

Excessive Legal Fees:

Protecting Unsophisticated Consumers, Class Action Members, and Taxpayers

CENTER FOR LEGAL POLICY
AT THE MANHATTAN INSTITUTE



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*The Scope of the Problem and Responses
by the Judiciary and Bar*

*Fees in Traditional Litigation:
A New Reform Proposal*

*Fees in High Stakes Litigation:
Class Actions and Suits by Government Agencies*

Sponsored by:

**Center for Legal Policy
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**U.S. Chamber of Commerce
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Introduction

The legal and popular press have followed an intense debate driven by concerns that many consumers of legal services are being charged excessive (sometimes outrageous) legal fees without their consent...either because they are not direct parties to a lawyer-client contract (class action members and taxpayers who pay the fees for government actions) or because they lack the knowledge and experience to negotiate a fair fee. The debate is fueled by the counterpoint denials that such problems exist. The Manhattan Institute Center for Legal Policy, The U.S. Chamber of Commerce Institute for Legal Reform, The Hudson Institute and The Federalist Society joined together to sponsor a one-day conference to discuss the issues.

In the early years of the practice of law in the U.S. contingency fees were prohibited based on the premise that a lawyer who is paid a percentage of a tort recovery ceases to be just an advocate and inappropriately becomes a self-interested party to the suit. Contingency fees first came into existence in the United States in 1848 when the New York State legislature, moved by a desire to provide victims of industrial accidents with ready access to the courts, repealed the state's statutes regulating lawyer's fees and opened the door for lawyers to become direct stakeholders in litigation.

In a 1994 Manhattan Institute publication, *Rethinking Contingency Fees*, Lester Brickman, Michael Horowitz, and Jeffrey O'Connell documented that contingency fee lawyers routinely charge one-third to one-half of plaintiff recoveries (often calculated from gross recoveries) effecting fees that they estimate to be from “\$1,000 to \$5,000 to as high as \$25,000 to \$30,000 per hour.” These effective

hourly rates are particularly problematic when they exist in a case where liability was quickly conceded and settlement activity consisted of a few letters and calls to the defendant to reach agreement on the amount of the damages.

There is some general public awareness of the problem. A 1995 survey published in *U.S. News and World Report* disclosed that 56 percent of the American public believe that lawyers use the system to protect the powerful and enrich themselves.¹

Lawyers are prohibited from charging excessive fees by state ethics codes, most of which are patterned after the American Bar Association's Model Rules of Professional Conduct. The current ABA Rule 1.5 (a) is as follows:

A lawyer's fee shall be reasonable. The factors in the current model rule to be considered in determining the reasonableness of a fee include the following:

- (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
- (2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
- (3) the fee customarily charged in the locality for similar legal services;
- (4) the amount involved and the results obtained;
- (5) the time limitations imposed by the client or by the circumstances;
- (6) the nature and length of the professional relationship with the client;
- (7) the experience, reputation, and ability of the lawyer or lawyers performing the services.

There is general agreement that these rules are rarely if ever enforced. An exception: In 1998 a Colorado appeals court upheld a

lower court's decision allowing a retired hospital orderly to win back the standard percentage her lawyer took for representing her after an automobile accident in which she was seriously injured by a drunk driver. The case involved little lawyer time; it was a simple matter of collecting on a \$100,000 uninsured-motorist policy that the plaintiff carried.² But, cases like this are isolated events in what many describe as a sea of abuses. Former Chief Justice Burger, a harsh critic of the legal profession's failure to live up to its ethical obligations noted: "Lawyers have a way of papering their profession with 'rules' which are advisory, vague, and widely ignored."³ Many of the panelists at this conference echoed the view that the state progeny of ABA Model Rule 1.5 are ignored.

In 1997 the ABA created the Ethics 2000 Commission, a 13 member body that is recommending changes in the Model Rules of Professional Conduct that will go before the ABA House of Delegates this summer in Chicago, Illinois. The changes recommended in Rule 1.5 (a) are 1) that the opening statement should be rephrased to assert "A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses," and 2) a factor #8, "the degree of risk assumed by the lawyer" should be added.

The good news is that the American Bar Association is recognizing that the degree of risk a lawyer is taking should be a factor in determining the fee. The bad news is that tinkering with the language of a rule that is rarely enforced has questionable value. HALT, a highly regarded nonprofit organization of over 70,000 individual contributors that has as its mission to change the legal system to make it more equitable and affordable for the average citizen has an article in its Winter 2001 newsletter on the ABA proposed rule change. HALT describes the Ethics 2001 Commission as a "resounding waste of time." Their point is that "The strongest ethics rules in the world are worthless if consumers don't know about them. Yet nowhere in the hundreds of pages of new rules is there any requirement that lawyers provide clients any information about their ethical responsibilities."

What follows is a discussion by judges, practicing lawyers, legal scholars, and a representative of the ABA of excessive contingency fees.

CONFERENCE HIGHLIGHTS:

PANEL 1: The Scope of the Problem and Responses by the Judiciary and Bar

This panel opened with Professor Lester Brickman, Cardozo Law School, staking out the position that excessive fees are a considerable problem, and that the financial incentive for bringing contingency fee claims “overwhelms all fiduciary, ethical and public policy considerations.” Professor Brickman is particularly concerned about the use of standard contingency fees in cases where liability is clear and damages are substantial.

In 1994, the ABA Committee on Ethics and Professional Responsibility issued Formal Opinion 94-389. This Opinion deals with the ethical issues raised by tort lawyers charging standard contingency fees of 1/3 to 50% even in cases where liability is clear, damages are substantial, and the lawyer knew at the outset that she, in all likelihood, would earn windfall fees of thousands of dollars an hour. The Committee gave ringing endorsement to the practice of defrauding clients by vastly over charging them in these situations. Elsewhere, I have characterized the Committee’s opinion as wrong as a matter of ethics law, malevolent as a matter of public policy, disingenuous in its presentation, unfounded in its critical assumptions, illegitimate in its rejection of ethical considerations in favor of political partisanship, and blatantly self interested in elevating lawyers’ self interests above their traditional fiduciary obligations to clients. (Editor’s note: this opinion was authored by co-panelist Larry Fox.)

Professor Brickman was one of many panelists to assert that the rules of professional conduct regarding excessive fees are not enforced.

Panelist Larry Fox, Drinker, Biddle & Reath, defended the use of contingency fees as the means to access the courts for claims that would not otherwise be litigated. Mr. Fox admitted that overreaching does exist. He emphasized, however, that the client's interest and lawyer's interest are perfectly aligned, both benefiting from as large a recovery as possible. He defended ABA Formal Opinion 94-389 on the grounds that early settlement offers are often "insultingly low" and do not remain on the table, so lawyers are justified in assessing a fee on the full recovery, not just on what was earned above and beyond the early offer.

Mr. Fox agreed with Professor Brickman that Rule 1.5 is not enforced. He rejects legislative remedies, however, which he believes would deprive lawyers of their professional independence.

Last, Mr. Fox drew an analogy between the fee a lawyer receives and the salary a corporate CEO receives.

Here I sit in the capital of free enterprise, the United States Chamber of Commerce building, in a country devoted to capitalism. Does anybody ever figure out what a CEO's salary is on an hourly basis? Do we care that Cindy Crawford gets paid \$100,000 for half a day's work? No. We make a decision that the economic impact of certain people's activities is worth the money.

The final panelist, the Honorable Thomas Griesa, U.S. District Court, Southern District of New York, indicated that he has no authority at all over fees.

If a private party, corporation or individual, brings a lawsuit in my court, I have no authority to deal with this question. I say this having never looked up the law; the issue just doesn't arise. Whatever arrangement has been made between the plaintiff and the plaintiff's lawyer and the defendant and the defendant's lawyer has been made entirely without my participation or knowledge.

Speaking about class actions, where the courts do have a role in determining fees, Judge Griesa cited a case—*Goldberger vs. Integrated Resources*—where a trial judge awarded 4% of a recovery and the Second Circuit gave a very strong endorsement of the moderate fee award. He believes this case indicates that courts are trying to curb the excesses in class action fees.

In the question and answer period moderator Stuart Taylor referred back to Mr. Fox's analogy between the lawyer and the entrepreneur. Mr. Taylor raised the question whether there is something different about lawyers that demands that we treat them differently. Professor Brickman responded that one of the requirements of the self-regulatory system of the legal profession is that fees are reasonable. He notes that for four or five hundred years in Anglo-American law fees have been regulated. He argues that if the profession is to remain self-regulated, the rules should have some real world impact. Mr. Fox supported better enforcement of the rules, although he defended the analogy to the free enterprise system when the circumstances involve a highly sophisticated consumer of legal services and a highly sophisticated lawyer.

PANEL 2: Fees in Traditional Litigation: A New Reform Proposal

In this panel Professor Richard Painter, University of Illinois Law School, and Jim Wootton, President of the U.S. Chamber Institute for Legal Reform offered up a proposal for contingency fee reform that was conceived by Mr. Wootton and further developed by Professor Painter. The intent of the proposal is to correct the imbalance in information that often exists between lawyer and client. Clients inexperienced in the law are not in a good position to comparison shop; where there isn't good information markets do not work. The proposal, The New American Rule, bridges the information gap with minimal market interference. The centerpiece of the proposal is a requirement that every contingency fee lawyer offer the client both a percentage fee and an hourly rate. In other words, the lawyer says: I charge X% as a contingent fee, but this

fee will not go above \$Y an hour. At the end of the litigation, the client chooses which to pay, presumably selecting the lesser amount. The rule also has several features that enhance disclosure, such as an up front non binding time estimate, disclosure of fees charged in similar cases, and monthly statements of hours spent on the case.

PANEL 3: Fees in High Stakes Litigation: Class Actions and Suits by Government Agencies

The panel was opened by the Honorable Vaughn Walker, U.S. District Court, Northern District of California. Beginning with a reference to common fund cases, where attorney fee awards are predicated upon the equitable doctrine against unjust enrichment, Judge Walker noted that in America the doctrine has “been turned on its head.”

The notion here is that the *class* bringing an action should not be unjustly enriched at the expense of the lawyer. It is a rather peculiar doctrine to apply in a situation where we are attempting to come up with a reasonable way to compensate lawyers for what is essentially an entrepreneurial activity; that is, to compensate lawyers for creating some benefit to the class. It’s rather like attempting to come up with a gratuity rule for good Samaritans. It does not fit the problem at hand.

Judge Walker explained the various methods for determining fees today and noted that all the methods “essentially amount to the same thing: a standardless method of determining fees.” The problem, as he sees it, stems from the fact the fees are not determined in an adversarial context. Fees are determined at the end of the case, when a settlement is on the table, after the risk has passed. He concludes that an *ex ante* bidding process to determine fees in class actions promotes competition.

Professor Roger Cramton, Cornell University Law School, focused his remarks on: 1) the asymmetry in the tobacco litigation that has shifted from the defendants having an advantage to the plaintiffs having an advantage, 2) the class action as a clientless activity for

lawyers and the implications of that fact, and 3) the reality that judges are self-interested actors in the class action context whose major desire is to dispose of cases. On the last point he commented:

Empirical studies show that over 90% of class action settlements are approved by federal courts, and an even higher percentage by state courts after so-called fairness hearings that often last 20 or 30 minutes. There are rarely any objecting parties who contest these settlements. The only information the judge has is the information given to him by the settling parties, who have no obligation to be candid about the fee allocation between the various lawyers, the deficiencies in the settlement, conflicts of interest involved, or what goes into calculating the fee. By and large, judges do not go out of their way to ask hard questions or pursue possible problems.

The next panelist, Professor Charles Silver, University of Texas Law School, maintained that “there is no rigorous empirical evidence that attorneys are frequently overpaid in private representations, class actions or state tobacco cases.” He further asserted that there is some evidence that attorneys who handle class actions are often underpaid.

As to fees for contingency fee lawyers and individual representation he notes:

Contingency fee lawyers take risks that guaranteed-hourly-rate lawyers do not take. Consequently, they earn somewhat more than those lawyers. That means the market is working the way it should. We should not expect to see them earning exactly what other lawyers earn because they’re not delivering the exact same services that other lawyers are delivering.

He sees class action lawyers under-compensated, however:

The most significant problem we have in class action litigation today is not over, but under-compensation of lawyers,

as well as a failure to tie lawyers' compensation to the risks that they incur in these cases. Why do we have this problem? Because everybody thinks about fees in terms of legal ethics. Fees in class actions have nothing to do with legal ethics and are not governed by ethical principles. Class actions are about due process of law, not legal ethics.

Professor Silver believes that fees in class actions should be used to encourage lawyers to maximize the recoveries of class members. "If it turns out that you have to pay the lawyer \$100,000 an hour to overcome risk aversion, do it. That's what due process requires." He further maintains that judges routinely ignore state bar ethics rules when managing class actions because they too believe class actions are not about ethics but about due process.

The next panelist, Michael Horowitz, Director of the Project for Civil Justice Reform at the Hudson Institute, countered Professor Silver's remarks by describing the fee debate as one where there is "the rhetoric of ethical regulation and fiduciary duty, and the reality, thanks in part to Charlie's efforts, to an almost complete (and increasing) real-world breakdown of enforceable ethical norms. We have busy judges who don't want to get involved in fee regulation and who find it easier, as Roger Cramton has pointed out, to award or endorse flat percentage fees. In the case of attorneys' fees, we have thus moved away from any semblance of regulation into the brave new unregulated world that Charlie posits."

The next panelist, Robert Peck, Senior Director of Legal Affairs, Association of Trial Lawyers of America, asserted that the majority of ATLA members do not make what a first year associate makes in a Washington DC law firm, but make less than \$100,000 a year. He maintained that although many members charge less, the typical contingency fee is 33% and represents a market rate that considers the compensation due an attorney, the contingent nature of the litigation, the investment made by the attorney by advancing costs, the inherent risk of non-payment or underpayment, the quality of the attorney's work and the result achieved.

As to fees in class action cases, he disagrees with Professor Silver and asserts that courts have increasingly been exercising their authority to police fees.

The final panelist, Boyden Gray, Wilmer, Cutler & Pickering, hailed the virtues of Judge Walker's fee auction innovation indicating that the LIABA did a study called "Turning the Tables", which looked at the results of auctioning off lead class roles. "The article and the study upon which it is based showed that auctions tend to bring the contingency fee down to 7%. This is a two-thirds reduction from the sort of ordinary 20% that I think one gets in the big cases—not thirty three: it's really probably more like 20–21%."

Panel One

The Scope of the Problem and Responses by the Judiciary and Bar

Mr. Stuart Taylor

Senior Writer, National Journal

Professor Lester Brickman

Benjamin N. Cardozo Law School

Mr. Lawrence Fox

Partner, Drinker, Biddle & Reath

The Honorable Thomas Griesa

U.S. District Court, Southern District of New York, 2nd Circuit

MR. STUART TAYLOR: This panel will consider the scope of the fees problem, if any, and responses to it by the judiciary and the bar. I'd like the panelists to consider, for instance, whether Peter Angelos should get a billion dollar/25% contingency fee for joining in as a free rider to the tobacco settlement at the tail end of a process that was started by others. Perhaps he should be rewarded for pushing a bill through the legislature that rigged the case. Perhaps brilliant legal entrepreneurship should be rewarded just as Bill Gates is rewarded. Should you get \$100,000 an hour—as some of the tobacco lawyers are reportedly making—if you hit it big on a contingent case? Should you get a third of a three million dollar verdict if it cuts into your quadriplegic client's award?

I should acknowledge certain conflicts of interest I have as the moderator. First, I've been a fellow traveler of the panelist who might take the dimmest view of Mr. Angelos and his trial lawyer friends. Second, I was the beneficiary this year of at least three class action suits. This has modified my perspective. I have a Toshiba

laptop computer with a problem in its floppy disk controller. I am going to get \$309.90 if I spend a few hours filling out the legal papers. My lawyer is going to get \$147.5 million since there are a few million of us getting the \$309.90. Another action I am involved in concerns something called “call options”. I am suing one of my best friends, who happens to be a member of the board—or was a member of the board—before it went belly up. I am also suing my former cell phone provider.

The three panelists include two renowned experts on the subject, Professor Lester Brickman and Lawrence Fox, and an eminent judge, Judge Thomas Griesa. We are fortunate to have such an unusually qualified panel.

Our panelists will go in the following order: Professor Brickman will go first. He has been a critic of contingent fees as they exist now, quite possibly the leading critic in the country. He teaches contracts, professional responsibility and land use, among other courses, at Cardozo Law School at Yeshiva University. His areas of expertise are lawyers’ ethics with a focus on lawyers’ fees, tort reform including administrative alternatives to mass tort litigation, and contingency fee reform. He’s widely quoted in the press. His writings have been influential in changing policy with regard to nonrefundable retainers and in setting the tone for national debate over tort reform. He’s been a member of the New York State Bar Association’s Committee on Professional Ethics and the Committee on Professional Responsibility of the Association of the Bar of the City of New York.

Our second panelist, Mr. Lawrence Fox, is a flaming liberal—his words, not mine—who has been a partner since 1996 and former managing partner in the Philadelphia law firm of Drinker, Biddle and Reath, where he specializes in corporate and securities litigation in the counseling of lawyers and law firms. He is a fellow in the American College of Trial Lawyers, a fellow in the American Bar Foundation and a member of the American Law Institute, where he served as an advisor to the Restatement of the Law governing

lawyers. He is also a member of the ABA Commission on the evaluation of the rules of professional conduct, chair of the ABA Post Conviction Death Penalty Representation Project, past chair of the ABA litigation section, and past chair of the ABA Standing Committee on Ethics and Professional Responsibility.

Judge Griesa was a trial attorney at the Law School Honor Graduate Program of the Department of Justice from 1958 to 1960 in the Admiralty Section. He then went to the admiralty law firm of Simons, Fish and Warner in New York. Then he went to Davis, Polk and Wardwell in New York City, where he became a partner. He was nominated for the federal bench by President Nixon in June of 1972. I might add that that was the only auspicious thing that happened to the Nixon administration in June of 1972. He became a judge for the United States District Court, Southern District of New York, in September 1972 and served as chief judge from March '93 to March 2000. Judge Griesa cautioned us at the beginning that he doesn't handle very many fee cases, but I think he is ideally qualified, after our first two panelists speak, to look for common ground.

