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ENRICHING LAWYERS, NOT HELPING VICTIMS

Why tort reform will help grow the economy and address injustice

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Contents

Introduction and Executive Summary

Alleviating the long-term burdens created by tort abuse should be a top priority regardless of the economic outlook. But the inflationary surge that began in mid-2021, coupled with the problems of declining affordability and long-term weak growth, amplifies the benefits tort reform offers.

Studies have consistently found that frivolous litigation reduces economic opportunities, jobs, and government revenues while increasing costs for all Americans. A 2021 study from the Perryman Group estimates that the full costs to the U.S. economy from tort abuse are 4.24 million lost jobs, $429.35 billion in lost output annually, and lost government revenues (federal, state, and local) of more than $110 billion annually.[1] On a per-person basis, this is a "tort tax" of $1,303.

Alleviating the losses from tort abuse all at once would boost the U.S. economy by approximately 2 percent. While not all the benefits would be realized immediately, tort reform would help mitigate the heightened risks of an economic slowdown by reducing costs to businesses, lowering prices for consumers, and incentivizing greater economic activity. Further, the accelerated economic activity generates more revenues for the federal, state, and local governments without the harmful effects caused by raising tax rates. Perhaps most important, families would see noticeable relief from the severe affordability crisis currently afflicting the nation.

"Studies have consistently found that frivolous litigation reduces economic opportunities, jobs, and government revenues while increasing costs for all Americans.

All these benefits are gained without having to re-argue the typical stimulus debates in Washington, D.C. In the current uncertain economic times, tort reform offers a win-win-win opportunity to improve our economic future.

Tort reform does not prevent people who suffer injuries from attempting to receive just compensation through the court system. Just compensation for injuries not only promotes a

more vibrant economy, but it is the right thing to do. Effective tort reforms safeguard access to the court system while minimizing frivolous and meritless litigation.

Also problematic are the contingency fee arrangements that allow attorneys to earn millions of dollars from class action lawsuits, particularly when private litigators are working on behalf of state attorneys general (AG). Regardless of a case's merits, these excess payments act as an excessive toll that either overcharge defendants or divert potential plaintiff compensation to their lawyers. Worse, the adverse incentives from these million-dollar payouts incentivize the very tort abuse problems imposing the large costs on businesses throughout the country. Allowing private litigators to use the state AG offices to earn unwarranted payouts exacerbates the problem.

To minimize frivolous litigation, the ability for the legal system to be a financial jackpot for litigators and meritless claimants must be curtailed. Reforms that achieve this goal include:

- Prohibiting attorneys general from hiring private law firms using contingency arrangements. When AGs need to hire outside counsel, these contracts should be fixed-fee arrangements that conform to the contracting practice standards applied to all other state contractors. This would close a growing loophole where private litigators use the power of the AGs office to enrich themselves. Further, the contingency fee arrangements are susceptible to abuse and cronyism that undermine the standing of the state's top lawyer.

- Increasing the penalties for filing clearly frivolous cases and cap the contingency fees litigators can receive from judgments (and settlements) in the plaintiffs' favor. This would decrease the incentive for filing meritless cases and, in turn, decrease the number of harmful lawsuits filed.

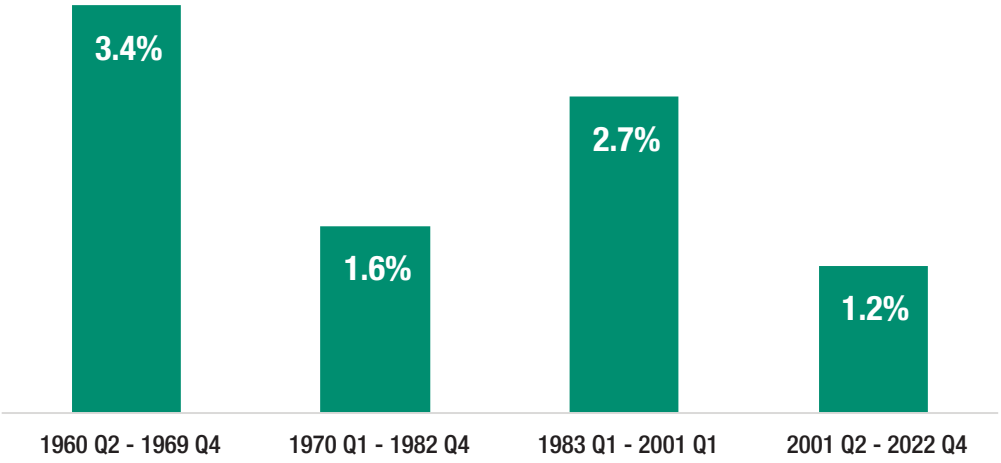
- Reducing the costs for defendants to defend meritless claims by requiring plaintiffs' attorneys to compensate the defendants for their legal costs. This would diminish the likelihood that they will settle (a typical strategy of filing frivolous lawsuits).

