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# TAKE THE MONEY AND RUN: INHERENT ETHICAL PROBLEMS OF THE CONTINGENCY FEE AND LOSER PAYS SYSTEMS

PHILIP J. HAVERS\*

On December 11, 1998, dozens of lawyers who represented the first states to settle with the tobacco industry over health care costs were awarded \$8.2 billion in legal fees, the richest legal payday in the nation's history.<sup>1</sup> The payout is the result of a \$34.4 billion settlement reached by lawyers who represented Florida, Mississippi and Texas and "is the first to result from a series of tobacco cases that culminated last month in a \$206 billion settlement between tobacco companies and 46 states and five United States territories."<sup>2</sup> A more extensive settlement which did not include those three states will probably produce billions more for plaintiffs' lawyers.<sup>3</sup> Although the arbitration panel awarding the \$8.2 billion in legal fees<sup>4</sup> awarded far less than the lawyers had claimed, the panel "gave the lawyers credit for taking the risks of being first to test the legal strategy of suing the tobacco industry to recover Medicaid costs related to smoking."<sup>5</sup>

In the months prior to the awarding of these legal fees, a public debate was sparked as to the proper amount which should be awarded to the attorneys. On one side are those who believe that billions of dollars, being such a huge sum, is an unjustifiable amount to pay any attorney regardless of the amount of the settlement: when calculated, the hourly amounts equal thousands of dollars per hour. On the other side of the debate are those who agree with the arbitration panel that the lawyers should be rewarded for taking on such an uncertain and complex case

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1. See Barry Meier, *Lawyers in Tobacco Case Will Receive \$8.2 Billion*, N.Y. TIMES, Dec. 12, 1998, at A1.

2. *Id.*

3. See *id.* For more on this settlement, see Eric Fettmann, *The War on Big Tobacco: It Was Money All Along*, N.Y. POST, Jan. 17, 1999, at 59; Meier, *supra* note 1; Mark Silva, *State's Tobacco-Suit's Lawyers Awarded More than \$3.4 Billion in Fees*, MIAMI HERALD, Dec. 12, 1998, at 1A.

4. See Meier, *supra* note 1. Originally, five of the attorneys had sought \$25 billion for negotiating the states' \$17 billion dollar settlement.

5. *Id.*

which required hours of time and a high level of expertise and skill. Noting the amount of time required as well as the fact that cases brought against the tobacco companies in the past had almost always failed, these supporters claim such a high level of return for the attorneys was justified, regardless of the amount of the hourly rate.

Such views over the tobacco litigation have rekindled the debate about whether the legal system should revise its legal fees; the current contingency fee system, many claim, is unworkable and subject to abuse, frivolous lawsuits, and unjustifiably high payouts to attorneys. This debate over legal fees, however, is not new. "In pre-revolutionary times, the young British colonies actually followed the English Rule of loser pays."<sup>6</sup> However, unlike the pure English version, the authorities strictly regulated the maximum amount of legal fees an attorney could charge.<sup>7</sup> After the American Revolution, opposition to government regulation resulted in a variety of individual states repealing the caps on attorneys' fees.<sup>8</sup> As the nineteenth century ended, most courts followed this latter view and denied attorneys' fees in awards for damages.<sup>9</sup>

At the turn of the century, each side was required to pay its own attorneys' fees.<sup>10</sup> However, this hourly billing method was seen by many as a mechanism by which the rich were able to file suits and seek redress in the court system, while the poor and middle classes were not as they simply could not afford to file the suits. This became increasingly evident as the price of legal fees rose to the point where many of the middle class were feeling the economic restraints on legal representation previously felt only by the poor. As a result, a system of contingency fee billing began to be used.<sup>11</sup> Under this system, the client was only billed, usually at a higher rate than under the hourly system, if the client won the case. The client then paid the attorney a percentage of the recovered judgment. This system is currently used, not only in risky litigation where it developed originally, but also in low

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6. Charles W. Branham III, *It Couldn't Happen Here: The English Rule—But Not In South Carolina*, 49 S.C. L. REV. 971, 975 (1998).

7. *See id.* *See also* Susanne Di Pietro & Teresa W. Carns, *Alaska's English Rule: Attorney's Fee Shifting in Civil Cases*, 13 ALASKA L. REV. 33, 37 (1996) (noting that colonial statutes regulated recoverable fees from a defeated adversary and from the attorney's client).

8. *See* Branham, *supra* note 6, at 975.

9. *See id.*; *see also* Di Pietro & Carns, *supra* note 7, at 37.

10. *See* Branham, *supra* note 6, at 975.

11. *See generally* Stevens v. Sheriff, 90 P. 799 (Kan. 1907); Miles v. Cheyenne, 148 N.W. 959 (Neb. 1914).

risk litigation cases and is beginning to be seen in transactional law.

A number of ethical questions have plagued the contingency fee system since its inception: Does such a system create the incentives to file frivolous lawsuits? Does the system change the fiduciary relationship between attorney and client? Is the contingency fee appropriate for cases involving no or little risk? Is the contingency fee based on a relatively large percentage of the final judgment appropriate in the context of the modern mega-judgments such as the ongoing Tobacco litigation? Moreover, if these latter two questions are answered in the negative, is it appropriate for the courts to interfere with the relationship between the attorney and client *vis a vis* the setting of legal fees? If the client is fully knowledgeable of the agreement's consequences, should the effects of the agreement felt by client even be an issue for the courts to address?

In contrast to the American contingency fee system is the English "Loser Pays system."<sup>12</sup> Under this system, the loser of a suit pays all of the legal costs for both sides, although typically, the loser's attorney will not actually insist on collecting his or her own fee.<sup>13</sup> Consequently, this makes litigation extremely risky and expensive. As a result, those with less money run the greater risk in any suit and, consequently, many do not see the legal system as a viable means of redress, given the risk of losing and its consequences.

This paper will examine the ethical challenges faced by two competing systems of billing clients: the American contingency fee system and the English rule, "Loser Pays" system. I will examine the advantages and disadvantages to each system and balance these factors to determine if one is preferable to the other. Finally, I will propose a new system which accounts for the ethical problems faced by both systems.

This article is not concerned with blatantly frivolous suits which are already dismissed for failure to state a claim.<sup>14</sup> The suits dismissed under Rule 12(b)(6) fall under two categories: those with valid claims, but with some procedural discrepancy which prevents the case from being heard, and those cases which on their face are meritless. This second type of lawsuit is relatively rare and because these suits are dismissed, their frivolous

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12. See HERBERT KRITZER, *THE ENGLISH EXPERIENCE WITH THE ENGLISH RULE: HOW "LOSER PAYS" WORKS, WHAT DIFFERENCE IT MAKES, AND WHAT MIGHT HAPPEN HERE* (1992).

13. See *id.* at 3.

14. See FED. R. CIV. P. 12(b)(6).

nature is already being properly addressed. However, these cases are relatively rare as the courts are loathe to dismiss a case out of hand without going through discovery. Because this bar for dismissal is so high at this point in the proceedings, many cases which, after discovery, turn out to be frivolous, clear this hurdle. These frivolous cases, having some small grounding in fact which allows them to proceed, are the cases that most concern the fee reformers. These cases are precisely those that some attorneys use to force settlement in order to obtain the high fees associated with the contingency system. Under the contingency fee system, a frivolous case may be settled by the institutional defendant simply because of the other costs involved. Such costs include negative publicity; insurance companies balking at covering companies which are high risks for litigation; and the desire to simply put the hassle of a suit behind them. Consequently, any viable fee system must address and discourage these types of lawsuits before they even get to the settlement stage.

