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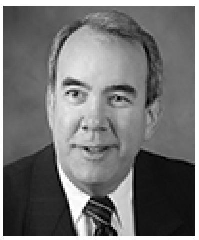
Growing Concern Over Contingency Fee Agreements Between Attorneys General and Private Attorneys



BY RICHARD A. SAMP

Contingency fee agreements have had a long and sometimes controversial history within the legal profession. While they enable clients to obtain representation that they might not otherwise have been able to afford, they can create conflicts of interest for a lawyer whose interests in maximizing fee awards may conflict with his duties to the courts and his client. Those conflicts are perhaps most readily apparent when the client entering into the contingency fee agreement is a State attorney general—an increasingly frequent occurrence during the past two decades.

While courts repeatedly have expressed concerns regarding the potential conflicts of interests that can arise when attorneys general hire special counsel to file lawsuits on a contingency fee basis, they generally have been unwilling to interfere with the process. State legislatures have also adopted a largely hands-off approach, limiting themselves to legislation designed to ensure that any contingency fee agreements are open to public inspection. As the number and scale of state lawsuits filed by contingency fee attorneys continue to increase, however, the targets of such suits—large pharmaceutical companies in particular—have begun to push back and challenge the propriety of entrusting such a large policymaking role to private attorneys not fully controlled by government officials. Courts and state legislatures should give careful consideration to these challenges.

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The Rise of the Contingency Fee Model

State and local governments generally rely on full-time employees to represent them in court proceedings, but throughout American history they occasionally have retained private attorneys to represent them when they lack sufficient manpower or expertise to handle a legal proceeding using in-house personnel. Such special attorneys traditionally were paid based on the number of hours worked. In recent decades, however, state and local governments have increasingly resorted to contingency fee contracts, whereby the attorney is paid based on a percentage of funds recovered in the litigation, and the attorney receives no fee if no funds are recovered.

The initial use of contingency fee contracts by state attorneys general is often associated with the litigation filed against the tobacco industry by all 50 States in the 1990s. Pursuant to the 1998 settlement of that litigation, major tobacco companies agreed to pay at least $246 billion to the States, and private attorneys representing the States pocketed $14 billion in fees. Those fees alerted private attorneys to the potentially lucrative nature of such contingency fee contracts. Indeed, while some of the private attorneys who grew fabulously wealthy as a result of the settlement had risked considerable time and resources in taking on the tobacco industry, others began work not long before the 1998

Master Settlement Agreement was reached and were awarded in excess of $10,000 per hour for their work.[1] In the ensuing years, the practice has become widespread, and a number of state attorneys general have nearly 100 pending cases in which they have retained private attorneys on a contingency fee basis.[2]

By retaining private attorneys on a contingency fee basis, state attorneys general expand considerably the number of lawsuits they can file without increasing upfront expenditures. Not surprisingly, many of the targets of those additional lawsuits are unhappy with that development and have raised numerous objections (in both the courts and state legislatures) to public use of contingency fee attorneys. To date, the objectors have met with only mixed success. However, the changing nature of contingency fee suits being filed by States in recent years—in particular, the quasi-criminal nature of those suits—increases the likelihood that current objectors may receive a more sympathetic hearing from courts and legislatures.

The Neutrality Principle

The retention of criminal prosecutors on a contingency fee basis is universally ''recognized to be unethical and potentially unconstitutional.''[3] That condemnation is founded on an understanding that an attorney prosecuting a criminal case has a duty to ''seek justice'' that overrides any desire to win his case.[4] Offering a prosecutor a financial reward for winning his case is thought to create an unacceptable conflict of interest that might tempt the prosecutor to deviate from his duty to proceed in a ''neutral'' manner.

This neutrality principle is understood also to apply to government attorneys when engaging in civil litigation.[5] Most state courts nonetheless have concluded that contingency fee contracts for public lawyers engaged in most forms of civil litigation are not unethical and do not violate the constitutional rights of defendants—provided that certain safeguards are maintained. For example, in a closely watched case involving claims filed against manufacturers of lead paint, the California Supreme Court held that the retention of contingency fee attorneys by government plaintiffs is permissible if, but only if, the fee agreement provides that: (1) full-time government attorneys retain complete control over the course and conduct of the case; (2) government attorneys retain a veto power over any decisions made by outside counsel; and (3) a government attorney with supervisory authority is personally involved in overseeing the litigation.[6] While recognizing that contingency fee contracts in civil litigation provide counsel with economic incentives to deviate from the neutrality principle, the court concluded that a total ban on such contracts was unwarranted because suits seeking an award of money damages do not affect the sort of ''fundamental rights'' at issue in a criminal case—at least where the civil suit does not threaten the viability of the business being sued. The court nonetheless made clear that there comes a point at which claims asserted in a public civil suit pose a sufficient threat to the defendant's interests that a contingency fee contract is not permissible.[7]

