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John C. Coffee Jr.

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RESCUING THE PRIVATE ATTORNEY GENERAL: WHY THE MODEL OF THE LAWYER AS BOUNTY HUNTER IS NOT WORKING*

JOHN C. COFFEE, JR.**

I. INTRODUCTION

Forty years ago, Judge Jerome Frank coined the term "private Attorney General" to recognize the role of private litigation in the enforcement of law.[1] In the intervening years, the "private attorney

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** Professor of Law, Columbia University Law School. B.A., Amherst College, 1966; LL.B., Yale Law School, 1969. The author acknowledges the advice and assistance of his colleagues Bruce Ackerman and Susan Rose-Ackerman of Columbia, Lewis Kornhauser of New York University Law School, Victor Kramer of the University of Minnesota Law School, Thomas Rowe of Duke University Law School, and Professor Charles Wolfram of Cornell Law School. None of these individuals bears responsibility for the views expressed herein. The author has also benefited from his discussion with a number of judges and plaintiffs' and defendants' counsel active in class and derivative action litigation, but because the latter have not had an opportunity to review this article, more specific acknowledgement will not be given. Finally, because the author is serving as Associate Reporter for the American Law Institute's *Principles of Corporate Governance and Structure: Restatement and Recommendations*, it should be understood that this article is solely an expression of the author's personal views and does not purport to represent the position of that document, except as expressly indicated.

1. Associated Industries of New York State, Inc. v. Ickes, 134 F.2d 694, 704 (2d Cir. 1943), *vacated as moot*, 320 U.S. 707 (1943) ("Such persons, so authorized, are, so to speak, private Attorney Generals."). The issue in *Associated Industries* was one of standing in an administrative law dispute, and no question of private damages was involved. Although Judge Frank was thus not faced with the lawyer as bounty hunter, he did explicitly recognize that Congress can confer standing on private persons, not simply to recover compensation for specific victims, but also "to vindicate the public interest." *Id.*

By 1970, the theory of the private attorney general had received the apparent endorsement of the Supreme Court. *See* Newman v. Piggie Park Enterprises, Inc. 390 U.S. 400, 402 (1968); Mills v. Electric Auto-Lite Co., 396 U.S. 375, 396 (1970). Lower court decisions were even more emphatic in their acceptance of the role of private litigation in the general" concept has become both a cliche and a crutch, receiving polite lip service from nearly all, but critical analysis from relatively few.[2] As most college sophomores know, the private attorney general is someone who sues "to vindicate the public interest" by representing collectively those who individually could not afford the costs of litigation; and, as every law student knows, our society places extensive reliance upon such private attorneys general to enforce the federal antitrust and securities laws, to challenge corporate self-dealing in derivative actions, and to protect a host of other statutory policies.[3]

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enforcement of statutory and constitutional rights. *See, e.g.*, Lee v. Southern Homes Site Corp., 444 F.2d 143 (5th Cir. 1971); Cooper v. Allen, 467 F.2d 836 (5th Cir. 1972); Sims v. Amos, 340 F. Supp. 691, 694-95, (M.D. Ala.), *aff'd*, 409 U.S. 942 (1972). *See also* Comment, *Court Awarded Attorney's Fees and Equal Access to the Courts*, 122 U. PA. L. REV. 636, 666-70 (1974) (development of private attorney general theory). In 1975, however, the Court halted this trend abruptly in *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240 (1975), ruling that the attorneys' fees of a successful plaintiff could only be shifted to the defendant for payment if a statute specifically authorized such an award or certain other special exceptions (i.e., "bad faith") applied.

The concept of the private attorney general should not be confused with this narrower issue of fee-shifting. In essence, the premise of the private attorney general is that announced by Judge Frank: private litigation can produce public good by enforcing statutory and other important policies. This policy premise, of course, depends on some method of financing the private attorney general, but a number exist: (1) the "common fund" or "substantial benefit" basis for fee awards, (2) statutory fee shifting, (3) public interest law firms supported by membership or philanthropic donations, and (4) contingent fee arrangements. The focus of this article will be on the perverse incentives that can and do arise to confound Judge Frank's confidence in private enforcement, once the lawyer becomes an entrepreneur.