### I. CONTINGENCY FEES

The contingency fee system was created to ensure that those with valid claims, but who were unable to pay the costs associated with filing and litigating those claims, have access to counsel and the courts.<sup>15</sup> Typically, these contingency suits involved an individual plaintiff and an institutional defendant; the theory being that the individual plaintiff, when faced with a formidable opponent who is used to dealing with suits, would otherwise be left without recourse because he or she is first bankrupted before the suit reaches a conclusion. Moreover, under a normal hourly fee system, the plaintiff was typically liable for his own attorney's fees, regardless of the outcome of the suit. Consequently, the risk of losing often prevented those from filing claims which are meritorious, but not guaranteed winners. Under the contingency fee system, the losing plaintiff is no longer required to pay the attorney a fee, thus making the filing of a suit much more palatable. However, because of the very real risk of not being paid in the event that the plaintiff lost, should the plaintiff win, his attorney is entitled to a larger percentage of the judgment (usually one-third for pretrial settlement, forty percent if it goes to trial and

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15. See MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 2-20 5-7 (1980). See also LESTER BRICKMAN ET AL., *RETHINKING CONTINGENCY FEES* 13 (1994) (noting that contingency fees ensure that many accident victims can have access to the courts which they would otherwise be unable to afford).

up to fifty percent if appeals are required)<sup>16</sup> than he would be under a normal hourly fee system.

### *The Ethics of the Contingency Fee System*

Human nature being what it is and, contrary to popular opinion, lawyers being humans, when opportunity rears its head in the form of large financial gains, many lawyers will abandon their principles of professionalism and seek out those gains, often at the expense of their client's interests. Although lawyers claim to believe that the law is a profession unlike any other, with an imbedded sense of ethics and values and that lawyers must always promote justice over our individual client's needs,<sup>17</sup> the structure of the system is far removed from this ideal. This is most fundamentally seen in the contingency fee system. Because the system gives the attorney a personal stake in the outcome of the case, the attorney is faced with some very difficult decisions: he may either hold true to his ideals of law as a profession which promotes justice or act as if it is simply a job like any other from which to derive income. Unfortunately, the contingency fee system fosters the latter view. Individual attorneys or firms cannot afford to take on cases to promote "justice" when a truly just outcome may be adverse not only to their client, but to themselves. Moreover, because the costs of litigation, borne by the attorney until he recovers the contingency fee, are so high, such an adverse outcome is intolerable and possibly ruinous.<sup>18</sup>

Because of this large personal financial stake, the attorney can no longer look upon his practice of law as one devoted primarily to justice. Besides calling into question this basis of our professional rules that he is now more likely to ignore or, at the least, will play with at the margins, the negative aspects of the contingency system work their way into the sacred relationship between the attorney and client. In making the attorney's fees dependent on winning the case, the system has given the lawyer a strong financial interest in the claim and, as such, the attorney has become almost a separate party in the litigation with his own interests and motivations.<sup>19</sup> As the lawyer invests more time and money, his personal stake in the outcome of the case increases<sup>20</sup>

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16. See BRICKMAN ET AL., *supra* note 15, at 13.

17. See EARL WOOD, FEE CONTRACTS FOR LAWYERS 12 (1936).

18. For an example of the financial risks run by attorneys in contingency fee cases, see JONATHAN HARR, A CIVIL ACTION (1995).

19. See THOMAS L. SHAFFER, AMERICAN LEGAL ETHICS 228 (1985).

20. See FREDERICK BENJAMIN MACKINNON, CONTINGENT FEES FOR LEGAL SERVICES 196 (1964).

and the more the lawyer's incentives begin to change.<sup>21</sup> Rather than seeking a just settlement for the client which adequately compensates the client for his injuries, the attorney must also account for the increasing costs and effort expended as the suit goes forward. Consequently, if the defendant is willing to settle early in the process, the plaintiff's attorney may be more willing to settle for a lower amount as he has not expended as much time, energy and expertise as he would subsequently. However, should the defendant only attempt settlement later in the process, the plaintiff's attorney is less likely to accept the amount offered even if it may have been adequate earlier. Although the client is supposed to make the decisions whether to settle and for how much, the reality is that it is usually the attorney who decides such issues.<sup>22</sup> An argument can be made that such control is beneficial to the client as the attorney is more likely to push for higher settlement offers, which, in turn, increases the client's net amount recovered. However, this tactic can backfire, leading the defendant to refuse negotiations and to insist on the case going to trial where the plaintiff runs the substantial risk of losing or of getting a lower amount than that offered.

Additionally, the contingency fee system often negatively affects the attorney-client relationship as the plaintiff/client often ends up receiving a smaller percentage than he originally anticipated. Because contingency fee agreements are often complicated, involving fee structures based on the various stages of the proceedings<sup>23</sup> and separating costs from fees, the client is often not fully aware of the effects of the contingency fee agreement on his judgment. In many cases, the attorney receives not only one-third of the damages, but also a substantial amount for legal costs.<sup>24</sup> The net effect of this combined amount for the attorney is that the plaintiff receives only about fifty-percent of the total damages recovered; an amount not properly understood by most plaintiffs when entering into the agreement with the attorney. Although technically attorneys are supposed to disclose this information and ensure that their clients understand the ramifications of these agreements, historically such a rule has been difficult to enforce.

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21. See SHAFFER, *supra* note 19, at 228.

22. See *id.*

23. See BRICKMAN ET AL., *supra* note 15, at 13; JOHN STREBY, LET'S TALK MONEY 46 (1987) (describing contingency fee agreements as well as more complex, but just as common, hybrid agreements combining hourly and contingency fees); WOOD, *supra* note 17, 304-12.

24. See WOOD, *supra* note 17, at 173. See also Edward Rosenthal, *Fee Cap May Not Deter Malpractice Suits*, WALL ST. J., Oct. 12, 1993, at B1.

This consequently destroys the attorney-client relationship between individual attorneys and clients, in addition to breeding a level of general distrust for the profession as a whole. Such a result is disastrous for the legal profession since our very livelihood depends on a solid reputation and the need for complete candor between attorney and client. If the client feels they cannot trust the attorney, either from bad experiences with other attorneys or because they understand the personal stake the attorney has in the fee system and consequently is wary of the attorney's motives when he proposes a certain cause of action or settlement, the entire system collapses.

Related to the issue of changing the profession from one concerned with justice to one used purely to gain financially, is the problem that the contingency fee system has bred a particular type of attorney and a particular type of client who now view the contingency system as a mechanism for high, relatively easy returns. Plaintiffs, "who would not think of entering on a lawsuit, if they knew they must compensate their lawyer whether they win or lose, are ready upon a contingency agreement to try their chances with any kind of claims. It makes the law more of a lottery than it is."<sup>25</sup> Additionally, because of the thirty-percent or more obtainable through the contingency fee system, these attorneys file frivolous lawsuits in the hopes of obtaining an early settlement.

Although the courts and A.B.A.<sup>26</sup> have attempted to curb these lawsuits through Rule 11<sup>27</sup> sanctions and by forcing the losing side in these frivolous cases to pay the innocent party's court costs,<sup>28</sup> many defendants find it more cost effective for them to settle the case rather than seek dismissal or litigate the merits. Just as with a growing mistrust between lawyer and client, this is also encouraging a growing mistrust between lawyers. No longer are lawyers in a suit viewed with professional respect as opponents seeking a just end to the case. Instead, lawyers in many contingency cases often end up personally disliking the other side. Moreover, in the profession generally, an animosity has

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25. SHAFFER, *supra* note 19, at 228.

26. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 3.1 (1995).

27. FED. R. CIV. P. 11. For further discussion of Rule 11, see Cooter & Gell v. Hartmarx Corp., 496 U.S. 384, 393 (1990) (noting that Rule 11's "central purpose is to deter baseless filings"); A. Mitchell Polinsky & Daniel L. Rubinfeld, *Sanctioning Frivolous Suits: An Economic Analysis*, 82 GEO. L.J. 397 (1993); William W. Shwarzer, *Rule 11 Revisited*, 101 HARV. L. REV. 1013 (1988).

