu.edu. I have benefited from comments by Haizhen Lin, David Rosenberg, and participants at the Southwestern Law School Asbestos Symposium.

1. See JACK B. WEINSTEIN, *INDIVIDUAL JUSTICE IN MASS TORT LITIGATION* 126-27 (1995).

litigation could advance the search for justice in allocations by ensuring that like cases are treated alike, but might retard the procedural justice goal by failing to give each claim its full consideration in court.

Another approach focuses on the goal of compensation, of making sure that each victim of asbestos exposure is compensated for the harms suffered. In recognition of scarce resources, the compensation approach focuses on ensuring that victims are prioritized according to the severity of their injuries.² Victims who suffer mesothelioma should come first, followed by victims of asbestosis, and then victims with various gradations of pleural disease.³ While compensation is an excellent goal, provided the injuries are genuine, one wonders why the litigation process should be preferred to a broader legislative solution. The litigation process involves enormous administrative and transaction costs that drain almost a third of the dollars set aside to compensate asbestos victims.⁴

A third general approach to the asbestos crisis, which is a distant third in terms of frequency of mention, is the goal of efficient resource allocation. Under the assumption that the asbestos claims that lawyers have filed over the years of this crisis involve cases of intentional or negligent harm, rather than inevitable accidents, asbestos litigation should be treated as a mechanism for efficiently regulating the conduct of injuring firms. The lawsuits should serve the goal of efficient deterrence by setting up incentives for firms to minimize the risks imposed on employees and consumers.

This essay will focus on the efficient regulation approach. The efficient regulation approach has received too little attention in recent years as the emphasis has been placed on ensuring compensation for asbestos victims. But the tort system's comparative advantage is as a regulatory mechanism rather than a compensation system.⁵ If compensation is the most important goal at hand, that can be accomplished at far less cost through some administrative system that does not involve litigation. And if the claims for injury based on asbestos exposure are not simply inevitable

2. See, e.g., Peter H. Schuck, *The Worst Should Go First: Deferral Registries in Asbestos Litigation*, 15 HARV. J.L. & PUB. POL'Y 541, 562 (1992).

3. For a discussion of asbestos related diseases, see MedicineNet.com, Asbestos Related Disorders, http://www.medicinenet.com/asbestos-related_disorders/article.htm (last visited Feb. 11, 2008).

4. STEPHEN J. CARROLL ET AL., ASBESTOS LITIGATION xxvi (RAND Inst. for Civil Justice 2005), available at http://www.rand.org/pubs/monographs/2005/RAND_MG162.pdf ("Defense transaction costs include the costs defendants and insurers incurred in all asbestos-related litigation, including litigation with other defendants and insurers. These costs amounted to more than \$21 billion by the end of 2002, or about 31 percent of total spending.").

5. OLIVER WENDELL HOLMES, JR., THE COMMON LAW 96 (1881).

accidents, then there is clearly a need for a regulatory mechanism to ensure that mass torts such as asbestos do not continue to occur.

I will start with a discussion of deterrence principles in the context of mass torts and then work my way gradually to the asbestos problem. One message I hope to convey is the importance of keeping deterrence and compensation goals distinct, and recognizing that compensation priorities should change in response to the deterrence goal. This has immediate implications for the current problem of handling marginal and fraudulent claims in asbestos litigation. Where the deterrence goals come to the forefront, for example in instances of reckless exposure, courts should be careful to distinguish deterrence and compensation goals, which may require defendants to pay damages that are not transferred to any claimants. Where the deterrence goals are less compelling, as in the instances of ordinary negligence or even less culpable conduct observed in modern cases, the importance of weeding out marginal and fraudulent claims becomes paramount.

II. A LITTLE BACKGROUND

Although I will focus on deterrence principles and only touch on details of the asbestos crisis, it is worthwhile to note a few general features of the crisis. Asbestos was considered a miracle product for centuries for its ability to withstand heat and retard fire.⁶ As early as the 1920s, scientists began to recognize its dangerous attributes.⁷ Microscopic asbestos fibers can be inhaled easily and remain in the respiratory system, where they cause diseases such as mesothelioma, asbestosis, and various degrees of pleural degeneration.⁸

6. See, e.g., Mesothelioma & Asbestos Awareness Center, Asbestos History, <http://www.maacenter.org/asbestos/history.php> (last visited Mar. 27, 2008).

The word "asbestos" comes from the Greek meaning "inextinguishable." Most likely, records indicate, the first asbestos mine was located in Greece on the island of Ewoia and was established sometime around the first century A.D. . . . However, most of early civilization found myriad uses for this "miracle" product. Historians note that during the times of the Holy Roman Empire, asbestos was already being used in building materials, thanks to its strength and fire-resistant properties. It was also used in women's clothing and other textiles. It is said that Romans would throw their asbestos tablecloths and napkins into the fire to clean them.

Id.

7. Michelle J. White, *Asbestos and the Future of Mass Torts* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 10308, 2004), available at <http://papers.nber.org/papers/w10308>.

8. See, e.g., CARROLL ET AL., *supra* note 4, at 13-14. The types of pleural degeneration caused by asbestos exposure have been described as "pleural plaques[, pleural] thickening, and pleural effusion." *Id.* at 14.