2. Economists have recently begun to examine seriously the institution of private enforcement of law. Among the best known efforts are: K. ELZINGA & W. BREIT, THE ANTITRUST PENALTIES: A STUDY IN LAW AND ECONOMICS (1976); Landes & Posner, *The Private Enforcement of Law*, 4 J. LEGAL STUD. 1 (1975); Polinsky, *Private Versus Public Enforcement of Fines*, 9 J. LEGAL STUD. 105 (1980); Schwartz & Mitchell, *An Economic Analysis of the Contingent Fee in Personal Injury Litigation*, 22 STAN. L. REV. 1125 (1970). *See also* Schwartz, *An Overview of the Economics of Antitrust Enforcement*, 68 GEO. L.J. 1075 (1980). Although incisive, these theoretical efforts generally have given little attention to the institutional context in which private litigation arises and the often complex incentive structure facing the private enforcer. For efforts which have begun to take account of these factors, see Dam, *Class Actions: Efficiency, Compensation, Deterrence, and Conflict of Interest*, 4 J. LEGAL STUD. 47 (1975); Reich, *The Antitrust Industry*, 68 GEO. L.J. 1053 (1980); Rhode, *Class Conflicts in Class Actions*, 34 STAN. L. REV. 1183 (1982).

A fundamental premise of this article is that more intellectual bridge-building must occur between those working on the purely theoretical level and those familiar with the institutional context, if theoretical critiques are to have useful applications.

3. Among the major federal statutes that authorize an award of attorneys' fees to finance private attorneys general are: (1) the Clayton Act, 15 U.S.C. § 15 (Supp. V 1981); (2) the Securities Exchange Act, 15 U.S.C. §§ 78i(e), 78r(a) (1976); (3) the Communications Act, 47 U.S.C. § 206 (1976); (4) the Fair Labor Standards Act, 29 U.S.C. § 216(b) (Supp. V 1981); (5) the patent laws, 35 U.S.C § 285 (1976) (award authorized in "exceptional cases"); (6) the Racketeer Influenced and Corrupt Organizations ("RICO") statute, 18 U.S.C. § 1964 (1976); (7) the Freedom of Information Act, 5 U.S.C. § 552(a)(4)(E) (1976); and (8) much recent

Of course, Judge Frank did not discover the infant private attorney general adrift in the bullrushes; the key institutions of the class action and the contingent fee already were well established,[4] and the very archetype of such litigation — the private antitrust treble damages action — dates back to the Progressive Era.[5] Nevertheless, his felicitous phrase conferred an intellectual legitimacy on practices that otherwise were scorned by the established bar as champerty and maintenance.[6] Today, as recent decisions on the award of attorneys' fees have clearly shown, courts have come to accept "the view of the

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environmental legislation, e.g., the Endangered Species Act, 16 U.S.C. § 1540(g)(4) (1976); the Submerged Lands Act, 43 U.S.C. § 1349(a)(5) (Supp. V 1981). The common law has long authorized an award of attorneys' fees out of any common fund that the attorneys' efforts generated. *See* Trustees v. Greenough, 105 U.S. 527, 533-37 (1882); Sprague v. Ticonic National Bank, 307 U.S. 161, 166-67 (1939).

The Congress' continued reliance on private enforcement is best shown by its response to Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240 (1975). Shortly after *Alyeska*, Congress amended 42 U.S.C. § 1988 to authorize fee shifting in civil rights cases. *See* Pub. L. No. 94-559, § 2, 90 Stat. 2641 (1976). Similarly, a host of recent environmental statutes provide for fee shifting. *See, e.g.*, § 307 (f) of the Clean Air Act, 42 U.S.C. § 7607(f) (Supp. V 1981) (authorizing fee shifting whenever the court "determines that such an award is appropriate"). This standard has been interpreted to authorize a fee award to plaintiffs even if they are not the substantially prevailing party. *See* Sierra Club v. Gorsuch, 672 F.2d 33 (D.C. Cir. 1982).