28. See 28 U.S.C. § 1927 (1988). See also, e.g., Roadway Express, Inc. v. Piper, 447 U.S. 752 (1980); Hall v. Cole, 412 U.S. 1 (1973). Both cases hold that if a party engages in bad faith litigation, the bad faith exception entitles the opposing party to an award of attorney's fees from the abusing party.



grown up where typically corporate defense attorneys have very little respect for the contingency plaintiffs' lawyers as they view them as money-grubbing sharks,<sup>29</sup> and the plaintiffs lawyers view corporate defense attorneys as mere extensions of the defendant corporate machine. Consequently, the discovery process has grown increasingly hostile and complex with both sides never completely trusting the other to divulge all of the required documents.

In addition to these interactive problems, we are increasingly seeing high contingency rates for cases where the outcome is not really in any doubt<sup>30</sup> or where the amount paid to the attorney is obscenely high for the amount of work actually done.<sup>31</sup> This is due, in part, to the increase of class actions in recent years.<sup>32</sup> Although fees in class actions are fixed by the courts,<sup>33</sup> the success and high profiles of class actions in recent years have encouraged other types of complex cases with multiple plaintiffs, but which are not technically class actions and thus not subject to the rates set by the courts.

For example, the courts have recently been swamped with asbestos litigation, each case involving multiple plaintiffs and defendants.<sup>34</sup> Although these types of suits involve a level of expertise not required in many non-complex suits and could justify a higher payout than the average tort suit, the incredibly high payouts to the lawyers are hard to justify. Part of this problem

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29. In interviews with several partners at top Chicago firms specializing in defending corporations, these attorneys recognized that some suits were meritorious, but claimed that many were filed solely to line the pockets of the plaintiffs' lawyers.

30. See BRICKMAN ET AL., *supra* note 15, at 21 (citing two mass disaster cases in which top litigators concluded that there was no way the plaintiffs could not recover; these were clear cases of innocent plaintiffs and liability on the part of the defendants).

31. See Meier, *supra* note 1. See also BRICKMAN ET AL., *supra* note 15, at 55 n.24 (noting a case in Texas which resulted in a \$122 million partial settlement and yielded the attorneys over \$40 million in legal fees despite the fact that most attorneys did not participate in the settlement negotiations and very little trial preparatory work had begun because of the high likelihood of settlement. The hourly rate of these attorneys was roughly estimated at \$25,000-\$30,000 per hour).

32. For an in depth look at class actions, see JAY TIDMARSH & ROGER H. TRANSGRUD, *COMPLEX LITIGATION AND THE ADVERSARY SYSTEM* 530-701 (1998).

33. BRICKMAN ET AL., *supra* note 15, at 13.

34. See, e.g., *Malcolm v. Nat'l Gypsum Co.*, 995 F.2d 346 (2d. Cir. 1993). In this case, 600 separate cases were consolidated into one action, with each plaintiff naming between fourteen and forty-two defendants. The jury award was over \$94 million. Although the suit was eventually remanded for improper consolidation, had it stood, the plaintiffs' lawyers would have collected over \$30 million in legal fees.

stems from the fact that contingency fees are based on a percent scale rather than an absolute dollar amount. Consequently, if one looks at the typical agreement which states that the attorney is entitled to the thirty percent if they win, this does not seem excessive. However, once the actual dollar figures are examined in the multimillion, or now, multibillion, dollar judgments in complex cases, such a fee appears obscene relative to the amount of work done.

Some have argued that the legal system is a market just like any other and, consequently, these multi-million dollar payouts to attorneys are merely reflections of the legal market. If the defendants honestly do not want to pay such fees, they should not settle the cases for such high amounts, nor should the plaintiffs agree to give the attorneys such a high percent of the potential award. Moreover, as these increasingly complex cases come to the fore, the lawyers are able to demand such high returns because of the uncertainty of litigating such issues as tobacco or asbestos, where for years, such cases were losers. In exchange for promising the attorney such a large cut of the final pie, the client receives the lawyer's expertise, time, and energy to litigate a risky and complex case.

The problem with this "law as a market" argument is that it completely destroys the long held belief of the ethical nature of the legal profession;<sup>35</sup> it places the legal profession in the same category as auto manufacturers, food producers, and the cigarette industry—all of which are governed solely by market and governmental pressures and which have no identifiable inherent ethical standards of their own.

In response to the growing concerns, the A.B.A. and court systems have revised their policies in order to regulate the rates. As Professor Brickman noted:

Section 2-106(A) of the Model Code of Professional Responsibility which barred 'clearly excessive fees', was superseded by Rule 1.5(a) of the Model Rules of Professional Conduct. Rule 1.59(a)'s bar against 'unreasonable' fees was expressly designed by the drafters of the Model Rules to eliminate the term 'clearly excessive' and thereby prohibit . . . unreasonable as well as patently unconscionable fees.<sup>36</sup>

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35. For an in depth debate on the inherently ethical nature of the legal profession and the need to be independent from the pressures of the outside, market-driven world, see SHAFFER, *supra* note 19, at 167-239.

36. BRICKMAN ET AL., *supra* note 15, at 15.

Moreover, the Model Rules, Ethical Consideration 5-7 notes that: "Because the lawyer is in a better position to evaluate a cause of action, [the lawyer] should enter the contingent fee arrangement only in those instances where the arrangement will be beneficial to the client."<sup>37</sup>

Using these rules, the courts have attempted to regulate excessive contingency fees. However, such judicial discretion is limited almost entirely to cases which actually reach the trial stage; for the vast majority of cases which settle, the courts have very little power to reduce the fees paid to the attorneys unless the defendant raises the issue, which is very rare as this concern is often dealt with by the plaintiff attorney in settlement negotiations. This is due primarily because settlement is considered a two party contract, with which the courts should not interfere. Consequently, when the courts have attempted to regulate the fees in settlements, the regulated party simply pulls out of the negotiations until such time as the opposing party capitulates and withdraws its request for judicial interference.<sup>38</sup> Again, this brings up problems of the attorney's fiduciary duties to his client as the attorney is now using his own interests as bargaining tools to an otherwise acceptable offer.

An even more compelling weakness of the contingency fee system is seen when attorneys begin calculating their fees by what they will recover relative to the amount of work they put into a given case. In addition to protracting the settlement process to force high settlements which, in turn, allow for high contingency fees, attorneys also have the option of seeking a quick settlement in order to avoid expending the effort that a protracted trial or heavily negotiated settlement requires. Consequently, the attorney may receive what equates to an extremely high hourly wage at the expense of his client's right to a higher recovery.<sup>39</sup>

To take a simple example which illustrates this point, if the attorney puts in 100 hours of work and receives one-third of a \$200,000 settlement, he has, effectively earned \$800 an hour for his services, but if the attorney had negotiated harder or taken the case to trial where the payout was \$360,000, but he worked 400 hours in preparing the case for trial, his return would only

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37. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-7 (1995). Although Ethical Considerations are not mandatory, this Consideration in particular is indicative of the court's power to review contingency fees for abuse.

38. The exception to this is, of course, when an independent arbitrator sets the fees as in the case of the Tobacco litigation, but even here, the attorneys would probably not agree to the arbitration without first calculating their chances at a high recovery and high level of fees awarded.

39. See MACKINNON, *supra* note 20, at 198.

be \$300 per hour. Even accounting for a graduated increase in the attorney's rate of return to fifty percent should the case go to trial, the attorney's hourly rate is equal to \$450 per hour, a significant difference from the \$800 an hour had he settled early. Moreover, this does not account for additional business which the attorney could have taken on as a result of not having to spend the long hours on this one particular case. It is apparent from both situations—that of the attorney using his fee as a heavy handed negotiating tool and, alternatively, using the settlement process as a means of extracting exorbitant hourly fees under the guise of a contingency fee, that the system is ripe for abuse and that the system encourages the attorney to abandon his fiduciary obligations to his client in favor of higher returns.