Asbestos can cause other nonmalignant abnormalities of the pleura: pleural plaques and

The stylized facts of the crisis can be summarized quickly. The major producers of asbestos hid the facts about the risks of exposure for decades.⁹ As evidence of this conduct became available, plaintiffs' lawyers brought waves of lawsuits against the producers involving claims of intentional or reckless conduct and generating punitive damage verdicts.¹⁰ The major producers have been driven out of business by lawsuits and the remaining defendants today are largely businesses that produced products that used asbestos, and who at worst may be considered negligent for failing to investigate or to act quickly to reduce the exposure risk to employees or customers.¹¹

We therefore have classes of defendants ranging from those who engaged in conduct that can be described as intentional or reckless, to those who may have negligently failed to investigate the risk, and even those who are arguably less culpable. We have classes of plaintiffs ranging from those facing a high risk of death from mesothelioma, to fraudulent claimants who have suffered no harm at all.

This is not the place for revisionism on the asbestos crisis, but some data suggest that the real story of asbestos is a bit more complicated than the stylized facts. As of 2002, 730,000 individuals had filed lawsuits in the U.S. and the total amount that defendants and insurers had paid to resolve claims was \$70 billion.¹² However, it has been suggested as a rough estimate that 400,000 lives were saved due to asbestos's ability to retard fires between 1942 and 1995.¹³ If we assign a value of \$7.5 million to each of these lives saved,¹⁴ then the benefit from asbestos suggested by this

thickening, and pleural effusion. Pleural plaques and thickening are scarring of the pleura, the membrane that lines the inside of the chest wall and covers the outside of the lungs. Pleural effusion is the presence of liquid in the pleural space. Pleural plaques and thickening can be diagnosed by a chest X-ray and can be accompanied by symptoms and diminished pulmonary function.

Id. (citation omitted).

9. *See, e.g., id.* at 12; White, *supra* note 7, at 5-6; PAUL BRODEUR, EXPENDABLE AMERICANS 4-5 (1974).

10. White, *supra* note 7, at 5-6.

11. *See, e.g.,* Helen E. Freedman, *Selected Ethical Issues in Asbestos Litigation*, 37 SW. U. L. REV. 511, 512 (2008).

12. *See* RAND INST. FOR CIVIL JUSTICE, ASBESTOS LITIGATION COSTS, COMPENSATION, AND ALTERNATIVES 1 (2005), available at http://www.rand.org/pubs/research_briefs/2005/RAND_RB9155.pdf; CARROLL ET AL., *supra* note 4, at xxiv, xxvi.

13. RACHEL MAINES, ASBESTOS AND FIRE: TECHNOLOGICAL TRADEOFFS AND THE BODY AT RISK 18 (2005).

14. This is a reasonable estimate based on studies of the value of a statistical life. *See, e.g.,* Joseph E. Aldy & W. Kip Viscusi, *Age Differences in the Value of Statistical Life: Revealed Preference Evidence* 23 (Resources for the Future Discussion Paper 07-05, 2007) (presenting table of age-specific value for the "value of a statistical life"), available at <http://www.rff.org/documents/RFF-DP-07-05.pdf>.

admittedly imprecise estimate of lives saved during the latter half of the 1900s is on the order of \$3 trillion (400,000 multiplied by \$7.5 million)—and this excludes the presumably more substantial life-saving impact over the first half of the 1900s. I am aware of no careful cost-benefit analysis of asbestos, but it appears possible that the benefit from asbestos exceeded its cost. And, if given the choice, most people would choose reduced lung capacity over death from fire.

But this is all water under the bridge now. Asbestos may be a product that has saved more lives than it has destroyed, but at this stage society is focusing only on the downside. My approach here is to treat the downside perspective as valid and to apply deterrence principles to it.

III. DETERRENCE AND MASS TORTS

A. *General Principles of Deterrence and Aggregate Litigation*

The problem of creating economically optimal incentives for precaution in the mass torts setting is closely related to the more familiar economic analysis of damage awards.¹⁵ In the punitive damages context, scholars have examined the problem of deterrence in connection to repeated torts.¹⁶ Repeated torts raise the same economic issues as mass torts.

Suppose, for example, a tortfeasor imposes a harm of \$100 on one victim every day. Suppose the cost of suit is \$10 for half of his victims (the ones injured on odd-numbered days) and \$200 for the other half of victims (the ones injured on even-numbered days). Given this, only half of the victims will bring suit against the tortfeasor. Since only half of the victims will bring suit (the ones for whom the cost of suit is \$10), the tortfeasor will not have optimal incentives to take precaution or to avoid harming victims. If he forbears from imposing the harm, he suffers a loss (e.g., in terms of precaution costs or in terms of forgone profits) of \$70. If he imposes the

15. See Keith N. Hylton, *Reflections on Remedies and Philip Morris v. Williams*, 4-9 (Boston Univ. Sch. of Law, Working Paper No. 07-06, 2007), available at <http://ssrn.com/abstract=977998>.