4. Although the rules governing the class action were substantially liberalized in 1966 when Rule 23 of the Federal Rules of Civil Procedure was amended, the class action has been a recognized legal form in American courts since the mid-19th century. *See* Beaty v. Kurtz, 27 U.S. (2 Pet.) 566 (1829); *see also Developments in the Law — Class Actions*, 89 HARV. L. REV. 1319 (1976). After early judicial hostility, the contingent fee was also accepted by American courts by the end of the 19th century, and by 1908, the American Bar Association had followed suit. *See* Leubsdorf, *The Contingency Factor in Attorney Fee Awards*, 90 YALE L.J. 473, 475 (1981).

5. Section 4 of the Clayton Act, 15 U.S.C. § 15 (Supp. V 1981), which authorizes a treble damages remedy for private litigants, is the successor to § 7 of the Sherman Act, 15 U.S.C. § 7 (Supp. V 1981), which was first passed in 1890. Apparently, the first successful private treble damages action was W.W. Montague & Co. v. Lowry, 193 U.S. 38 (1904).

6. The debate over the propriety of the lawyer as entrepreneur continues today, as much of the bar still views the contingent fee contract as an impermissible investment by the attorney in his client's action. *See* Findlater, *The Proposed Revision of DR 5-103(B): Champerty and Class Actions*, 36 BUSINESS LAWYER 1667, 1669-70 (1981). Champerty, of course, is a prohibited arrangement under which a nonparty subsidizes the costs of a litigation in return for a portion of the proceeds. From this same perspective, the private antitrust class action can be (and has been) described as "legalized blackmail." *See* Handler, *The Shift from Substantive to Procedural Innovations in Antitrust Suits — The Twenty-Third Annual Antitrust Review*, 71 COLUM. L. REV. 1, 9 (1971). To some within the defense bar, private enforcement litigation appears uniformly frivolous and extortionate in character. For a representative example, see Duesenberg, *The Business Judgment Rule and Shareholder Derivative Suits: A View from the Inside*, 60 WASH. U.L.Q. 311, 332-33 (1982). Although such an assessment betrays its author's bias, the relevant point here is that the private attorney general model has only an incomplete and sometimes tenuous acceptance within many segments of the bar and judiciary.

lawyer as a calculating entrepreneur regulated by calculating judges."[7]

Much can hang on the choice of words, and the phrase "private attorney general" is as value-loaded in an affirmative sense as the term "bounty hunter" is in a negative one. Both terms, however, represent only different sides of the same legal coin. Once the perjorative terminology is stripped away, the critical public policy issue is exposed: to what extent can we sensibly rely on private litigation as a mechanism of law enforcement? This is a broad question, one that subsumes the considerably narrower, but more frequently debated, issues of the appropriate standard for determining attorney fee awards and the desirability of the class action as an enforcement device. This question is best approached by measuring the distance between the basic policy premises that underlie the private attorney general and the current reality that it has produced:

The conventional theory of the private attorney general stresses that the role of private litigation is not simply to secure compensation for victims, but is at least equally to generate deterrence, principally by multiplying the total resources committed to the detection and prosecution of the prohibited behavior. For example, the Supreme Court relied upon precisely the perception that "private enforcement . . . provides a necessary supplement" to public law enforcement when it first decided to recognize implied private causes of action under the federal securities laws.[8] Yet more recent Supreme Court decisions curtailing those same implied causes of action have emphasized the dangers latent in class action litigation brought by the bounty hunter, who, in effect, lacks an actual client to constrain him.[9] Lower federal judges have been even more explicit in their view that the legal system is being

7. Leubsdorf, *supra* note 4, at 481 (referring to the cases discussed *infra* notes 57-60).

8. J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964). The Court noted that the SEC examined over 2,000 proxy statements a year, a volume which precluded an independent examination of each statement. Based in large part on this observation, it concluded that a private cause of action should be implied in favor of injured investors because private enforcement was necessary "to make effective the congressional purpose." *Id.* at 443. In essence, the Court was assuming that private enforcement would multiply the resources committed to preventing securites fraud.