Limits on the Power of Attorneys General

Defendants have had more success in challenging contingency fee agreements based on claims that state law limits the authority of state attorneys general to enter into such contracts. In a number of States, courts have held that the state legislature retains significant control over the award of and payments under contingency fee contracts.

For example, the Supreme Court of Louisiana held in 1997[8] that Louisiana's Attorney General violated separation-of-powers principles by entering into a contingency fee contract to represent the State in a civil action; it held that such contracts required an express grant of authority from the state legislature. The court noted that the State Constitution granted the legislature exclusive authority to control the appropriation of state funds. The court held that the Attorney General's award of contingency fees to private attorneys violated that exclusive authority in the absence of express legislative authorization.

Two recent decisions by the Mississippi Supreme Court imposed similar constraints on the power of the Mississippi Attorney General to authorize payment of contingency fees directly from a defendant to a private attorney. The court held that under Mississippi law, any payments in settlement of a state lawsuit belong to the State and must be paid to the State rather than directly to the contingency fee attorney (even when such direct payments are explicitly provided for in contingency fee agreements signed by the Attorney General).[9] The full impact of the Mississippi decisions has not yet been determined. They could prove very significant if the courts ultimately rule that it is up to the state legislature to decide how much of a fee the law firms at issue are entitled to receive. However, if (as the Attorney General argues) the law firms are permitted to deposit the funds into the Attorney General's discretionary fund and he in turn is permitted to write a check immediately returning all the funds in question, the two court decisions will end up being of little significance.

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[1] *See generally,* Leah Godesky, *State Attorneys General and Contingency Fee Arrangements: An Affront to the Neutrality Doctrine?*, 42 Colum. J.L. & Soc. Probs. 587 (2009).

[2] *See, e.g.*, the website of Mississippi Attorney General Jim Hood, http://agjimhood.com/index.php/sections/divisions/outside_counsel (listing active contingency fee contracts his office has executed). Conversely, a 2007 Executive Order bars federal agencies from retaining contingency fee attorneys. *See* Exec. Order No. 13433, 72 Fed. Reg. 28441 (May 16, 2007).

[3] *People ex rel. Clancy v. Superior Court*, 39 Cal.3d 740 (1985).

[4] *See, e.g., Berger v. United States*, 295 U.S. 78, 88 (1935) (the prosecution's interest ''is not that it shall win a case, but that justice shall be done.'').

[5] *See, e.g.,* ABA Model Code of Professional Responsibility, Ethical Consideration 7-14 (stating that a ''government lawyer in a civil action or administrative proceeding has the responsibility to seek justice'' and ''should refrain from instituting or continuing litigation that is obviously unfair.'').

[6] *County of Santa Clara v. Superior Court*, 50 Cal. 4th 35, 64 (2010). In arriving at its decision, the California Supreme Court relied heavily on an earlier decision of the Rhode Island Supreme Court in a case raising similar claims. *Rhode Island v. Lead Industries Ass'n Inc.*, 951 A.2d 428 (R.I. 2008).

[7] *Id*. at 55-56 (citing *Clancy*, 39 Cal.3d 740).

[8] *Meredith v. Ieyoub*, 700 So.2d 478 (La. 1997).

[9] *Pickering v. Langston Law Firm*, 88 So.3d 1269 (Miss. 2012) (ordering law firm to deposit a $14 million fee into the state treasury); *Pickering v. Hood*, __So.3d__, 2012 WL 3172092 (Miss., Aug. 2, 2012) (ordering law firm to deposit a $10 million fee into the state treasury).