16. A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 HARV. L. REV. 869, 874-75 (1998) (proposing that in a repeated harm setting, the punitive award should be determined by dividing the judgment by the probability of liability); Keith N. Hylton, *Punitive Damages and the Economic Theory of Penalties*, 87 GEO. L.J. 421, 444 (1998) (offering that in a repeated harm setting, the punitive award should be determined either by the defendant's gain divided by the probability of liability or the victim's loss divided by the probability of liability).

harm, he suffers a loss of \$50 due to liability (\$100 multiplied by the 50% probability that his victim will sue). Clearly, he will impose the harm, which is bad from a resource allocation perspective because society suffers a loss of \$100 each day rather than the \$70 cost of avoidance. I will refer to this as the *underdeterrence* outcome.

Punitive damages have been proposed as one solution to the underdeterrence outcome in the repetitive harm scenario.¹⁷ If the total damage award of each victim who sues the tortfeasor is multiplied to \$200, then optimal incentives will be created by the tort system in this scenario. If the damage award is set at \$200, then each time the tortfeasor imposes a loss on a victim he will expect to pay \$100 (\$200 multiplied by the 50% probability that his victim will sue). The optimal *multiplier* is generally equal to the reciprocal of the probability that the tortfeasor will be held liable.¹⁸

Another solution to the underdeterrence outcome in the repetitive harm scenario is *aggregate litigation*.¹⁹ The aggregate litigation approach (exemplified by the class action) involves bundling all or many of the claims into one lawsuit.²⁰ Since the proof problems are the same in each, the cost of litigation can be shared among the multiple claims in the aggregate lawsuit.²¹ Thus, if all of the claims are bundled, a lawyer can create a class of victims suing for the aggregate loss, at a cost of \$200. The economies of scale provided by aggregate litigation offer efficiency gains relative to decentralized litigation,²² and also offer a solution to the underdeterrence problem when litigation costs exceed claims for some victims.

The optimal deterrence approach illustrated in the foregoing example is not so much concerned with compensation as with *internalizing* to the

17. Polinsky & Shavell, *supra* note 16, at 873-74.

18. *Id.* at 889. However, the Polinsky & Shavell analysis does not take into account the costs of litigation as a barrier to lawsuits. See Keith N. Hylton & Thomas J. Miceli, *Should Tort Damages be Multiplied?*, 21 J. LAW, ECON. & ORG. 388, 389 (2005).

19. The common example of aggregate litigation is the class action device. On the economics of class actions, see, e.g., Geoffrey P. Miller, *Class Actions*, in 1 NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 257-62 (Peter Newman ed., 1998); David Rosenberg, *Mandatory-Litigation Class Action: The Only Option for Mass Tort Cases*, 115 HARV. L. REV. 831 (2002); Richard A. Nagareda, *Autonomy, Peace, and Put Options in the Mass Tort Class Action*, 115 HARV. L. REV. 747 (2002). However, I am using the term aggregate litigation to refer to any process that bundles, consolidates, or aggregates claims into one or a small number of lawsuits. I will use the terms aggregate litigation and class action as if they are synonymous in the text. I know they are not the same, but the differences are not important for this analysis.

20. Miller, *supra* note 19, at 257.

21. *Id.* at 257-58.

22. On scale efficiencies, see Rosenberg, *supra* note 19, at 847-53.

tortfeasor all of the harms associated with his conduct. If the costs of his conduct are internalized to the tortfeasor, he will take cost-justified precautions to avoid imposing those harms. On the other hand, if the damage judgment against the tortfeasor exceeds the value of the victims' harms, over-internalizing victim losses, the result may be *overdeterrence* of the tortfeasor's conduct. The tortfeasor might be forced by the threat of liability to take precautions that cost \$150 in order to avoid imposing a harm of \$100.

In general there are two deterrence goals that can be recognized. One is the *internalization approach* described up to this point. The other is the *complete deterrence approach*.²³

The complete deterrence approach aims to shut down the offensive conduct rather than to find an optimal stopping point.²⁴ While the internalization approach aims to find the optimal frequency of some harm-causing activity, the complete deterrence approach aims to set the frequency of the activity at zero.

The complete deterrence approach is preferable to the internalization approach in two settings. One is where the injurer's conduct involves *bypassing the market*—that is, where it is a taking that occurs in a low transaction cost setting.²⁵ When it is cheap and easy for the tortfeasor to seek the consent of his victim before taking something from the victim, the tortfeasor should be forced to seek consent.²⁶ Complete deterrence in this case means removing any gain the tortfeasor gets from bypassing the market.

The other setting in which the complete deterrence approach should be preferred to the internalization approach is where the tortfeasor's activity is *always socially undesirable*,²⁷ in the sense that the social costs of the injurer's activity far outweigh any objective notion of its social value. An

23. For discussion of both approaches to deterrence, see Hylton, *supra* note 16. The two approaches are implied, though not explicitly discussed, in Gary Becker's early economic analysis of criminal punishment. See Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. OF POL. ECON. 169 (1968). In Becker's model, setting the penalty equal to the gain to the offender's gain, which implements the complete deterrence goal, is appropriate only when the offender's gain is less than the victim's harm. *Id.* at 191-93.

24. Hylton, *supra* note 16, at 421.

25. On the market bypassing theory, see Richard A. Posner, *An Economic Theory of the Criminal Law*, 85 COLUM. L. REV. 1193, 1195-96 (1985). The market bypassing theory is equivalent to the property rule theory of Calabresi and Melamed. See Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1092 (1972).