9. In Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), the majority opinion, written by Justice Rehnquist, states bluntly (and without citing any supporting evidence): "There has been widespread recognition that litigation under rule 10b-5 presents a danger of vexatiousness different in degree and kind from that which accompanies litigation in general . . . ." *Id.* at 739. In particular, Justice Rehnquist objected to the ability litigation under Rule 10b-5 gave "a plaintiff with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value . . . ." *Id.* at 241. This language seems clearly directed at the lawyer as bounty hunter. *See also* Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (further restricting 10b-5 actions by requiring scienter).

exploited, rather than aided, by such attorneys,[10] and a significant anti-plaintiff tilt appears evident in recent decisions on standing,[11] attorneys' fees,[12] and class certification.[13]

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10. Recent decisions restricting attorneys' fees and tightening class certification and standing requirements are examined *infra* notes 12, 13, and 60. The shift in judicial attitude, however, is also conveyed in less formal statements. The following quotation is from a brief talk recently given by a Federal Circuit Judge (and former law professor) at a symposium for law professors, which the author attended in late 1982: "During the One Hundred Year's War, Europe was nearly brought to its knees by roving bands of mercenaries who pillaged and robbed and left a barren landscape in their wake. The modern equivalent of these mercenaries is the plaintiff's attorney in antitrust class actions." Granting that the judge was intending to be provocative, one still must recognize that he is commenting on a reality that he has encountered and by which he has been dismayed.

11. In both the fields of securities and antitrust law, the Supreme Court imposed significant limitations during the mid-1970's on the standing of a private plaintiff to sue on a statutory federal cause of action. *Compare* Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977) (indirect purchaser denied standing under antitrust laws) *with* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (shareholder who neither purchased nor sold securities denied standing to assert violation of Rule 10b-5). Concomitantly, other decisions by the Court denied standing to private plaintiffs to assert implied causes of action. *See* Cort v. Ash, 422 U.S. 66 (1975) (refusing to recognize an implied cause of action based on a criminal statute prohibiting corporations from making contributions in Presidential elections). It is not the purpose of this article to analyze or critique these decisions, but they do suggest a common pattern.

12. Some recent decisions have been severely critical of the plaintiffs' bar as a whole. *See In re* Armored Car Antitrust Litigation, 472 F. Supp. 1357, 1381-82, 1388-89 (N.D. Ga. 1979) (court slashed requested fees by two thirds). Other decisions have focused on the expenditure of excessive time, the unnecessary use of senior personnel, or the absence of minimally adequate time records. *See* Barnett v. Pritzker, 73 F.R.D. 430, 434 (S.D.N.Y. 1977); Blank v. Talley Industries, Inc., 390 F. Supp. 1, 4 (S.D.N.Y. 1975); *In re* Penn Central Securities Litigation, 416 F. Supp. 907, 925 (E.D. Pa. 1976), *rev'd on other grounds*, 560 F.2d 1138 (3d Cir. 1977).