Abusive lawsuits exploit the courts for personal gain but impose widespread losses. These losses are an important contributor to the long-term decline in the U.S. economic growth rate. The current precarious economic position of the U.S. underscores the importance of finally addressing this long-term problem.

Background

Robust economic growth is the *sine quo non* for improving the living standards for poor and rich alike. A more prosperous economy is also essential for addressing pressing public policy problems such as the crisis of underfunded public pensions, underfunded entitlements (e.g., Medicare and Social Security), and the rising numbers of Americans who find themselves homeless. Unfortunately, the average annual growth in key measures of our prosperity has been sub-optimal for decades.

FIGURE 1
AVERAGE ANNUAL GROWTH RATES IN REAL GDP PER CAPITA 1960 Q2 THROUGH 2022 Q4, SELECT PERIODS



Source: Author calculations based on data from the St. Louis Fed FRED database. Average annual growth rate is measured as the compound average annual growth rates between the period endpoints.

Figure 1 presents the average annual growth rates in real gross domestic product (GDP) per capita, which is a measure of the improvement in the U.S. standard of living. Figure 1 categorizes GDP per capita into four periods based on the Pacific Research Institute's multi-part study *Beyond the New Normal*.[2] The *Beyond the New Normal* series connected the varied average annual growth rates between these periods to the differences in the economic policy environments that generally prevailed.

Taken as a whole, fiscal, monetary, trade, and regulatory policies implemented during the 1960s, 1980s, and 1990s supported robust economic growth. Not coincidentally, these periods saw relatively faster average annual growth rates in GDP per capita. Alternatively, the policies that were implemented during the 1970s, 2000s, 2010s, and today create(d) adverse

incentives that ultimately deter robust economic growth. These periods saw relatively slower average annual growth rates as a consequence.

These patterns demonstrate that a top priority for political leaders across the country should be to reinvigorate economic growth. This requires reforms that re-establish the beneficial policies that prevailed during the strong growth periods, and ideally improving upon them. There is a long list of necessary reforms to achieve this goal that includes:

- Establishing an affordable level of government spending,
- Creating a more efficient and less costly tax system,
- Instituting a monetary policy that promotes a sound dollar and abstains from distorting the capital structure,
- Promoting growth in international trade, and
- Implementing widespread deregulation, which ensures that key social and environmental goals are met while significantly reducing the regulatory costs that act as a large tax on businesses.

Connected to necessary reforms to the regulatory system, policymakers should remove the growing burdens the state and federal tort-systems are creating. Actual or threatened litigation costs are an ever-expanding pall hanging over the economy that sap our vitality. Opportunities to create new products and services or improve efficiencies are currently being lost due to the overly litigious environment that causes excessive risk aversion.

“Opportunities to create new products and services or improve efficiencies are currently being lost due to the overly litigious environment that causes excessive risk aversion.

Perhaps most egregiously, state attorneys general offices are, too often, getting into the action with the assistance of private litigators working on a contingency fee basis. These contingency arrangements create potential conflicts of interest where the interests of the private litigators diverge from the interests of the public.

Ultimately, prosperity suffers and economic growth is unnecessarily diminished. The need for effective tort reform is, consequently, an important pro-growth policy that will help accelerate our current inadequate economic growth rates. Tort reforms must strike the right balance, eliminating the detrimental incentives for frivolous and meritless litigation while still protecting the rights of injured parties to seek compensation for meritorious cases.

The Tort System Is Trending Toward Excesses

There is ample evidence that the federal and state tort systems have run amok and are now imposing unacceptably large costs on businesses large and small. Starting with the impact on small businesses, the well-intentioned (and in many cases needed) Americans with Disabilities Act (ADA) has become a tool for filing abusive lawsuits by a relatively small number of attorneys (aka serial litigants). Saenz (2020) noted that serial litigants are the pairings of plaintiffs and attorneys that file ADA lawsuits against multiple businesses, regardless of whether the plaintiff suffered actual harm. They are incentivized by the fact that attorney's fees are awardable in ADA lawsuits.

The *Texas A&M Journal of Property Law* notes that serial litigators often live in other states and use Google Earth to find minor violations of the ADA.[3] Leveraging these opportunities, the litigators will sue the local small businesses, many of whom believed they were in compliance, without providing the businesses an opportunity to fix the infraction because fixing the infraction is not the point – suing the business is.