Related to these issues is the problem that although the Model Rules and individual state bars have expressly forbidden the use of contingency fees in cases where there is little or no risk of nonpayment of fees,<sup>40</sup> the reality has become that the contingency fee is virtually the “exclusive method of compensating attorneys in personal injury cases.”<sup>41</sup> Despite the rules governing the types of cases which may employ contingency fees, it is incredibly difficult for the courts to actually police these cases.<sup>42</sup> Usually those cases which are not contested and, consequently the result is never in doubt, settle out of court, resulting in the inability of the courts to monitor the fee system, whereas those cases which actually do come before the court are usually those in which settlement has broken down and a credible claim to the uncertainty of the outcome can be made. Moreover, it is simply impractical for the courts to police every case for its fee structure.<sup>43</sup> Because of the general lack of enforcement of the rules governing billing as well as the higher payout the contingency fee provides, contingency fees have become the rule rather than the exception in tort litigation.

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40. See generally *Yermakov v. Fitzsimmons*, 718 F.2d 1465 (9th Cir. 1983); *Comm. on Prof'l Ethics & Conduct v. McCullough*, 468 N.W.2d 458 (Iowa 1990) (contingency fee upheld because of uncertainty of outcome of litigation); *Thibaut, Thibaut, Garrett & Bacot v. Smith & Loveless, Inc.*, 576 So.2d 532 (La. App. 1990); *Attorney Grievance Comm'n v. Kemp*, 496 A.2d 672, 678-79 (Md. 1985); *In re Hanna*, 362 S.E.2d 632 (S.C. 1987).

41. Janet A. Laufer, *Of Ethics and Economics: Contingent Fees for Legal Services*, 16 AKRON L. REV. 747, 747-48 (1983); see also BRICKMAN ET AL., *supra* note 15, at 18.

42. See BRICKMAN ET AL., *supra* note 15, at 19.

43. See *id.*

## II. THE ENGLISH RULE—LOSER PAYS

Given the aforementioned concerns regarding the contingency fee system, a movement started in the late 1980s to actively reform the American system and replace the contingency fee system with a system similar to that seen in England. The English Rule or "Loser Pays" is based on a simple premise—that the losing party in any lawsuit must pay the reasonable costs and legal fees of the opposing side.<sup>44</sup>

Although the political support in America for the English Rule has slipped away since being actively raised in the late 1980s, due in part to the departure of its most ardent supporter, Vice-President Quayle,<sup>45</sup> from public office, the movement has slowly regained ground to introduce the system to America. Such support has come from both public and private quarters.<sup>46</sup> Despite the congressional failure to approve a Loser Pays measure, private suits requesting reimbursement of fees and costs by the loser are increasing. Most recently, a Springfield, Virginia woman who had her brain-damaged husband's feeding tube removed after it sustained him for three and one-half years is seeking reimbursement for her legal costs and sanctions against the state for challenging her authority. The woman, Michele Finn, recently filed motions in Circuit Court over her legal costs and for sanctions against Gov. Jim Gilmore and other state officials to deter the government from abusing its authority for their own political agenda.<sup>47</sup> The matter is still in litigation. Although virtually unheard of twenty years ago, such suits for reimbursement of not only court costs, but attorney fees, are gaining momentum.

### *The Ethical Problems of the English Rule*

Despite its simple premise and the seemingly positive result of the suit's victor being vindicated and therefore not burdened with large fees and costs resulting from an action which they were either justified in bringing or of which they were unjustifiably accused, the reality of the English Rule is far more complex

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44. See Branham, *supra* note 6, at 973.

45. See KRITZER, *supra* note 12, at 1 n.1. Former Vice-President Quayle actively promoted litigation reform and supported a proposal to impose the Loser Pays system in Diversity cases filed in the federal court system. See PRESIDENT'S COUNCIL ON COMPETITIVENESS, AGENDA FOR CIVIL JUSTICE REFORM IN AMERICA (1991).

46. See THE REPUBLICAN PARTY, CONTRACT WITH AMERICA (1984).

47. *Refund Sought in Right to Die Case*, N.Y. TIMES, Nov. 12, 1998, at A1.

than merely having the loser pay the fees and costs of the winning side.

The initial ethical problem with the system is that it affects different classes of legal participants differently. Most tort defendants are institutional—either corporations or insurance companies<sup>48</sup> and are actually expected to pay the costs if they lose; they both have the assets and usually their budgets account for future emergencies. Moreover, insurance companies are designed to give payouts and budget accordingly.<sup>49</sup> “An individual or small business with limited means, whether a plaintiff or defendant, is likely to be more severely affected by the risk than a well-heeled opponent, especially one who is a repeat player (such as an insurance company) capable of spreading risk over a large number of cases.”<sup>50</sup> Additionally, the rule is virtually meaningless to the very rich or corporate *plaintiffs* as they can afford the risk of having to pay the opposing side in the event that they lost.<sup>51</sup> Likewise, it would not affect the very poor who qualify for what limited legal aid America provides; this class of people has few assets which could be seized to pay the opposing side in the event that they lost. Therefore the negative effects of the Loser Pays rule are limited to the middle and lower classes who do not qualify for legal aid.

In contrast to America, England has three primary mechanisms which make the Loser Pays system feasible.<sup>52</sup> First, England has a system of legal insurance which is nonexistent in America.<sup>53</sup> Litigation insurance permits those who are involved in lawsuits to mount strong cases without respect to costs. If they lose, the litigant pays a portion of the costs, but most are picked up by the insurance carrier. Consequently, this system protects individuals from the dangers of filing suits which, while meritorious, may not be guaranteed winners.<sup>54</sup> Because of the inherent

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48. KRITZER, *supra* note 12, at 3.

49. See Edward F. Sherman, *From “Loser Pays” to Modified Offer of Judgment Rules: Reconciling Incentives to Settle With Access to Justice*, 76 TEX. L. REV. 1863, 1882 (1998).

50. *Id.*

51. See Branham, *supra* note 6, at 975 (noting that because those rich enough to litigate, whether individuals or corporations, would have a lethal advantage in a Loser Pays system, the middle and lower classes are at a greater risk of exploitation).

52. Note, however, that even in England, “for the ordinary citizen unqualified for Legal Aid a lawsuit is quite out of the question.” Herbert M. Kritzer, *Legal Fees: The English Rule*, A.B.A. J., Nov. 1992, at 54, 55 (quoting PATRICK DEVLIN, *THE JUDGE* 69 (1979)).

53. See *id.* at 55.

54. See *id.*

risk of these types of suits, under the English rule and without litigation insurance which helps minimize the risks involved if one loses, these types of cases would never be filed. Although some may argue that this has the positive effect of reducing litigation, it is extremely important to note that while reduction of frivolous suits is desired, we do not want to discourage valid claims from being brought simply because of their costs; every person deserves their day in court.

Another mechanism widely unavailable in the United States, but which is common in England is that of legal aid.<sup>55</sup> Although America has such programs, their scope is limited to the extremely disadvantaged and is typically unavailable "for cases which could be handled through contingent fees, and those cases are the primary target for the loser pays rule."<sup>56</sup> Consequently, while twenty-eight percent of plaintiffs in England receive legal aid,<sup>57</sup> only those below the poverty line receive such assistance in the United States.

Finally, about twenty-nine percent of English plaintiffs in accident cases, including nonwork-related claims, receive legal financial assistance from their trade unions.<sup>58</sup> "Generally, unions provide both legal representation for their members and absorb litigation costs."<sup>59</sup> In contrast, American unions rarely get involved in litigation unless the claim is directly work related. As a result of these mechanisms in England, the Loser Pays system allows the average individual<sup>60</sup> to bring valid claims, while incurring only *some* of the risk of a suit (through insurance premiums, having to pay a percentage of the legal costs based on a scale of their earnings). As America has no such mitigating programs, the burden of losing falls squarely on the shoulders of the average individual, thereby making it virtually impossible, economically speaking, to file a case.

A large problem of the Loser Pays system is that it does not adequately address administrative issues. If the English system is imported to America, it is unclear whether the losing party should pay for those fees and costs incurred from litigating motions and pleadings which it won during the process despite

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55. See KRITZER, *supra* note 12, at 8.