PROFESSOR LESTER BRICKMAN: My task is to define the scope of the excessive fee problem and consider the responses of the judiciary and the bar. To do so, I am going to focus on the tort system, which, according to an American Bar Association report, "is a mirror of society's morals and a legal vehicle for helping to define them."⁴ Very pious words—and I suggest, on that basis, that we are a nation at moral risk. Our tort system is infected with perverse incentives that raise transactional costs to intolerable levels and inflate medical care costs by billions of dollars annually. Vast amounts of wealth are being transferred through the tort system under the cover of dubious claims—and in some cases, fraudulent schemes—such as those that permeate much of asbestos litigation. Despite arguments to the contrary, liability being assessed under the tort system continues to expand at breakneck pace. It is clear why this is occurring. It is a consequence of the defining feature of our tort system, namely, the contingency fee. Over the

past 40 years, the effective hourly rate of return that contingency fee lawyers earn in inflation adjusted dollars has increased by ten to fifteen times. Effective hourly rates today are thousands of dollars an hour, sometimes \$25,000 and \$50,000 an hour; in tobacco litigation, the figure is as much as \$200,000 an hour. The financial incentive for bringing contingency fee claims overwhelms all fiduciary, ethical, and public policy considerations.

One of the most important conclusions I have reached in my research is that the rate of wealth transfers in our tort system is a function of lawyers' rates of return on their investments.⁵ Hourly rates received by tort lawyers have far more impact on the volume of tort litigation than, say, the frequency of injuries or the content of tort doctrine. This has profound implications for our civil justice system. The principal effect of the oversized incentive system is an enormous increase in the volume of tort litigation. While some question the existence of a "litigation explosion" by pointing to relatively static case filing rates in recent years, they conveniently omit from their statistics the tens of millions of plaintiffs represented by claims filed each year in the form of class actions.

Another effect of the fee-incentivized system is the spawning of an injury industry. Two thirds of automobile accident claims—and, by the way, automobile accident claims are approximately 60% of all tort claims—include claims of whiplash associated with bodily harm. Despite all of the miracle cures of our modern medical system, whiplash remains untreatable. I can say with absolute certainty that there never will be a cure. Consider two recent studies.

The first study was done of a European country where injured parties have their medical expenses paid by the state.⁶ In this country, there is no compensation for pain and suffering. The incidents of whiplash are zero. People who had been in accidents had no more or less chronic neck pain than people who had not been in accidents. In other words, chronic whiplash is not a medical event. It simply reflects the compensation system.

In another recent whiplash study, a Canadian jurisdiction was looked at that switched from a tort to a no-fault system.⁷ The conclusion here was no less striking. When tort compensation became unavailable, whiplash claimants experienced lower levels of pain, higher levels of physical functioning, the virtual absence of depression, and much faster recovery.

This country leads the world in whiplash claims because profit is such an integral part of the accident compensation system. The contingency fee provides a clear explanation. As a rule of thumb, pain and suffering damages—which account for almost 50% of total tort damages and which were an invention of judges as a means of compensating contingency fee lawyers—are worth approximately three times actual damages (actual damages being mostly medical expenses).⁸ Given the incentives for lawyers to run up medical bills in order to run up contingency fees, it is no surprise that, according to the Rand Institute for Civil Justice, 35% to 42% of medical costs claimed from automobile accidents are excessive or fraudulent.⁹

The self-interested response of the bar to all this is to cheer on the forces of “Litigation, Inc.” and to oppose attempts to limit the growth of the tort system. In 1994, the ABA Committee on Ethics and Professional Responsibility issued Formal Opinion 94-389.¹⁰ This Opinion deals with the ethical issues raised by tort lawyers charging standard contingency fees of 1/3 to 50% even in cases where liability is clear, damages are substantial, and the lawyer knew at the outset that she, in all likelihood, would earn windfall fees of thousands of dollars an hour. The Committee gave ringing endorsement to the practice of defrauding clients by vastly over charging them in these situations. Elsewhere, I have characterized the Committee’s opinion as wrong as a matter of ethics law, malevolent as a matter of public policy, disingenuous in its presentation, unfounded in its critical assumptions, illegitimate in its rejection of ethical considerations in favor of political partisanship, and blatantly self interested in elevating lawyers’ financial interests above their traditional fiduciary obli-

gations to clients.¹¹ I would also suggest that the opinion is fattening (to lawyers' wallets).

In the same article I concluded that Formal Opinion 94-389 is a distressing display of ethical insensitivity to the current practice of routinely over-charging contingency fee clients. It simply reflects the mutual financial interests of the trial and defense bars; both want to preserve windfall fees as a way of promoting litigation. I noted that when the battle between ethics and money is played out, there can be no doubt about the outcome. Money talks; ethics walks.

Larry Fox, my fellow panelist, is the author of this ABA Opinion. He will, no doubt, point out that while the Committee said that charging standard contingency fees is almost always ethically permissible, such charges have to be "reasonable." Enforcing ethical standards by invoking the reasonable fee standard is based on the following syllogism: lawyers who charge unreasonable contingency fees violate the ethics codes. Violations of the ethics codes result in disciplinary sanctions. Therefore, in the world of the ABA, contingency fee lawyers are subject to ethical constraints. There is a critical flaw in this logic. Contingency fee lawyers are virtually *never* disciplined for charging unreasonable fees, that is, for charging substantial risk premiums in cases without meaningful risk. Presumably, the ABA knows that there are virtually no disciplinary sanctions applied to contingency fee lawyers for charging unreasonable fees; I suggest, then, that the ethical standards of the ABA may properly be questioned.

To unmask the duplicitous nature of the reasonable fee mantra, I did an empirical survey of the enforcement of ethical norms in the contingency fee area.¹² The findings are appalling. Stated simply, in most jurisdictions, a lawyer charging a standard contingency fee in a tort claim essentially ends any ethics inquiry about the excessiveness of the fee. There is no case-by-case enforcement for even gross abuses of ethical rules regulating contingency fees. The failure of the disciplinary system is massive; one can reasonably conclude that, in reality, there are no ethical rules regulating the use of standard contingency fees.

Let me turn to the response of the judiciary to the excessive fee issue. There is little basis for optimism that this problem will be solved by the courts. When contingency fees received the imprimatur of the fledgling ABA almost a century ago, it was on the condition that courts carefully supervise fees to protect clients against lawyers' overreaching. Overreaching was understood as charging percentages that yielded rates of return not commensurate with risk. Courts once upon a time did indeed protect clients, at least on occasion; for the most part, however, no protection occurs today. The judicial regulatory scheme has become a device more for public display than for client protection.

Some judges justify a *laissez-faire* approach by saying that fee setting is a matter of private ordering. The tort system, however, is a public institution and fees that are charged to access the civil justice system are a matter of public concern. Moreover, in each jurisdiction, the contingency fee is fixed by tort lawyers. There is no bargaining that takes place about the fee. So much for private ordering.

Two areas where courts cannot eschew responsibility for enormous increases in fees are in class action and common fund cases. Courts award fees in these cases that vastly and routinely over-compensate lawyers. Judges justify the fees by noting that attorneys must have sufficient compensation, by way of incentive, to undertake litigation. Even accepting that claim at face value, it does not justify the enormous fees—the hundreds of millions of dollars—being awarded. Moreover, use of the lodestar instead of the percentage method for fee setting does not eradicate over-compensation. The unspoken truth about the lodestar is that it is often laden with uncountable numbers of hours. These hours are counted even though they lack credibility.

If law firms were audited to determine how many hours each lawyer was claiming in *all* of their class action cases, I have no doubt that, in many, fees would be literally out of this world. Instead of a day being merely 24 hours, as it is on Earth, the number of hours in a day would more closely correspond with those on Saturn or

Jupiter. A principal consequence of over-compensation is the proliferation of class action activity without any redeeming social value. It is simply fee-driven.

One of the more pernicious fee setting devices that courts have permitted is the basing of class action fees on artificial settlement values when actual payments to the class will be a fraction of that amount. Thus in the type of settlement called the “reversionary settlement” where funds unclaimed by the class revert to the defendant, the fees awarded can easily amount to 200% or more of the amount actually paid to class members.¹³

Another judicial response deserves mention. If you hire a lawyer and she sells you out or performs incompetently, you have certain protections as a client. You can sue for breach of fiduciary obligation or for malpractice. But if the lawyer hires *you*—that is, if you have been conscripted into a class action—all of your protections have been stripped away by the courts. Even if the class action lawyer performs abominably or deliberately sells you out, even if the settlement is so egregious that it requires you to reach into your own pocket to pay the lawyer, once a court accepts the settlement you have no legal recourse. Thanks to the courts, you cannot sue for breach of fiduciary obligation or malpractice. The courts have erected firewalls around class action lawyers to protect them, no matter how outrageous their conduct. This is a leading reason why class action lawyers are increasingly selling out claimants’ interests. They can bargain away class action rights for a higher fee without repercussion. Excessive contingency fees promote wealth transfers, I suggest, that should make the Mafia envious.

In summary, we can expect no support from the bar for reform and there is little reason to look to the courts. (There is, however, a recent Second Circuit decision, *Goldberger vs. Integrated Resources*,¹⁴ which indicates that *some* judges are aware that current class action fees vastly over-compensate lawyers.) I think the only possible source of relief is in the legislative arena and, perhaps in the west-

ern states, in the use of the initiative process. I will leave that possibility to be discussed by other panelists.

MR. LAWRENCE FOX: I expected that after Lester finished the ABA would lie bleeding on the floor. I wasn't so sure that the judiciary would suffer but it took a beating as well. I didn't realize that to defend contingency fees I would need to become an expert on the existence or nonexistence of whiplash. Since I do not know anything about the subject, I'll have to confine my remarks to arguments I anticipated.

I have worked for the American Cancer Society and for the Big Brothers' Association. Today, my charitable impulses are directed at Mel Weiss, Dick Scruggs, and Peter Angelos. I am here to defend the contingency fee system. I do not believe it is perfect. But I do think we ought to go back and look at first principles. What does the contingency fee system provide? It provides access to the courts for the adjudication of claims that otherwise would not be litigated. This, it seems, is the heart of the controversy: most people who rail against class actions and contingency fees are the object of these claims. Understandably, those who are adversely affected by these things oppose them. The important considerations, however, are whether these claims are valid and whether these claims would get heard if a contingent fee were not available. I submit that they are and that they would not. We should be proud that our legal system allows these claims to be brought instead of barring people from the courthouse door.

The contingency fee system is wonderful for those of us who deal in billable hours and hear our clients complain about that method of billing constantly. The contingency fee aligns the interests of the lawyer and the client perfectly. I admit you can have overreaching. Absent overreaching, however, the client's interest in a larger recovery and the lawyer's interest in increasing the fee are perfectly compatible, and this arrangement is preferable to a situation where my clients complain that I am spending too much time on their case or assigning too many associates to the matter. Contingency

fee clients never have to worry about the lawyers' efficient or inefficient work since their fee does not turn on that factor.

In the contingency system, where there is no recovery, there is no fee. Lester and those who agree with him suggest that, in the American tort system, 100% of claimants are collecting huge amounts of money, but it is money that was available to these claimants at the outset of the representation. A quick look at the statistics on these cases reveals, to the contrary, how many plaintiffs' cases are lost. I am proud of those defeats because I come from a defense firm. Many cases go to trial and the plaintiffs' lawyers lose; both lawyer and client, therefore, walk out the courthouse door with nothing.

As for the much maligned ABA Formal Opinion 94-389: I would ask each of you to read it and determine for yourself if it is as malevolent, irresponsible and destructive as Professor Brickman suggests. We were asked a number of questions that led to preparing 94-389. One of them was this: if a client receives an early settlement offer and if that early settlement offer is declined, is it permissible for a lawyer to charge a contingency fee on that early settlement amount? Imagine that you get an early settlement offer of \$10,000. You ultimately recover \$100,000. Is the lawyer entitled to 30% or 25% or 40%—whatever the arrangement is—of that \$10,000? We said yes. First of all, the early settlement offer is by and large a myth. There are some reasonable early offers like these, but early settlement offers are usually so insultingly low that they are not worth paying attention to. Second, consider a good early settlement offer that is turned down by the client. The problem with the earlier hypothetical is that it assumes that that \$10,000 remains sitting there waiting for the plaintiff any time she wants to take it, even if she loses in court. That is not the case. I have made early settlement offers, on occasion, and when they are rejected I take them off the table. I then try to assure that the plaintiff recovers zero. I force the plaintiff's lawyer to fight for that first \$10,000 just like she has to fight for the rest of the money. Thus lawyers truly earn that fee. The Commission's response was reasonable and certainly not unethical.

The Commission was also asked whether it is ethical to charge a contingency fee where liability is clear. This too, in large part, presents a mythical situation. Airline cases may be clear, but these are certainly exceptions. In any event, considering the hypothetical, we concluded that it is perfectly acceptable to charge a contingency in that case. Even when liability is clear there is a fight over the amount and the allocation of damages. There are many other imponderables in the process. For instance, after you get your judgement do you collect it? Is there a deep pocket that is prepared to pay it? Is there going to be an appeal on the basis of excessive damages? If a lawyer charges a contingent fee in a case of clear liability it remains ethical. I am proud of the opinion; it got it exactly right.

Lester's gripe, which is legitimate, is that the rule we've got—namely, Rule 1.5—is not enforced. This does not mean that the rule is not correct. It also does not mean that the solution to the problem is to eliminate contingency fees, severely restrict them, or invite the legislatures to change them. On that point, the last thing we should do is to invite legislatures to muck around with legal business. The regulation of lawyers should remain exactly where it is, with the judiciary. As soon as we go down the legislative path, we may gain something important regarding the reform of contingent fees, but the lawyers of America will lose something far more important, namely, professional independence.

Let me turn briefly to the tobacco fee cases because they have set off many alarms. I argued, even before these cases were decided, that if tobacco fee lawyers received huge fees they were entitled to them. Tobacco agreements, for example certainly the one crafted by Peter Angelos, were negotiated with extraordinarily sophisticated clients after a request for proposal was issued and bids were submitted. Mr. Angelos' bid was the lowest of all the bids Maryland received. Few lawyers, I remind you, wanted to take those cases back then. The arrangement was for 25% of the recovery fee, a fair fee when it was entered into and a fair fee now that it's worth a billion dollars or whatever the figure might be.

Why do I think this result is fair? If the Attorney General of Maryland was told on the day that the tobacco agreement was signed that the lawyers would get one billion if the state would get four billion, he would have been thrilled with that result. These arrangements were agreed to because that result was so unlikely. The Attorney General of Maryland, I recall, was so uncertain of the outcome that he wasn't even willing to front the expenses. Peter Angelos did.

Everybody is asking, now, if the lawyers' fees are reasonable. No one is particularly interested in looking at cases where the result goes the other way. When the first person approaches a lawyer who handles a contingent fee matter and says, "you know, I agreed to give you 1/3 here because I thought I would recover a million—but since we only recovered \$50,000 and you put in a lot of work, I think you ought to get 50% or 75%," then perhaps it will be time to recalculate contingent fees in the wake of unexpected success.

There is an obsession with hours in this context. Lester Brickman loves to talk about hours and hourly rates, but I don't believe these things are important in contingency fee evaluations. Here I sit in the capital of free enterprise, the United States Chamber of Commerce Building, in a country devoted to capitalism. Does anybody ever figure out what a CEO's salary is on an hourly basis? Do we care that Cindy Crawford gets paid \$100,000 for half a day's work? No. We make a decision that the economic impact of certain people's activities is worth the money.

Why doesn't this logic extend to lawyers? Lester calls attention to Rule 1.5; one of its multiple factors is number of hours. I ask: if a lawyer is very efficient and accomplishes an extraordinary result, does that make the fee unreasonable? I know lawyers have a special obligation not to charge unreasonable fees. But the question is whether the reasonableness of the fee should be measured by time or by result. I favor result; hours shouldn't even be discussed. If you move four billion dollars from one side of the table to the other you should be rewarded just like a CEO is after creating a

four billion dollar enterprise. Lester may not like the fact that four billion dollars is moving from one side of the table to another. But that is a different discussion. Perhaps we shouldn't have cases against tobacco companies or manufacturer liability cases. These are also questions for another day. Lester's objection has nothing to do with whether the fees themselves are actually reasonable.

Some legislatures have enacted rules limiting contingency fees. Most of them have got it wrong. Legislators say it's okay for a lawyer to charge 25% of the first \$100,000 and 20% of the next \$100,000 and 15% of everything else. This strikes me as backwards logic within a free enterprise system. The first \$100,000 is the easiest \$100,000 to earn. Think about selling your house. Pick a number that is half the value of your house—you could sell your house for that figure tomorrow without any assistance. Why should the realtor get 6% of that first \$100,000? Alternatively, if your realtor says she can get you a million dollars for your house, you would happily agree to give her 50% of the last \$100,000 because you wouldn't think your house is worth anything near that amount. The best work of the lawyer is the last billion dollars if it's Peter Angelos, or it's the last \$100,000 if it's mere mortals doing regular cases.

It's time to stop flogging lawyers because they make a lot of money and because they have a huge impact on our legal and political system. People don't like the influence of lawyers and therefore their fees have been made into a lightning rod for more general anger. The fee system is not perfect, but it's adequate. I wish that every time a client came to a lawyer the lawyer would evaluate the individual case and come up with a fair number. The lawyers of America don't do that and I don't believe they are going to do that, which is a reality we have to deal with.

THE HONORABLE THOMAS GRIESA: In Federalist 51, James Madison notes that men are not angels. He describes a series of institutional arrangements that address this fact, a system in which different elements of self-interest largely cancel each other out. Else-

where, however, Madison admits that citizens need a great deal of virtue and no political arrangement will work if they don't have it.

Many questions have been raised by this panel. What procedural or legal arrangements are there for the controlling of attorneys' fees? Should fees be calculated on an hourly basis or calculated as a percentage of recovery? Do our laws and ethics rules tend in one direction or the other? These questions are very important, and we should seek to answer them as well as we can. No arrangement, however, is going to prevent problems if the bar consists of abusive members and if clients are not alert. No revision of civil procedure, alone, is going to cure what ails us. You still have to deal with human beings whether you've got judges or arbitrators. Changing procedures does not change as much as we think.

What Lester described is terrible, namely, lawyers bringing class actions simply to collect fees. While this sort of abuse exists, I know from experience that a lot of class actions are very important on their merits. They deal with serious wrongdoing that has created liability. Some tort litigation is sheer fraud, but I am not so cynical to believe that litigation is all driven by thieves. All of the things that Lester spoke of I deplore. But I hesitate to remedy the situation by a change in fee arrangements. I also would like to point out that many recoveries are well deserved.