For example, common targets of Title III serial litigation are parking lots with too few disabled parking spaces because this is a deficiency that is easy to see for a "drive-by" plaintiff. Although all Title III lawsuits involve a real violation of the ADA, serial lawsuits are brought by a person whose only injury was being exposed to an ADA violation, whereas genuine lawsuits are brought by a person who suffered a real inability to use the goods or services of a business. This problem results in Title III violation complaints lacking credibility in courts that are battling overcrowded dockets, and where the profit motives of attorneys distort the system in ways that are contrary to disability policy.[4]

SPOTLIGHT ON ABUSE

THOUSANDS OF ABUSIVE ADA LAWSUITS

Potter Handy, a law firm based in San Diego, found itself in 2022 on the wrong side of the district attorneys of Los Angeles and San Francisco. The prosecutors complained that Potter Handy had filed "thousands of boilerplate, cut-and-paste federal-court lawsuits that falsely assert its clients have standing under the federal Americans with Disabilities Act."[5]

The lawsuits were filed "on behalf of a few repeat plaintiffs" against "small businesses with little regard to whether those businesses actually violate the ADA," according to the district attorneys. The lawsuits "are financially onerous," with Potter Handy demanding "damages of at least $4,000 per alleged violation." The suits are especially hard on small businesses, "particularly those owned by immigrants and individuals for whom English is a second language," as they "are often less familiar with the complexities of the American legal system, are rarely able to afford the risk and expense of defending themselves in court."[6]

Potter Handy ADA lawsuits pressure "owners to settle as quickly as possible for an amount between $10,000 and $20,000," reports the Courthouse News Service.[7] The prosecutors estimated Potter Handy used the method to extract "more than" $5 million from small businesses "in less than three years."[8]

As of April 2022, a single Potter Handy client had filed more than 800 lawsuits, another in excess of 1,700. One of the targets was Renmin Yan, owner of Hon's Wun Tun House in San Francisco. Yan immigrated to the U.S. from China in the late 2000s, worked 11 years as a waitress, then bought the restaurant in 2018. She ended up settling to the detriment of her small business.[9]

DanVy Vu, who comes from a family of Vietnamese refugees, and her husband opened a restaurant in 2019, pouring "all our savings and dreams" into the San Leandro, California, establishment. Then came the pandemic shutdowns, layoffs to keep the restaurant from failing, a mortgage deferment, withdrawals of personal savings – and a lawsuit. The restaurant was being sued for $75,000 for ADA violations.[10]

The plaintiff, reports the *New York Times*, was "a 71-year-old man with muscular dystrophy" who had "filed more than 180 A.D.A. lawsuits in California." Vu had accommodated the man months earlier with his seating restrictions. While doing so, she recalled "something she had been told when the restaurant was being designed: that they had to follow the rules 'down to the smallest detail' when it came to the" ADA. Some plaintiffs sued businesses, she learned, "to make a living."[11]

"Top Hatters has survived," the *Times* reported, "but Vu is still crawling her way out of debt."[12]

Meanwhile, the prosecutors who brought the suit against Potter Handy lost their challenge. Their complaint was dismissed in August 2022 by San Francisco Superior Court Judge Curtis Karnow. San Francisco District Attorney Brooke Jenkins, who was not in office when the suit was filed, appealed the decision October 2022.[13]

"As a recent federal court ruling has confirmed, our lawsuit alleges facts showing that Potter Handy files fraudulent lawsuits with the intent of shaking down small businesses for profit" said Jenkins, adding that it remained the goal of the prosecutor's office "to bring clarity to the law and hold Potter Handy accountable for its years-long alleged fraud scheme."[14]

These lawsuits have also become a major financial threat to too many small businesses. Critics complain that they are driven by the "economics of attorney fees" that provide handsome returns for lawyers who often come from other states[15] and, too often, meager renumeration for the actual plaintiffs. Chandlee (2018) notes that, in 2016 alone, a total of 6,601 ADA Title III lawsuits were filed in federal court, which is a 37 percent increase in one year. This does not account for mediated ADA violations and settlement agreements made prior to filing a lawsuit. California and Florida are hotbeds for litigation, where 2,468 and 1,663 ADA Title III lawsuits were filed, respectively, against mostly small businesses that had architectural accommodation violations.[16]

If there was a growing epidemic of significant ADA violations, then the growth in these lawsuits could be justified. But as Saenz (2020) noted, too many of these cases are minor technical violations. Sometimes known as "drive-by" lawsuits, as "plaintiffs usually only pass by the business (and) take a cursory measurement of some sort of purported ADA violation" before filing. The alleged infractions named in the suits "can be something as minor as a sign being slightly askew from its required location or a handicap parking spot being a

few inches too narrow," says Virginia-based Setliff Law. "A lot of times plaintiffs are suing businesses under the guise of an ADA violation when they have never stepped foot on the business's property and have no intention of doing so in the future. This is not the true intent of the ADA."[17]