As a result of these perceived abuses, a host of recent Courts of Appeals decisions have begun to tighten the evidentiary and procedural requirements for the determination of fee awards. These decisions have specified relatively precise standards for the determination of the attorney's normal hourly rate and have restricted the evidence admissible to establish that rate. Revealingly, the District of Columbia Circuit — traditionally, a "liberal" circuit and one favorably disposed toward the private attorney general — has lead the way in this regard. *See* Copeland v. Marshall, 641 F.2d 880, 891-94 (D.C. Cir. 1980); Donnell v. United States, 682 F.2d 240, 251-53 (D.C. Cir. 1980); Nat. Ass'n of Concerned Veterans v. Sec. of Defense, 675 F.2d 1319, 1324 (D.C. Cir. 1982); Environmental Defense Fund v. E.P.A., 672 F.2d 42, 58 (D.C. Cir. 1982); Alabama Power v. Gorsuch, 684 F.2d 1, 3-4 (D.C. Cir. 1982); Sierra Club v. Gorsuch, 684 F.2d 972, 975 (D.C. Cir. 1982). For similar results in other circuits, see Jorstad v. I.D.S., 643 F.2d 1305, 1310-11 (8th Cir. 1981); Chrapliwy v. Uniroyal, Inc., 670 F.2d 760, 767-69 (7th Cir. 1982); Northcross v. Board of Ed., 611 F.2d 624, 638-39 (6th Cir. 1979), *cert. denied*, 447 U.S. 911 (1980). These cases are considered in more detail *infra* note 60.

13. On the issue of class certification, the trend is again adverse to the plaintiff. *See, e.g.*, East Texas Motor Freight System, Inc. v. Rodriquez, 431 U.S. 395 (1977) (denying class certification); Gen. Tele. Co. of Southwest v. Falcone, 102 S. Ct. 2364 (1982) (same).

At the lower federal court level, a recent trend is to deny certification on the grounds of the unmanageability of the action. *See e.g.*, Windham v. American Brands, Inc., 565 F.2d 59 (4th Cir. 1977) (en banc), *cert. denied*, 435 U.S. 968 (1978); *In re* Transit Company Tire

This reversal in judicial attitude cannot be explained simply as the transition from the liberal Warren Court to the conservative Burger Court. The hard truth is that the private attorney general as a legal institution has not lived up to its early promise. This observation alone should not be surprising, because few things in life work as well in practice as in theory. Thus, the more important assertion, which will be the central focus of this article, is this: *the reasons for this shortfall between the promise and the performance of the private attorney general are entirely predictable and almost inevitable once we examine the incentive structure that current law presents to the private enforcer*. Similarly and more optimistically, these problems are also substantially remediable if we revise that incentive structure.

In theory, the private attorney general is induced by the profit motive to seek out cases that otherwise might go undetected. Economists have even worried that the net result might be overenforcement and excess deterrence.[14] Yet the available empirical evidence does not provide much support for the thesis that the private attorney general sig-

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Antitrust Litigation, 67 F.R.D. 59 (W.D. Mo. 1975). *But see In re* Corrugated Container Antitrust Litigation, 80 F.R.D. 244 (S.D. Tex. 1978) (certifying class despite manageability problems); *In re* South Central States Bakery Products Antitrust Litigation, 86 F.R.D. 407, 423-24 (M.D. La. 1980)(same). Undoubtedly, a lively debate is possible on the merits of this issue, but in overview the idea that a proposed action can be too large and too complex to permit its adjudication in the federal courts must be recognized as a significant retreat from the liberal optimism of the private attorney general concept.

Similarly, much recent litigation has arisen concerning the adequacy of the class representative and his counsel. Defendants now attack successfully the skill, experience, and integrity of the plaintiff's attorney on the theory that the court must examine the credentials of the plaintiff's attorney before it permits the action to proceed as a class or a derivative action under Rules 23 or 23.1 of the Federal Rules of Civil Procedure. *Compare* Block & Warren, *New Battles in the 'Class Struggle' — the Federal Courts Reexamine the Securities Class Action*, 34 BUSINESS LAWYER 455 (1979) (defendant's view) *with* Susman, *Prosecuting the Antitrust Class Action*, 49 ANTITRUST L.J. 1513 (1980) (plaintiff's view). *See also* Latimer, *Damages, Settlements and Attorneys' Fees in Antitrust Class Actions*, 49 ANTITRUST L.J. 1553 (1980). This article does not attempt to address the specifics of these issues; rather, the immediate point is that the willingness of federal courts to hear the collateral issue of the adequacy of plaintiffs' counsel suggests a judicial skepticism about the functioning of the private attorney general.