56. *Id.*

57. See Kritzer, *supra* note 52, at 56.

58. *See id.*

59. *Id.*

60. However, even under this system, "about 40 percent of English plaintiffs are subject to the downside risk of the English Rule, according to a 1986 study conducted for the Lord Chancellor's Department, the management arm of the English judiciary." *Id.* at 55.

losing the final judgment. In England, although motions and pleadings exist, they are not nearly as extensive as in America and, consequently, the costs of these motions are not usually an issue. "English courts, and therefore parties, lump all costs together and look at them globally only at the end of the litigation."<sup>61</sup> In contrast, in America, the pretrial discovery process, with its various filings, is extremely costly and time consuming. Consequently, any Loser Pays system must adequately address not only the final judgment, but also the costs of these intermediate procedures. Although failure to make or cooperate in discovery is punishable by Rule 37 sanctions,<sup>62</sup> these cases are reserved for extreme cases of misconduct. The rule imposed by the Loser Pays system would inevitably lead to further litigation as to the adequacy of the motion; whether a motion which was filed was actually necessary, was indulgent or intended just to burden the opposing party with the motion's costs.<sup>63</sup>

Likewise, it is equally unclear as to what constitutes a reasonable amount to be paid to the other side. Although in England there is "a well-established set of norms as to what various aspects of legal representation should cost,"<sup>64</sup> American jurisprudence has given birth to a hugely varied level of fees. Issues such as whether or not a single, flat rate should be instituted as opposed to a variable rate based on the experience and skill of the attorney or on the nature of the case, its riskiness and complexity<sup>65</sup> are huge hurdles that must be overcome before any such system can be implemented.

This gives rise to another problem. In England, disputed fees are not handled by the courts. Instead, special taxing masters or registrars deal with fee disputes and make rulings on cost shifting.<sup>66</sup> Although these are roughly equivalent to magistrates

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61. John Heaps & Kathryn Taylor, *The Abuser Pays: The Control of Unwarranted Discovery*, 41 N.Y.L. SCH. L. REV. 615 (1997); see also LORD WOOLF, ACCESS TO JUSTICE: INTERIM REPORT TO THE LORD CHANCELLOR ON THE CIVIL JUSTICE SYSTEM IN ENGLAND AND WALES (1995).

62. FED. R. CIV. P. 37.

63. For example, certain discovery motions could be filed, which, while technically winners in the sense that they release discoverable information and therefore the opposing party must pay for the motion, are unnecessary as the requesting party already has the information. It is not a stretch to imagine, especially in complex litigation, lawyers using the discovery cost rule as a mechanism to burden the opposing party with multiple requests, motions, and pleadings, simply to increase costs upon the party.

64. KRITZER, *supra* note 12, at 2.

65. See *id.* at 14.

66. See Kritzer, *supra* note 52, at 58.



or court commissioners<sup>67</sup> in America, to argue that these commissioners or magistrates should handle these issues is unrealistic as many magistrates are finding themselves backlogged with their existing duties. Consequently, under such a system, either the courts must assume the new role of policing fee disputes between the parties or a new entity must be created, thereby further contributing to the backlog and bureaucracy already seen in the court system.

Just as in the contingency fee system, a fundamental question must be addressed as to whether it is even appropriate for courts to interfere with the rights of the two parties to negotiate for certain costs and fees. If the case goes to trial, an argument can be made that the courts have a strong public policy incentive to regulate fees *vis a vis* the opposing parties in order to halt the abuses currently seen, but if the case first settles, it is very difficult to argue that the courts have a role in the cost shifting negotiations which take place; if the courts attempt to curb frivolous suits by using, as one mechanism, the controls on costs and fees, this automatically reduces the leeway given to the parties to settle—they simply do not have the negotiating power which they currently have. On the other hand, if the courts do not play a role in the settlement process out of deference to the parties' freedom to negotiate, the entire rationale for having the English Rule crumbles as most frivolous lawsuits are filed based on calculations as to the chances of settlement before the courts even become involved.

Another fundamental issue is whether the Loser Pays system would have any effect on frivolous suits. If it would not, then it should not be adopted given the aforementioned concerns. If it would reduce the frivolous suits, then the question becomes whether the reduction of frivolous suits justifies the loss of legal recourse which is currently available to the middle and lower classes.

Although the Loser Pays system has found great support among those who wish to abolish frivolous suits and reduce the overall level of litigation,<sup>68</sup> it appears that the Loser Pays system is not a sound means to accomplish this goal in America. As Amy Farmer and Paul Pecorino noted:

The theoretical literature to date does not lend strong support to the use of the English rule as a means of reducing costs associated with nuisance suits. In the Katz (1990) model of nuisance suits, total litigation costs are invariant

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67. *See id.*

68. *See* PRESIDENT'S COUNCIL ON COMPETITIVENESS, *supra* note 45.

to the use of the English rule. His is a screening model in which the uninformed defendant makes a take-it-or-leave-it offer to an informed plaintiff. Ex ante, the defendant cannot distinguish plaintiffs who are legitimately injured from those who are filing nuisance suits. The defendant must trade off the cost of settling nuisance suits against the cost of taking legitimate cases to trial. In equilibrium, the defendant uses a mixed strategy under which plaintiffs receive a hard offer of zero with some probability.<sup>69</sup>

It is clear that the heart of the frivolous lawsuit is the settlement process. No attorney in his right mind would file a suit which he knows he would lose at trial if he did not believe he could first settle. Consequently any system which seeks to reduce these frivolous suits must necessarily address settlement issues and it is highly debatable whether the English Rule would have any such effect. "There has been much debate in the law and economics literature over the effect of fee shifting rules on settlement. Richard A. Posner and Steven Shavell have concluded that fee shifting of the English 'loser pays' type would decrease the likelihood of settlement."<sup>70</sup> Others, such as Keith Hylton, have found that "[t]he incentive to litigate rather than to settle a dispute is greater under the British than under the American rule."<sup>71</sup> From the wide range of theories regarding the effects of Loser Pays on the settlement process, such as Posner's view that it would reduce settlement to John Donohue's view that settlement rates would be largely unchanged,<sup>72</sup> perhaps the most that can

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69. Amy Farmer & Paul Pecorino, *A Reputation For Being a Nuisance: Frivolous Lawsuits and Fee Shifting in a Repeated Play Game*, 18 INT'L REV. L. & ECON. 147, 148 (1998). In this article, Farmer gives an in depth explanation of the Katz model.

70. Sherman, *supra* note 49, at 1869; *but see* John J. Donohue III, *Opting for the British Rule, or if Posner and Shavell Can't Remember the Coase Theorem, Who Will?*, 104 HARV. L. REV. 1093, 1099 (1991) (presenting a model showing that the settlement rate would be identical under the American and British rules and arguing that Posner and Shavell failed to consider the Coase theorem).

71. *See* Sherman, *supra* note 49, at 1869; *see also* Keith N. Hylton, *Fee Shifting and Predictability of Law*, 71 CHI-KENT L. REV. 427, 444-45 (1995). Consequently, those individuals or corporations which are more able to sustain a protracted trial and are therefore more likely to call the opponent's bluff, are typically not sued under the English Rule. However, Hylton's argument is weak in this regard as it appears that the same can be said for the current American system whereby those with more resources and who have a reputation for not settling are typically not subjected to frivolous suits as those attorneys know that their case would never survive a trial.

72. *See* John J. Donohue III, *The Effects of Fee Shifting on the Settlement Rate: Theoretical Observations on Costs, Conflicts, and Contingency Fees*, 54 LAW & CONTEMP. PROBS. 195, 222 (1991).

be said of the effects of Loser Pays on settlement is that the data is unclear. Consequently, it would be somewhat hasty to adopt such a radical revision of the fee system until more is known about the effects of it on settlement.

Moreover, there is no real need to even pursue that line of inquiry. If the Loser Pays system had some effect on frivolous suits as its proponents claim, it must also have an effect on meritorious suits for similar reasons. Just as with frivolous claims where the plaintiff would supposedly be discouraged from filing a suit due to the sanctions of having to pay the other side's costs and fees, the same threat is equally discouraging to potential plaintiffs seeking to file meritorious claims: most individuals are averse to paying an hourly fee of at least one hundred dollars to their own lawyer in the event they lost, (although in these losing situations, most lawyers would probably not collect), but to have to pay the opposing side's legal costs as well could be so damaging that the possibility, however small, of losing would be enough of a deterrent to filing an otherwise meritorious claim.