The abuse of the ADA through frivolous litigation exemplifies the large and growing tort threat to the nation's small businesses. But it is not just small businesses that are harmed. Large businesses are also adversely impacted by the deteriorating environment. A 2018 U.S. Chamber's Institute for Legal Reform study examined the excesses plaguing the securities class action system.[18] The study documented that the increasing frequency of securities lawsuits has been driven by an increase in the number of suits "filed without regard to their merit." For instance, an Institute for Legal Reform study noted that securities lawsuits were filed against 85 percent of all merger and acquisition deals of $100 million or greater, but "it strains belief to suggest that virtually all such deals were affected by fraud."[19]

The National Economic Research Associates' most recent report says aggregate settlements in federal securities class action suits for 2022 reached $4 billion, more than doubling the $1.9 billion inflation-adjusted total for 2021. The average settlement value was up as well. At $38 million, it was more than a 50 percent increase over 2021. Plaintiffs' attorney fees and expenses totaled more than $1 billion.[20]

The constant litigation threat makes it more difficult and costly for companies to improve their operational and/or financial efficiencies. Beneficial improvements would not only contribute to stronger economic growth, but also ensure consumers have wider access to a better variety of goods and services.

> **"A lot of times plaintiffs are suing businesses under the guise of an ADA violation when they have never stepped foot on the business's property and have no intention of doing so in the future. —Setliff Law**

Another tactic attempts to hold companies responsible for failing to warn investors of unexpected adverse events – such as a data breach. Holding a company responsible for not reporting the risk of an event that was unknown at the time is the epitome of frivolousness. It is an impossible standard that burdens companies with additional risks and costs.

State laws are also driving the problem. The California Supreme Court, for instance, adopted "the novel theory of 'innovator liability.' This theory exposes a company that invested millions or billions of dollars into developing a medication to liability when a person who took a generic version made by a competitor alleges an injury from the drug."[21] Holding a company responsible for actions of another company that is its competitor is a clear case of frivolous litigation. After all, how can a company be aware of, let alone control, the actions of its business competitors?

California's Proposition 65 (Prop 65) is another example of good intentions gone awry. Prop 65 requires companies to post warning labels on products when dangerous chemicals are present. This requirement is perfectly reasonable. But the abuse of Prop 65 is not. As the Institute for Legal Reform documented, using Prop 65,

> plaintiffs' lawyers brewed up a lawsuit against 90 coffee companies, accusing them of violating the law because coffee contains acrylamide. It's a naturally occurring chemical, and organizations like the National Cancer Institute have suggested there is no evidence that exposure to acrylamide in foods is a cancer risk. In 2020, a judge threw out the coffee lawsuit for good.
>
> This was a major victory for coffee producers (and those who enjoy a hot cup of joe). But trial lawyers were still able to use Prop 65 to rake in millions of dollars through lawsuits over acrylamide in food.[22]

The purpose of Prop 65 is not to subject companies to litigation from naturally occurring substances that are not cancer risks. Such lawsuits clearly violate the proposition's purpose and exemplify the tort abuse problem.

SPOTLIGHT ON ABUSE

PROPOSITION 65: A BRIBE FOR THE TRIAL BAR?

Proposition 65, also known as the Safe Drinking Water and Toxic Enforcement Act, was passed by a 63-37 percent margin by voters in 1986. Under Prop 65, businesses are required "to provide warnings to Californians about significant exposures to chemicals that cause cancer, birth defects or other reproductive harm." The measure "also prohibits California businesses from knowingly discharging significant amounts of listed chemicals into sources of drinking water." Thirty-five years later, only 2 percent of Prop 65 cases had been related to water, while "hundreds of product lawsuits" had generated "millions of dollars annually for plaintiffs' attorneys, some of whom represent environmental groups focused only on this law," according to Bloomberg Law.[23]

Eight years before that article was published, then-Gov. Jerry Brown said Prop 65 had "been abused by some unscrupulous lawyers driven by profit rather than public health." He was one of a "number of California" policymakers "calling for an overhaul of" the law, which was being "abused by some lawyers, who bring nuisance lawsuits to extract settlements from businesses with little or no benefit to the public or the environment."[24]

Despite reform legislation, Assembly Bill 227, being enacted in 2013, the abuses continued. From 2015 to 2019, there were 3,800 Prop 65 settlements leading to "$142.2 million in penalties and attorney's fees or costs," reports Bloomberg. Law firms raked in the largest share of the disbursements, "nearly $109 million."[25]

"Warning cases," which are much easier to prove and then settle, according to Bloomberg, are another means for seeking "jackpot justice" under Prop 65. The process involves "buying a product, testing it, finding a chemical on the Proposition 65 list, and filing a notice of violation if no warning was issued. The cases almost never wind up at trial."[26]