14. *See* Landes & Posner, *supra* note 2. The basic problem with private enforcement in their view stems from the fact that the optimum penalty must exceed the social loss caused by the prohibited behavior in order to compensate for a probability of apprehension, which is always less than 100%. Thus, if the probability of detection were 50% it would take a $200 fine to deter a $100 crime (in terms of expected benefit to the offender). Increasing the penalty to offset the margin by which the probability of detection falls below 100% produces, they argue, two inconsistent effects: (1) it achieves deterrence, but (2) it attracts additional bounty hunters, because increasing the potential reward is a powerful signal to the market. This latter consequence is a negative one in their view because at the same moment that adequate deterrence is achieved, additional private enforcers are induced to enter the field, lured in by the increased penalty. In short, equilibrium is destroyed, because the very act of

nificantly supplements public law enforcement by increasing the probability of detection.[15] Although this evidence is incomplete and

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increasing the penalty to an adequate level attracts excess private enforcers and leads to overenforcement. The result is excess social investment in law enforcement.

The counter-arguments to this essentially static model are numerous. The most obvious objection is that the size of the penalty to the law violator need not equal the bounty to the bounty hunter; rather, the latter amount (i.e., the fee award) can be regulated by the court to achieve optimal deterrence. Of course, existing law intuitively does this: the fee award seldom exceeds 25% of the recovery in a class action and the contingency bonus can explicitly consider the need for encouraging private enforcement. Equally important, the Landes/Posner analysis ignores the problems of search costs, risk aversion, and free riders, problems which exist under current law and on which this article focuses. *See infra* notes 16-44 and accompanying text.

15. Relatively little empirical work on private enforcement merits careful scrutiny. Probably the leading recent study of the class action is by Benjamin DuVal, a research scholar at the American Bar Foundation. *See* DuVal, *The Class Action as an Antitrust Enforcement Device: The Chicago Experience (Part II)*, 1976 A.B. Found. RES. J. 1273. In this study of private antitrust litigation in the Northern District of Illinois, DuVal found "a striking correlation between plaintiffs' success and the existence of governmental proceeding." *Id.* at 1282. More specifically, he found that (1) plaintiffs always obtained some settlement if there was a parallel governmental proceeding, (2) large settlements were in all cases preceded by a governmental proceeding, and (3) in the absence of a governmental proceeding, "private class actions have rarely met with success . . . ." *Id.* Of even greater relevance to the issue of whether private litigation expands the scope of law enforcement, DuVal reported that private antitrust class actions seldom undertook to prove difficult or complex legal theories, but rather tended to concetrate on simple per se violations (i.e., price fixing). *Id.* at 1274-77. He concluded:

> Clearly, then, the availability of large fees has not broadened the scope of antitrust enforcement measured in terms of the kinds of legal theories advanced . . . . [P]laintiff's attorneys have not displayed an increased willingness when suing on behalf of the class to undertake the difficulties involved in proceeding in the absence of *per se* violation. Rather, they appear to have been relatively less willing to undertake the greater difficulties of challenging practices that fall outside the scope of existing *per se* rules in class actions than in nonclass cases.

Id. at 1275-77. A detailed individual case study has reached broadly similar conclusions. *See* Wolfram, *The Antibiotics Class Actions*, 1976 A.B. FOUND. RES. J. 273. Professor Wolfram also noted both a prevalence of "tag-along actions," and a suspicious tendency for plaintiffs' attorneys' fees to be based on easily manipulated "purely administrative matters." He concluded both that only limited judicial control existed over the settlement process and that it was "doubtful in the extreme" that private enforcement was performing adequately within the limited context that he studied. *Id.* at 361-63.

In this article's terminology, the failure of the private attorney general to undertake difficult or novel cases not earlier initiated by the government can be explained in terms of the combined effects of (1) the disparity in search costs and the failure of current legal rules to offer a higher expected return for actions initiated by the private enforcer, (2) a high level of risk aversion, given the substantial investment the private attorney must make, and (3) the "free rider" problem under which late-appearing plaintiffs' attorneys can intervene and seek a share of the action initiated by the original plaintiffs' attorney. *See infra* text accompanying notes 16-44.