This fundamental problem with the Loser Pays system could possibly be overcome if the procedural safeguards seen in England are implemented here. If the system is implemented without an expansion of legal insurance, legal aid or union support, legal representation will become unavailable to most Americans due to the increased financial burdens on them. Although an argument can be made that the current system, with its low financial risks, fosters unnecessary litigation and a mentality of "I've been hurt, who can I sue,"<sup>73</sup> the alternative provided by the English Rule goes to the other extreme whereby individuals with a valid grievance have no recourse. Because our legal system was founded on the belief that every individual is entitled to his or her day in court,<sup>74</sup> such a system that prevents legal recourse solely because of low or even moderate economic means would be anathema. However, expanding legal aid and legal insurance as well as forcing the already overly bureaucratic unions into the world of individual suits would only complicate matters as the unions and insurance companies would want to participate in the proceedings to ensure proper management of the funds. The end result of this would be a potential loss of autonomy by the very plaintiffs we are seeking to protect as these third parties

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73. In the television show *Ally McBeal*, one exaggerated character's philosophy of life is, "If you don't like the way you've been treated, sue." Although a facetious show, it well represents an increasingly common attitude among some in our society who have come to view the legal system as a mechanism created solely to provide them with personal wealth from real or imaginary grievances.

74. See *Martin v. Wilks*, 490 U.S. 755, 761-62 (1989).

with a vested interest in the outcome of the case would want to dictate which attorneys are hired and would demand significant say in the trial and settlement strategies.

Besides the administrative and social differences between England and America which would make it difficult to institute the English Rule here, it does not even appear that the English Rule is working well in England.<sup>75</sup> Despite the institutional safeguards in England:

[T]he costs of litigation in England are now so high that [e]xcessive cost[s] deter people from making or defending claims. A number of businesses [say] that it is often cheaper to pay up, irrespective of the merits, than to defend an action. For individual litigants the unaffordable cost of litigation constitutes a denial of access to justice.<sup>76</sup>

Not only does such a system affect the defendant's desire to settle, but it has also created the strong incentive on the part of plaintiffs to take whatever settlement offer is made in order to avoid the risk of huge costs.<sup>77</sup> Consequently, a prospective litigant must calculate whether he can afford, either as plaintiff or defendant, to actively litigate a claim in the first place, rather than settling for the sum proposed by the other side. From the standpoint of viewing the legal process as a mechanism for justice rather than a financial transaction of offer and acceptance, such incentives cannot be palatable, no matter how much we want to encourage settlement.

Finally, under the Loser Pays Rule, the costs of litigation are now generally higher in Britain than anywhere else except, possibly, the state of California.<sup>78</sup> As one company noted, "the cost of defending UK litigation, paid by our professional indemnity insurers, now exceeds our annual budget for training and development."<sup>79</sup> All of these concerns have translated in a move by the current government to reform the system and significantly modify, if not abolish the Loser Pays Rule in England.

### III. POSSIBLE SOLUTIONS TO BALANCING FRIVOLOUS SUITS WITH MERITORIOUS CLAIMS

Despite general hostility in America to the Loser Pays system, the system exists in some states, albeit in a modified form. Alaska, for example, has a modified Loser Pays system in their

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75. See generally Heaps & Taylor, *supra* note 61.

76. *Id.* at 616.

77. See Kritzer, *supra* note 52, at 56.

78. See Heaps & Taylor, *supra* note 61, at 617.

79. *Id.* at n.7.

Rules of Civil Procedure, Rule 82.<sup>80</sup> This Rule shifts the costs and fees of the prevailing party to the losing party based on a set schedule determined by the amount of judgment and prejudgment interest and on whether or not the case went to trial.<sup>81</sup> The courts have some leeway in setting these fees based on eleven factors, but if the amount varies from the statutory schedule, the court is required to outline which factors caused the discrepancy.<sup>82</sup> These factors are:

- (A) the complexity of the litigation;
- (B) the length of trial;
- (C) the reasonableness of the attorneys' hourly rates and the number of hours expended;
- (D) the reasonableness of the number of attorneys used;
- (E) the attorneys' efforts to minimize fees;
- (F) the reasonableness of the claims and defenses pursued by each side;
- (G) vexatious or bad faith conduct;
- (H) the relationship between the amount of work performed and the significance of the matters at stake;
- (I) the extent to which a given fee award may be so onerous to the non-prevailing party that it would deter similarly situated litigants from the voluntary use of the courts;
- (J) the extent to which the fees incurred by the prevailing party suggest that they had been influenced by considerations apart from the case at bar, such as a desire to discourage claims by others against the prevailing party or its insurer; and
- (K) other equitable factors deemed relevant.<sup>83</sup>

Although the results of the system have been mixed, it is generally agreed that this system does not reduce frivolous claims.<sup>84</sup> Some claim that because the court has discretion in awarding fees based on the above factors, including the reasonableness of the claims and bad faith, it allows for greater management of these frivolous claims. Others, however, claim that although the judges technically have the freedom to limit fees, it is very difficult to prove bad faith as most lawyers would ensure during the settlement process that such claims will not be

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80. ALASKA R. CIV. P. 82.

81. *Id.* See also Branham, *supra* note 6, at 975.

82. See *supra* note 80.

83. *Id.*

84. See Branham, *supra* note 6, at 975; see also Di Pietro & Carns, *supra* note 7, at 43 (noting that in a survey of Alaskan lawyers, no consensus existed as to Rule 82's effectiveness or benefits).

brought by the opposing side. Even if the Alaska Rule does reduce frivolous suits, we are still forced to balance the decrease in frivolous suits with the basic concerns seen in the English Rule: just as under the English Rule, the increasing costs of litigation are making the Alaska Rule prohibitive for the average person to file a suit.<sup>85</sup>

Another permutation of the Loser Pays system is that proposed by Judge William Schwarzer. Under the Schwarzer plan, either party may propose a settlement.<sup>86</sup> If the offer is refused and the opposing side is unable to obtain a better judgment, the offeror would be entitled to recover its reasonable attorney's fees. While this proposal is supported by many in the legal community as it encourages early settlement, it faces two sharp criticisms. First, the plan fails to address those frivolous suits which are filed solely with the intention of inducing the opposing side to settle early. In these circumstances, Schwarzer's system is inapplicable because the plaintiff's attorney will accept the settlement offer rather than allow the frivolous case to go forward which could subject himself to possible sanctions for filing the frivolous suit. A second concern is that such a proposal encourages settlement so early that proper discovery has not been allowed. This is best exemplified by a proposal several years ago by the National Association of Securities Dealers which would have required an investor subject to arbitration to pay the court costs and fees—including attorneys fees—if the later arbitration award was less than the earlier settlement offer.<sup>87</sup> The primary concern with the proposal was that it encouraged settlement so early in the process that neither side had the benefit of discovery proceedings on which to make a rational decision on how to proceed.<sup>88</sup> Because the Schwarzer proposal is very similar to the NASD plan, this discovery issue must be addressed before it is implemented.

### *Rules 11 and 37*

Before analyzing how the current system should be overhauled given its current abuses, it is first necessary to examine the enforcement mechanisms already in place and to determine if, by approaching them in a different manner, an overhaul is even necessary. For example, Rule 11 already exists to deal with

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85. See Di Pietro & Carns, *supra* note 7, at 44.

86. See Stuart Taylor, Jr., *Attacking Legal Waste in Bill Clinton's Washington*, AM. LAW., May 1993, at 6-7.

87. See Michael Siconolfi, *NASD Withdraws 'Loser Pays' Arbitration Proposal*, WALL ST. J., July 6, 1994, at C1.

88. See *id.*

frivolous suits. However, the bar for what constitutes a Rule 11 violation is currently very high and the fee-shifting mechanism of the Rule is used only in limited circumstances.<sup>89</sup> Should this bar be lowered and the fee shifting mechanism be utilized more frequently, a complete overhaul may not be necessary.