The return on this effort is "easy money," said attorney Joshua Bloom, who previously worked at the Natural Resources Defense Council and later defended companies in Prop 65 suits.[27] And it continues in the present. Prop 65 lawsuits grew by more than 250 percent from 2012, when 908 suits were filed,[28] to 2020, when 3,185 were filed.[29] As of October 31, 2022, "California businesses had settled 564 claims and paid out $12.7 million, with plaintiffs' lawyers receiving 88.1 percent or $11.2 million in 2022.[30]

"Does Proposition 65 really protect consumers," asks Darrell Feil, a small business owner in Bakersfield, California, "or is it just an indirect bribe to the influential trial bar?"[31]

State-level tort abuse does not happen only in California. Americans for Tax Reform ranks Georgia as the worst state in 2022-2023, in large part because the state's tort system encourages (presumably inadvertently) personal injury awards that exceed $10 million – termed nuclear verdicts.[32] Between 2010 and 2019, according to ATR, "53 nuclear verdicts in personal injury and wrongful death cases were reported in Georgia totaling more than $3 billion."[33] There is nothing nefarious about large verdicts, per se, if those damages were caused by the plaintiff and the judgment accurately reflects the harm. There are reasons to be skeptical.

Driving these large payouts is a tort-friendly legal environment. For instance, Georgia state law explicitly allows anchoring tactics that litigators use to frame juror's perceptions of the dollar amount of damages for pain and suffering awards[34] – with the bias toward excessive awards, of course. The "anchoring effect" is "a well-known cognitive bias in negotiation." It "is the tendency to give too much weight to the first number put on the table and then inadequately adjust from that starting point."[35] Lawyers and negotiators are well versed in the anchoring phenomenon, as well as in techniques to defuse the anchor. Ordinary jurists are less versed in these techniques, however. Allowing lawyers to manipulate the framing of the pain and suffering awards creates a clear bias toward excessive judgments, which includes the large number of nuclear verdicts.

Another aspect of Georgia's legal environment also encourages excessive litigation. A decision by the Supreme Court of Georgia in 2021 (*Alston & Bird, LLP v. Hatcher Management Holdings, LLC*) forbids defendants from apportioning the damages to nonparties when there is only one defendant named in a suit. This means that even when defendants are found to be only "partly" responsible for the damages, they must still pay for the full value of those damages. Therefore, defendants who are found to be 50 percent responsible for injuries must pay 100 percent of the costs if they are the only defendant sued. In most other states, the defendant would be responsible for only half the costs if they are responsible for only half of the damages. This higher responsibility threshold creates greater financial risks for businesses by holding them financially liable for another entity's actions.

While Georgia and California are among the states that incentivize excessive and meritless litigation, these incentives pervade all the state tort systems to varying degrees. The economic consequences from all these frivolous lawsuits are not insignificant, estimated to be in the hundreds of billions of dollars.

Tort Excesses Create Adverse Economic Consequences

A 2021 study by the Perryman Group estimated the economic impact from excessive litigation, finding that frivolous lawsuits cost the U.S. economy,

- $284.8 billion in annual direct costs,
- $429.35 billion in annual output (gross product) and 4.24 million jobs when dynamic effects are considered, and
- $70.3 billion in annual federal revenues, $22.1 billion in annual state revenues and $18.6 billion in annual local government revenues.[36]

Overall, the study found that the frivolous lawsuits impose "a 'tort tax' of $1,303.10 per person" nationwide.[37] Confirming these impacts, a November 2022 study by the U.S. Chamber of Commerce Institute for Legal Reform similarly found that,

> tort costs amounted to $443 billion, or 2.1 percent of U.S. gross domestic product (GDP). These tort costs include:

- $229 billion in general and commercial liabilities, which cover a broad range of personal injury, consumer, and other claims;
- $196.5 billion in automobile accident claims; and
- $17.5 billion in medical liability claims.[38]

Just as troubling, the latest data shows the economic losses from excessive litigation are growing at a disturbing rate. According to the Chamber's report,

> overall, the direct economic costs of the tort system have grown at an annual rate of ***six percent a year*** over the period 2016 to 2020, with commercial liability growing at a faster rate than personal or medical professional liability. This rate exceeds both the growth in inflation, which averaged 1.9 percent, and GDP, which grew at 2.8 percent over the same period. Because growth in the tort system has outpaced GDP, tort costs as a percentage of GDP grew from 1.88 percent to 2.13 percent.[39]

With the costs of the tort system rising faster than the overall growth rate in the economy, there is little doubt that the share of meritless or frivolous lawsuits is growing. According to testimony from Elizabeth Milito of the National Federation of Independent Businesses (or NFIB, which is the trade association that represents small businesses),

> Small businesses shoulder a disproportionate percentage of the load when compared with all businesses. For example, small businesses pay 81 percent of liability costs but only bring in 22 percent of the total revenue. It is not surprising that many small business owners "fear" getting sued, even if a suit is not filed.[40]

As Milito testified, the trends are inter-dependent: rising costs from frivolous lawsuits change business behavior.

