Introduction

ON OCTOBER 11, 1998, A FREIGHT TRAIN STRUCK AND killed Michael Corcoran as he worked on a Union Pacific track bed in Illinois. Soon afterward, a railroad representative offered his widowed wife, Mary, a $1.4 million settlement. Mary, a 46-year-old former waitress, did not know how to judge whether the settlement offer was fair. An experienced lawyer could advise her, but at what price?

The answer may surprise and even enrage you.

The following spring, Mary visited Harpoon Louie's, a bar in Winthrop Harbor, Illinois, to reminisce about her husband with the regulars. Joseph P. Dowd, a small-time lawyer who had heard about the accident, happened to be at the bar also. He introduced himself to Mary and offered to take her case and refer it to a big-time lawyer. He would later explain his motivation for doing so: "Somebody gets run over by a train and killed and leaves a wife and two children. That's a good case."

Mary gratefully accepted Dowd's offer to help. She told him she wanted to retain one of the top personal injury firms in Chicago, Corboy & Demetrio, because her father had gone to school with one of the partners. Dowd arranged a meeting with Thomas Demetrio, and Mary agreed to pay the firm "25 percent of any sum recovered from settlement or judgment" with Dowd to receive 40 percent of that attorney's fee. She had no idea – because her lawyers did not tell her – that their fee would include a big slice of the $1.4 million that the railroad had already offered her.

After two years of effort, the Corboy & Demetrio lawyers concluded that they could not improve on Union Pacific's $1.4 million offer. They recommended that Mary accept it and then did something lawyers almost never do. Because they couldn't improve Mary's settlement offer, they waived their fees.

Not so Joe Dowd. He demanded $140,000, his 40 percent share of the $350,000 fee that the big-time lawyers waived. Mary balked. Could Dowd really charge her $140,000 for attending a few meetings, making a few phone calls, and reading a file? An Illinois trial court said yes. An appeals court concurred and added that Mary should have protected herself by including a provision in Dowd's retainer agreement stating that the lawyer would only get a percentage of the value he *added* to the settlement offer.[1] Alas, Mary did not realize that she needed a lawyer to negotiate a lawyer's fee.

Failing to point out to an unsophisticated client that the agreement she was being asked to sign would entitle the lawyers to 25 percent of her $1.4 million settlement offer – even if the lawyers did not add one penny to that amount – surely was a deceptive act. If an Illinois business had engaged in similar conduct, it would have been subject to suit under both the Illinois Consumer Fraud Act and the Uniform Deceptive Trade Practices Act.[2] Virtually all states have enacted similar statutes that lawyers have turned into weapons of mass extortion aimed at pharmaceutical companies, large retailers, and other businesses (as described in the second section of Chapter 11). Why didn't these acts protect Mary Corcoran? Simple: Under state court rulings, lawyers are exempt from these legislative protections for consumers;[3] they are instead subject to disciplinary regimes set up by state supreme courts. However, according to the Illinois courts, what Mary Corcoran's lawyers did was perfectly fine.

Alas, what happened to Mary Corcoran is not uncommon. Similar fleecings take place hundreds of times a year – perhaps even thousands.[4] Nor are the Illinois courts' decisions approving the fee and how Dowd "earned" it an aberration. It is the law of the land in all fifty states that victims of wrongful acts, called torts,[5] are fair game for one-sided

bargains dictated by personal injury lawyers – a law promulgated by lawyers, for lawyers, enforced by judges who are lawyers, and heartily endorsed by the ethics committee of the American Bar Association (ABA) in an advisory opinion notable for its blatant self-interest and disingenuous analysis.[6]

Instead of being protected by her lawyer and the courts, Mary Corcoran fell prey to a powerful force. Over the past fifty years, this force has (1) shaped our civil justice system to best serve the interests of lawyers while providing a cumbersome, inconsistent, and unpredictable system for compensating injured persons; (2) created perhaps the most powerful regulatory regime in the land – one that dwarfs federal and state regulatory agencies; (3) empowered lawyers and courts to hold the fate of entire industries in their hands and extract billions of dollars in what are, effectively, ransoms; (4) inflated medical costs due to auto accidents by at least $30 billion annually; (5) empowered lawyers, in collaboration with judges, to usurp legislative authority and engage in policy making for profit; and (6) led to a litigation explosion.