Let me comment on what judges should do about fees and whether what they do is successful. I do not know a great deal about what goes on in courts other than my own. I can only tell you what I do. I am a federal trial judge. I sit in the Southern District of New York. In normal cases—and by that I mean cases that are not class actions—I have no authority at all over fees. If a private party, corporation or individual, brings a lawsuit in my court, I have no authority to deal with this question. I say this having never looked up the law; the issue just doesn't arise. Whatever arrangement has been made between the plaintiff and the plaintiff's lawyer and the defendant and the defendant's lawyer has been made entirely without my participation or knowledge.

Very often, however, I am present when parties conclude a settlement; they wish to call in a court reporter and have the terms dictated. I will hear a lawyer say that the recovery is, say, \$150,000, to be paid by the defendant to the plaintiff. The lawyer for the plaintiff will make sure the client understands that, out of this sum, he will be paid, say, \$50,000.00 plus \$4,500.00 in disbursements. The client agrees, and I have no way of knowing whether he is unhappy or happy. I cannot recall an instance when there was a dispute about the terms in my presence. Not infrequently, in the course of the settlement discussions, the lawyer will reduce his fee. He will say, "look, we are entitled to such and such but in order to encourage a settlement we will reduce that amount." This is an indication—albeit a small one—that there are honorable lawyers out there who are not wholly fee driven, who are not trying to get the last buck they can in the worst possible way.

Not only do I not get engaged in fee issues, until recently I have not even considered the issue under discussion. The first time I seriously thought about contingency fees was when I attended a luncheon given by the Manhattan Institute in New York City. I heard Professor Painter, who is on a later panel, speak about the problems with the fee system. I confess this so you can see how far divorced at least this trial judge is from the issue. I am not blasé about the topic, nor do I suggest that these things are not extremely important. But the issue has not come my way.

To some extent, there are fraudulent lawsuits. There are devils and angels among lawyers, as there are among all human beings. There are certainly situations where there are excessive recoveries, and there are recoveries in cases where they are not deserved. Recoveries in some actions have put a terrible tax upon businesses and have caused the production of certain products to cease. There are severe impacts on the medical profession and the hospital industry. Remember, though, that there are rules of law. There are jury instructions given by judges. If there is a need for change, if certain aspects of recovery in lawsuits are excessive, there ought to be some examination of the rule of law and the way judges instruct their juries.

You can't hear too many people in the legal profession speak for long without claiming to be a hero. I am no exception. I am very concerned about excessive damages and there are a couple of things I do to address the issue. When, in a tort case, a litigant talks about millions and millions of dollars in damages, I instruct the jury that the purpose of the damage award is *not* to transport somebody from low economic status to Palm Beach or the French Rivera. The purpose of damages is to compensate fairly and to recognize the type of economic level the person is in. I've given that instruction over and over and nobody has even ever appealed it.

One of the problems in our tort system is excessive punitive damage awards. There are many things you can say to a jury by way of instruction. I think the highest punitive damage award ever awarded in a case of mine was approximately \$70,000.

Let me mention the instances when federal judges do get involved in fees. These, of course, are class actions and derivative actions. I don't recall too many derivative actions recently; I've frequently handled class actions.

Many class action settlements, including the approval of legal fees, are very modest. This situation reminds me of reactions to the OJ Simpson trial. That trial was broadcast all over the world and I suppose people in Pakistan and Nigeria thought it was a typical case; meanwhile, in courts throughout America, calm, low-key, businesslike trials were going on without much attention. While I don't know much about the tobacco case or other attention-grabbing litigation, I do know what goes on in typical class actions. First of all, cases are generally settled. I have never tried a class action to conclusion. Secondly, the plaintiffs' lawyers often do a lot of work. Third, settlements are often quite modest because nobody has a lot of money to put into the settlement; and often the fees are quite modest as well. Frequently, fees have to be a percentage of the recovery because the hours spent cannot be compensated.

In our circuit, there was a recent case dealing with class action fees. Professor Brickman referred to it earlier—*Goldberger vs. Integrated Resources*. The decision was written by Judge McLaughlin. It considers a settlement that was reached in a case concerning the Drexel Burnham Lambert Group that totaled 54 million dollars. The plaintiffs' lawyers applied for a 25% fee of that 54 million, which amounted to 13.5 million dollars. Judge Kram, the trial judge, awarded 2 million dollars, approximately 4% of the recovery. The plaintiffs' lawyers went to the Second Circuit and made very strong objections. Judge McLaughlin turned them down. It's a very interesting opinion and it indicates that, at least in our circuit, a trial judge has the discretion to use a percentage of the recovery as a basis for fees or to consider the number of hours actually and reasonably billed. Judge McLaughlin gave a very strong endorsement of a moderate fee award. This case suggests that courts are trying to curb the excesses in class action fees.

MR. TAYLOR: My question to the panel concerns the analogy that Mr. Fox made between the lawyer and the entrepreneur. We live in an age of entrepreneurs, twenty-something Internet billionaires and hugely compensated corporate executives whose rate of pay goes up exponentially compared to their employees. Like lawyers, a lot of these people are fiduciaries. We don't hear much talk about capping their compensation. My question: is there something different about lawyers or about the legal system that demands that we treat them differently? Alternatively, if the analogy to entrepreneurs is accurate, why have any rules against unreasonable fees?

PROFESSOR BRICKMAN: I think there is something fundamentally different between corporate pay and lawyers' fees in the context of a tort system. Larry Fox said, in opposition to my recommendation that there be legislative solutions, that he favors a self-regulatory system. In fact, Larry wants it both ways. He wants legislatures to butt out so that lawyers can regulate themselves. One of the requirements for the self-regulatory system, of course, is that fees are reasonable. Notice that Larry doesn't want fees regu-

lated to ensure their reasonableness. He wants, then, a regulatory system that keeps fees from being regulated.

We've had for four or five hundred years in Anglo-American law the concept of a fiduciary obligation. From the very outset, lawyer fees have been regulated; this goes back to the origin of lawyer fees in England. There has always been court regulation of lawyers' fees, certainly, in the past more so than today. If we are going to have a self-regulatory system then it ought to work. The words "fees shall be reasonable" should have some content. I dare say that if you look at the tobacco fees, which have been exempted from the regulatory system, no one, except maybe Larry, can argue that they are reasonable. The requirement of a reasonable fee is vacuous or the Bar has simply stepped aside—which is what I suggest—and allowed abuses to proceed without any overlay of ethical and fiduciary concepts. I certainly object to that.

MR. FOX: Lawyers' fees should certainly be reasonable. The ethical mandate means something. There are legions of cases where lawyers have overreached; most clients are not sophisticated and it is easy to see how this happens. The power imbalance in the lawyer/client relationship requires that we have a rule and that that rule be enforced. I urge that it be enforced more frequently.

My point, alternatively, is that when you have a highly sophisticated consumer of legal services and a highly sophisticated lawyer and they engage in negotiations, and the prospect of a billion dollar recovery or a ten billion dollar recovery is remote. Once in a while, after a 25% fee is agreed to, lo and behold, the lawyer succeeds beyond everyone's expectations. The 25% is still a reasonable fee. One measure of its reasonableness is how other people who cause similar economic impacts are compensated in our country. The analogy with entrepreneurs isn't perfect. But the free enterprise system dictates that it is reasonable to pay a CEO—a fiduciary, I hasten to add—an extraordinary amount of money because of an extraordinary accomplishment. I have no trouble defending the tobacco fees as reasonable if they were negotiated in that way.

JUDGE GRIESA: There is no question that a lawyer occupies a unique role in our system. A litigation lawyer is different from a basketball player, an entertainer, or a corporate executive, among other reasons, because litigation is carried on in court and it depends to a certain extent on public resources. This said, I generally believe that it is better to leave the setting of fees to market forces. I dread the prospect of legislatures trying to manage fee arrangements. I envision a setup of unpleasant complexity; I also envision mistakes made and the need for frequent revisions.

The market should, alternatively, be influenced. It undoubtedly is influenced by increased discussions of this subject. Changes will neither be perfect nor fast, but I prefer a gradual method to a flurry of codification.

AUDIENCE QUESTION: What would the appropriate compensation be for the lawyers in the Toshiba case?

MR. TAYLOR: The actual fee award was \$147.5 million, which was, I think, only about 10% or 15% of the total. I would be interested in knowing what this comes to on a dollar per hour basis. I'd also be interested in knowing whether whatever entrepreneurship led to that settlement is going to be leveraged into multiple settlements with other companies at similar rates.

AUDIENCE QUESTION: Larry argues that the obligation depends on who the client is. He implies that if the client is Union Carbide or another sophisticated consumer of legal services, the lawyers' fiduciary obligation is minimized in comparison, say, to a widow who can't speak English. That shifting standard just doesn't hold water with me.

MR. FOX: That is not my argument. The fiduciary obligation always remains the same. My point is that one way of judging whether the fiduciary obligation is fulfilled is to consider whether you are dealing with players with equal power and equal market sophistication. I think it makes all the difference in the world. If the tobacco

cases had been negotiated not with an attorney general but with a clerk in the attorney general's office who was told 25% is fair and she said "great," we would adopt a completely different analysis of this situation. Maryland gave out an RFP. It was sent to 150 law firms, and only 6 submitted bids. This is a measure of how many people were willing to take the risk. A sophisticated consumer of legal services signs an agreement and says this is wonderful—my state is well served by this. The same state cannot now walk away from the deal later and claim breach of fiduciary obligation.

Alternatively, if you had a situation where a lawyer hoodwinked another lawyer, knew some information and didn't share it with a prospective client, it wouldn't make any difference how sophisticated the client is even if it was the general counsel at Union Carbide or a former counsel at Aetna. Sophistication is irrelevant: you still have the fiduciary obligations of disclosure and fairness. My point, again, is that one measure of reasonableness is the negotiation process itself. In a country that celebrates free enterprise, I think it is appropriate that willing buyers and willing sellers make agreements both think are fair.

AUDIENCE QUESTION: Can fee reform work in classic class action cases where there is no real client to negotiate with about a fee?

MR. FOX: It doesn't work at all. This is why courts need to be active in the fee setting area; judges have a very significant role to play when the client is only a nominal client. This, by the way, doesn't depreciate the value of these cases. Here, courts have to be active in evaluating the work that is done in front of them, the amount of time spent, and a variety of other factors.

Consider the common fund cases where there was no initial client. If you had a deal with that first client and he said I'll get you a 25% fee it would be irrelevant; somebody has to come in and overlook this process. That's completely different from the Maryland Attorney General negotiating with Peter Angelos.

AUDIENCE QUESTION (to Mr. Fox): You argue that the legal profession should be self-regulating. Professor Brickman cited the RAND Institute study that found that 35% to 42% of all medical claims in auto cases are excessive or fraudulent because of incentives in the tort system, namely the pain and suffering multiplier. The cost of this activity is approximately four billion dollars a year. The Insurance Research Council looked at 87,000 closed claims for auto accidents and found comparable results. In similar claims, people who dealt with lawyers recovered four times as much money as those who did not; however, the actual dollars going to clients with lawyers was less. In the wake of this activity, could you tell us what the Bar has done in disciplining its members?

MR. FOX: When I say that the industry is enforcing its own rules, it is important to remember that each state has its own disciplinary authority. Professionals can file complaints. If defense lawyers for those insurance companies aren't filing complaints in fraudulent cases then we are not going to achieve any adjudication. Incidentally, I was retained at one point on this issue. There are statistics that show quite different results from what you claim; in fact, people do much better monetarily when they use a lawyer than when they don't.

JUDGE GRIESA: In response to the earlier comments about fraudulent recoveries for whiplash, I think the way to deal with this is to attack the liability rules themselves, the loose rules of law that allow these things to proceed. The Manhattan Institute has actually taken this approach. Peter Huber wrote a book about expert testimony.¹⁵ Walter Olson has written a book about the law of employment discrimination.¹⁶ Those writings and others like them have influence in the court system and get to the root of these problems.

Panel Two

Fees in Traditional Litigation: A New Reform Proposal

Ms. Barbara Olson

Counsel, Balch & Bingham LLP

Professor Richard Painter

University of Illinois Law School

Mr. James Wootton

President of the U.S. Chamber Institute for Legal Reform

MS. BARBARA OLSON: When I was asked to moderate this panel I realized that several disclosures would be necessary: I not only work for Blach & Bingham but I am also a lobbyist working with Haley Barbour. Legislating by litigation would put many of my colleagues, and me, out of work. I also have the distinction of being a graduate of Cardozo Law School. I didn't get to take any of Professor Brickman's classes as a student but now I see I certainly should have.

I will start my remarks today by considering the multi-state tobacco settlement. We've all heard about the 500 million dollars that will go to lawyers annually for the next 25 years. Most of us also know about the two or three hundred lawyers who signed the settlement agreement. The *New York Times* has estimated, I believe, that tobacco-related lawyers' fees could reach thirty billion dollars. The first installment, 8.2 billion dollars, went to the lawyers behind the Florida, Mississippi, and Texas settlement. Eight hundred and seventy four million dollars went to Dick Scruggs' law firm alone, with 339 million earmarked especially for him.

I mention these figures as a reminder that, when we discuss the issue of lawyers' fees, we are talking about millions and billions of dollars. When you consider these figures, the first question should be: what is being done with this money? The most significant place that this windfall is going is the political arena. Sixty million dollars have been contributed to anti-tort reform candidates. The Associated Press estimates that trial lawyers gave 4.1 million dollars during the first 6 months of 1999. Since 2000 is an election year, I would imagine current spending is closer to that 4.1 million increased by a couple of zeros. There is then, at present, a source of money that rivals what both the Democratic and Republican parties are giving to candidates. This is one reason why campaign finance reform is such a pressing issue.

Richard Painter is here today to speak about another area of reform: limits on excessive fees. Richard is well known for his work in the ethics area. He is a Professor at law at the University of Illinois College of Law. He authored *Legal Ethics Casebook* with Judge Noonan from the 9th circuit. And he's also authored *Securities Law Casebook*. He testifies often in both houses of Congress on securities class actions. And he clerked for Judge Noonan on the 9th circuit after graduating from law school.

Jim Wootton, our next speaker, is the President of the US Chamber Institute for Legal Reform. He distinguished himself by becoming one of the thorns in ATLA's side because he worked on and helped enact the Y2K act of 1999, which limited liability for Y2K failures. Prior to coming to the Chamber he headed two non-profit corporations, the Safe Streets Alliance and the Safe Streets Coalition. There he was a principal drafter and advocate for truth-in-sentencing provisions, which wound up in the 1994 crime bill. He has written numerous articles, graduated from both the University of Virginia and the University of Virginia Law School, and is a member of the Virginia Bar.

Before I turn things over to the panelists, I have a hypothetical that may help explain how Jim Wootton's American Rule works. Imag-

ine my name is Patty. I am a 40 year old mother and I've been in a terrible car wreck. In that wreck, I was driving my Ford Van and my 3 year old child was thrown from the vehicle and killed. I have some awful injuries and significant pain and suffering. I drive to my lawyer who is well known. I tell him about my case.

Would the American Rule apply any differently if I lived 100 miles from a lawyer? In that circumstance, I wouldn't really have access to a market. I've driven to my lawyer because I've read about the hundreds of thousands of dollars he has recovered for other people. Further, would it be any different if I tell my lawyer that, at the time of the crash, my child wasn't wearing a seatbelt? Or that I had been drinking a little bit before the accident occurred? My suit is not cut and dry; the lawyer will have to do considerable work. How would the American Rule apply with the lack of market and the absence of clear liability?

PROFESSOR RICHARD PAINTER: Before we get to Patty—a good opportunity to test the new American Rule and see how it works in practice—I want to provide some background and ask, what is a contingent fee? In the contingent fee, three services are bundled into one. One is legal services being provided by the lawyer. Another is financing by the lawyer—litigate now, pay later. The third component is litigation insurance; if you lose your case the lawyer will pay the cost of the legal services. The premium for this litigation insurance, of course, is the percentage of the case conveyed to the lawyer in the contingent fee arrangement.

Why are these three products bundled together and not sold separately? Much of this has to do with champerty laws. It is prohibited at common law to finance the litigation of another person or pay someone else's lawyer in return for a percentage of future returns. In the United States, we've developed an exception to the prohibition of champerty. Lawyers may provide champerty through litigation insurance and financing in a case when they represent the client on a contingent fee.

How efficient is the market in setting lawyers' fees? Does the market dictate a price to the client, the consumer, that reflects the risk involved? If it does, you would expect three factors to influence the size of the contingent fee. First, how much lawyer time is needed? While you can't know this for sure, lawyers can usually estimate how much time they will need for a case in advance. In Patty's case, the lawyer would see that there is going to be some trouble down the road. Patty had been drinking, her child was not wearing a seatbelt. The case will not be easy to settle with the insurance company. In an easier case, recovery would be likely, and the time needed for the case would be substantially less.

The second factor in calculating fees is likelihood of success. Patty's case, as mentioned, is not especially strong. There is also a third factor, the size of the case. If the injuries are egregious, the amount of the judgment is likely to be higher; if a contingent fee is being charged, of course, that means the lawyer will recover more money.

You would expect, in this country, an efficient market for lawyer champerty, which is essentially what the contingent fee is. (Furthermore, for public policy reasons, the United States has encouraged its lawyers to provide this service.) In an efficient market you would expect these three factors—lawyer time, likelihood of success, the size of the case—to vary and, therefore, pricing of the cases to differ. A lawyer's portfolio of cases should have a range, something that Larry Fox admitted. Some cases should charge 20%, some 50%. I am not sure I am willing to go up to 70% because I suspect if the chance of success is so low that you may very well have a strike suit on the horizon; but 50% is reasonable in a few cases. There might be many 15% and 10% and 5% cases out there, but there should be a range.

Well, is there a range? That is an empirical question; we can test the market to see if it is really efficient. Lester Brickman wrote an article on this issue in UCLA Law Review a number of years ago.¹⁷ More recently, Herbert Kritzer, from the University of Wisconsin, has done work on the topic.¹⁸ He is quite skeptical of Lester's

claims that the market is not efficient. Lester's point is that, in effect, lawyers are charging the same fee for every case, that is, 33%. In many cases more than this percentage is being charged but very rarely less.

In Kritzer's study of the Wisconsin Bar, he found that 53% of cases involved retainers specifying a fee as a flat percentage of recovery. An additional 39% used a variable percentage. Of the cases with a fixed percentage, a 33% contingency fee was used 92% of the time. The cases with a variable percentage started out at 25% for pretrial work, but once there is any substantial amount of work, more than one or two pretrial hearings, you kick up to 33%, and then 40% or more on appeal. Kritzer found that a rigid 25%, 33%, 40% fee schedule dominated in the additional 39% of cases using a variable percentage fee.