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While state legislatures appear to have significant power to limit the use of contingency fee agreements by state attorneys general, most have displayed little willingness to exercise that power broadly. Instead, they have focused on eliminating potential abuses of the contingency fee system. For example, at least 14 States (Arizona, Connecticut, Colorado, Florida, Indiana, Iowa, Kansas, Minnesota, Mississippi, Missouri, North Dakota, South Carolina, Texas, and Virginia) have adopted variations of the Private Attorney Retention Sunshine Act (PARSA), model legislation proposed in 1998 by the American Legislative Exchange Council to govern retention of contingency fee attorneys by state attorneys general. PARSA requires open and competitive bidding for state contracts, public hearings for contracts larger than $1 million, and documentation of attorneys' hours, expenses, and hourly rates. In other States (*e.g.*, Georgia), ''sunshine'' requirements have been imposed by virtue of orders issued by the state governor or attorney general.

Pay-to-Play

The impetus for sunshine legislation has not arisen based on concern about the conflicts of interest inherent in use of contingency fee litigation, but rather based on the potential for corruption. The fear is that huge potential fees available to private counsel retained by states on a contingency fee basis will induce some lawyers to employ improper means to obtain such contracts.

Experience over the past several decades indicates that the fears of corruption are well justified. The American Tort Reform Association (ATRA) has documented pay-to-play policies employed by numerous state attorneys general. Contingency fee contracts have routinely been awarded to law firms that are among the largest contributors to the attorney general's election campaign. For example, in *Beyond Reproach?: Fostering Integrity and Public Trust in the Offices of State Attorneys General* (2010), ATRA reported on the award of contingency fee contracts to law firms that had made huge campaign donations to attorneys general in Alabama, Louisiana, Mississippi, New Mexico, and New York. In most of the cases, the law firms were not located in the State that awarded them the contingency fee contract—thereby eliminating the possibility that the lawyers involved had made campaign contributions simply because they were admiring constituents of the attorney general in question. At least one attorney general was jailed for his part in a pay-to-play scandal. Former Texas Attorney General Dan Morales succumbed to temptations arising from the tobacco industry's $18 billion payment to Texas, that State's share of the 1998 tobacco settlement; in 2003 Morales was sentenced to four years in prison for attempting to steer $1 million of the attorney fees arising from that settlement to himself and another lawyer.[10]

''Sunshine'' provisions should help to reduce the danger of corruption. By requiring competitive bidding, public disclosure of contract terms, and legislative oversight of fee awards, States can ensure that they are getting fair value for the fees they pay to private attorneys. But from the standpoint of defendants who complain that they are being sued by private attorneys who have inherent conflicts of interest, assurances of fair value are of little solace. With the exception of Louisiana, attorneys general in every state have broad discretion to hire contingency fee attorneys to bring civil actions on behalf of the state. State legislators clearly enjoy asserting oversight authority over state attorneys general, but they are as likely as the attorney general to applaud the large monetary judgments that can be generated by lawsuits filed on a contingency fee basis. While California's *Santa Clara* decision and similar decisions in other States have conditioned contingency fee hiring on an agreement by the attorney general to closely monitor the work of private counsel (to ensure compliance with the neutrality principle), defendants in such suits complain that in practice it is virtually impossible for the attorney general to maintain close supervision—nor is there any way for the defendant to determine the degree of supervision that is taking place. Accordingly, for tort reformers seeking to limit the number and scope of contingency fee lawsuits being filed by state attorneys general and county attorneys, adoption of ''sunshine'' statutes holds little promise for relief.

Risperdal—A Case Study

The debate over government use of contingency fee attorneys has heated up considerably within the past several years, due in large measure to the changing nature of the lawsuits being filed by such attorneys. In years past, suits consisted primarily of efforts to recoup damages suffered by a State or its citizens—*e.g.*, the cost of cleaning up an environmental spill, or the recovery of public funds improperly paid to a health care provider. Such suits often are uncontroversial; if a State is damaged due to another's wrongdoing, one can reasonably expect the State to sue to recover its damages, and retaining private attorneys on a contingency fee basis is sometimes the only means by which a State can obtain the resources necessary to file suit. Moreover, when the monetary recovery being sought is limited to the damages actually incurred, any threat to the neutrality principle created by use of contingency fee counsel is diminished because counsel will have only limited ability to inflate the requested recovery as a means of inflating his potential fee.

Recent contingency fee suits filed by state attorneys general have focused on punishing alleged corporate wrongdoing, especially in the health care field.