This force, of course, is the contingency fee. The incentives created by contingency fees are so powerful that the U.S. Treasury bars lawyers (and others) preparing tax returns from charging contingency fees out of fear that their use would lead to corrupt practices and cost the U.S. government billions of dollars in lost revenues. Even so, of all of the elemental forces shaping our legal and political systems, this force – enveloped in stealth sheathing and largely flying below our radar screens – is the most underappreciated. Though well known to lawyers, its workings and effects are only dimly understood by most of the public.

If you are injured and want compensation, you may process a tort claim on your own. It is desirable (and sometimes essential), however, to hire a lawyer in cases of serious harm. Lawyers, like all professionals, want to be well paid for their services. The contingency fee is the way personal injury lawyers finance access to the courts for most of us who are wrongfully injured and want to seek compensation. In a contingency

agreement, tort lawyers lend their services to injured persons, typically advancing litigation costs, including filing fees, court reporter charges, and expert witness fees. In exchange, tort lawyers charge a standard percentage of the recovery, usually one-third (or more) plus reimbursement of their expenses. American lawyers spend more than $100 million annually on thousands of ads in the Yellow Pages, on billboards, late night television, and the Internet trumpeting the mantra, "no fee unless you win." If you win, however, you will end up paying your lawyers at least one-third of your award plus expenses.

Even if your lawyer does not add any value to your claim, you will likely still fall victim to a scheme that is a routine part of contingency fee practice. When an injured person hires a lawyer to pursue a tort claim, even if the claim already has substantial value at the time the lawyer was hired, the lawyer assigns the value of the claim as zero and applies the contingency fee to the entire recovery. I call this scheme, which snared Mary Corcoran, the "zero-based accounting scheme." Even in the absence of a pre-retention settlement offer, the very fact that a contingency fee attorney agrees to represent a client on a contingency fee basis indicates – as a court has noted – that the cause of action "had value in the very beginning."[7] Stephen Gillers, a leading legal ethics professor at New York University School of Law, concurs that "most personal injury cases – certainly most that lawyers are willing to accept – have some value" and questions why "the plaintiff's lawyer [should] get a full contingent fee for 'recovering' this amount."[8] The plain answer is: They do so because they can.

Because of these and other artifices and a greatly expanded tort system, tort lawyers' profits have risen prodigiously to levels far beyond what is necessary to create sufficient incentives for lawyers to provide access to the civil justice system. Lawyers justify their fees by saying that they bear the risk of losing the case. Indeed, by chasing down business through advertising and aggressive outreach, some lawyers appear to be among our society's quintessential entrepreneurs. They invest and put at risk time and capital, sometimes amounting to millions of dollars,

in exchange for a percentage of an uncertain recovery. Professional athletes, rock stars, hedge fund managers, and CEOs enjoy huge earnings. Why not lawyers? How can we say that their returns are excessive, so long as the field of play is level and they play an honest game?

But in fact, the field of play is tilted; the deck is stacked; the game is fixed. Many lawyers charge for entrepreneurial risks they don't actually bear. By careful case selection, they prevail in the substantial majority of the cases they accept. Despite the limited risk, their share of damage awards routinely amounts to one-third or more.

Lawyers can charge for these phantom risks because they use positional advantages to shield themselves from market forces. They charge standard contingency fees, even in cases where there is no meaningful liability risk and a high probability of a substantial recovery. They benefit from enormous economies of scale in class actions and other large-scale litigations but do not share these benefits with their clients. They take advantage of complex state and federal regulatory systems, conceived of and applied by lawyers. They use their influence, if not control, over ethics rules to advance their self-interest. When ethics rules appeared to require lawyers to adhere to heightened fiduciary standards rather than the *caveat emptor* rules of the marketplace when bargaining with clients over fees, lawyers simply changed the rules so that they do not apply to the fee-bargaining process – as the Illinois court emphatically pointed out to Mary Corcoran.

Lawyers further exploit the bar's arcane ethics rules, such as those prohibiting business structures that encourage price competition, to extract unearned profits. They use the bar's monopoly over the practice of law to prevent competition from nonlawyers. They appear to be entrepreneurs when, in fact, they mostly are what the great economist Adam Smith called "rent seekers."