26. See Posner, *supra* note 25, at 1195-96.

27. Keith N. Hylton, *The Theory of Penalties and the Economics of Criminal Law*, 1 REV. L. & ECON. 175, 184 (2005); Posner, *supra* note 25, at 1201-05.

actor who plays with a loaded gun on a crowded subway car imposes a risk on others that is objectively far in excess of the value of the gain he gets. The law should seek to completely deter the conduct rather than internalize the loss of a victim. If, for example, an enormously wealthy individual who could easily pay the damages suffered by twenty gunshot victims decides to play with a firearm in a subway car, that actor should be penalized at a level that makes it *subjectively unprofitable to the actor* to engage in the activity, rather than simply requiring him to compensate victims.

These broad deterrence principles apply to the repetitive harm setting discussed at the outset of this section. We have two deterrence methods, multiplication and aggregation, and two deterrence goals, internalization and complete deterrence. This implies an array of four method-goal combinations that can be considered. However, rather than considering each of the method-goal combinations in the abstract, let us return to the concrete examples.

In the repetitive harm problem examined earlier, I concluded that the punitive damages multiplier method and the aggregate litigation method both solved the problem of underdeterrence by internalizing victim harms to the tortfeasor. These cases serve as illustrations of the internalization approach.

The complete deterrence approach involves wiping out gains enjoyed by the tortfeasor. In many cases that will be accomplished by the internalization approach, though not in all cases. Moreover, the complete deterrence approach implies a different view of the purpose of the damage award. Whereas the internalization approach aims to require the tortfeasor to compensate all victims for their injuries, the complete deterrence approach aims to ensure that the tortfeasor gains nothing from the injury-causing conduct.²⁸

To provide an illustration of a setting in which the complete deterrence approach is preferable to the internalization approach, suppose the actor invades the victim's property in a setting in which the invader could easily have gained permission before the invasion (low transaction costs). Suppose, for example, the tortfeasor uses the garages of victims in order to park his fleet of cars. The gain to the tortfeasor of using someone's garage is \$10 per day. The loss to the victim is trivial; suppose it is only \$1 for each invasion. I will refer to this as the case of the *efficient invader*, because the gain from his invasion exceeds the cost imposed on victims.²⁹

28. Hylton, *supra* note 15, at 4.

29. One might ask whether there are any real cases with economic structures similar to the "efficient invader" example. Consider *Jacque v. Steenberg Homes, Inc.*, where defendant Steenberg Homes hauled a mobile home across Jacque's property after being refused permission

This can be viewed as an example of repetitive harm because the tortfeasor uses someone's garage every day. Suppose, as in the example of the previous part, only half of the victims would have an incentive to bring suit.

Under the internalization approach, the tortfeasor would be required to pay a damage award in a single suit of \$2 (\$1 multiplied by a factor of 2 because only half of the victims sue). However, since the tortfeasor's gain is \$10, the internalization approach would not deter his conduct. Even after paying compensatory damages, he still gains \$9 on average from every invasion, so he will continue to invade victims' garages. Alternatively, an aggregate lawsuit would impose a damage judgment of \$1 multiplied by the number of claimants (all victims). However, the tortfeasor's gain is \$10 multiplied by the number of victims. It follows that he would not be deterred by the aggregate lawsuit.

Under the complete deterrence approach, the court would require a judgment of a *minimum* of \$10 multiplied by the number of claimants (all victims) in an aggregate lawsuit. In an individual lawsuit, the complete deterrence approach would require a judgment of \$20 to the plaintiff.

B. *Special Incentives under Aggregate Litigation*

So far I have considered principles of deterrence in the context of multiple or repetitive harms. In this part, I want to examine the special incentive problems of the aggregate harm setting.

The classic example of a case that is ideal for aggregate litigation is a mass tort that causes harm to many people at the same time. Aggregate litigation is ideal as a solution to the underdeterrence problem when those harms are small in relation to the cost of litigation.³⁰ However, aggregate litigation can be justified even when the harms are large relative to the cost of litigation.

Suppose the defendant is responsible for a mass tort that harms 100 victims by the amount of \$2 each. Assume that the evidence of tortious conduct is so strong that the victim will win his lawsuit with certainty, and the cost of bringing a lawsuit is \$100. The reason the cost of suit is \$100 is that even though the plaintiff will win, he must still gather the evidence and present it with at least a moderate level of skill to a court.

to cross the property. 563 N.W.2d 154, 156 (Wis. 1997). The only other way Steenberg Homes could have delivered the home to its customer would have been to clear a road with as much as seven feet of snow in some parts. *Id.* at 157. Clearly, the harm done to the Jacques was less than the gain (the snow removal cost avoided) by Steenberg Homes. The court awarded a punitive judgment of \$100,000 to the plaintiffs. *Id.* at 156.

30. Miller, *supra* note 19.

It should be clear under these assumptions that no individual victim will have an incentive to bring a suit, since the net reward from a lawsuit is $\$2 - \$100 = -\$98$. In this case, aggregate litigation (the class action device) is necessary in order to internalize to the tortfeasor the harms imposed on victims. In the absence of the class action device, no victim would find it in his interest to bring a lawsuit, and the injurer would not be required to pay for the harms imposed on victims. Realizing that he will not have to pay for the harms imposed on victims, the injurer would have no incentive in the future to avoid the conduct that imposed the harm. Again, we observe the underdeterrence outcome.