Recent contingency fee suits filed by state attorneys general, however, have focused to a far greater degree on punishing alleged corporate wrongdoing than on recovering damages incurred. That trend has been particularly pronounced in the health care field. State attorneys general have sued virtually every major pharmaceutical manufacturer under a variety of consumer protection statutes, alleging that the manufacturers have made fraudulent claims regarding their drugs. The

[10] *See* Steve Barnes, National Briefing, ''Southwest—Texas: Prison for Ex-Official,'' *New York Times* (Nov. 1, 2003).

suits generally allege that the manufacturers should be subject to civil penalties for each of the thousands of steps taken within the State to market their drugs. As a result, manufacturers find themselves subject to multibillion-dollar claims in suits in which no evidence of actual damages is presented. Such civil suits, whose principal purpose is to punish the defendant for alleged wrongdoing, can accurately be described as quasi-criminal in nature. For the same reasons that contingency fee contracts are deemed unethical in criminal cases, there is strong reason to question the propriety of such contracts in quasi-criminal cases in which there is virtually no upper bound on claims for damages.

The phenomenon is well illustrated by lawsuits filed by numerous States against Johnson & Johnson and its Janssen Pharmaceutica subsidiary (collectively ''Janssen'') for allegedly fraudulent promotion of the antipsychotic drug Risperdal. In general, the complaints allege that Janssen improperly promoted Risperdal for uses not approved by the Food and Drug Administration and falsely downplayed risks associated with the drug, particularly the risk of diabetes. Janssen has consistently asserted that every statement it made regarding Risperdal was truthful and is protected by the First Amendment. It won dismissal of Risperdal-related lawsuits filed by attorneys general in Pennsylvania and West Virginia.[11] State trial courts in Arkansas, Louisiana, and South Carolina, on the other hand, entered judgments totaling nearly $2 billion against Janssen in cases asserting violations of consumer protection laws—even though the States' contingency fee attorneys introduced no evidence in any of the three cases that anyone was actually injured by Janssen's allegedly fraudulent conduct.[12] All three judgments are on appeal.

On August 31, 2012, Janssen settled claims asserted by 36 other States regarding its drug marketing practices. Without admitting any wrongdoing, Janssen agreed to pay $181 million to settle all claims related to Risperdal and Invega (another drug it was alleged to have promoted improperly)—an average payment of $5 million per State.[13]

It is beyond the scope of this article to discuss the merits of Risperdal claims being asserted by States. The dismissal of those claims by courts in Pennsylvania and West Virginia nonetheless suggests that Janssen possesses substantial defenses to claims that its marketing of Risperdal defrauded consumers. Moreover, the willingness of attorneys general in 36 other States (many of whom are not represented by contingency fee counsel) to settle Risperdal claims for $5 million per State suggests a rough consensus regarding the appropriate level of sanctions to be imposed on Janssen for allegedly fraudulent statements not shown to have inflicted injury. In light of that consensus, there is at least some reason to suspect that the massive damage awards being pursued against Janssen by contingency fee attorneys representing Arkansas, Louisiana, and South Carolina are in excess of the amount warranted by the pursuit of ''justice,'' a goal that state attorneys general are ethically required to pursue.

In each of the three lawsuits, contingency fee attorneys representing the State are entitled to receive a percentage of whatever funds are ultimately recovered from Janssen. That contractual entitlement provides counsel with a strong financial incentive to seek to maximize requested penalties—without regard to whether the penalties being sought (amounting to hundreds of millions of dollars) represent a just result.

New Challenges to Contingency Fees

Several pharmaceutical companies have responded to such quasi-criminal lawsuits by filing lawsuits of their own against the state attorney general's decision to retain private counsel on a contingency fee basis. Most prominently, GlaxoSmithKline has sued Louisiana in response to a lawsuit asserting improper marketing of Avandia (a drug approved by FDA for treatment of Type 2 diabetes);[14] Merck has sued Kentucky in response to a lawsuit asserting improper marketing of Vioxx (a nonsteroidal anti-inflammatory drug that was withdrawn from the U.S. market in 2004);[15] and AstraZeneca has sued South Carolina in response to a lawsuit asserting improper marketing of Seroquel (a drug approved by FDA for treatment of serious mental health conditions).[16]

Among the three plaintiffs, GlaxoSmithKline has perhaps the best chance of success in light of the Louisiana Supreme Court's 1997 *Meredith* decision that adopted severe restrictions on the power of the Louisiana Attorney General to hire contingency fee attorneys. Glaxo's lawsuit points out that the Louisiana legislature has adopted statutes imposing strict requirements on any effort by the Attorney General to retain private counsel and alleges that the Attorney General did not comply with those requirements in retaining the private lawyers who filed the Avandia lawsuit.