Currently, Rule 11 requires an attorney to certify in his pleadings that to the best of his knowledge the suit or motion has not been presented for any improper purpose, is well grounded in fact, and is "warranted by existing law or a nonfrivolous argument for the extension, modification or reversal of existing law."<sup>90</sup> If the court determines that this Rule was violated, it may, either *sua sponte* or upon a motion, impose on the offending party a sanction which may "include an order to pay the other party or parties the amount of the expenses incurred as a result of the violation, including reasonable attorney's fees."<sup>91</sup> However, such fee-shifting is seen as the exception rather than the rule and is only used in cases requiring an effective deterrent.<sup>92</sup>

The Rule purports to establish an objective standard, "intended to eliminate any empty-head pure-heart justification for patently frivolous arguments."<sup>93</sup> However, in establishing this objective standard, the Rule must necessarily allow for arguments for a change in law and new theories of law. Consequently, despite the Rule's modified language to include a "good faith clause,"<sup>94</sup> courts simply "cannot know how likely the plaintiff thought its suit was to succeed at trial."<sup>95</sup> As a result, the Rule's value for deterrence is minimal except in the most egregious cases; Rule 11's current good faith standard leaves open the issue of what constitutes a frivolous case. If Rule 11 is to be applied more rigorously, the burden of proving bad faith must necessarily be lessened.

Reducing the burden of proving bad faith, however, would not be beneficial to our legal system. Under the current system, if good faith is shown, the inclination is to avoid fee shifting in order to protect everyone's right to a day in court and to protect

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89. FED. R. CIV. P. 11.

90. LUCIAN AYE BEBCHUCK & HOWARD F. CHANG, *An Analysis of Fee-Shifting Based on the Margin of Victory: On Frivolous Suits, Meritorious Suits, and the Role of Rule 11* (National Bureau of Economic Research, Inc. ed., 1994); *see also id.* at n.9 (noting recent amendments to Rule 11 include a "good faith" clause).

91. *Id.*

92. FED. R. CIV. P. 11(c)(2).

93. *Id.* advisory committee's notes.

94. *Id.*

95. BEBCHUCK & CHANG, *supra* note 90, at 27.

the entrepreneurial bar seen in America.<sup>96</sup> In England, the Loser Pays rule discourages suits which “advance unique legal theories or new causes of action, and thus might dampen this aspect of the entrepreneurial style of the plaintiff’s bar.”<sup>97</sup> Imposing harsher sanctions on attorneys through Rule 11 would further undermine this spirit. This would have a detrimental effect on many new, cutting-edge legal practices. The newly developing field of Cyber-litigation for example, relies heavily on attorneys taking cases with little or no precedent and promoting new theories to match the changing technology. Copyright infringement on the Internet is becoming increasingly common, yet existing law does not adequately address these problems. Many attorneys are taking these cases, believing that they are acting in good faith, but also knowing the financial risks due to the uncertain status of the law in this field. If the Rule 11 bar is lowered so that the courts are more likely to impose Rule 11 sanctions in cases with little precedent or, as opposing counsel may term them, “frivolous cases,” these attorneys are much less likely to take these new and important cases.

In addition to deterring cutting edge cases through financial sanctions, Rule 11 sanctions also create a professional stigma not present under either the Loser Pays or the contingency fee system. Unlike Loser Pays or the contingency fee system, if the attorney loses, the only penalties he incurs are financial, but if he loses in a Rule 11 proceeding, he loses a substantial part of his professional reputation. Any attorney who is slapped with a Rule 11 sanction is looked upon by his colleagues as someone less than honorable; someone who broke the rules. As a result, the bar for imposing Rule 11 sanctions is and should be extremely high and reserved only for the most egregious cases. Therefore, while lowering the Rule 11 bar would have the desired effect of deterring the less egregious, but nonetheless frivolous cases, it would also probably deter many nonfrivolous, good faith cases which might be either cutting edge or without much precedent, but which are valid nonetheless.

Another existing mechanism is Rule 37.<sup>98</sup> Rule 37 is used to compel discovery and then sanction those who do not comply. If the motion to compel is frivolous, the court may authorize the moving party to pay the opposing side’s costs in opposing the

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96. See KRITZER, *supra* note 12, at 11. Professor Kritzer claims that a significant difference between the English legal system and the American system is that the American system fosters a more entrepreneurial bar, whereas the English system is typically reluctant to expand into new areas of practice.

97. *Id.*

98. FED. R. CIV. P. 37.



motion.<sup>99</sup> Just as with Rule 11, however, a determination whether the motion is frivolous is predicated on a finding of a lack of good faith by the moving party. Again, however, because courts are hesitant to discourage relevant motions, the bar for good faith is low. Consequently, its deterrence effect is minimal. If that bar is raised, then Rule 37 may become more effective at preventing frivolous suits, but it will also deter certain meritorious claims.

#### IV. PROPOSAL

In designing a new fee system, we can never lose sight of our goal: "to induce plaintiffs to sue if and only if they are entitled to prevail at trial."<sup>100</sup> Moreover, several important issues must be taken into account. First, the system must create the proper incentives to allow people with valid claims to file suits while dissuading those with frivolous suits. To force those with valid suits but which, for whatever reason, lose, to pay the same penalties as those who file frivolous suits (i.e. paying the costs of the opposing side) would defeat the very purpose of trying to encourage these meritorious suits. Second, the plan must take into account the differing incentives at the different stages of the proceedings. Schwarzer's proposal, for example, while addressing frivolous suits at the trial stage has no real solution for frivolous suits filed with the intent of forcing a settlement. Third, the certainty of the outcome is crucial to which path one takes.<sup>101</sup>

The following proposal combines the best of the Loser Pays system and the contingency fee system, thereby reducing frivolous suits while still encouraging those with meritorious suits to proceed. This system does not discourage frivolous suits through financial penalties, but instead, uses the institutional mechanisms of settlement and trial to discourage suits and preventing frivolous suits from settling before going to trial. Finally, this proposal takes account of the certainty of certain claims and the incentives this has on whether to file, settle or go forward to trial.

This proposal is based on a two-tiered approach to fees, rather than a one-tiered system seen in both the contingency fee and Loser Pays systems. The first tier addresses those cases which never make it to trial. These cases which settle in the discovery or pre-discovery phase of a trial are billed at an hourly rate, similar to current transactions. The caveat to this is that if no settlement is reached, then the lawyer does not collect even his hourly

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99. See *id.*

100. BEBCHUCK & CHANG, *supra* note 90, at 1.

101. For a discussion on the role of certainty in litigation, see *id.* at 6-12.

rate. However, once the case reaches trial, it enters the second tier of billing. Even if it settles during this time, the case becomes subject to a contingency fee and the hourly rate becomes moot.

This has several benefits. First, this would discourage those who file frivolous suits solely to gain huge settlements. Because the large contingency fees will not exist in pretrial settlement, the settlements should be smaller. Moreover, because the attorney who files frivolous suits would only be able to collect based on the amount of hourly work done, his incentive to file the suit is greatly diminished; the only way to collect the high contingency fee is to have the case actually go to trial and hope he can settle it during the trial. This in-trial settlement would be virtually impossible if the case is a loser to begin with because now the defendants, who may have settled previously to avoid negative publicity, the hassle of trial etc., no longer have this incentive.

From the defendant's perspective, this proposal is appealing on several levels. First, the number of frivolous suits would decrease for the reasons discussed above. Second, the settlement amount should be lower as lawyers, when negotiating, take into account the high contingency fees. While the hourly fee will be taken into account, it should not be as high as the contingency fee. Third, under a Loser Pays system, the plaintiffs are often insolvent or, at least unable to pay the total fees. Consequently, it is impossible for the defendant, who is typically a corporation, to collect the legal fees should the defendants win. Should the defendant lose, however, because they do have the assets to pay the fees, they almost always have to pay, resulting in a disparate treatment of defendants and plaintiffs. This system does away with this disparity as each side must take care of their own fees out of whatever settlement or judgment there is.