Suppose the harm to each individual is \$200. Now, each victim will find it rewarding to bring a lawsuit. If a victim decides not to sue, he suffers a loss of \$200. If he decides to sue, he receives a net gain of $\$200 - \$100 = \$100$.

Aggregate litigation is no longer necessary in this scenario, where harms are large relative to the cost of litigation, in order to induce a victim to bring a lawsuit against the mass tortfeasor. However, the underdeterrence outcome is still possible, and may be probable. Consider the victim's incentives again. If he is the first to bring a suit, he must prove liability and this will cost \$100. However, if he waits for another victim to sue first, he may be able to avoid the cost of proving liability, and his litigation costs fall to (let us assume) \$10.

Now we have a more complicated set of payoffs from litigation. To explore the incentives, and to identify the gains from aggregate litigation, assume that aggregate litigation (class action) is not available. If both parties sue simultaneously (in different courts), each gets a net reward of \$100. If one victim waits for the other one to sue first, the first one gets a payoff of \$100, the second one gets a payoff of \$190. If neither sues, the payoff to each is zero, which means that each suffers the loss of \$200 without compensation.

The strategy of suing yields the payoffs of \$100 (if others sue simultaneously) or \$100 (if you sue alone). The strategy of waiting yields the payoffs \$190 (if the other victim sues first) or \$0 (if no one sues). The payoffs can be described in the following matrix.

	<i>Sue</i>	<i>Don't Sue</i>
<i>Sue</i>	100, 100	100, 190
<i>Don't Sue</i>	190, 100	0, 0

With this payoff structure, the outcome “*Sue, Don’t Sue*” is the one that appears likely to result (the Nash equilibrium). In the other two outcomes, “*Sue, Sue*” and “*Don’t Sue, Don’t Sue*,” one party has an incentive to switch his strategy choice. However, the “*Sue, Don’t Sue*” outcome will involve one victim getting a lot more than the other.

The unequal outcome in the scenario in which one party sues and the other waits (the “*Sue, Don’t Sue*” equilibrium) is likely to be similar in its psychological effects to the famous Ultimatum Game.³¹ In the Ultimatum Game one party moves first and cuts a pie into two parts, and the second party decides whether the pie can be consumed or thrown away. Although it would be rational for the second party to accept any division of the pie chosen by the first mover, even if the first mover takes almost all of the pie and leaves only crumbs for the second mover, in real simulations the second mover often throws away the pie if the first mover splits the shares unequally.³²

The psychology of fairness illustrated in the Ultimatum Game may play a role in litigation outcomes in mass tort settings. In the most likely outcome in the absence of the class action device (or some method of aggregating claims), the “*Sue, Don’t Sue*” equilibrium, the actor that sues first will feel as if he is the loser relative to the actor who waits. He may correctly view himself as being used by the actor who waits to sue second. That perception may lead the first actor to decide never to sue first. If both parties are led by the psychological demand for fair outcomes to adopt a policy of not suing first, then the “*Don’t Sue, Don’t Sue*” outcome becomes the one that is frequently realized. Both parties wait to sue, which may result in weaker cases when they finally decide to go to court.

If the scenario described here were repeated, the parties could rotate in and out of the first mover position, and there would be a sense that being the one who sues first is not playing the sucker’s role. But a mass tort is

31. See, e.g., L.G. Telser, *The Ultimatum Game and the Law of Demand*, 105 THE ECON. J. 1519, 1519 (1995).

A common version of the ultimatum game goes like this. A sum of \$10 is available for distribution on just this one occasion to two people, *A* and *B*, strangers to each other, provided they can reach an agreement on how to share it. Many experiments prevent *A* and *B* from having any means of identifying each other before, during or after the game. *A* can make only one offer to *B* of any amount between 0 and \$10. If *B* accepts the offer then they can share the \$10 according to their agreement. If *B* rejects the offer then each gets zero.

Id.; John Gale et al., *Learning to Be Imperfect: The Ultimatum Game*, 8 GAMES & ECON. BEHAV. 56, 56-90 (1995); Richard H. Thaler, *Anomalies: The Ultimatum Game*, 2 J. OF ECON. PERSP. 195, 195-206 (1988).

32. See, e.g., Rachel T. A. Croson, *Information in Ultimatum Games: An Experimental Study*, 30 J. ECON. BEHAV. & ORG. 197, 209 (1996); Hessel Oosterbeek et al., *Cultural Differences in Ultimatum Game Experiments: Evidence from a Meta-Analysis*, 7 EXPERIMENTAL ECON. 171, 171-72 (2004).

unlikely to be replayed many times. It is a one shot scenario, which takes place in a setting in which the distributional consequences of suing first are obvious.

The demand-for-fairness problem suggests that aggregate litigation (class action) may be a powerful means of avoiding the underdeterrence outcome even when the harm to the victim is large relative to the cost of litigation. These two scenarios—cost of litigation small relative to harm, and cost of litigation large relative to harm—illustrate the positive welfare gains that are offered by aggregate litigation.

IV. THE FRAUD PROBLEM

In addition to avoiding the underdeterrence outcome in mass tort settings, aggregate litigation introduces some socially undesirable incentives. The most obvious is the incentive to include fraudulent claims.