Kritzer's data shows quite clearly—although I am not sure he intended it to work out this way—that Lester is right. This market isn't working the way you would expect an efficient market to price cases. We don't see a range from the 5% to 50%. We see the cases sticking around 33% (and tending upwards) but very little on the downside.

Why is this the case? As Kritzer points out, and I think he is right, the problem is lack of information.¹⁹ The client is not in a good position to comparison shop. This is not like a corporation hiring a CEO; this is an injured person in a disadvantaged situation.

Let's return to the example of Patty who, as you recall, is miles away from the lawyer that she wants to hire. Let's assume that she knows very little about the lawyers in her immediate proximity, that she knows very little about the legal profession and very little about the three factors (likelihood of success, size, time) that should determine how the case is priced.

The client must have information; when there isn't information, markets don't work. My other area of teaching and writing is in

securities regulations. One of the hallmarks of securities regulation is that if you get the information out there, the markets work a lot more efficiently than if you do not. The same is true in the lawyers' fees context.

The New American Rule bridges the information gap with minimal market interference. The rule is a simple set of propositions originally put together by Jim Wootton. I was brought in on the project to flesh things out with more detail. Jim's proposal, in essence, is that every contingent fee lawyer should offer the client both a percentage fee and an hourly rate. At the end of litigation, the client chooses which to pay. Almost every client is going to choose the lower fee. In other words, the lawyer says, "I charge 20% as a contingent fee, but this fee will not go above \$1,000 an hour." If the case is particularly risky, this fee can be set at \$2,000 an hour or even \$5,000 an hour as long as the parties agree.

Jim does not like me to describe this choice as a cap. It is, however, a limit on how high contingency fees can go. Lawyers who, unlike clients, have all the information about a case, guarantee that the fee will not exceed X percent per hour. Let's pretend that Patty had a much better case—the child was wearing a seatbelt and mom was completely sober. Under the new Rule, it would be much more difficult for a lawyer to take advantage of Patty.

Under contingent fee arrangements as they currently operate, the lawyer can talk Patty into a 33% fee, as seems to be the typical case. The lawyer can tell Patty that her case *seems* strong, but things are more complicated than she thinks: insurance companies never like to settle; they are on the look out for fake injuries. Convincing them otherwise takes time. The judge on this case is a real jerk and doesn't like plaintiffs. These claims are believable because the lawyer has all the information and Patty has none; she has no choice but to agree. Meanwhile, Patty has a slam dunk case that is going to be settled with a one-hour telephone call, a call that brings in 33% of \$300,000 for the lawyer.

Deception will not be eliminated with the Rule, but at least Patty's fee won't go any higher than, say, \$1,000 an hour. Her lawyer would, under the Rule, be obliged to tell her that the fee is going to be 33% or \$1,000 an hour, whichever is higher. With that sort of information at the outset, Patty may just shop around.

That is the essence of the New American Rule. There are other requirements that Jim suggests that help the Rule function more smoothly. One of them is that the lawyer must provide the client, at the outset, with a non-binding time estimate. Once again, this is information the lawyer has that the client doesn't have. This may not be an accurate estimate. It may turn out to be wrong. But at least it helps bridge the information gap.

Similarly, the New American Rule would require lawyers to post on their web pages the prices they have quoted to other clients. Specifics on each client are not necessary, just the low for the previous year, the medium, the high, and perhaps the top quartile for both the percentage and hourly rates. The client, then, can see where his case fits in the lawyer's portfolio. The client can also see if the lawyer refuses to budge from a high hourly number. If in every case the client is quoted a 33% or 40% fee and the lawyer's cases are diverse (in terms of the three risk factors), perhaps clients would feel cheated; risks vary, but the prices don't. Clients would be encouraged to get second quotes or to visit web pages to see how other lawyers price their cases. This is minimal disclosure that is not very burdensome in an age when many law firms are setting up web pages and posting information about their services and credentials.

I suggest one additional requirement: namely, that every lawyer disclose how far their cases deviate from their non-binding hours estimates. This could be done on a yearly basis. Clients could then see which lawyers consistently low-ball the number of hours they need; this would discourage deceptive practices that get around the Rule's requirements. The client would see that in the typical case the lawyer was 10% off. Clients could use this information to discount the estimate they received or to recalculate it.

It may seem that there are a lot of calculations involved in choosing a lawyer under the Rule. It's really just some basic addition, subtraction, and a little multiplication. Web pages and software can make this process easy. Many clients could, for the first time, at least get an idea which lawyer is best for them depending on how they think the case is likely to come out, what their preference is with respect to risk, and a variety of other factors.

At the end of the day, the New American Rule is about disclosure of information and minimal interference with the contract. All it does is ask lawyers to name a per hour limit on fees, encourage them to be up front about the amount of time they are likely to spend on a case, and determine, in advance, how much they will be compensated for risk. Other proposals have been floated; for example, Lester Brickman wants to regulate the pricing of contingent fees. You can get lawyers out of the champerty business altogether, which is what many countries do by prohibiting a contingent fee. I see the new American rule as a more measured response to the problem; it can facilitate markets through the sharing of information.

MR. JAMES WOOTTON: First of all, I want to thank Judy Pendell for taking this idea and sharing it with Richard. Having him think the Rule is a good idea gives me great comfort; he is better able to evaluate its merits than I. I had the experience of practicing law in a small town. Part of the reason I came up with this Rule is because of what I understand about the practice of law through personal experience. Let me illustrate this with a story.

When I graduated from the University of Virginia Law School, I stayed in Charlottesville—the aspiration of many UVA lawyers—and opened my own firm. Almost immediately, the Supreme Court decided *Bates vs. State Bar of Arizona*, the case that basically outlawed bar association restrictions on lawyer advertising.²⁰

I had been an economics major as an undergraduate, and I thought the fact that lawyers were charging a point for real estate closings in Virginia was ridiculous. Under this system, if you had a \$100,000

house, lawyers were going to charge you \$1,000 and on up the scale. On top of this, the seller of the house also had to buy title insurance. The amount of risk being born by the lawyer in this circumstance was pretty small; theirs was a pretty ministerial act. In a lot of places, closing is done by title companies or by savings and loans.

I decided to put an advertisement in the Sunday paper that I would do these things for substantially less, which would have made me a lot of money. I was a solo practitioner. I needed the business. Nothing happened, however; nobody responded to my ad. No one, that is, except the bar association, who notified me that I was subject to a secret disciplinary proceeding for having violated their rules. I thought about that for a while. I'm sure they would have given me a fair hearing in secret. But I decided to talk to the reporter who covered the courthouse in Charlottesville about what was going on and he found it rather intriguing. He wrote a story about my situation and put it on the front page of the *Charlottesville Daily Progress* along with my ad and I suddenly had all kinds of business. The bar association dropped their complaint.

I think the bar association is ill equipped these days to regulate the practice of law. I know that is heresy; I know that there is great resistance to that idea among traditional bar members. I am not unsympathetic to their objections, but I think you have to earn the right to be a self-regulator. The bar has lost that right.

The New American Rule, as Richard explained, is pretty simple. You go into an office and the lawyer tells you two numbers. One is an unrestricted hourly rate. It can be anything that the lawyer thinks is appropriate to the level of risk in the case as well as to other factors such as the amount of damages you might recover. The other number is a percentage of the recovery. I made it a percentage of the *net* recovery because I think a lot of games are played on the expense side of things. That could be subject to negotiation.

The American Rule came out of conversations that Judy arranged with me, Wally Olson, and Professor David Bernstein of George

Mason, Wally and David talked about all the things we might do to reform lawyers' fees, such as loser pays and some other ideas. In the course of our discussion, David mentioned a new development in England, an attempt to bridge the gap between government funded legal services and access to the justice system. The English have come up with a conditional fee. A client sees a lawyer and negotiates an hourly rate; the deal is, you pay nothing if you have no recovery but you pay double the hourly rate if you do. There is no cap; the fee could conceivably eat up the whole recovery.

That system has some weaknesses from my point of view, so I came up with an idea that is a hybrid of the American rule and the English rule. People think of the American rule as a contingency fee. It's not. It's simply that clients pay their own attorney fees. The contingency fee allows clients who don't have the means, to get access to the justice system. The New American Rule, to repeat, is a hybrid: it says that you get two price quotes and at the end of the day, you get to choose between the two.

As Richard mentioned, there are other prophylactic measures that we are suggesting. For example, a monthly statement of hours is required from the lawyer who works on your case. Lawyers will hate this rule for many reasons. It's an administrative burden; but more importantly, it will expose how much time is really spent on cases. The client benefits, of course, from this information. I've seen studies that show that the number one complaint of clients is lawyer procrastination; if lawyers send a bill every month saying they didn't do anything it will give clients more control of the situation.

Another element of the Rule concerns something that Larry mentioned during the last panel; namely, we don't think that the same rules ought to apply to the sophisticated consumer of legal services. The Rule basically doesn't apply when the client has a non-contingency fee lawyer who is advising on a separate contingency fee arrangement. This means if you have a general counsel, an in-house counsel, or an outside counsel for other purposes, it wouldn't apply to you. You can make whatever deals you want. If you are a

sophisticated consumer of services you are going to be able to cut a sophisticated deal.

One thing the public understands about attorney fees is that they are a zero sum game. Anything that is paid to the attorney is not being paid to the client. In a choice between the defendant and the client, the public is for the client. Between the client and the lawyer, the public is for the client. What the Rule does is give some power to the client since they are in an unequal bargaining position. At the end of the day, as Richard explained, the Rule is about disclosure. It's about lowering information costs. I'd like to see this applied in the class action setting as well, but that's a complicated balancing act that has to correspond with other reforms.

The hypothetical client, Patty, is in a difficult situation. She needs to drive 100 miles to her lawyer and she doesn't have a lot of choices. Without choices, she is even more under the control of her lawyer because it's very costly to shop around. The Internet is a phenomenal tool at least in this: it lowers information costs. This low cost gives power to the client population. At the end of the day, the only thing the Rule does that really interferes with the market is give clients a little help. We basically give clients the power to choose. The Rule forces disclosures about time and money; you decide whether or not you want to pay the hourly rate of your lawyer.

Having practiced law in a small town, my experiences may be a little different from academics following this issue. My experience is that lawyers don't like to take cases where there is any question about liability. If they've got a lot of business, they will not take cases where there is no promise of a win. The next issue, then, is what are the size of the damages in a particular case.

Imagine a driver in an automobile accident is terribly injured. The accident was clearly not his fault. This driver goes to a lawyer and asks for help. The lawyer discovers some information in an initial interview; the client is sent to a doctor, and then a paralegal pulls

the file together and does most of the rest of the work. The file then goes to the insurance adjuster.

Let's say that there is a \$300,000 policy limit. Generally, the insurance company will sit on the claim for a while. They will act like they are really working the file when they are not; they don't want to incur any unnecessary costs and they know that the case is a loser. At the end of a decent interval a check is sent. It's made out to the lawyer—in some states, it will be made out to the lawyer and the client—and it is deposited in the lawyer's trust account. Checks will be cut at a closing. The client comes in, receives (assuming no expenses) \$200,000; the lawyer pockets the other \$100,000.

It may be that a particular lawyer's reputation made the insurance company pay faster; for that, they ought to get a premium on the hourly rate. It may be that lawyer is particularly effective and gets quick results. The financial aspects of the deal, however, ought to be disclosed to the client. Clients who are really disabled, and many of them are, may never work again. This money is going to be what keeps them from depending entirely on government payments. \$100,000 is a significant sum to that person. We as the keepers of the legal profession ought to be sure that practitioners are not using their ability—either their market ability or their ability to litigate—to take advantage of the people that need to be compensated.

Larry's argument—that rough justice settles these things over time—is a fallacy because lawyers get to pick the cases. If lawyers had to take every case that walked in their doors, they would have some cases that are dogs and they would have to litigate them. They would have cases with high liability and they would finance the unprofitable cases with them. But, that isn't what lawyers do. Lawyers are businessmen like everybody else. They make their money—I learned this the hard way, as a solo practitioner—by saying no to high-risk cases. We ought to make public the calculations that lawyers do so clients can benefit from the information.

AUDIENCE QUESTION: Much has been said about the vulnerability of plaintiffs and how they should be protected from their lawyers. I hear a lot of complaints about corporate law firms overcharging as well. What are your proposals for this kind of abuse? What in the Rule deals with corporate law firms and defense counsel?

PROFESSOR PAINTER: I am very critical of contingent fees, for example, in mergers and acquisitions. I am not happy with the AOL and Time Warner merger; Time Warner's counsel agreed to take a 30 million dollar contingent fee if the deal closes and, I believe, a couple of million dollars whether or not the closing occurs. This is my personal opinion: the deal was approved by the Time Warner Board and certainly they are a sophisticated consumer of legal services in need of far less protection than someone like Patty.

That said, I think shareholders have rights in these situations. There are abuses in this arena and they need to be focused on. It is, however, up to shareholders to bring pressure on management and make sure boards negotiate fees in the interest of the company and its shareholders. It's better to bring the pressure there, within the corporations. There is less need for regulation by the bar. Corporate lawyer overcharging problems are agency problems. It's a matter of corporate law; the client and the shareholders of the client must insist on fairness. In sum, I do think there are problems and they need to be addressed. But it's a separate issue.

AUDIENCE QUESTION: You've talked about all the disclosures mandated by the Rule. I wonder what, at the end of the day, is left of the fiduciary duty of lawyers. To refer to your example, Jim. Let's say there is an open and shut case with clear liability, lots of paper work, disclosure, internet information. It's an open and shut case and the lawyer gets his \$100,000. Shouldn't there *still* be the requirement of a reasonable fee in accordance with legal ethics? Won't all this paper work and disclosure business undermine the movement towards enforcing the reasonable fee provisions and the fiduciary obligations of lawyers? Isn't that the real bottom line we seek?

MR. WOOTTON: It's a good question. I think Judge Griesa's quote from Madison that men are not angels is apt. I would add, though, that review by the courts of fees continues under the Rule for determining what is reasonable. There is nothing given up as a part of our reform. Instead, the court is going to have more information about what *is* a reasonable fee; they are going to have access to monthly billing statements and how many hours are being devoted to the case. You are going to have the various estimates that were made to clients. The court might even have information about what firms are doing in a variety of other cases. These disclosure requirements are not tremendously burdensome given the technology we have today.

AUDIENCE QUESTION: Have you done a study of pricing by other entities that bear risk? For example, insurance companies charge premiums to sell insurance to people who fall across a pool. The pool can be people who are high risk, low risk, medium risk. Have you compared what lawyers charge across their portfolios with the variation in the premiums that insurance companies charge for bearing risk? It would be interesting to know if lawyers are doing something that looks pretty much like what insurance companies are doing. The same might be true for real estate agents. They charge contingent percentages. They get paid if they sell property. They don't get paid if they don't. But my understanding is that they charge standardized premiums across entire portfolios of properties even though properties vary in value, likelihood of sale, amount of time/effort required to sell, and marketing. I'm asking, in short, if you have any cross-disciplinary evidence that leads you to believe there is really a unique problem in law. Further, if it is your position that the same degree of standardization exists in different industries, does that mean there is not only a lack of competition in law, but a lack of competition in insurance and real estate world as well?

PROFESSOR PAINTER: I have not done an empirical study of the type that you describe. But I have thought about this issue. Real estate fees can exemplify competitive pricing. In the real es-

tate business, higher priced homes often go to separate real estate companies. Some communities, at least, charge lower percentages and there is a good deal of negotiation that occurs. There are also “give-backs” of the fee being negotiated at closing; when an offer is made on a house, the broker brings an offer to the seller. If it’s not particularly attractive, the dealer may give a portion of the broker fee in return for the offer being accepted. As I say, I have not looked at this in any detail, but it seems that there is a fair amount of adjustment going on in that market.

There seems to be some variation in the insurance business as well. If you are an old or sick person, your life insurance rates will be different than people’s rates who are young and healthy. There seems to be a spreading out. I gather, though, that there are some areas where there may very well be stickiness regardless of the amount of risk involved—that the insurance is being priced the same for everybody. My conclusion is, where that occurs, there may be a lack of competition. There may be competition with respect to quality, service, and so forth, but a red flag is raised: in a competitive market for champerty, which is what this really is, some cases should be priced differently than others.

To return to Patty, if she had been drinking, that’s a harder case to win than then a slam-dunk case. The fee percentage should be different in different cases. It’s a red flag to me when lawyers’ fees are constant and I think in other industries this should be a red flag as well. Providing clients with information helps solve the problem by giving clients more power to select a lawyer.

AUDIENCE QUESTION: Is the standard contingency fee that you refer to common only in cases of a certain type? Are other cases handled through flat fees, hourly rates and so forth?

PROFESSOR PAINTER: Kritzer found, in his Wisconsin study, that when there was a flat fee used, 92% of cases were at a rate of 33%. Are you asking if lawyers sometimes offer an hourly rate to bypass the whole contingency arrangement?

AUDIENCE MEMBER: Yes, like realtors handling closings on a flat fee rather than on a percentage of the property value.

PROFESSOR PAINTER: Kritzer found very few alternative arrangements. They made up 1%, 2%, maybe 3% of his survey of Wisconsin plaintiffs' lawyers.

AUDIENCE MEMBER: In particular types of cases?

PROFESSOR PAINTER: Personal injury cases.

AUDIENCE MEMBER: Isn't it possible that personal injury cases, at least personal injury cases of a certain size, have attributes that make the contingency fee structure appropriate and the 33% figure a good benchmark in terms of reasonable compensation? In cases where 33% would be inappropriate, the lawyer charges through a different fee structure—that is, in M&A cases, real estate cases, divorce cases. In other words, don't we see the fee structures geared to cases where that fee structure is appropriate?

PROFESSOR PAINTER: That assumes that all victims in automobile accidents have the same circumstances—the injuries are the same, the amount of lawyer of time is the same. Personal injury cases can not be generalized; it is difficult to see why there should be a benchmark of 33%. It could, however, be the mean.

AUDIENCE MEMBER: Well, except that if Patty's chance of liability is weak, isn't it possible that no lawyer is going to take her case on a contingency fee? A lawyer is going to say, look, the chance of recovery here is minimal. I'll charge you an hourly rate otherwise I won't take the case.

MR. WOOTTON: If I understand your point, it may be confusing the level of risk that is undertaken in any given case, which would allow for some kind of scale over the percentage of recovery, and the hourly rate. Whether or not cases traditionally are done

on a contingency basis at all, they are done on a flat fee or an hourly rate based on the client's ability to pay. The contingency is the part of the fee that is the financing provided by the lawyer. My experience is lawyers don't finance their fee when there isn't a very high likelihood of recovery.