The key, however, is not to make this system too defendant-friendly at the expense of those meritorious suits; the interests of both the defendant (protecting him from frivolous suits) and the plaintiff (allowing meritorious suits to go forward) must be given equal weight. Therefore, not only does this two-tiered system discourage frivolous suits and lower settlement amounts, but it also has the positive result of encouraging meritorious suits. If the case settles prior to trial, the plaintiff has to pay the lawyer the hourly rate out of the judgment, just as she does now, but unlike the Loser Pays system, if the case does not settle and is simply dropped, her attorney does not receive anything and so, the plaintiff is no worse off than before. Consequently, the negative impact of the Loser Pays system is mitigated as middle class and lower class plaintiffs can still afford suits.

This also forces the attorney to be more selective in choosing the cases and also more aggressive for his client during settlement negotiations. However, because the amount which the lawyer will recover in settlement is not tied to the amount recovered, we do not have the ethical dilemma currently seen of the attorney becoming a financially interested party. To be sure, the attorney still has an interest in having a positive result for his client, but this will always be the case as any advocate would always want his client to win; if not for financial reasons, for his own prestige and repeat business by the client.

Two criticisms of this system can be made, both dealing with the effects on meritorious suits. First, there is a risk that meritorious suits will be affected because the attorneys become more selective and, as a result, marginal suits will not be taken on. This would certainly echo Professor Kritzer's fear that the Loser Pays system discourages the entrepreneurial bar of America. However, this fear is unfounded as it comes from a misguided view as to the purpose of the legal system.

In every claim, no matter how meritorious, there is some risk of losing. Currently, our system promotes the idea that the attorney must bear the brunt of this risk through not collecting the fee should he lose and, if he gambles in risky cases, he also reaps the rewards of high returns. This may be a valid view. But the basis of this view stems from the belief that the attorney should bear the risks and rewards because it is he, based on his skill and expertise, who must make the professional judgment as to whether or not the case is viable. What the contingency system has done, however, is to shift that professional burden away from the *legal* merits of the case and toward whether or not the case is of a particular type—emotionally charged or high profile, but with few legal merits—and whether the defendant is particularly settlement minded—wants to avoid negative publicity and is willing to payout a large settlement to avoid such publicity. Thus, many of these suits that we currently deem meritorious simply because they settle or win at trial for whatever reason (e.g. emotionally charged) are actually not legally meritorious at all; they merely fall into a particular category of special settlement-minded cases with little legal foundation. Under this proposal, without the large payouts and the very real risk of nonpayment if the case does not settle, the lawyer must now return to the merits of the case to evaluate their potential.

Alternatively, a modification can be made which alleviates the fear of discouraging meritorious suits. Rather than requiring that the attorney not recover anything if the case collapses, the attorney and client can formulate a fee schedule not to exceed X

number of dollars.<sup>102</sup> In this agreement, however, the attorney would commit that if the fees began to exceed the agreed on amount, he would continue to act in good faith in negotiations or trial preparatory work unless he genuinely believed the case was a loser. The A.B.A. and Federal Rules could further implement guidelines on how to sanction attorneys who violate this good faith clause. This system would then allow the attorney to take the more marginal cases with an expectation of at least some compensation. However, it must be explicit that the attorney must act in good faith in these cases and cannot simply take on frivolous cases, knowing that he will drop them eventually after reaching the maximum.

The second negative aspect of this proposal could be that it may discourage settlement on meritorious cases because attorneys want to take the case to trial in order to bump up their fees to the contingency level. It is at this point that we institute the Schwarzer Rule. If, after discovery, a settlement offer is proposed and is refused because the plaintiff wants to take the case to trial for higher attorney fees and then gets a lower judgment, then he is forced to pay the opposing side's fees and costs. This should, in most cases of a reasonable settlement offer, deter such conduct. Moreover, if the attorney refuses to take the offer solely because of his desire for contingency fees, without consulting his client, he could be held in violation of the Rules of Ethics.<sup>103</sup>

The final component of this proposal is that the courts and arbitration panels must be given some leeway in setting fee caps for the multimillion dollar complex cases to avoid the egregious \$30,000-\$40,000 an hour payouts. A good benchmark of what constitutes reasonable payouts are those criteria outlined by the Alaskan system.<sup>104</sup> This is not to say that the courts must go into the fees of every case before them, because, as noted above, the administrative costs of this would be prohibitive, but should a fee dispute arise or, be egregious on its face, in the case of a \$30,000 an hour payout, the courts should have the *sua sponte* power to examine the fee agreement and lower it if necessary.

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102. Just as courts and the A.B.A. have set caps on contingency fees, so too could these entities establish a fee schedule based on the stage of settlement. For more on A.B.A. regulation of contingency fees, see BRICKMAN ET AL., *supra* note 15, at 17-19.

103. Although neither the Model Rules nor the Model Code require that the plaintiff solicit a settlement offer, they do require that if an offer is made, the attorney must consult with his client before accepting or rejecting such an offer. See MORTIMER D. SCHWARTZ ET AL., PROBLEMS IN LEGAL ETHICS 136 (4th ed. 1997).

104. See *supra* note 80.

## CONCLUSION

It is apparent that the existing contingency fee system encourages frivolous lawsuits and, as such, must be amended. Moreover, the contingency fee system has fundamentally altered the relationship between attorney and client, resulting in distrust, the loss of respect for the law, and the perception by lawyers and the general populace alike that the legal profession is simply a job like any other without any higher ethical calling. It is also apparent that the Loser Pays system is no better. At best, the data on whether such a system will reduce frivolous suits is inconclusive, while it is clear that such a system destroys the ability of many middle and lower income people from filing meritorious suits. Such a system would be intolerable in America where we believe that every person is entitled to their day in court if they have been wronged. Although we want to abolish frivolous lawsuits which cost our system and individuals time and money, it cannot be at the expense of a particular class's right to proper representation.

The proposed system addresses the problems faced by plaintiffs, defendants and the judicial system as a whole. The system permits only an hourly fee until trial. This actively discourages frivolous suits that are brought solely to settle before the merits of the case can be actually tried. Because the high returns to the lawyers are seen only if the case goes to trial, these lawyers no longer have the incentive to file the case, knowing that either the payout is no longer there or that their case would not survive the scrutiny of the courts where the high payouts do exist.

Moreover, this system also allows for meritorious suits to be filed. Under both the original proposal of the attorney not collecting the fee or under the modified system with a fee cap in the event the case dissolves, the burden on the losing plaintiff is minimized. To be sure, there is some risk, but litigation is never risk free; the key is to ensure that the risk is not prohibitive. Additionally, unlike the Loser Pays system, this system protects those who file meritorious cases, but who end up losing for other reasons, from being forced to pay the high costs of the opposing side.

From the defendant's perspective, this system is also beneficial. Not only should settlement amounts be lower as the attorney's fees are not tied to the amount settled for, but this system protects those corporate defendants who are now being viewed as cashcows by contingency lawyers because of their propensity to settle early and often for high amounts.

Under the proposed system, the ethical problems seen in the early, crucial stages of the proceedings, of the attorney having a vested interest in the outcome, while not completely obviated, have been marginalized. Also, because the incentives to settle early, in the form of contingency fees, have disappeared, this system now encourages the attorney to focus on the case's merits to decide whether to risk the now greater likelihood of a trial. Finally, because of the Schwarzer Rule, unlike the current system, this proposal actually encourages the attorney to ensure that his client makes an informed decision. The attorney now has an incentive to make sure that he carefully weighs his case's chances of not only winning at trial, but for a higher amount than the settlement offer. This system therefore benefits plaintiffs and defendants alike, while maintaining the ethical practices of the profession and returning some of the moral obligations to the individual lawyers.