If a class is formed with 100 victims, it will be obvious to the lawyer bringing the class action lawsuit that the cost of determining whether each of the 100 victims is truly a victim will be substantial in most settings. Perhaps in some cases it will be easy to distinguish true victims from phonies. A mass tort that leaves records, such as a scam that takes \$1 from the bank accounts of 100 people, should permit the court to separate real victims from phonies. But in most settings, records that would enable a court to quickly identify every real victim will not be available.

Given some uncertainty over the status of an individual plaintiff in aggregate litigation, the class action lawyer has an incentive to include fraudulent victims in the class. The lawyer knows that it is costly to determine whether any given victim is fraudulent. He knows that it would not be rational, given the cost of checking, to examine every victim in the class to determine validity. On the other hand, the gains from expanding the class are immediate to the lawyer.

If, on the margin, the gain from including an additional victim in the class exceeds the cost, the lawyer will include an additional victim. The gain is simply the additional damage amount claimed by the new victim. The cost is the expected penalty that might be suffered if the victim is later discovered to be fraudulent. If the only penalty is the exclusion of that new victim from the class, then there will be a strong incentive to include fraudulent victims. Unless the penalty exceeds the gain of including an additional fraudulent victim, the lawyer will have an incentive to add the fraudulent claim.

This incentive can generate an industry. Suppose, for example, physician records are needed to prove that a victim is suffering from a certain injury, and the injury is one that cannot be verified precisely and at low cost. The demand for fraudulent victims will then support the production of physician records to support fraudulent injury claims. This has already been observed in asbestos and silicosis litigation.³³ The asbestos and silicosis cases have generated cases in which fraudulent claims have been added in order to boost the size of the class.³⁴

In addition to simply boosting the total damage award, the addition of a fraudulent claim also enhances the likelihood of settlement.³⁵ If the defendant faces the risk of an enormous judgment representing the claims of thousands of plaintiffs, it will feel great pressure to settle in order to avoid a bankrupting damages judgment. Including fraudulent claims therefore not only enhances the aggregate award, it enhances the probability of a settlement.

Suppose the percentage of the total judgment taken by the lawyer is α . The total amount of damages for the fraudulent claims is D_f . The probability of the fraud being discovered is q . If the fraud is discovered, the attorney will not be able to collect fees from those cases, and will be required to pay a penalty S . Under these assumptions, the attorney will include a subclass of fraudulent claims with total damages D_f if

$$\alpha(1-q)D_f > qS,$$

which means that the expected gain to the attorney from fraudulent claims exceeds the expected penalty.³⁶ The fraud will be deterred only if the sanction is set so that $S > \alpha(1-q)D_f/q$. In other words, *the sanction for fraud should be at least as large as the attorney's expected gain from the fraudulent claims, divided by the probability of detection.*

To see what this implies in terms of magnitude, suppose the attorney's take is 20% and the total number of fraudulent claims is 10,000.³⁷ Suppose

33. Lester Brickman, *Disparities Between Asbestosis and Silicosis Claims Generated by Litigation Screenings and Clinical Studies*, 29 CARDOZO L. REV. 513, 514-18 (2007).

34. *Id.*; Lester Brickman, *On the Applicability of the Silica MDL Proceeding to Asbestos Litigation*, 12 CONN. INS. L.J. 289, 291-92 (2006).

35. *Id.* at 308-09.

36. A more precise description of the lawyer's incentives would say that the lawyer will include a fraudulent subclass if $\alpha(1-q)D_f - C > qS$, where C is the cost of generating the fraudulent subclass (e.g., fraudulent mass screenings). To simplify the discussion, I have treated C as equal to zero.

37. This is a realistic number; it is the same size (plus one) as the fraudulent silicosis class discovered by Judge Janis Jack in the silicosis MDL. See Freedman, *supra* note 11, at 522.

each of these claims seeks only \$15,000 in compensation. The probability of being detected is 10%. Under these assumptions, plaintiffs' attorney should be hit with a sanction of *at least* \$270 million.

Another perspective on the fraud problem can be gained by considering the demand for fraudulent victims. Suppose the penalty is equal to zero. Then the gain to the attorney from including the fraudulent subclass, under the foregoing assumptions, is \$27 million. At this level, the revenue from fraudulent claims could easily support a minor industry in the processing of false claimants.³⁸ If the only sanction for including fraudulent claims is the dismissal of those claims, the incentive to develop subclasses of fraudulent claims will remain strong.³⁹

V. IMPLICATIONS AND APPLICATIONS

The lessons from these general considerations can be illustrated with an example. Let us start with the *efficient invader* example considered earlier. Suppose the tortfeasor parks his cars in private garages without seeking consent from the property owners, in a setting of low transaction costs. Assume that there is a litigation class of 150 victims. One hundred of the victims are real victims of the garage invader's conduct. Fifty of the claimants are fraudulent—the invader never parked in their garages. Each real victim suffered a loss of \$1. Each fraudulent victim suffered a loss of \$0. In each case of a real victim, the garage invader gained \$10. What should be done?

If the attorney's lawsuit includes no claim for punitive damages, it will seek an aggregate judgment of \$150. This aggregate claim includes a

38. Brickman, *supra* note 33, at 519.

To read the hundreds of thousands of chest X-rays and pulmonary function tests generated by the litigation screenings and to produce the massive numbers of medical reports needed to advance the scheme, plaintiffs' lawyers and the screening companies have hired small number of doctors who share one common characteristic: their apparent willingness to enter into business transactions with lawyers and screening companies for the sale of tens of thousands of X-ray readings and diagnoses in exchange for the payment of millions of dollars.