Panel Three

Fees in High Stakes Litigation: Class Actions and Suits by Government Agencies

Mr. Fred Barnes

Executive Editor, The Weekly Standard

The Honorable Vaughn Walker

U.S. District Court, Northern District of California, 9th Circuit

Professor Roger Cramton

Cornell University Law School

Professor Charles Silver

University of Texas Law School

Mr. Michael Horowitz

Director of the Project for Civil Justice Reform, The Hudson Institute

Mr. Robert Peck

Senior Director of Legal Affairs, Association of Trial Lawyers of America

Mr. C. Boyden Gray

Partner, Wilmer, Cutler & Pickering

MR. FRED BARNES: I'm delighted to be here. I'm going to play a very small role on this panel. I may ask a question or two, but I don't claim to be an expert and all our panelists certainly are; it's an unusually distinguished panel.

Our first panelist will be the Honorable Vaughan Walker, a federal judge in the Ninth Circuit U.S. District Court for the Northern District of California.

HONORABLE VAUGHN WALKER: I would like to talk about the nuts and bolts of attorney fee setting in class actions from a

judge's point of view; particularly, what judges have to work with in making these decisions.

We start with the basic premise that we have in this country about attorney fees, the so-called "American Rule." Under the Rule, each party bears his own expenses of litigation, including attorney fees. A notable and longstanding exception has been in common fund cases, in which the attorney creates a fund that compensates both the lawyer who creates the fund and the victim. Attorney fee awards in those cases are predicated upon the old equitable doctrine against unjust enrichment.

Ironically, in America the doctrine against unjust enrichment has been turned on its head. The notion here is that the *class* bringing an action should not be unjustly enriched at the expense of the lawyer. It is a rather peculiar doctrine to apply in a situation where we are attempting to come up with a reasonable way to compensate lawyers for what is essentially an entrepreneurial activity; that is, to compensate lawyers for creating some benefit to the class. It's rather like attempting to come up with a gratuity rule for good Samaritans. It does not fit the problem at hand.

Four methods have been used by judges to determine attorney fees in common fund cases: the lodestar, the percentage fee, the benchmark, and, as a few of us have tried, the auction.

The earliest federal cases relied upon the percentage fee. The notion was that there is some standard reasonable fee and that is some percentage of the amount of recovery. But, by the 1970's it began to be clear to many commentators, and to many judges as well, that this percentage fee approach was resulting in extremely high fees.

In response, the lodestar system was conceived with the objective of compensating lawyers fairly for what they had done by taking the hours of work times a reasonable hourly rate, adjusted by a multiplier. The multiplier was to reflect the time and labor that was involved, the magnitude and complexity of the litigation, the risk

of the litigation, the quality of the representation, the relation of the fee to the ultimate recovery, as well as public policy points of view. Naturally, if you take “reasonable hours” times a “reasonable hourly rate,” and then you add an imponderable factor such as a multiplier, you’ve got a highly unpredictable means of determining attorney compensation.

In the 20 years after the lodestar came into widespread use in common fund cases, it has become an incentive for lawyers to run the clock. It created enormous problems. Judges are now forced to analyze time records, which is difficult to do in any kind of a fair way. Judges, particularly federal judges, don’t like to think of themselves as time clerks, and understandably so.

In 1984 the Supreme Court, in *Blum vs. Stenson*, suggested that we should return to a percentage-based means of calculating attorney fees.²¹ The following year, the Third Circuit appointed a blue-ribbon task force that recommended a return to the percentage method, a recommendation that the court adopted in 1995 in the General Motors fuel tank litigation.

Today, most circuits approve of either a lodestar method or a percentage method, though the District of Columbia Circuit and the Eleventh Circuit generally mandate the exclusive use of the percentage method. And, of course, we have the Ninth Circuit. It used to be in law school that there was the majority rule, the minority rule and the Massachusetts rule. In the federal courts, these days there is the majority, the minority and the Ninth Circuit rules. The Ninth Circuit, putting its own spin on things, employs a 25% flat fee method, adjusted by the six or so factors that are used in the multiplier calculus of the lodestar.

Now what, if anything, is wrong with this picture from a judge’s standpoint? All of these methods essentially amount to the same thing: a standardless method of determining fees. Earlier, we heard a reference to the *Goldberger* decision from the Second Circuit.²² I commend it to your reading. It is a thoughtful analysis of this prob-

lem on appeal from a District Court that had allocated 4% of the common fund for attorney fees. The Second Circuit justified that 4% recovery.

On May 9, 2000, a very thoughtful judge in the Eastern District of Pennsylvania, Judge Katz, applied essentially the same methodology that the Second Circuit used in *Goldberger*. He arrived at a fee calculation of just under 30%. But the same method cannot possibly lead to two such disparate results if it is applied with any degree of rigor.

The problem with each of these methods is that the fees are not determined in an adversarial context. Judges are ill equipped to decide anything that is not presented as a clash of ideas. In addition, with each of these three methodologies, the principal-agent problems between the client and the lawyer are disguised.

Principal-agent problems are disguised because there is no real risk for the attorney until after the recovery has been obtained. The risk of litigation is assessed after the risk has passed. By the time a judge makes a decision on distributing attorney fees, a recovery is already on the table. The only thing standing between the judge and closing out the case is disposing of the attorney fee award. All of the pressure is in favor of closing out the case in a way that is satisfactory to the lawyers.

Lawyers are very good at reading a case in terms of how it develops. They are also quite good at reading the judge's reaction, and they adjust their litigation calculus accordingly. The problem of the possible sellout settlement of a class, or the possibility of over-litigation, is something that is disguised. It is under the table, and it is under the table because the fees are determined after the fact rather than in advance.

This realization gave rise to the idea that creating a common fund on behalf of a class is really not different from any other kind of governmental service and therefore ought to be determined before any effort is undertaken. This places upon the lawyers, who

are, after all, creating the litigation, the threat that they're not going to succeed; this forces them to evaluate the case at the earliest possible point. In addition, an *ex ante* fee determination promotes competition. As in any other kind of a bidding process for a governmental service, you open up the process to people who can compete. You have real competition in an *ex ante* fee determination process undertaken at the beginning of a case, rather than at the end.

Finally, an *ex ante* determination of fees allows both lawyers and courts to consider and argue the effect of the fee arrangement.

There's no panacea to the problem of setting fees in these cases. But I do believe that there is an institutional role that organizations such as those that are represented here can play. They can urge courts to look at the fee calculus at the very beginning of the case, before the litigation starts, rather than allowing this to be postponed until the end and to be determined by standardless methods.

This urging alone would bring forth many of the issues that we have discussed and would give judges an opportunity to think about these issues and to rule on them in a meaningful way.

MR. BARNES: The next panelist is Professor Roger Cramton of Cornell Law School, who has entitled his remarks, "Forestalling the Race to the Bottom: Providing Standards for Class Action Settlements."

PROFESSOR ROGER CRAMTON: My theme has a lot in common with what you've just heard, except that it will concern the process through which class action settlements are approved. The ideal result would bring some standards into what now is largely a void.

One caveat: I'm dealing only with large, complex class action settlements, usually of a mass tort character. I'm not dealing with garden variety small class actions that are not limited and that can go to trial, rather than simply being certified for purposes of settlement. For example, suppose 23 homeowners in a particular devel-

opment have a common claim against the developer. The damages are somewhat different but they combine them in a class action. They hire an attorney. Their class representatives are likely to take a very active interest in the attorney's behavior. The majority of the class is going to generally get what it wants in terms of accepting a settlement or going to trial. That's a different animal entirely. I'm not dealing with that type of class action.

Three quotations set the stage for my remarks. The first is by Michael Jordan, an R.J. Reynolds attorney, boasting at a shareholders meeting in 1988 of company victories in smoking victim cases: "The aggressive posture we have taken regarding depositions and discovery continues to make these cases extremely burdensome and expensive for plaintiffs' lawyers. To paraphrase General Patton, the way we won these cases was not by spending all of Reynolds' money, but by making the other son-of-a-bitch spend all of his."

The second is by Bill Lerach, one of the best known plaintiffs' class action lawyers and a senior partner in Milberg, Weiss: "I am a very fortunate lawyer. I have no clients."

The third is by a federal district judge who wrote, when approving a class action settlement: "In deciding whether to approve this settlement proposal, the Court starts from the familiar axiom that a bad settlement is almost always better than a good trial."

What do these statements tell us about the current use and abuse of class actions today, especially in the tort context? First, the R.J. Reynolds comment. It surely was true about smoking victims' cases in the 1980's. In those years, asymmetries of representation often put individual small-firm plaintiffs' lawyers against the powerful, enormously wealthy tobacco companies. These companies did in fact use every technique they could, including attorney-client privilege, to conceal documents in discovery that should not have been concealed, which led to unjust results in many cases. At that time, before the factual predicate was developed for fraud and deceit claims by smokers against the tobacco

companies, the companies had a strong defense, still potent, that smokers had sufficient knowledge of smoking's dangers and therefore assumed those risks.

What a tremendous reversal of fortune since then. A group of plaintiffs' lawyers, who became multi-millionaires from the asbestos wars or other victories, invested their resources in targeting the tobacco companies. They wielded political power and got favorable legislation passed in some states that eradicated the assumption of risk defense. Discovery in these later cases produced documents that suggested an industry-wide conspiracy to suppress evidence and possibly commit fraud.

Now it seems that the asymmetry is working the other way. The cost to the plaintiffs is relatively low in a situation where the defendant faces thousands of lawsuits, both individual and class actions, in multiple jurisdictions, which threaten the very solvency of the tobacco companies. This is a situation where the unfairness is reversed from earlier cases. It's almost impossible to litigate and defend this multitude of lawsuits, so the companies are forced to settle. What we have, as a result, is a corrupt and collusive national settlement, violating constitutional norms of representative democracy and federal supremacy, not to mention the export/import clause and the commerce clause.

The plaintiffs' lawyers have made an unbelievably profitable investment in the tobacco wars as a result of the master settlement agreement now adopted by every state. The question now is what will these lawyers do after they've each bought their Lear jet and yacht? What new targets will they pursue with their wealth? It's instructive that on the day that plaintiffs' attorney Richard Scruggs said he was targeting HMO's, \$12 billion in value was lost in HMO stocks.

A corporate defendant facing a large number of individual and class action cases has litigation costs and risks that are much larger than those of the plaintiffs' lawyers. Collusive class action deals with one or more of these plaintiffs' lawyers may well be their best strategy.

My second point concerns Bill Lerach's remark that, as a plaintiffs' class action lawyer, he doesn't have any clients. That's an accurate statement of today's reality; this is the age of mass tort and consumer class actions. These actions are created, in every respect, by lawyers. Lawyers develop the facts, develop the legal theory, and seek out class representatives, who are often token figures who tend to know nothing about the case. The lawyers then bring lawsuits in one or in multiple forums. They make deals with other class action lawyers to fight off competitors or to gain lead counsel status, and they decide when and for what to strike a deal with the defendant companies.

These class action lawyers act as entrepreneurs. They consider themselves (like all of us consider ourselves) as white knights doing the good work of the world. They're bringing wrongdoers to justice, deterring corporate misconduct, and the like. But even with the best of motives, they're in a very difficult situation, which some of them will reveal if you talk to them candidly. If they don't strike a deal with the defendant, the defendant will seek out another plaintiff's lawyer and strike a global deal in another forum that will bind the whole class. This deprives the first lawyer of any return on the work he has done. This process is fairly characterized as a race to the bottom. The structural incentives and awards in this system are off balance and wrong.

Everyone agrees that a large class has no motivation or opportunity to monitor the actions of class counsel. In the vast majority of these cases, the plaintiffs' lawyers are acting as rational entrepreneurs and the defendants and their lawyers are ready with attractive deals. Consequently, what often emerges is a generous attorney fee and a paltry recovery for the class action plaintiffs. The dangers of this self-serving behavior are aggravated by lawyer-shopping and forum-shopping problems.

The lawyer shopping problem has already been mentioned: if a particular lawyer is making a very good case against the defendants and the settlement seems likely to come at too high a price, the

defendants seek out another lawyer in another forum with whom they make a secret deal. This settlement is then presented to the court, along with the filing of the class action, and includes, of course, a handsome attorney fee provision.

The forum shopping problem occurs when a defendant shops for a forum, be it a state where the law is somewhat more favorable or a federal court that is known to be friendly in particular matters. In essence, we have a reverse auction where competing class lawyers underbid each other in order to settle their own action first, foreclose the others, and be the only lawyer to capture the attorney fee award.

What about the process features of class actions and the role of the judge? Do they vindicate the rule of law? Rule 23 requires the court to approve a class action settlement, give other class members notice and the right to object or opt out, and provide judicial review of attorneys' fees and the other aspects of the fairness hearing. The rule also requires that class counsel fairly and adequately protect the interests of the class.

My third quote states the reality here. "A bad settlement is almost always better than a good trial." Judges are self-interested actors whose major desire is to remove cases, especially complex ones, from their dockets.

Empirical studies show that over 90% of class action settlements are approved by federal courts, and an even higher percentage by state courts after so-called fairness hearings that often last 20 or 30 minutes.²³ There are rarely any objecting parties who contest these settlements. The only information the judge has is the information given to him by the settling parties, who have no obligation to be candid about the fee allocation between the various lawyers, the deficiencies in the settlement, conflicts of interest involved, or what goes into calculating the fee. By and large, judges do not go out of their way to ask hard questions or pursue possible problems.

I think there's wide agreement among scholars and observers in this area that what I've said is largely true, although most people would not put it as strongly. I'm not arguing for the abolition of the class action device; indeed it's very necessary. As evidenced by recent cases, however, it's in bad shape and needs to be reformed. The rest of my remarks concern what we can do to improve the process standards under Rule 23, to encourage judges to be more stringent in examining these settlements, and to give them sufficient information to do so.

We need to do three things. First, in large cases, we must ensure that the fairness hearing takes on the safeguards of an adversary proceeding, rather than an *ex parte* one, with adequate discovery, a complete record, and elaborate findings by the judge. Having a complete record is the only way to vindicate the appellate process.

Second, in all cases we must encourage or require the production of information that will fully inform the judge and complete the record for appeal. Third, we must require class counsel to actually do the work that would justify the large fees they routinely get.

Returning to Judge Keenan's remark that a bad class action settlement is almost always better than a good trial, we must ask: better for whom? Certainly not for the absent members of the class, whose legal claims have been erased. Certainly not for democratic institutions, which have been largely displaced by privately created legislative schemes that operate without public participation of any kind by elected officials.

In these settlements, the only people who benefit are class counsel. Defendants get the benefit of paltry settlements, and the judges are relieved of doing the honest-to-God work of trying class actions and deciding legal questions on their merits.

What should we do? We need to introduce the adversarial process in large-scale class actions, and we should do it by statute or rule.

We should set an arbitrary dollar amount. For example, if the settlement is \$100 million or more, the court must appoint a guardian *ad litem* who is funded by the settling parties out of the amount of the award. This guardian would be a devil's advocate, charged with producing information relevant under the law to the fairness and adequacy of the proposed settlement and the reasonableness of the attorneys' fees. Neither of the parties will like it, nor will the judge. But it's the only way to do justice in this area.

We generally adhere to the adversarial system in our judicial process, but what we have here is a charade. Judges can only deal with the information presented to them and all they currently hear from the settling parties is, "This is a wonderful deal." They hear all the good things and none of the bad things.

Second, a statute or court rule should impose on the settling parties the same obligations of candor with the court that are imposed on a lawyer in an *ex parte* proceeding: A duty, under Rule 3.3(d) of the Rules of Professional Conduct, "to inform the tribunal of all material facts known to the lawyer which will enable the tribunal to make an informed decision, whether or not the facts are adverse." The absent class members should be treated the same way as absent parties in an *ex parte* proceeding.

Third, Rule 23 needs to be modified and amended to require more specific findings by the trial judge on a number of appropriate matters. Judge William Schwarzer, who's had tremendous experience in this field, has written a series of articles on class actions. He wrote a very good piece that recommends eleven findings that should be required by judges when they pass on a Rule 23 settlement, under Rule 23(e). We need this reform because it requires judges to explore questions regarding conflicts of interest or future claimants being treated adequately.

Fourth, with respect to attorney fees, the *Goldberger* mentioned earlier sheds some light on the way we ought to go.²⁴ We should implement a percentage fee method, but require that the class counsel

provide full hourly data and essentially meet lodestar procedural requirements. The method should normally be based on a percentage fee, except where the calculated fee egregiously departs from the worth of the hourly time the lawyers put in, in which case it should be modified to some proportionate relationship.

You have to remember that in the class action settlements we're discussing, cases are certified only for settlement. They cannot be tried. The lawyers who are settling do not have the leverage of saying, "We are going to go to trial unless you give us a better deal." They are always worried that another lawyer is going to settle with these same defendants in another venue and deprive them of their fees. These are special situations and they need special provisions.

Now, the coupon settlements are an extraordinary scandal. But they could be taken care of easily. All we have to do is establish, by rule, that the class action lawyers only get paid if the benefits are paid to the class, rather than lawyers offering class members a free airline ticket which only one half or one third of the class ultimately uses. In such cases, the value that the parties set on the benefits of the settlement for purposes of calculating the attorney fee is always inflated.

What we should do is make the class counsel earn their pay by monitoring the settlement, encouraging class members to use the benefit, and compensating attorneys only for the group that claim the benefit. Lawyers would get paid over time, rather than up-front and never thereafter following up to provide data on how many class members actually received a payment or benefit.

Finally, and perhaps most importantly, the current position of American judges is that members of a class do not have the right that all other clients have once representation is over. They can not bring a separate suit charging their lawyer with breach of fiduciary duty or professional malpractice. They should have that right. It's an illusion to think that the habitual finding that the class was adequately represented is enough. This is never a fully litigated determination of

whether or not class counsel behaved competently and ethically during proceedings. Members of the class, if they did not opt out, should have a right to bring separate malpractice actions.

If these changes were made, Bill Lerach and his firm might have to purchase malpractice insurance. One interesting aside—maybe it's some poetic justice—when Fischel and Lexicon hit the Milberg Weiss firm with a third party action potentially worth hundreds of millions of dollars in damages, Milberg Weiss settled for \$50 million. It turned out they had no malpractice insurance. They believed Bill Lerach's logic and thought, "We have no clients." Therefore, we don't need malpractice insurance. The firm members had to cough up the \$50 million.

PROFESSOR CHARLES SILVER: I've decided to use multi-media and to give you something to look at.