Economists use the term "rent" or "economic rent" to mean something different than a monthly payment to the landlord. Economic rent encapsulates any positional gain that exceeds opportunity costs: an earning, unrelated to productivity, realized by manipulating the legal

environment or by taking advantage of a dominant position in the market.[9] This rent is the difference between the rent seeker's actual price and the price he would charge in a fully competitive environment. The investment in rent seeking may produce lucrative returns but does not generate benefits for society as a whole as does trade and production of goods and services. In layman's terms, economic rent is *unearned* financial gain. Unlike mere profit seekers, who extract value by offering a better product at a lower price, rent seekers often bypass the market and lobby the government for advantages that markets cannot confer. Oil companies seek rents, or unearned gains, for instance, when they lobby for tax breaks. Farmers who seek price subsidies, labor unions that seek government mandates for above-market wages, and automakers who seek protective tariffs are rent seekers, too.

Personal injury lawyers, though they ideally serve a socially protective function, are rent seekers. They extract rents in a variety of ways. First, lawyers have entrenched their position as monopolistic producers of legal services. For example, they use unauthorized practice of law statutes to keep out competition from those who would charge less, such as insurance adjusters who could provide effective but much less expensive claim settlement services were they able to market these services to the public. Second, tort lawyers also extract rents by inhibiting price competition. Virtually all tort lawyers in a community charge identical contingency fee percentages – usually 33⅓ percent of the plaintiff's recovery and 40 percent in mass tort cases – allowing them to collect fees that can amount to thousands of dollars an hour. They enforce this anticompetitive strategy through ethical codes that preclude the establishment of business structures that could foster price competition. A third form of rent-seeking behavior is the collaborative enterprise of tort lawyers and lawyer-judges to expand tort liability and lawyers' profits. This envelope-expanding litigation imposes significant costs on the economy by increasing uncertainty and the difficulty of doing business.

Some degree of rent seeking, however, may be beneficial to tort clients. Because these clients cannot monitor their lawyers' behavior, they

have to rely on the incentives created by the contingency fee. A too-low contingency fee yields an insufficient incentive for the lawyer to invest the requisite time and litigation costs to maximize a recovery. The outcome may be a lower net recovery for the client than if the contingency fee were higher. The optimal contingency fee, then, is one that minimizes both lawyers' rents and underinvestment in claims.[10]

Most rent-seeking behavior by tort lawyers, however, does not redound to a client's benefit. Consider what Joseph Dowd did in securing a substantial positional gain. He used the bar's monopoly over the practice of law to extract substantial unearned profits from Mary Corcoran. She was forced to pay a contingency fee just to know whether the settlement offer she received was fair – a fee that would come entirely out of the money she had been offered as a settlement *before* she had a lawyer.

Tort lawyers' rent-seeking behavior is not limited to the abusive fee practices that tort victims like Mary Corcoran fall prey to. Both the rent-seeking activity of tort lawyers and the rents thus obtained raise a far greater basis for concern. This is the same concern that we face in reforming our health care system – the effects of financial incentives on doctors and other service providers and how those effects impact national policy.[11] Just as we must factor in doctors' financial incentives in determining how to reform the health care system, we must also take lawyers' financial incentives into account in deciding how to reform a civil justice system that allowed Mary Corcoran to fall prey to her lawyer's avarice – a civil justice system that has generated profits from contingency fees, as measured by lawyers' effective hourly rates, that have soared to unimaginable heights.[12] It is beyond cavil that at some level of lawyers' profitability, the financial incentives to litigate perversely affect our civil justice system. Too-high incentives in the form of greatly increased effective hourly rates distort the objectives of the tort system and impose other social costs. One such effect is substantially higher volumes of tort litigation, which are not justified by increased levels of injury or the need to induce potential injurers to increase investment in product safety. Despite these effects, most legal scholars have largely ignored the role of

increased profitability of tort litigation in contributing to dysfunctional wealth transfer.[13] Unlike these scholars, Stuart Taylor Jr., a leading legal journalist, has focused on the issue with laser-like intensity. Surveying the legal landscape, he laments "how often plaintiffs' lawyers pervert our lawsuit industry for personal and political gain, under the indulgent eyes of judges, without rectifying any injustices, at the expense of the rest of us."[14]

Profits from contingency fees also account for the vast expansion of the range of acts that can give rise to tort liability. A modern-day Rip Van Winkle who awoke after a decades-long slumber would be amazed to learn of the many new ways that he could be held liable to others. Similarly, a large manufacturer can awake one morning to learn its very existence was at risk because the legal system had retroactively decreed that *all* of the millions of products it sold over the past twenty-five years are legally defective.