Id.

39. If the probability of detection is sufficiently high, plaintiffs may not have an incentive to file fraudulent claims. After all, the plaintiffs' lawyer incurs some cost in filing a claim. If the return from a fraudulent claim were equal to zero, then the lawyers would lose money on fraudulent claims. Thus, dismissing fraudulent claims, without penalizing lawyers, may eliminate the incentive to file such claims if the probability of detection is sufficiently high. An alternative approach to discouraging fraud is the mandatory summary judgment proposal. See Randy J. Kozel & David Rosenberg, *Solving the Nuisance-Value Settlement Problem: Mandatory Summary Judgment*, 90 VA. L. REV. 1849, 1853 (2004). The mandatory summary judgment could be successful at deterring fraud if the probability of detection is sufficiently high.

fraudulent surcharge of 50%. Interestingly, on deterrence grounds this is still too low. The tortfeasor's gain from conduct affecting the real victims was \$1000. A judgment of \$150 would be insufficient to efficiently deter the garage invader's market-bypassing conduct.

On the other hand, the attorney has bundled fifty fraudulent claims in a class of 150. This is an abuse of the legal system that should not be tolerated. Under the analysis of the previous section, if the probability of fraud being detected is only 10%, the sanction applied against the attorney should be at least \$90.

Although there is massive fraud in this example, it is not clear on economic grounds that the defendant should be spared having to pay the \$150 judgment. The \$150 assessment is below the \$1000 that is necessary in this example to appropriately deter the tortfeasor's invasive conduct. The best practical solution on deterrence grounds would require the tortfeasor to pay the entire judgment, with the fraudulent excess of \$50 going to the state. The plaintiffs' lawyer should be assessed a penalty of \$90.

The key lesson of this example is that the goals of deterring tortious conduct and fraudulent litigation can be separated and pursued through different instruments. In the *efficient invader* example, the proper regulatory goal with respect to the defendant is complete deterrence. This implies that the damage judgment should be no less than the amount required to eliminate gain from the defendant's market-bypassing conduct. The complete deterrence goal also applies to the plaintiffs' lawyer's inclusion of fraudulent claims. The appropriate penalty against the lawyer eliminates any expectation of gain from that strategy.

The goals of regulating injury causing conduct and deterring fraudulent litigation can be pursued separately. This implies that a finding of fraud on the part of the plaintiffs' attorney does not immediately imply that the defendant should be relieved of some part of the damage claim. If the defendant's conduct is the type that should be completely deterred, then a finding of fraud does not immediately imply a reduction of the judgment. On the other hand, if the defendant's conduct is the type for which the internalization goal is appropriate—for example, cases of ordinary negligence rather than expropriation—then any finding of fraud among claims should immediately lead to a reduction in the damage judgment.

The upshot of this analysis is that defendants in mass tort cases should be prioritized according to their degree of culpability. For those defendants that are guilty of unambiguously malicious conduct, such as deliberately exposing consumers or employees to a substantial and hidden risk of injury, the need to worry about overdeterrence lessens greatly, and the more important problem to avoid is underdeterrence. Of course, plaintiffs'

lawyers who bundle fraudulent claims should be sanctioned in these cases. However, it may not be appropriate on deterrence grounds to set the portion of the judgment covering the marginal or fraudulent plaintiffs at zero. It would be inappropriate to award compensation to fraudulent plaintiffs, but the amounts claimed by those plaintiffs can be transferred to the state as part of a punitive award.

For defendants whose conduct can be described as negligent (in contrast to reckless or intentional), there is a valid overdeterrence concern. The plaintiffs' lawyers should be sanctioned for bundling fraudulent claims. In addition, the defendants should not be required to pay damages covering the claims of fraudulent plaintiffs. Further, the claims of marginal plaintiffs should be examined carefully to avoid overcompensation.

VI. APPLICATION TO ASBESTOS LITIGATION

In light of the apparent incentive to include fraudulent claims in mass tort settings, a policy of sanctioning plaintiffs' attorneys who bundle fraudulent claims would be desirable. The plaintiffs' attorney should be considered responsible for the quality of claims he represents. If an attorney is permitted to avoid responsibility by arguing that he had no knowledge of the fraudulent claims, then attorneys who knowingly bundle fraudulent claims will find no obstacles in their way.

Judge Janis Jack dismissed the fraudulent claims in the silicosis litigation,⁴⁰ but the incentive for fraud will not be removed unless there are penalties applied to attorneys who bring fraudulent classes. Since fraud is difficult to detect,⁴¹ the penalties should be substantial—no less than the revenue anticipated from the fraudulent claims divided by the probability of detection. Thus, if an attorney bundles 10,000 fraudulent claims of \$10,000 each, charges a 30% contingency fee, and faces a detection risk of 10%, the minimal sanction for his fraud is \$270 million.

Admittedly, it may be difficult to determine the probability of detection. However, since the sanction level is determined at its minimum, a court that applied a sanction for fraud would need only to determine an upper-bound estimate of the probability of detection. If the lawyer's expected revenue from fraud is adjusted for the upper-bound detection estimate, there should be no basis to complain that the sanction is inappropriate.