I'm going to advance two arguments in my talk, which is entitled "Much Ado About What? Where is the Evidence of Excessive Attorney Compensation?" First, there is no rigorous empirical evidence that attorneys are frequently overpaid in private representations, class actions or state tobacco cases. Second, there is some evidence that attorneys who handle class actions often are underpaid. They're paid too little, despite the fact that they're earning millions and billions of dollars. I do not expect this to be a popular position to take in front of this audience.

One of the things that has bothered me about most of the debate here so far is that it's theory deprived. Nobody has started out by telling you what you would expect to see in the way of attorneys' fees in a perfectly competitive market.

In labor market equilibrium, we would expect to see that differences in the level of compensation for service providers would reflect real differences in those service providers' contributions. That is, real differences in the costs they're bearing, in the skills they're bringing to the task, and in the risks that they're taking.

Why is it that we expect differences in compensation to reflect differences in levels of service? Because if there were excessive compensation available, then other service providers would have an incentive to enter those practice areas and compete away the profits being made in the form of excess compensation. If we have freedom of access to the legal markets and freedom of movement laterally among the specific practice areas of the legal market, we should not expect to see significant profits being collected. These stipulations beg the question: are there barriers to entry to the legal market? There used to be. In the grand old days of legal ethics there used to be many barriers to entry. But guess what? There aren't anymore.

I have two quotations for you. The first is from Richard Abel's *The Transformation of the American Legal Profession*: "The entry barriers that lawyers painfully constructed over half a century have failed to withstand the assaults by the growing numbers aspiring to become lawyers. This should not be surprising. Supply control in a capitalist economy can never be more than temporary. Its very success engenders more vigorous attacks."²⁵

In the second quotation, Robert Nelson and David Truebeck say roughly the same thing, but you don't need to read them. Just remember Dan Quayle. There are too many lawyers in this country. America has 70% of the world's attorneys and we're getting close to the one million-lawyer mark. It is not possible for the bar to have swelled to such a size and still maintain that there are significant barriers to entry into the legal profession.

There is a growing population of lawyers that, in my opinion, reflects the growth of our economy. If you don't believe me, take a look at my article in the current Yale Law Journal entitled, *What's Not to Like About Being a Lawyer*.²⁶ It contains cites and data about the positive correlation between economic growth and the growth of the legal profession, both in this country and others.

What has happened as a result of the demise of barriers? The answer is exactly what you would expect in a competitive market:

the prices of legal services and lawyers' salaries have fallen. A quotation from Sander and Williams supports this contention: "From 1970 to 1985 the price of legal services fell by 10%. From 1972 to '82, partner income fell 15%, and incomes of sole proprietors fell a remarkable 46%."²⁷ Richard Posner, that noted liberal, explains another result of lawyer proliferation: "The increase in competition that has occurred since the 1960's has forced lawyers to serve their clients better and so to rely less on mystique and more on specialized knowledge that has general value to the client."²⁸

What's happened in the legal sector is exactly what one would expect to see in a competitive market when barriers to entry are reduced. Supply goes up, price goes down, and quality of service improves as lawyers compete with one another aggressively for business. As a result, we also see that contingent fee lawyers rarely receive windfalls. Studies have shown that the returns earned by contingent fee lawyers are not much out of line with the returns earned by lawyers who work on a guaranteed compensation basis.

Herbert Kritzer studied 511 Wisconsin contingent fee lawyers for a 1997 article.²⁹ What did he find? Lawyers' fees from contingency fee work do not differ substantially from the median rate charged for hourly fee work. That's exactly what we would expect to see, because if it were possible to make buckets of money being a plaintiff's attorney without taking any risk, all of the securities, income tax, and trust and estates lawyers would enter the contingency fee market.

Stock and Wise conducted a different empirical study. They looked at data collected on ordinary contingent fee representations in a variety of different jurisdictions. What did they find? Compared to non-contingent cases, the estimated risk premium for cases taken on contingency is about 16%.

What we're seeing is exactly what we would expect to see in a competitive market. Contingency fee lawyers take risks that guaranteed-hourly-rate lawyers do not take. Consequently, they earn

somewhat more than those lawyers. That means the market is working the way it should. We should not expect to see them earning exactly what other lawyers earn because they're not delivering the exact same services that other lawyers are delivering. But enough about contingency fee lawyers and individual representation. What about contingency fees and class actions?

A lot of gross exaggeration has taken place here about what the fees are in class actions. Most class actions are very small. They settle for a couple of million dollars and the fees tend to be a half a million dollars or less. What we would really like to know is why class actions are like that. Why is it that so many class actions settle for small sums?³⁰

One possible reason is that fees are too small to justify the risk that lawyers would incur to take large cases and prosecute them successfully. That's not just my opinion, it's also the opinion of Stock and Wise. Who are Stock and Wise? They are professors at the Kennedy School of Government who are trained economists. They published a piece in *Class Action Reports* in which they apply an economic model that looks at something called risk aversion.³¹

Risk aversion is something that you haven't heard anyone talk about on this panel. That's because in individual plaintiff representations, risk aversion really isn't a problem. Lawyers who handle personal injury cases have diversified portfolios. They're like stockholders. They have lots of shares in lots of different companies, so they have a predictable rate of return on their portfolios.

Class action lawyers aren't like that. They have a relatively small number of cases, each of which represents a very large non-diversifiable risk. They are incredibly risk averse. Now, the rational thing for a risk averse person to do when faced with large risks is to settle cheaply unless highly motivated to do otherwise.

Stock and Wise say, "Multipliers would have to be substantially higher than recent court-awarded multipliers to induce firms to

take on larger cases with lower success probability." As it is today, class action lawyers will take on cases where the likelihood of recovery is at least 70 to 80%. They then settle those cases or sell them out cheaply because they're not incentivized to take the risks that would be required to make something of them. They're not even going to take cases that have a 50% likelihood to win because the payoff does not warrant it.

The most significant problem we have in class action litigation today is not over, but under-compensation of lawyers, as well as a failure to tie lawyers' compensation to the risks that they incur in these cases. Why do we have this problem? Because everybody thinks about fees in class actions in the wrong way. Everybody thinks about fees in class actions in terms of legal ethics. Fees in class actions have nothing to do with legal ethics and are not governed by ethical principles. Class actions are about due process of law, not legal ethics. The purpose of the class action is to insure that a person who has not actually appeared in court is bound only when he or she is adequately represented.

Accordingly, the manner of regulating fees in class actions should be calculated with an eye to insuring that every class member is adequately represented. What does that mean? It means we should regulate the fee in a way that encourages lawyers to maximize the absent class members' net recovery. If it turns out that you have to pay the lawyer \$100,000 an hour to overcome risk aversion, do it. That's what due process requires.

If such a fee is inconsistent with the state bar ethics rules that limit fees to a reasonable amount, I say too bad for them. Judges routinely—I emphasize routinely—ignore state bar ethics rules when managing class actions because they understand that class actions are not about state bar ethics rules. They're about due process.

Every state in the country has something called the aggregate settlement rule. But no judge presiding over a class action has ever applied it to a class action settlement. Why? Because the aggregate

settlement rule allows a group lawsuit to settle only with the unanimous consent of every client who participates. Can you imagine the difficulty of getting every class member to consent to a class-wide settlement? It would never happen. If we're going to have class action settlements at all, we can't apply that rule. So judges don't. Judges also ignore the duty of loyalty rules in class actions. They allow lawyers to do all kinds of things in class actions that lawyers representing individual clients would not get to do. They also ignore the duty of obedience.

My point is simple. Judges should also ignore the fee rules. They should set fees in class actions with an eye to maximizing the net recovery of class members and they should not care one whit about the criteria that state bars have adopted. I explain all of this at much greater length in a forthcoming article in the *Tulane Law Review* and I have explained it in other writings I have already published on class actions.³²

Why are fees in class actions so controversial if, as I believe, they are too low? It's because when fees in class actions are handled as they should be, in a manner that's calculated to maximize the value of the claims, defendants get upset. The defendants are the people who are here today. You, the defendants, don't want fees in class actions to be handled in a manner that maximizes the value of class actions. You, the defendants, want fees in class actions to be handled in a way that minimizes the value of class actions. So you complain when judges try to tie the fees to the recovery. That's one reason that fees are controversial.

By the way, it really vexes me that people keep blaming plaintiffs' attorneys for the reversions that we see in class action settlements. I do not know a single plaintiffs' attorney who has ever proposed that unclaimed funds in a class action should revert to a defendant. Defendants always insist on that. If defendants were willing to give up on reversions, which everybody including me regards as terrible, reversions would disappear tomorrow. I don't know why plaintiffs' attorneys are being blamed for this feature of settlements.

Why else are class action fees controversial? Defendants don't like these fees, so they underwrite tort reform movements. The tort reform movements spend lots of money getting abuses of fees into the media, and certainly there are lots of fee abuses in lots of different cases. All the statistics that I've talked about are aggregate statistics.

The American legal system is huge. If you look hard enough, you'll find all kinds of things to complain about, and defendants and tort reformers have created a mechanism that gets distorted cases into the media and keeps ordinary cases out. I offer as an example the case of the grandmother who spilled hot coffee into her lap at a McDonald's. Everybody's heard of it.

Why have you heard of the McDonald's case? Because millions of dollars were spent to make sure that you did. But the McDonald's case is just one case out of a zillion. Its importance is minuscule, and I'm sure that what you heard about it was totally incorrect. What we have is a one-sided media affair.

Finally, I want to address the tendency to think about fees in class actions in ethical terms instead of due process terms. Let's consider the tobacco cases.

I have a simple thesis. There's nothing wrong with the fees that were promised in the tobacco cases. Why? For every reason that I can think of. First, the contracts were made by sophisticated clients who were themselves represented by lawyers. Second, the market provided opportunities for the attorneys general to shop for the lowest possible rates. In Texas, I know for a fact that the attorney general hung out a "help wanted" sign and for a long time could not get any lawyers to take the case.

Moreover, tobacco case fees varied with market conditions. Lester Brickman has studied the fees that were offered by the states. I think he will agree with me that, generally speaking, the fees declined over the course of the litigation. As it became clearer that

there might be sizable recoveries, the fees declined—which is what you would expect to see in a competitive market. The private attorneys involved took exceptional risks. Remember, they were asked to finance millions of dollars out of their own pockets. That's incredible, given the size of the firms involved. Start throwing in risk aversion, because these are non-diversifiable risks, and the fees have to go up astronomically.

My favorite point, though, is this. When the attorneys general announced these contracts back in the early or mid-1990's, nobody complained. I was there in Texas in 1996 when our attorney general, Dan Morales, announced our contract. It said 15% of the recovery would go to the lawyers. You don't win anything, you don't get paid. Did Governor George W. Bush jump in and say, "Hey, that's excessive?" No. He said, "I leave this decision to my attorney general." What did John Cornyn, our current attorney general, say at the time? Not one word. What did the seven state legislators who subsequently intervened in the case to attack the payment of the fees say at the time? Nothing. They were all in hiding.

Why is it that nobody complained back in 1996 when our contract was announced and it was publicized that 15% of the state's recovery, which was then thought to be around \$400 million, was excessive? Because it wasn't unreasonable and because they were cowards. Our detractors knew they couldn't stand up to object without appearing to be in the lap of the tobacco industry.

A lot of this, I think, is politically motivated. Why is it politically motivated? Trial lawyers support Democrats. No kidding.

Here's an article from *The Dallas Morning News* this week. "Trial lawyers give heavily to Democrats. Tobacco attorneys among biggest donors." It basically says the tobacco lawyers in Texas are Governor Bush's worst nightmare. And they are. My take on this is very simple. It's their money. Let them do whatever they want with it. They can give it all to charity; they can spend it on jets; they can give it to Democrats. I don't really care. That's not a matter of legal ethics at all.

Now, there are other reasons why the attorney fees in the tobacco cases are controversial. One of them is legitimate. The controversy over tobacco fees raises legitimate concerns about excessive governmental power, but this is miscast as a concern about the ethics of contingent fees. I'll read you a quote. "Businesses have undertaken a campaign to prevent states from retaining private attorneys on a contingent fee basis, the compensation arrangement that enabled the attorneys general to bring the tobacco companies to their knees. At stake in this epic struggle is nothing less than the balance of power between the private and public sectors."

That, it seems to me, is the legitimate issue at stake in the tobacco cases. How much power are the states going to have to exert over private businesses? If they have access to contingent fees, they have tremendous power. If they don't, then their power is considerably less. Who am I quoting? I'm quoting myself. There is a legitimate issue here. I am as anti-regulation and as fearful of government power as any person sitting in this room. I guarantee you, given the positions I've taken in public, that if Governor Bush becomes President, I will be more fearful of public power than any of you. But you know what? Fear of public power is not a good reason for not paying these lawyers.

Why is that? Because governments do all kinds of things that they should not do, including things that are dumb and things that are clear abuses of power. There are many projects that might be better left to the private sector: school finance, garbage collection, public transportation, collection of child support, insurance for bank deposits and retirement funds. There also are many public projects that are misguided, especially the war on drugs.

That said, I think that anyone who contracts with a government to provide a service in connection with any one of these projects is entitled to be paid the contract rate. The fact that the government is doing something that's stupid or excessive is not a reason for breaching a contract with a private service provider. Teachers, military contractors, all who make contracts with government are en-

tituled to be paid the contract rate. They do not deserve to have ethics professors or politicians carping about their fees after they have done what they agreed to do.

MR. BARNES: We now move to the Washington, D.C. wing of the panel, beginning with Michael Horowitz, who many of you know is the senior fellow and director of the Project for Civil Justice Reform at the Hudson Institute.

MR. MICHAEL HOROWITZ: I agree with the core of what Charlie Silver has said. With him, I strongly believe that legal fees should be based on a clear and fair relation between risk and reward. Charlie and I part company, however, when he claims that this can be done by letting the devil take the hindmost, by treating lawyers as businessmen and by treating clients as if they were simply commercial customers, by doing nothing but enforcing fee agreements as written by lawyers and signed by their clients. Charlie would trash the rules in existence, operative legal ethics codes that require fees to be reasonable ones, and would openly abolish the present fiduciary basis of the attorney-client fee relationship. (He would do so by simply not enforcing presently governing rules without repealing or amending them. But, let's pass by the ethics and propriety of his "if-you-don't-like-a-rule-let's-simply-ignore-it" jurisprudence in the interest of debating the virtues and value of his arguments about fiduciary rules and standards.)

In making his case, Charlie offers a supposed analogy between attorneys and insurance companies. As he points out, insurance companies have large pools of clients, some of whom are young, healthy and unlikely to get sick or die, from whose premiums large profits can be expected to be made. But what Charlie doesn't mention is that insurance companies are obliged by a complex set of generally enforced laws and regulations to balance those profits against the losses likely to be incurred by insurers' obligations to offer insurance to riskier customer cohorts. What he neglects to mention is that the insurance business is a highly regulated one, where high rates of return generally lead to State-mandated rate reductions.

It's not "self-regulated" by bar association ethics . . . rhetoric enforced, if at all, only against a small handful of small-fry lawyers.

What we have, as Lester Brickman has made clear, is a situation where there is but the rhetoric of ethical regulation and fiduciary duty, and the reality, thanks in part to Charlie's efforts, to an almost-complete (and increasing) real-world breakdown of enforceable ethical norms. We have busy judges who don't want to get involved in fee regulation and who find it easier, as Roger Cramton has pointed out, to award or endorse flat percentage fees. In the case of attorneys' fees, we have thus moved away from any semblance of regulation into the brave new unregulated world that Charlie posits.

Charlie thinks this world a swell one because he thinks that abandoning attorney-client fiduciary standards creates a better risk/reward relationship for both attorneys and clients in mass tort cases, creates a fairer balance between the work done by attorneys and the compensation they receive. This world will be in even fairer balance, he says, once mass-tort contingency fees get even higher.

My difference with Charlie pivots on the issue of whether, in the real world of today's mass tort cases, there is often even the slightest relationship between the risks that increasing numbers of attorneys bear and the rewards they are increasingly receiving.

In making his case, Charlie highlights the McDonald's case. It's good advocacy for him to do so, for the hot coffee spill case was one in which, against great odds, a lawyer took on a brutally risky case and won. For that reason, I think it a strategic mistake for the business community—and for Fred Barnes—to present the McDonald's case as a paradigm of runaway tort law.

I may believe that the lady burned by the coffee shouldn't have won her case. But I also know that her lawyer took on substantial risk and deserved to be well compensated for his success—and I've got no beef with the standard percentage fee he received. On the other hand, I'd like to talk about the cases Charlie ignores—for example

the paradigm claim of a patient whose wrong leg has been sawed off by a drunken surgeon. Today, when such a wronged, afflicted victim hobbles into a lawyer's office, the lucky lawyer can expect to become a multi-millionaire at no risk to himself. His payoff will indeed be handsome enough to allow him to refer the case to another lawyer who will do the work and with whom he can split his fee and still make his million. As distinguished from Charlie's insurance companies, lawyers today increasingly revel in such a world—one in which (as distinguished from insurance companies) they and they alone decide what cases to take and what fees to charge. Mass tort case lawyers now increasingly exploit the bar's monopoly of access to the courts to mulct clients of millions and now billions of dollars, doing so "in exchange" for assuming few if any risks and while adding little and often negative value to their clients' claims.

Which brings us to the tobacco cases, a Teapot Dome scandal that puts Charlie's theories of risk/reward ratios in mass tort cases to real world test. In my view, the cases are a terrifying harbinger of what's coming, and pose the largest single strategic threat to the well-being of America's 21st Century legal, commercial and political systems. Here's the record: Many lawyers in the recently settled tobacco cases will earn hundreds of millions and *billions* of dollars in fees for no-risk, copycat, late-filed representations, and even the lawyers who first brought the cases and assumed real risks of non-payment when they did so are scheduled to receive fees far in excess of any imaginable fiduciary standard and far in excess of what they needed to hope for as a *quid pro quo* for the representational risks they assumed.

Let's look at but a mere sample of the seamy record of the tobacco fee awards that Charlie Silver purports to defend. In Maryland, Peter Angelos now seeks a \$1.1 billion fee for a case described by the President of the Maryland State Senate (who thinks Angelos should get a mere \$500 million fee) as one in which the legislature—and I quote—"changed centuries of years of precedents to guarantee [him] a win." Angelos, by the way, is the largest single contributor to the Maryland Democratic party and is a controlling,

if not *the* controlling figure in Maryland politics today. This is the man who wants 1,100 million dollar bills, taken from the taxpayers of the State of Maryland, for a case that he couldn't lose.