> In nine years at NFIB, I have heard story after story of small business owners spending countless hours and sometimes significant sums of money to settle, defend, or work to prevent a lawsuit. And while our members are loath to write a check to settle what they perceive to be a frivolous claim, they express as much, if not more, frustration with the time spent defending against a lawsuit. In the end, of course, time is money to a small business owner.[41]

The same strategies apply to large businesses that are altering their operations to defend or protect themselves against the potential for being sued – regardless of whether the case would be frivolous or not. Inevitably, businesses that are attempting to minimize their litigation risk exposure are unable to operate efficiently. They also must devote more resources – both staff time and money – toward safeguarding against being sued rather than innovating their operations or developing new and better products and services. Consequently, the large and growing problem of frivolous litigation is contributing to the marked slowdown in economic growth illustrated in Figure 1.

"With the costs of the tort system rising faster than the overall growth rate in the economy, there is little doubt that the share of meritless or frivolous lawsuits is growing.

The Crisis Created by the 'Deputized' Private Litigator

A common denominator is adverse incentives of private litigators. Contingency fees offer litigators the promise of substantial revenues should they win a large judgment or, even better, a settlement. These potential paydays incentivize private litigators to seek out large numbers of plaintiffs to maximize their returns.

One recent case illustrates the problem. Florida-based attorneys brought numerous ADA filings against modest-size business owners in the small towns of Midland and Odessa, Texas, many of whom were unaware that any violations existed at their business. Nevertheless, the Florida-based attorneys sought settlements between $6,000 and $10,000 per defendant. Relative to the average contingency fee of one-third to 40 percent of the recovery,[42] the 20 cases the Florida lawyers filed offered a potential $80,000 payday, which was based on minor violations where the harm for most plaintiffs was the exposure to the ADA violation not from plaintiffs suffering actual injuries or lacking access to the business.

As troubling as these practices are, an even more disturbing development involves private litigators working with state attorneys general offices on a contingency basis to pursue litigation (or settlements) against a range of industries. Essentially, private lawyers find a target and then proposition the state attorney general's office to litigate the case for a fee, typically lower percentage than the standard contingency fee – around 10 percent to 20 percent of the judgment.

The *New York Times* writes of the phenomenon that,

> the lawsuits follow a pattern: Private lawyers, who scour the news media and public records looking for potential cases in which a state or its consumers have been harmed, approach attorneys general. The attorneys general hire the private firms to do the necessary work, with the understanding that the firms will front most of the cost of the investigation and the litigation. The firms take a fee, typically 20 percent, and the state takes the rest of any money won from the defendants.[43]

This process is reminiscent of a private investor scouring the landscape for profitable investment opportunities, except in this case the potential profits arise because state AGs are outsourcing the state's policing authority to private litigators. While state AG offices may be undermanned, these arrangements have many adverse consequences, particularly with respect to the economic damage that excessive and meritless litigation can cause.

Each state's attorney general is the top law enforcement officer of the state and is responsible for protecting the legal rights of all individuals, businesses, and charities living or operating in the state. Private law firms are not responsible for protecting these legal rights, especially the rights of the accused.

The private law firms' incentives are to find as many potential lawsuits as possible, particularly those cases where the defendant has deep pockets. Once a deep-pocketed defendant has been found, and a contingency arrangement with the AG has been made, the private law firm's motivation is to extract as high a judgment (or settlement) from the defendant of the lawsuit as possible, regardless of the case's ultimate merits or the appropriateness of the penalty.

"The private law firms' incentives are to find as many potential lawsuits as possible, particularly those cases where the defendant has deep pockets.

The contingency fee relationship creates the potential for an obscenely large payoff for lawyers who are supposedly representing the "public interest." Due to the contractual arrangements, the AG's office now has these same adverse incentives. As an AG's use of the contingency fee arrangement increases, the likelihood that more frivolous lawsuits are filed increases as well. More frivolous lawsuits lead to greater losses for the state economy.

In one instance of a contingency arrangement gone bad, Oklahoma Attorney General Gentner Drummond fired in early 2023 Whitten Burrage, an Oklahoma City law firm. It was one of two outside firms contracted by the state that together collected 90 percent of the $55.5 million in contingency fees – more than one-fifth of the state's total settlement – that was recovered from its opioid legal action.