Over the past fifty years, expanded tort liability and higher profits have driven higher levels of litigation. This has led to a veritable litigation explosion. The more we *can* resort to courts, the more we *do* resort to courts. A litigious society benefits lawyers and judges by expanding their regulatory powers but with a high social cost.

The consequences of this legal rent seeking are thus profound. Contingency fees have empowered lawyers to shape our civil justice system in ways that further their financial interests to our detriment. The contingency fee is the "key to the courthouse" for most persons wrongfully injured, but whereas the public senses that lawyers manipulate the civil justice system to serve their own ends,[15] few are aware of the formidable costs that come with the benefit. This book, which distills over twenty years of my research on contingency fees, sets out to change that.[16]

If, after reading this book, you come away with the message that this is just another attack on "greedy" trial lawyers, then I have failed in my essential purpose. Trial lawyers are greedy but so too are CEOs, hedge fund managers, bankers, actors, doctors, teachers, airline mechanics, oil

and drug companies, politicians – to name but a few – as well as you and I. What distinguishes trial lawyers from the rest of us is the positional advantage that judicial control over the practice of law and use of contingency fees has enabled them to attain. If you want to be titillated by tales about greedy trial lawyers or, for that matter, about companies that "put profits over people," you are well supplied by cottage industries dedicated to those pursuits. If you want to understand how contingency fees distort our civil justice system and endanger democratic governance, then read on.

My intent in this book is fourfold: (1) to demonstrate how contingency fees have empowered lawyers to shape our civil justice system in ways that further their financial interests while relegating the interests of the public to secondary importance; (2) to point out a compelling need to provide the same scrutiny now focused on our havoc-wreaking financial institutions on the costs imposed by the financial incentives for tort and class action lawyers to file lawsuits; (3) to show how fundamental allocations of power between the branches of government have been recast by contingency fee lawyers in collaborative efforts with judges to enlarge both the scope of liability of the tort system and the role of judges in allocating resources; and (4) to offer politically feasible corrective measures that are protective of both consumers of legal services and of society. My goal is to bring about reform of the civil justice system by exposing the corrupting influence of powerful financial incentives and the seamy world of contingency fees that the bar and the courts not only tolerate but, in some ways, protect and even nurture.

I come to the subject of contingency fees not only as a scholar of lawyers' ethical obligations but as a critic of mass tort litigation. These perspectives make me distinct from most torts scholars. I have been teaching legal ethics since the outset of my teaching career in 1965. In the mid-1980s, I developed a specialized interest in ethical issues raised by lawyers' fees. In several articles, I challenged the use of the nonrefundable retainer – an upfront, nonrefundable fee charged by matrimonial, criminal, and bankruptcy lawyers often amounting to thousands of

dollars, which a lawyer would entirely keep even if the next day the client decided not to proceed and the lawyer had not yet done any work. Relying on this scholarship, New York's highest court outlawed the use of nonrefundable retainers,[17] and many other state supreme courts have followed suit.

By the late-1980s, I had begun to delve into lawyers' contingency fee practices. In a 1989 article in the *UCLA Law Review*,[18] I criticized the practice of charging standard one-third contingency fees in cases where there was no meaningful contingency or risk. I likened charging contingency fees in the absence of risk to *Hamlet* without the Prince of Denmark. Based on this article and others that followed, I developed a public profile as a critic of lawyers' fee abuses and have been a key participant in the ongoing battles to reform contingency fee practices.[19] In the ensuing twenty-plus years, I have been a keen observer of contingency fee practices and of lawyers' behavior. I have studied those practices, investigated them, debated them, written about them, and developed critical data about how this system works, who benefits, and how. In addition to my writings on contingency fees, I have focused my research on mass torts and have published articles on fraudulent claim generation driven by contingency fees in such mass tort litigations as asbestos, silica, fen-phen (the diet drug), silicone breast implants, and welding fumes. Here, too, I have acquired a reputation as the leading expositor of mass tort fraud. I have poured the sum total of this experience into this book.

Though contingency fees have been hotly debated among legal experts over the last several decades, this is the first book that analyzes the costs imposed by contingency fees and challenges the view of torts scholars that tort lawyers' profits, though great, are socially beneficial. Contrary to a broad consensus in contemporary legal scholarship, I argue that the level of financial incentives available to lawyers to litigate distort the objectives of our civil justice system and impose other unconscionable social costs.

In the chapters that follow, I explore just how profitable the contingency fee has become, why profits have burgeoned, and how the quest