In the Florida tobacco case, the lawyers have been awarded a \$3.43 billion fee. What's a billion dollars, as Everett Dirkson used to say, except that, in time, a billion dollars here and there starts to add up. In the Florida \$3.43 billion case, the lawyers were retained after the legislature changed the laws of the State to create, in the words of the statute's author, a "slam dunk case that couldn't be lost."

On and on the tobacco fee scandal goes, with multi-million and billion dollar payoffs to politically wired Democratic and Republican attorneys. We are looking at \$500 million a year in fees scheduled to be paid to 300 lawyers more or less—that's probably on the high side—for the next 10,000 years!!! We are looking at \$300,000, \$400,000 per hour fees in zero risk cases, and that is the nature of a rotten Teapot Dome scandal that will give a handful of lawyers sufficient capital to, as they say, "invest" in and significantly control state judicial elections and entire political systems well into the 21st Century.

In one of the cases Judge Walker cited, the court stated the obvious: that a \$100 million case was not ten times harder for a lawyer to conduct than a \$10 million case, and that it was therefore wrong (and unfair to his client) to permit a contingency fee ten times larger in the \$100 million case and that it was equally unnecessary to do so in order to insure effective representation in future cases of that sort.

To get closer to home, let me ask whether a \$250 billion case is a thousand times harder for a lawyer than a \$250 million case? Of course not. The kind of compensation we're looking at from multi-billion dollar cases is creating a new class of billionaire lawyers—forty, fifty, or sixty of whom will be in the Forbes 400 in the next ten to 15 years unless we enforce fiduciary standards when dealing with fees in mass tort cases.

The ironic thing is that a \$250 billion case is not 2500 times harder for a lawyer than a “mere” \$100 million dollar case—all things being even close to equal, it is in fact *less* risky to take on and easier to win. The reason for this is nicely captured by Judge Posner in the *Rhone-Poulenc* case.³³ This was a case where the District judge had certified as a class action a series of claims brought by a highly sympathetic group of class plaintiffs, hemophiliacs with AIDS who had sued companies that had provided transfused blood.

Noting that all of the plaintiffs had been aggregated into a single case, Judge Posner did a simple calculation. He found that the potential liability in that one case was greater than the net worth of all of the defendants combined. As such, he then rightly found that the class action certification required the defendants, as the price of playing the game of law, to bet themselves. Judge Posner thus found that to certify the cases into a single class litigation—a “merely” procedural decision—was the functional equivalent of a decision on the merits rendered against the defendants.

A defendant faced with a single case which, if lost, terminates its existence, is in the same position as a man confronted with a gun to his head and asked for his wallet. In such a situation, the most prudent course is to bargain for a share of your billfold. It’s imprudent to risk the life of a company on a single case, and the legal merits of a defendant company’s position will matter less and less in determining whether a defendant will thus be obliged to surrender to mass tort claims made against it. In such cases, the defendants’ lawyers will engage in a Kabuki to skinny down the size of the ransom that their client pays. And, this will be increasingly truer as tort lawyers, flush with tobacco and other mass tort case fees, have billions to “invest” in elections of state judges.

Imagine yourself the general counsel of McDonald’s, or the general counsel of Exxon a few years from now. Imagine there are floods on the East Coast and droughts in the Midwest. Imagine then that the Midwestern farmers and the East Coast beach house owners are suing the oil companies for the value of their proper-

ties. Imagine that they are joined in their claims by state attorneys general and other public officials alleging billions of dollars of lost tax revenues caused by alleged global warming caused by hydrocarbon fuels. Imagine further that your files have memos speculating on the relation between automobile fuels and higher temperatures. Finally imagine that ten to fifteen state supreme courts are dominated by tort lawyers as a result of the elections of, and election campaigns financed by, billionaire attorneys. (I think the ten-fifteen speculation modest, given the likely effect of multi-million dollar lawyer investments in state judicial elections.) As Exxon general counsel, what are your alternatives?

Or, let's say you're the general counsel of McDonald's and are being hit by lawsuits based on the high cholesterol content of hamburgers brought both by states and medically impaired customers. Leave aside that legislatures have refused to bar the sale of Happy Meals. Forget that you tried to introduce low fat hamburgers, and that consumers refused to buy them. The simple fact of the matter is that you've almost got to be crazy to defend yourself to judgment against such suits, irrespective of the merits of your defenses. (Among other things, your stocks will be phenomenally depressed for as long as the cases go on.) In the end, your job as general counsel of McDonald's will be twofold: first, make sure that competitors like Kentucky Fried Chicken are also defendants, and next try to reduce the amount of the settlement so that the tort/excise tax on every hamburger eaten is not 25 cents but 15. You will work to ensure that the global warming case only adds 15 rather than 20 cents to each gallon of gas—or 75 cents rather than a dollar to every pint of booze or \$25 rather than \$50 to every pistol price tag. What is the best way to do that? Easy. Work with the guys who control the litigation, the thousand or so lawyers who are colluding with state attorneys general seeking free revenue windfalls that come into state coffers without anyone ever having to vote for a controversial tax increase. As defense attorney here's what you do: give the lawyers six rather than three cents on every hamburger eaten from now till the end of time, three or four cents per gallon of gas rather than a mere penny, five rather than two dollars per pistol.

You get the point. Do that and you'll get your settlement, with only 15 cents added to the price of hamburgers.

Now, where is Congress, where are the state legislatures, in all this business? Nowhere. What of taxation without representation principles, of constitutional provisions vesting legislatures with the power to tax? Again no place. These sorts of cases will corrupt our system, and corrupt it more fundamentally than is commonly supposed. And they will produce tens of billions in unethical fees in straight-out blackmail cases whose legal merits and/or lack thereof will be of increasingly marginal significance.

MR. ROBERT PECK: This has been a very entertaining day for me. I've witnessed leaps of logic and heard factual predicates that can only exist in a world of computer-generated animation, where dinosaurs come alive and take on human qualities. So we've achieved at a bargain price, on this panel, what it took more than \$200 million for Disney to do in its movie *Dinosaur*.

Earlier panelists have described studies I have read as though they say something entirely different from the reports' express words. The ATLA web site has also been scrutinized, and the news headlines reprinted on the site have been portrayed as reflections of our policy. I've heard our convention, which is scheduled from July 29 to August 3, moved by one speaker to sometime in June. I've heard celebration over the fact that ATLA lawyers did not sue over Y2K because of Chamber supported legislation, yet that legislation exempted personal injury claims from its coverage, which, of course, is what our lawyers sue about. Instead, I would have expected embarrassment. The lack of problems or litigation exposes the hoax that there was a Y2K litigation crisis. Even in the Third World countries where they did not spend money to fix the alleged problems, there did not seem to be any problems.

And I've heard a New American Rule announced, a Rule where sophisticated clients—i.e., the clients that are members of the Chamber—are exempted. It exists only for consumers who actu-

ally sue the members of the Chambers. If that isn't a virtual reality in terms of credibility, I don't know what it is.

This attitude seems to be at the core of the complaints about the tobacco fees as well—lawyers are supposedly going to spend their fees, according to today's speakers, on state supreme court races. This is a common complaint from the business community; however, the business community has targeted those races as well and achieved the majorities they wanted in Texas and Alabama by precisely the tactics they imagine on the part of this handful of tobacco lawyers.

Accusations of unfair campaign practices in judicial elections were first made this year in South Carolina by a front group called Citizens Against Lawsuit Abuse, which charged that plaintiff lawyers were flooding the campaign coffers of their favorite judges. Yet, when the South Carolina newspapers actually looked at the election records, they found that defense lawyers—lawyers for businesses—actually dominated in terms of campaign contributions.

My fellow panelists apparently live in a different world than I do. I submit that their world consists of bugbears that don't exist in the real world.

In this world, legitimate claims are always paid and lawsuits are rendered unnecessary. Let me talk about one of these “obvious” liability cases, where payment should have occurred. All of this debate, frankly, is very theoretical to me. I’m a constitutional lawyer. I’ve never handled a personal injury case. I’ve never handled a contingency fee case. But this past fall my mother slipped and fell in a grocery store and it became real to me. She was 76 years old. She was caring for her then dying sister, shopping in an unfamiliar store. They failed to put out the little signs that warn you about a wet floor. Her shopping cart slipped out from under her hand and she slipped and broke her arm.

Now, this is a tough old lady. She doesn’t use Novocaine when she goes to the dentist. As soon as she fell down, the store man-

ager came over and said, “It’s all our fault. Just send our insurance company your bills. We’ll pay for it.” She incurred about \$5,000 in medical costs. \$5,000 to her is a substantial amount of money. She collected the relevant papers and sent the information to the person at the insurance company that she was told to send it to. In response, she received a letter saying liability should be borne by the cleaning subcontractor, which unfortunately was out of business.

Under New Jersey law, where my mother lives, the supermarket is wholly responsible. She makes phone calls, she sends registered letters, she tries to get the insurance company to respond. She’s stonewalled. Now, \$5,000 isn’t enough money for the kind of time and expense it would take a trial lawyer to pursue this for her. This is a case of obvious liability. It just happens that her son works for the Association of Trial Lawyers. I can call a prominent trial lawyer in New Jersey who, I assumed by reputation alone, would cause the company to wake up and say, “Okay, we’ll pay the medical bills,” because we’re only talking about \$5,000.

Instead, *he* gets stonewalled. The insurance company knows if they waste his time he’s not going to spend the time on the case. They were wrong in this instance simply because this was my mother. But what they assumed is more often the paradigm case in the “apparent and obvious” liability instance. We can talk about all these other things, but the fact of the matter is that the quotation you heard earlier from Roger, from the New Jersey case, is the obvious strategy that is often used to wear out the plaintiffs’ lawyers because they are capped. If they have a certain percentage of a pretty much guaranteed recovery, you can lessen their economic incentives simply by dragging out the case.

I know that my invitation to appear today is a function of my position with ATLA. So let me begin addressing this panel’s topic by describing a number of propositions that ATLA supports. These are resolutions that we have adopted with respect to the issues under discussion today. But first, let me say that the fear

of trial lawyers having tons of easy money to spend on all sorts of things is a myth. The majority of our members do not make what a first year associate in a law firm in Washington, D.C. makes. In fact, the majority of our members make less than \$100,000 a year. I do wonder where all these excessive easy fees are hiding.

As for ATLA policies: we believe that contingent fees are the key to the courthouse for many people, particularly from the middle and lower classes. Only through a contingent-fee lawyer can many individuals hold people accountable for their injuries and receive just compensation. Further, some of the charges leveled against these lawyers ring hollow because contingent-fee arrangements operate as powerful screening mechanisms that prevent frivolous lawsuits from being filed. Consider that plaintiffs win fewer than half the jury trials, which is a powerful disincentive to speculative lawsuits.

We believe that class action suits can be important vehicles for consumers to halt and deter wrongful conduct. At the same time, we recognize that class actions have the potential to affect individual rights adversely and could interfere with an individual plaintiff's right to exercise choice of counsel and the right to trial by jury.

Accordingly, we believe that tort and consumer causes of action should be prosecuted as class actions only when society's interest in deterring wrongful conduct can be maintained, when individual litigation meant to address that wrongful conduct would be impractical, and when the rights of victims to fair and timely compensation can be protected.

ATLA opposes the use of class actions in a manner that diminishes the right to trial by jury or equal access to the courts. Meaningful exercise of the Seventh Amendment right to trial by jury requires, first, that plaintiffs have a choice about whether to pursue remedies individually or as members of a class out of which they have a right to opt out. Second, that they have a right to insist on individualized jury trials. Third, any waiver of the right to trial by jury should be a knowing and informed choice. Fourth,

plaintiffs are entitled to the counsel of their choice, whose loyalty should be undivided by any conflict of interest.

ATLA opposes class actions that propose to adjudicate the rights of future claimants, i.e. those who have not yet been injured. Future claimants have rights that are not easily discovered; further, the causal link between the conduct of the wrongdoer and the injured party cannot reasonably be ascertained. The right to trial by jury for such persons must be preserved and such persons should be afforded the opportunity to opt out of the class action without penalty during a reasonable period of time following the date they were injured, i.e., when they could have reasonably discovered their injury, or when they could reasonably discover that causal link.

To the extent that a proposed settlement class or a proposed court rule amendment permitting certification of such a class might lead to the adjudication of the rights of future claimants or to collusive settlements, ATLA opposes such certification and opposes any rule that would permit it.

ATLA also opposes limited fund class actions and settlements unless there is a genuine danger that the defendant's liability will so exceed the defendant's available resources that a substantial number of plaintiffs would be deprived of a source of compensation under traditional tort proceedings. Moreover, the plaintiffs in question have to be accorded the same rights in regard to the defendant as any other secured creditor.

And finally, in our view the aggregation of mass tort claims should be restricted to those instances in which both the rights of victims to fair and timely compensation and the deterrent effect on those whose culpability has generated the risk are best served.

Now, having established our perspective on some of the underlying issues that go into the fee discussions, let me discuss the place of attorney fees. The typical rate, 33%, does represent a

market rate. Many of our members charge less than 33%, particularly when they're starting out, as a way of generating business. The standard arrangement, however, appropriately considers the compensation due to an attorney, the contingent nature of the litigation, the investment made by the attorney by advancing costs, the inherent risk of non-payment or underpayment, the quality of the attorney's work, and the result achieved.

We know that class action Rule 23 and its state analogues give judges ample authority to police such fees. Courts, despite earlier comments, have increasingly been exercising that authority. Such authority should be exercised scrupulously, especially when the client is an unsophisticated consumer of legal services. In the case of the state tobacco litigation, for example, the state attorneys general were not unsophisticated consumers. No one has suggested problems in the attorney fees paid by the tobacco companies to their lawyers, which has amounted to more than one billion dollars a year.³⁴

What some consider a useful approach to these fees is to chart them as hourly rates. Seen in that light, the fees seem outrageously high. But this is uninformative. In fact, the consideration of the number of hours expended is wrong-headed. By the same token, a sports agent who negotiates a tremendous contract for his under-performing professional athlete client will receive a significant fee as part of his percentage for what may be only a handful of hours' work. Instead of being criticized for having an outrageous hourly fee, his or her skill is admired.

I submit that, in the case of the class action lawyer, it is more useful to look at the overall benefit to the class rather than to look at the hourly fee. When a utility cheats a consumer of a mere dollar a month, the amount of excess profit can easily reach tens of millions of dollars in short order. While an individual consumer in such an action could never bring an individual case to stop the practice, a class of consumers can. Even if the refund they ultimately receive from a year's worth of utility avarice might amount to a mere twelve dollars,

the reform of billing practices and the recoupment to all consumers of tens of millions of dollars is surely a benefit worthy of the contingent fee that was set up in the beginning.

Remember, by choosing a contingent fee lawyer, a consumer is in essence also agreeing to subsidize other cases where the case does not result in a payment and the risk is thus spread across a wider field, much like the concept of insurance. While my utility hypothetical provides what we consider a good use of class actions, ATLA has serious problems with the kind of coupon class action settlements that amount to giving consumers worthless credits while the lawyers receive substantial cash.

Herb Kritzer's studies at the University of Wisconsin have been mentioned a number of times. But his studies demonstrate that on average contingent fees are *not* overpaid.³⁵ He points out that plaintiffs' lawyers incur risks when they invest time and energy in a portfolio of contingent fee cases, and that on the whole they do not earn excessive returns, particularly when this risk is taken into account. In fact, while there are many who get uncommonly exercised about the issue, there is, according to the leading civil procedure treatise, a virtual absence of empirical data showing any significant incidence of excessive fee.³⁶ This is something that Charlie Silver has also shown.

The most frequently proposed alternative to the lodestar is problematic as well. On this, virtually everyone agrees. Moreover, as the First Circuit has recognized, it breaks significantly with precedent. Courts have and should exercise their express authority to approve class action settlements that are fair and reasonable, reject those settlements that are not, and properly award reasonable attorneys' fees to plaintiffs' counsel who have obtained an ascertainable economic benefit to the class members.

MR. C. BOYDEN GRAY: I think it is good to have plaintiffs' lawyers. If you didn't have trial lawyers it wouldn't be much fun as a defense lawyer. In the South, where I grew up, there was a saying,

“God bless the man who sues my client.” And I think that’s fair. But I do think that lawyers on both sides ought to be subject to the marketplace like everybody else, like the people that they serve.

Professor Silver suggests that the marketplace is working very well for both sides, the defense side and the plaintiff side. I’m not really sure about that. On the defense side, the legal profession is undergoing lots of jolts now. For example, you see dot com firms bidding up the beginning lawyer rates in an extraordinary fashion. The fact of the matter is, over the last decade or so, law firms have lost half their business to in-house corporate counsels. This basically happened because they were overcharging. The marketplace reacted to this in a kind of ham-handed way, by taking a lot of business in-house. This is not necessarily good for the company, because often you don’t get the independence of judgment that I think lawyers should be providing and clients ought to be demanding.

It has been estimated that lawyers’ rates on the defense side are between three hundred and three hundred and fifty billion dollars a year. And half of that is going to the in-house lawyers. Of course, the other half is still going to outside legal services. I think the computer is going to help us get to the point where we can operate, as the expression goes, B to B, that is, business to business. We’re seeing that happen all throughout the corporate sector. This should happen to legal services as well (and to related services such as accounting). Perhaps then there will be a more competitive basis for clients to seek counsel and counsel to sell their wares to their clients.

I also wonder about the marketplace on the plaintiff’s side of the matter. Judge Walker didn’t talk too much about his own innovation, which he described to me earlier as having come about almost off the cuff. The innovation is to use auctions, which he mentioned in the context of it being one of the four ways of dealing with common fund attorney fee compensation. The LIABA did a study called “Turning the Tables,” which examined what happens when you auction off lead class roles. The article and the

study upon which it is based showed that auctions tend to bring the contingency fee down to 7%. This is a two thirds reduction from the sort of ordinary 20% that I think one gets in the big cases—not thirty three: it's really probably more like twenty, 21%. With auctions we're down to seven. Now, this is not all that unusual. A President Clinton appointee, Judge Kaplan, is doing the same thing in the *New York vs. Sotheby's* case, the price fixing case. Judge Kaplan is going to auction off the lead role.

In response to this, development, Steve Susman, the brother of Tom Susman, said, "Oh, this is great. I've been cut out of this deal. Now I think I may try to get back into the game under an auction." "Cut out," he said. That was a very interesting way of putting it. Of course, a lot depends on how fair the bidding process was. Apparently, in Texas you had full open bids: Professor Silver says the whole thing was hawked quite openly, the way services or highway contracts are put out to bid. I'm not sure that's true. What I've read in the press is that it was a very closed system. Unless you agreed in some way, informally, to engage in a little political campaign kickback, you didn't get into the game. And, according to the press, Joe Jamail said he wasn't going to play that game. Accordingly, he didn't get a piece of the action.