All three lawsuits rely heavily on the neutrality principle and the quasi-criminal nature of the claims being asserted. The suits allege that the financial incentives offered to the contingency fee attorneys create a conflict of interest for the attorneys that is unacceptable in civil cases asserting quasi-criminal claims. The suits al-

[11] *Commonwealth of Pennsylvania v. Ortho-McNeil-Janssen Pharmaceuticals, Inc.*, ___ A.3d ___, 2012 WL 3030512 (Pa. Comm. 2012); *State of West Virginia v. Johnson & Johnson*, 266 W.Va. 677 (2010). In both cases, the States were represented by private attorneys retained on a contingency fee basis.

[12] *State of Arkansas v. Ortho-McNeil-Janssen Pharmaceuticals, Inc.*, No. CV 2007-15345 (Circuit Court of Pulaski County, Arkansas, 2012)(judgment against defendants for $1.19 billion, based on 240,000 violations of Medicaid fraud law); *Caldwell ex rel. State of Louisiana v. Janssen Pharmaceutical, Inc.*, No. 11-1184, 2012 WL 3761900 (La. App. 2012) (affirming judgment against defendants for $258 million, plus $70 million in fees); *State of South Carolina ex rel. Wilson v. Ortho-McNeil-Janssen Pharmaceuticals, Inc.*, No. 07-CP42-1438 (S.C. Court of Common Pleas, 2012) (judgment against defendants for $327 million, based on 553,000 violations of South Carolina Unfair Trade Practices Act).

[13] On August 2, 2012, Johnson & Johnson announced that it had also agreed ''in principle'' to settle (for an unspecified amount) claims by the federal government regarding allegedly improper promotion of Risperdal and several other drugs. The federal claims are materially different from state claims arising under consumer protection laws, however. The latter focus on claims that a pharmaceutical manufacturer has defrauded consumers by making false claims. In contrast, the federal government generally focuses on whether a manufacturer is marketing drugs for a use not approved by FDA; federal law generally prohibits such marketing even when the speech at issue is completely truthful.

[14] *GlaxoSmithKline LLC v. Caldwell ex rel. State of Louisiana*, No. 612562 (La., 19th Judicial District Court).

[15] *Merck Sharp & Dohme Corp. v. Conway*, No. 11-51 (E.D. Ky.).

[16] *AstraZeneca Pharmaceuticals, LP v. Wilson*, No. 2011-CP-42-1213 (S.C. Court of Common Pleas, 7th Circuit).

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lege that the conflict of interest renders unethical their continued representation of the States and deprives the pharmaceutical companies of their due process rights under the federal and state constitutions. Those claims are receiving serious consideration; trial courts have denied motions to dismiss filed by Kentucky and South Carolina.[17]

The ethical propriety of using contingency fee agreements for the purpose of retaining private attorneys in state cases seeking quasi-criminal penalties remains a largely open issue. The rules are clear at either extreme: contingency fee agreements are never permitted in criminal cases, while they are generally permissible in run-of-the-mill civil cases—provided that the attorney general retains ultimate litigating authority and closely monitors the work of outside counsel. But as explained by the seminal decision of *People ex rel. Clancy v. Superior Court*,[18] the answer to the question becomes murky when a civil suit is designed to punish the defendant, not to recover actual losses, and the potential damage claims are large. As the number of such quasi-criminal state lawsuits increases and defendants display an increasing willingness to challenge the retention of contingency fee attorneys in those cases, courts are likely to provide a clearer answer to that question in the years ahead.

[17] Ed Silverman, ''Merck Can Sue State for Outsourcing Vioxx Lawsuits,'' *Pharmalot.com* (April 9, 2012) (available at http://www.pharmalot.com/2012/04/merck-can-sue-state-for-outsourcing-vioxx-lawsuits/); Ed Silverman, ''AstraZeneca Can Sue South Carolina: Judge,'' *Pharmalot.com* (Jan. 5, 2012) (available at http://www.pharmalot.com/2012/01/astrazeneca-can-sue-south-carolina-judge).

[18] 39 Cal.3d 740 (1985)