"While your efforts under the Contract have certainly succeeded in enriching yourselves far beyond what you deserve, those efforts have fallen far short of delivering the results that Oklahomans are entitled to receive," Drummond said in letter. The firm's take from the settlement was $34 million.[44]

In two other instances, the attorneys general in Iowa and Kansas fired Morgan & Morgan, which bills itself as "America's Largest Injury Law Firm," from contingency-fee contracts with both states. Iowa Attorney General Brenna Bird said her state's agreement with the firm had "primarily benefit[ed] out of state trial lawyers."[45]

Mississippi has a long record of empowering private attorneys to perform the AGs responsibilities, which go back to the state's first-in-the-nation's tobacco settlement in 1997.[46] The current state Attorney General, Republican Lynn Fitch, seems to be continuing the practice, having hired private attorneys to sue Centene, a state Medicaid contractor. The state alleged that Centene overcharged Medicaid for pharmacy benefits; the company settled for $55 million, netting the private attorneys a cool $2.5 million. The practice was even more widespread under the previous AG – Democrat Jim Hood. During his tenure, private attorneys earned $121.1 million in fees and expenses (based on $2.8 billion being awarded to the state).

Multi-million-dollar payouts are a strong incentive for private attorneys to find a reason to target companies, whatever the reason. This incentive inevitably conflicts with the public interest of the state that is rested with the attorney generals' offices.

SPOTLIGHT ON ABUSE

CONTINGENCY FEES' IMPACT ON SETTLEMENTS

Millions of Americans have been affected by the opioid crisis. The poster child for the crisis has been Purdue Pharma, which filed for bankruptcy in 2019 under the weight of thousands of lawsuits. The company, based in Stamford, Connecticut, and members of the Sackler family, who through trusts owned and controlled Purdue, were accused "of fueling the opioid epidemic through deceptive marketing of its highly addictive pain medicine."[47]

Purdue, now Knoa Pharma after Chapter 11 reorganization, had "pleaded guilty to misbranding and fraud charges related to its marketing of OxyContin in 2007" and did so again in 2020.[48]

While Purdue Pharma has rightfully received national scorn for its role in exacerbating the crisis, the ongoing cases are a textbook example of the problem of private law firms being hired by state AG offices to prosecute cases like this one – and profiting from potential settlements. Ultimately, these private firms are taking away potential settlement dollars that could be aiding victims who have suffered actual harm.

When he was Oklahoma's attorney general, Mike Hunter contracted three private law firms in that state's "sprawling opioid lawsuit," which produced a $270 million settlement in 2019. Two of the outside firms were Texas-based Nix Patterson LLP and Oklahoma City-based Whitten Burrage, which collected 90 percent of the $55.5 million in contingency fees, more than one-fifth of the total settlement.

Contingency fees have been a topic of controversy and political debate in Oklahoma since the late 1990s, when the state was awarded $2.3 billion over 25 years as part of a multi-state settlement with the tobacco industry, and private attorneys collected more than 10 percent of that sum.[49] In 2022, Oklahoma Gov. Kevin Stitt signed Senate Bill 984, which limits contingency fees on a schedule based on the dollar amount recovered and caps the maximum fees for a single firm at $50 million.[50] The intent of the legislation is to remove incentives to maximize damages even if the facts in the case don't justify the amount.

In 2021, several state attorneys general re-litigated a previous settlement with Purdue and the Sackler family because they were unhappy with the two parties' bankruptcy plan. The attorneys general "objected to the settlement, arguing the Sacklers' contribution was insufficient to deter other corporate wrongdoing."[51]

Lawyers at Kleinberg Kaplan, a New York City-based law firm, advised a number of "states on the appeal of the September 17, 2021, order of Bankruptcy Judge Robert Drain confirming the plan of reorganization of Purdue Pharma LP and affiliates."[52]

Three months later,

> U.S. District Judge Colleen McMahon of the Southern District of New York on Thursday vacated Purdue Pharma's $4.3 billion bankruptcy settlement, finding that its controversial inclusion of a liability release for the Sackler family was not authorized by the U.S. Bankruptcy Code.[53]

Like Hunter in Oklahoma, Washington Attorney General Bob Ferguson contracted with private litigators to seek penalties from opioid manufacturers, distributors, and retailers. From the state's 2022 $476 million settlement with three opioid distributors, $20 million was to be distributed to Motley Rice, a South Carolina law firm Ferguson brought in to assist.[54]

The local media reported in 2022 that Ferguson had "developed a pattern of rejecting initial settlement offers." In March 2022, he announced that the state "would receive an additional $113 million from Purdue Pharma, maker of Oxycontin, after he and

other state attorneys general formally objected to the company's bankruptcy plan." Three months later, he "also rejected a national settlement with Johnson & Johnson in another opioid-related lawsuit."[55]

Motley Rice, by its own account, "represents dozens of governmental entities, including states, cities, towns, counties and townships in ongoing investigations and litigations" in connection to opioid lawsuits.[56]

Early in 2022, a tort reform group noted that "a coalition of 11 state attorneys general" was accusing local governments "and their private lawyers of engaging in fee-driven litigation that has interfered with the states' ability to negotiate global opioid settlements with companies." It was "a money grab by local government officials and the lawyers they hired to represent them on a contingency fee basis."[57]