Now Florida, in the tobacco cases, was not much better. Apparently the state attorney general's office put out some feelers for firms to participate in the process; the feelers went out only to the trial bar and not to the defense bar. And even then there was an entry fee of ten thousand dollars which not too many people could afford to pay.

How far does this go? I don't know. But I think the answer should be to subject lawyers to the same rules of competition that everybody else is subject to. I think that if judges would, like Judge Walker, put the lead class plaintiff out to bid, in cases involving governments and in private cases, so that there is competition in the marketplace, then many of the questions about ethics, reasonableness, and fairness would disappear. This is what I hope will happen in the future on both the defense and the plaintiff side.

At present, the incentives for lawyers are skewed. We have the worst of all possible worlds, where the defense lawyers are looking to cheat the class plaintiffs in a big case by quietly colluding with the plaintiffs' bar, saying, in essence, "Look, we'll give you a big cut. Let's just get rid of this case and sacrifice the interests of both the defense and the real plaintiffs." A little competition, it seems to me, would go a long way to resolving these issues.

MR. BARNES: I am going to forego my question about the McDonald's case, except to say that I defend the news media in this instance, which I rarely do. Professor Silver described the case as one out of a zillion, which is why it got all that coverage. The media covers the planes that crash, not the ones that land safely. People know about the McDonald's case because it is interesting news.

AUDIENCE QUESTION: This is addressed to Mr. Peck. You indicated that a client who chooses a contingency fee lawyer is in reality choosing to subsidize the lawyer's other cases. My question is, where does that statement of yours come from? What is the lawyer's motivation? Before you answer that, let me suggest a possible response, namely that this is utterly wrong as a matter of legal ethics. Unfortunately, this possible response of mine is in fact a reflection of what lawyers actually do. They impose costs on the no-brainer cases and create windfall fees to subsidize themselves so they can take on higher risk cases. Now, it seems to me your statement is consistent with Professor Silver's view that legal ethics should have no role in fee setting. In that sense you both agree. But I would like to know the source of your statement that it is perfectly appropriate for contingency fee lawyers to overcharge one client in order to subsidize themselves to take on riskier cases.

MR. PECK: Well, first of all, let me disagree with your assumption that anyone is being overcharged. Here you have an opportunity to get a lawyer that you could not otherwise afford to pay because you could not otherwise afford a lawyer. You choose a

contingency-fee lawyer with the understanding that if he does not win the case, he does not get paid. Now, simple common sense will tell you that if some of those lawyers lose their cases and they do not get paid, and since lawyers need to have a certain amount of income to continue to hold their shingle out there, then there is a way to figure out those costs. It is just like a business that does have loss leaders to draw in clients. That is part of the overall price setting. This does not mean that a client is being overcharged. What it does mean is that for this kind of a service there is a certain kind of market rate.

AUDIENCE QUESTION (Professor Brickman): I want to express a certain measure of sympathy with Mr. Peck, surprisingly. His larger concern, which I share, is that some of the easy cases appear to be tough because, as Boyden just said, the defense lawyer exploits the inherent conflict of interest between the plaintiff's lawyer and his client. The defense lawyer says to the plaintiff's lawyer "settle for peanuts," and you'll make one thousand dollars an hour. This is selling out your client. "But," the conversation continues, "if you go for top dollar, even if you get it, I'll see you make ten bucks an hour." And that is a concern, a legitimate one. But I want to ask you if there is no response to that. What are the reforms on the table? Would the rule that exists in an area of contingency fee representation that really works, that is, in condemnation cases, apply to all contingency cases? In condemnation cases, the plaintiff's lawyer can only levy his contingency fee on the value he adds to the claim, that is, the amount that he ultimately gets for his client that exceeds the state's offer for one's back yard or the home they want to build the road through. Now defense lawyers hate that as much as plaintiffs' lawyers do, because they're no longer in use. If you were to apply a rule like that in all tort cases, the defendant would have an incentive to put real money on the table and take the case off the table without having to pay the premium to the plaintiff's lawyer or pay his own lawyers. Why can't we have a setting that reverses the incentive for defendants to do all the bad things you say they do, and you're right

in thinking so, but one which would also cut out the windfall fees for the plaintiffs' lawyers in the easy cases?

MR. PECK: I don't think the incentives work in the way that you have described. I think that it would be very easy to institute a system in which, essentially, 50% is offered as a starting settlement cost and therefore basically reduces by 50% the possible fee. This would make it more difficult for the plaintiff's lawyer to pursue the case. And if this is done this on a regular basis, a lot of plaintiffs' lawyers are eliminated.

AUDIENCE QUESTION (Professor Brickman): Let us assume that we implement this rule, to say that the plaintiff's lawyer cannot charge a contingency fee above the early offer, that he is limited in his ability to charge these massive one third fees, but only in cases where the offer is sweet enough that the claimant, after consulting his own lawyer, accepts the defendant's early offer. This would, in other words, create a disincentive for the defendant to make a low-ball offer. In fact, we have such a situation in a whole set of cases that we do not have the time to get into, but assuming you're right, and I do not, what about saying you can only charge a contingency fee against the value you add if the defendant's offer is high enough to be accepted by the claimant. And if it is not, then the lawyer can charge his full contingency fee. Do you have a problem with that?

MR. PECK: I frankly don't follow you, because if the offer is high enough for the client to accept, the case is over.

AUDIENCE MEMBER (Professor Brickman): Except that the lawyer charges 33 and 40% today when the offer is high enough. Now, how about a situation in which you cannot have that kind of 33 and 40% windfall if the lawyer hasn't added any value to the case? He hasn't put in any work; there's just a notice to the defendant, "I've got a claim." The defendant comes in with an offer that is sweet enough that there's no basis for proceeding any further. Why should the lawyer, who has assumed no risk in that case, and done no work, get his 33 and 40%?

MR. PECK: Why don't we just do blind bidding as well? It simply does not seem like a very workable approach.

PROFESSOR SILVER: I have two quick points. First point: if Michael Horowitz is right about these cases, then there's a market to be made out there by an entrepreneur who goes out and offers to take them in return for agreeing to some kind of a structured fee like the ones you are talking about. And one of the interesting questions would be: why aren't we seeing that market being created? My other point is that I reject the idea that there's this cross-subsidization taking place, which is the assumption behind Professor Brickman's question. I've already flipped the coin ten times and the question is do I flip the coin the eleventh time, which is the equivalent of taking the next plaintiff case. I ask myself, "do I expect to make money on this case?" If the answer is yes, then I take the case. If the answer is no, I don't take the case; I don't take the gamble. The only question that's interesting to me is this: is there a market such that the return that I expect to make on that case actually reflects the real value of my services? Once I take the case, it goes into my portfolio. But it's only at that point that cross-subsidization occurs, and cross-subsidization at that point is irrelevant because we've already gone through the process of bargaining over the fee. It's already my case. Therefore, I think that the whole cross-subsidization idea is erroneous. The only thing we should be looking at is the marginal incentives under which the decision to take cases or reject them is made.

AUDIENCE QUESTION: It seems to me that the strongest case for some sort of distorting situation was the case in which there really is no client, the class action situation. There are only two real solutions offered for that. One was Roger Cramton's guardian *ad litem* solution. The other was Boyden Gray's auction solution. New York has the guardian *ad litem* solution for all kinds of underage people and so forth. It was absolutely notorious as a way in which judges funneled money to their friends. So I'm not at all confident about that as a way of restoring an adversarial element

to the system. Regarding the auction system, it seems to me that it is a great way to get the prices down. But if you don't have a real client, who monitors the provision of services that the lawyer bids to provide? And finally, if Professor Silver truly believes that attorneys general are sophisticated clients in the right sense of the world, that is to say, they have optimal constraints on their behavior, then I have a bridge that I'm sure he'd be interested in buying.

PROFESSOR CRAMTON: A brief response. You have mentioned some practical problems with the guardian *ad litem* approach. I agree that the proposal needs a lot of structure and detail, and that it has worked very badly in some situations, encouraging judicial patronage to former partners or friends. You didn't mention any of the other proposals that I also advanced, among which, it seems to me, is the one that ought to be most appealing in terms of deterrence and responsiveness to the fiduciary duties that a lawyer owes to his clients, namely, the possibility of a subsequent malpractice and breach of fiduciary obligation suit.

MR. GRAY: I do not have much to add. I was only addressing the issue of price, the actual fee. I do think that the fee, if it is awarded by the operation of the marketplace, might end up discouraging some of the more frivolous cases from being brought, which would make the judge's job easier. But perhaps a trial judge would want to comment on that.

JUDGE WALKER: Judge Williams is someone who spends most of his professional time interpreting congressional statutes that have been enacted to solve one problem or another, so, like me, he has to be skeptical of any claim to sweeping reforms. This includes being skeptical about ways of reforming perceived problems with attorney fees. The auction method that Mr. Gray talked about and that I've used in a number of cases is one way of addressing this problem. There are, of course, problems with any kind of auction: the possibility of a race to the bottom, the possibility of lemon lawyers bidding a low bid in order to acquire the right to proceed in the case. Judges who use that method

have to be very aware of that possibility and take measures to insure that the class is going to receive the quality of representation that the class is entitled to.

But I think a perhaps more fundamental method than that of an auction (or of some other means of attempting to simulate the market) is to insist that judges and lawyers address the fee issue at the very beginning of a case, rather than at the end. Most of the problems that we have with the present fair attorney fee problem-solving methodologies stem from the fact that the issue is not addressed until after the action ends. The risk has been borne, the recovery is there, and it is simply a question of dividing it up. You can assess risk much more effectively before the risk has been borne. And yet we allow lawyers and judges to postpone consideration of this issue until after there is any real loss at stake. So I think a great measure that appellate courts could insist upon, with some effectiveness, in dealing with these problems is simply to tell judges something like this: "look, judges, you've got to set the fees at the beginning of the case rather than at the end."

MR. HOROWITZ: I want to put in a word for the lodestar approach. That is to say, you take the base line fee of what the defense lawyer gets, and then you accept the notion that the plaintiff's lawyer has assumed certain risks in bringing the case. It's a variable sort of risk. Echoing Judge Walker, I know that such an arrangement may first create an incentive for lawyers to run up their hours, and that it may also impose substantial burdens on judges to monitor how many hours have been put in. There is an easy response to these concerns, and the market has already created it. Today, there are firms retained by defendants that carefully, rigorously and effectively scrutinize law firm billings.

It seems to me entirely possible for judges to use the services of such firms by designating them as special masters. What this does is to put both defendants' lawyers and plaintiffs' lawyers in essentially the same position of having their fee claims expertly and carefully monitored. Good District Judges like Milton Pollack in the South-

ern District of New York adjust plaintiffs' lawyers' fees with multipliers based on assumed risks and significant results. But it is also quite feasible to do this without imposing difficult burdens on the courts by delegating to specialists with competence in the field the determination of the non-duplicative hours actually spent on cases by plaintiffs lawyers, while leaving for the court the responsibility of calculating the hourly rates and the appropriate multipliers.

On the other hand, I am troubled by Judge Walker's bidding beforehand proposal. I think in many cases it will be very hard to know. And frankly, I think the collusion likely to be involved between groups of often-collegial sub-specialty lawyers is going to be hard for the courts to monitor.

AUDIENCE QUESTION: My question is for Professor Silver. You mentioned that the high rate of expenses that attorneys have incurred in the tobacco cases is a good reason for them to be awarded astronomical fees. However, they are contracted by a governmental agency. This means that they are at least indirectly accountable to taxpayers. Should they not be required to document all of their expenses? Should they not be required to show documentation for all the expenses they say they have incurred?

PROFESSOR SILVER: I assume you say what you say because in Texas there has been a controversy over the production of documents. Actually, that controversy is widely misunderstood. It was at the request of Attorney General Dan Morales, a request made after the contract was negotiated and contrary to its provisions, that expense sheets need not be submitted to the state on a monthly basis. The attorney general was worried that production or submission of expense documentation would be an open record that would in turn be subject to discovery by the press. And if it were discovered by the press it would immediately be published in the newspapers, at which point you are basically telling the defendant how much of your money you are spending and on what, thereby giving the defendant a very significant insight into what your litigation strategy is without him having to reciprocate. So the agree-

ment was that we would not submit any expenses in that litigation until the end of the day.

Furthermore, the plaintiffs' attorneys had no objection to submitting documentation of their expenses in Texas. What they had an objection to was the abuse of information relating to the litigation by the current attorney general, who is their political enemy. They have volunteered repeatedly to turn over records of expenses in response to a discovery request promulgated in the Federal District Court where the litigation is currently pending and in which court the State of Texas chose to put the lawsuit.

Attorney General John Cornyn has not once, in two years, submitted a request for those documents through the Federal District Court. His view is that the Federal district judge cannot be trusted to preside over an ethics investigation. I invite you to decide for yourself the merits of that view.

MR. BARNES: Let me close with one comment. The issue has been raised a couple of times that perhaps the Chamber of Commerce has an interest in reform because it is in the best interest of its members. I think that one of the things that has been a hallmark of this discussion is that a lot of people come with various interests and various ideas of what proposals ought to be, and I think these have been evaluated on the basis of their merit. We need to continue this discussion in that spirit, because it was fruitful to hear the parameters of the problem and different perspectives on the need to pursue it further.

Notes

¹ Stephen Budiansky with Ted Gest and David Fischer, “How Lawyers Abuse the Law”, *U.S. News and World Report*, January 30, 1995, at 51.

² “Courts Whittle Down Lawyers’ Fat Contingent Fees,” *The Wall Street Journal*, January 28, 1998, at B2.

³ “The ABA Has Fallen Down on the Job”, *The Wall Street Journal*, August 10, 1994, at A9.

⁴ *Towards a Jurisprudence of Injury: The Continuing Creation of a System of Substantive Justice in American Tort Law*, at 12-5 (1984); American Bar Ass’n Special Comm. On the Tort Liab. Sys.

⁵ *Contingent Fees Without Contingencies: Hamlet Without the Prince of Denmark?*, 37 UCLA L. Rev. 29 (1989); *Rethinking Contingency Fees: A Proposal to Align the Contingency Fees System with its Policy Roots and Ethical Mandates* (1994), co-authored with M. Horowitz and J. O’Connell; *Contingency Fee Abuses, Ethical Mandates, and the Disciplinary System: The Case Against Case by Case Enforcement*, 53 Washington & Lee L. Rev. (1996); *ABA Regulation of Contingency Fees: Money Talks, Ethics Walks*, 65 Fordham L. Rev. 247 (1996).

⁶ Harold Schrader, et al., *Natural Evolution of Late Whiplash Syndrome Outside the Medicolegal Context*, *The Lancet*, May 4, 1996; at 1207, 1209-10.

⁷ Denise Grady, *In One Country, Chronic Whiplash Is Uncompensated (and Unknown)*, NY Times, May 7, 1996, at C3. See also, J. Cassidy, L.J. Carroll, et al., *Effect of Eliminating Compensation for Pain and Suffering on the Outcome of Insurance Claims for Whiplash Injury*, 342 N. England J. Medicine 1179 (April 20, 2000).

⁸ C. Wolfram, *Modern Legal Ethics* 528 N. 21 (1986); *Compensation for Automobile Injuries In The United States*, All Industry Research Council (1989) at 65-66 and Tables 5-5, 4-17 at 48, 4-5 at 34.

⁹ Caroll, Stephen J. et al. The Costs of Excess Medical Claims for Automobile Personal Injuries (1995).

¹⁰ ABA Comm. on Ethics and Professional Responsibility, Formal Op. 389 (1994), reprinted in ABA/BNA Lawyer's Manual on Professional Conduct 1001:248 (1995).

¹¹ *ABA Regulation Of Contingency Fees: Money Talks, Ethics Walks*, 65 Fordham L. Rev. 247, 249 (1996).

¹² *Contingency Fee Abuses, Ethical Mandates and the Disciplinary System: The Case Against Case-By-Case Enforcement*, 53 Wash. & Lee L. Rev. 1339 (1996).

¹³ See Waters, et al. v. Intl. Prec. Metals, No. 97-5074 (11th Cir. 1999), Brief of *Amicus Curiae*, Lester Brickman et al.

¹⁴ 209 F.3d 43 (2000).

¹⁵ Judging Science: Scientific Knowledge and the Federal Courts. MIT Press, c. 1997.

¹⁶ The Excuse Factory: How Employment Law is Paralyzing the American Workplace. The Free Press, c. 1997.

¹⁷ *Supra*, at note 2 (1989).

¹⁸ *The Wages of Risk: the Returns of Contingency Fee Legal Practice*, 47 DePaul L. Rev. 267 (1998).

¹⁹ For Kritzer's views on this subject, see *Contingent-Fee Lawyers and Their Clients: Settlement Expectations, Settlement Realities, and Issues of Control in the Lawyer-Client Relationship*, 23 Law & Soc. Inquiry 795 (1998).

²⁰ 433 U.S. 350 (1977).

²¹ 104 S. Ct. 1541.

²² 209 F. 3d 43 (2000).

²³ Willging, Hooper, and Niemic, Federal Judicial Center, *Empirical Study of Class Actions in Four Federal District Courts*, at 56-58 (1996)

²⁴ *Id.*, at note 19.

²⁵ 20 L. & Soc'y Rev. 7 (1986).

²⁶ Charles Silver and Frank B. Cross, 109 Yale L.J. 1443 (April, 2000).

²⁷ Richard H. Sander & Douglass Williams, *Why Are There So Many Lawyers? Perspectives On A Turbulent Market*, 14 L. & Soc. Inquiry 431 (1989).

²⁸ Overcoming Law 92 (1995).

²⁹ *Supra*, at note 15.

³⁰ Denise N. Martin et al., *Recent Trends IV: What Explains Filings and Settlements in Shareholder Class Actions?*, National Econ. Research Assocs. (1996).

³¹ James H. Stock & David A. Wise, *Market Compensation in Class Action Suits: A Summary of Basic Ideas and Results*, 16 Class Action Rep. 584 (1993).

³² *Due Process and the Lodestar Method: You Can't Get There From Here*, 74 Tul. L. Rev. 1809 (2000).

³³ 51 F.3d 1293 (7th Cir. 1995).

³⁴ Editor's Note: For a discussion of the problems with these fees please see *Regulation by Litigation: The New Wave of Government Sponsored Litigation*. Manhattan Institute Conference Series I.

³⁵ *Supra*, at note 15.

³⁶ Wright, Miller, & Kane, Federal Practice and Procedure: Civil 2d, §1803, at 507 (1986 & Cum. Supp. 1997).



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