In light of the incentive for fraud, courts should permit defendants in

40. See Brickman, *supra* note 34, at 312.

41. See Brickman, *supra* note 33, at 578-80.

mass tort litigation to challenge the validity of claims and to require an audit of the plaintiff's class. The audit could be based on a random sample, or, if sampling is not feasible, statistical modeling. In order to regulate incentives to seek an audit, the cost of the audit should be shouldered by the party who "loses" the audit. If the defendant requests an audit of the claims, and the audit fails to find evidence of substantial fraud, the defendant should bear the cost of the audit. If, on the other hand, the audit finds evidence of substantial fraud, the audit cost should be shifted to the plaintiffs' attorney.

The cases involving intentional or reckless exposure to risk should be treated differently from those involving claims of negligence only. Where the evidence strongly supports a finding of intentional or reckless conduct, courts should separate deterrence and compensation concerns in asbestos litigation. Although fraudulent claims should never be compensated, marginal claims should be treated with more leniency where the defendant has engaged in reckless conduct. In addition, the portion of the judgment that would cover the claims of fraudulent plaintiffs could be transferred to the state rather than deducted from the total damage judgment, provided that the total damage judgment is well within the range of an economically appropriate penalty.

Admittedly, this implication may seem less useful in the asbestos context, where there is a long lag (e.g., twenty years) between exposure and the filing of a claim. However, when businesses make decisions to expose people to risks that may materialize many years in the future, those decisions should be presumed to be rational. It is appropriate then to impose a penalty that eliminates gains from malicious or reckless conduct, even if the penalty has to be imposed many years after the conduct.

The following numerical example illustrates the function of a gain eliminating penalty in the most culpable cases of asbestos exposure. Suppose the employer knowingly exposed 10,000 employees to asbestos, at levels and for periods that were likely to cause the most severe asbestos-related diseases. The exposure was so severe that it raised the annual risk of death by $2/10,000$. Assume the employer knew about the risk and refused to communicate the risk to employees. If the annual wage premium for an incremental death risk of $1/10,000$ was (during the time of exposure) \$750, then the employer's gain from refusing to communicate the risk would have been \$15 million per year. Assume that the risk exposure continued for ten years.

The employer's gain is equal to the savings (due to not having to pay the wage risk premium) of \$15 million per year over ten years, which is \$150 million. However, this approach ignores the interest earned on the

savings. To take the time value of money into account, let us consider the employer's incentives looking forward. Suppose in "year zero," the employer is looking at the stream of gains he gets over the following ten years from employing workers without informing them of the asbestos exposure risk. The gain to the employer looking forward in year zero is equal to the present value of a stream providing \$15 million per year over ten years. Suppose the rate of interest is 5%. Then the present value of the gain to the employer in year zero is \$115.8 million.⁴² Suppose, now, that the damage awards from tort suits do not appear until year thirty (and, to simplify, assume all of the tort suits are filed in year thirty). With an interest rate of 5%, the present value of a liability bill of D will be $.23D$ in year zero when the employer is deciding whether his plan is profitable.⁴³ The employer's plan will therefore be profitable, looking forward in year zero, as long as \$115.8 million is greater than $.23D$. Thus, in order to set the total liability at level that deters the employer's plan, the liability bill in year thirty must be no less than \$503 million.⁴⁴ If the compensatory awards given in year thirty (and onward) amount to less, assessed in year zero on present value terms, than \$503 million, then the awards will be insufficient on deterrence grounds. This illustrates the scenario in which it might be desirable to decouple the employer's damage payment and the compensation received by plaintiffs. Fraudulent victims would not receive compensation, but the employer may not receive a deduction on his damage bill.

The cases of intentional or reckless conduct have largely been run through the courts and the remaining defendants today involve conduct that may have been negligent at worst. For these cases, it is extremely important to avoid the overdeterrence problem. Plaintiffs' attorneys should be sanctioned for fraud; the dismissal of fraudulent claims is not enough to deter fraudulent claim bundling. In addition, marginal claims should be examined carefully to avoid any imposition of excessive damages against defendants. The efforts by judges to prioritize claims according to the severity of injury are entirely appropriate in view of the low culpability of most asbestos defendants today.⁴⁵

42. For an interest rate r , the present value of a stream offering \$1 every year for ten years (beginning next year) is $(1/r)[1-(1/(1+r))^{10}]$. Multiply this discount factor by \$150 million with $r = .05$, and the answer is \$115.8 million.

43. The discount factor is $(1/(1+r))^{30}$, which is equal to $.23$ when $r = .05$.

44. The employer's plan is profitable only if $\$115.8 \text{ million} > .23D$. It follows that the minimum penalty is $D > \$115.8\text{m}/.23 = \503 million .

45. On prioritization efforts within the courts, see Freedman, *supra* note 11, at 512-13.

VII. CONCLUSION

The asbestos crisis has revealed some of the benefits and costs of aggregate litigation. In addition to economies of scale, aggregate litigation avoids the underdeterrence problem that is likely to arise in mass tort settings. However, aggregate litigation also introduces an incentive to bundle fraudulent claims. It is important to separate the deterrence principles that apply to the conduct of defendants from the deterrence principles that apply to fraudulent claimants.