In a brief filed in federal court, Texans for Lawsuit Reform (TLR) objected to the "mountains of fees claimed by private counsel," which had "become a costly scourge on these classes of suits, the courts, and indeed, on our government structure."[58]

TLR further observed that private lawyers had "fanned out around the country, recruiting municipalities as clients with promises they could win funding for local programs safe from appropriation by state legislators" as lawsuits against Purdue and other opioid producers began to pile up. Their selling point was the 1998 tobacco settlement with the states, in which four U.S. tobacco companies agreed to pay hundreds of billions of dollars for the costs of treating smoking-related illnesses and antismoking campaigns. But little of that sum was ever seen by local governments and put to use in antismoking programs.[59]

Critics will say that's because funds are intercepted by "unscrupulous litigators seeking to enrich themselves."[60]

"Entrepreneurial law firms gallivant from state to state seeking out favorable judicial climates and friendly AG partners to pursue litigation against industries and businesses with deep pockets," says Tiger Joyce, president of the American Tort Reform Association. "Over the last couple of decades, the trial bar has perfected its trial lawyer playbook to exploit our nation's biggest crises."[61]

The practice of the state attorneys general enlisting the counsel of private contingency-fee lawyers has become increasingly common, adds Joyce, which means the prosecutorial power of the state is often more aligned "with a profit incentive, based on contingency fees"[62] rather than seeking justice.

Policy Reforms to Strike the Right Litigation Balance

The studies cited above found that the total annual costs frivolous and meritless litigation impose on the economy are around $430 billion to $440 billion. This is the equivalent of losing around 2 percent of the nation's $26 trillion economy. The losses exceed the $411 billion the federal government spent on the initial $1,400 stimulus checks sent out to buffer families from the COVID-19 economic shutdowns.[63] These figures provide important perspective on the benefits to the average family from reform.

A top priority for reformers should be limiting attorneys general outsourcing their official duties to private litigators. The legal enforcement of state laws should not be an opportunity for a private party to earn a financial jackpot. The economic costs from tort abuse is worsened when litigators use the power of the state to pursue these financial windfalls.

Attorneys general should be prohibited from hiring private law firms using contingency arrangements. Should it be in the public interest for an AG's office to hire private lawyers, the contracts should be fixed-fee arrangements that conform to the contracting practice standards applied to all other state contractors.

As the cases described above illustrate, private litigators' expected return from these cases is too high. This is why the numbers of meritless and frivolous cases filed continue to grow. Reversing this trend requires the expected returns from filing meritless cases to decline. This can be achieved by increasing the costs on plaintiffs that file clearly frivolous cases and/or capping the revenues litigators can receive from judgments (and settlements) in the plaintiffs' favor.

Taken together, these reforms would require courts to sanction attorneys, law firms, or other parties who file frivolous lawsuits and require them to compensate defendants who were injured by their filing of a frivolous lawsuit. Under current law, courts may, but are not required to, sanction the parties filing clearly frivolous and meritless cases.

Imposing penalties and requiring plaintiffs' attorneys to compensate defendants for legal costs increases litigators' expected costs for filing frivolous claims. At the same time, the possibility that defendants will not be financially responsible for defending frivolous claims decreases their expected costs and diminishes the likelihood that defendants will settle. Forcing a quick settlement is a typical strategy of filing frivolous lawsuits. The lower expected returns will deter frivolous litigation.

Another reform idea is to cap contingency fees. For instance, a proposed 2022 measure in California that did not appear on the ballot would have limited, "the amount of contingency fees attorneys can charge prevailing plaintiffs for tort claims (for example, personal injury, product liability, negligence) and certain consumer-protection violations (for example, unfair competition, false advertising, warranty). [It would have also limited] such contingency fees to 20% of the amount recovered by the plaintiff."[64]

Some states alternatively implement a sliding scale contingency fee system where the percentage cap is higher for lower judgments and declines as the value of the judgment breaches set thresholds.

Implementing comprehensive reforms such as these would help reduce the pall of frivolous litigation on the economy while still safeguarding the right of injured parties to seek restitution for their damages.

Conclusion

An effective court system enforces contracts and ensures that individuals and companies that have suffered legitimate economic harms have the opportunity for restitution. Abusive lawsuits, on the other hand, exploit the value created by the state and federal court systems for personal gain. The result is a less vibrant, higher-cost, economy. Consequently, an important component of a comprehensive pro-growth policy reform package needs to remove the incentives to file frivolous and meritless litigation. When combined with broader policy reforms, litigation reform will accelerate U.S. economic growth. A faster economy is essential to raise the living standards for families both poor and rich and help successfully address the pressing public policy issues facing the nation.

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About PRI

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