Within some areas of securities law enforcement, much of this same pattern is discernible. Professor Michael Dooley has studied private actions involving allegations of insider trading and found no instance in which a successful private action was not preceded by an SEC action. *See* Dooley, *Enforcement of Insider Trading Restrictions*, 66 VA. L. REV. 1, exceptions no doubt exist to any generalization, a recurring pattern is evident under which the private attorney general simply piggybacks on the efforts of public agencies — such as the SEC, the FTC, and the Antitrust Division of the Department of Justice — in order to reap the gains from the investigative work undertaken by these agencies.[16] As a

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16 & 16 n.82 (1980). Once again, the private enforcer appears to be piggybacking on the efforts of the public enforcer, because the expected benefits from originating new actions do not exceed those available from piggyback actions where the risk and uncertainty are less.

With respect to derivative actions and securities class actions, more positive evidence exists as to the efficacy of private enforcement, but firm conclusions are not possible given the lack of reliable data about the adequacy of settlements. Professor Thomas Jones has reported that 75% of such actions appeared to result in some measure of relief for shareholders (although only one percent of this total was represented by litigated judgments in favor of plaintiffs). *See* Jones, *An Empirical Examination of the Resolution of Shareholder Derivative and Class Action Lawsuits*, 60 BOSTON U.L. REV. 542, 567 (1980). A closer review of this data, however, shows that many of the most successful actions identified by him (e.g., the Mattel, Gulf Oil, United Brands, and IT&T settlements) involved matters of public record (and indeed notoriety) growing out of earlier SEC investigations into illegal foreign payments and securities fraud. *Id.* at 547-56. In still other cases, settlements appear to have produced little monetary recovery or other relief on which a definite value could be placed. *Id.* at 556-63.

16. Cases are legion in which private antitrust class actions have followed a prior governmental prosecution or indictment. Typically, these cases are consolidated in the district court where the grand jury was located in order to facilitate ease of access to the materials discovered by the grand jury during its prior investigation. Indeed, these "tag-along" private actions are so predictable that the Rules of the Judicial Panel on Multi-District Litigation expressly provide for the re-assignment of such cases to the district in which the original action was brought. *See* Rules 9 and 10, R.J.P.M.L., 65 F.R.D. 253, 259-60 (1975). For representative examples in which the court's opinion clearly reveals that the private actions rode on the coattails of a prior governmental proceeding, see *In re* Folding Carton Antitrust Litigation, 75 F.R.D. 727, 728 (N.D. Ill. 1977) (more than 50 private treble damage suits followed criminal action alleging price fixing); *In re* Sugar Industry Antitrust Litigation, 73 F.R.D. 322, 332 (E.D. Pa. 1976); *In re* Chicken Antitrust Litigation, 669 F.2d 228, 232-33 (5th Cir. 1982) (33 individual or class suits filed against defendants following civil suit by Antitrust Division); *In re* Ampicillin Antitrust Litigation, 526 F. Supp. 494, 495 (D.D.C. 1981); *In re* Grand Jury Investigation of Cuisinarts, Inc., 665 F.2d 24, 29 (2d Cir. 1981) ("Shortly after the return of the federal indictment, private antitrust actions against Cuisinarts and its retailers commenced to flood the federal courts"); *In re* Protection Devices and Equipment and Central Station Protection Service Antitrust Cases, 295 F. Supp. 39 (J.M.J.D.L. 1968) (80 different private cases filed in seven different districts following civil action by United States); *In re* Plumbing Ficture Cases, 295 F. Supp. 33, 33 (J.P.M.D.L. 1968) (39 actions consolidated in district court where prior indictments were returned); *In re* Ocean Shipping Antitrust Litigation, 1982-1 Trade Cas. (CCH) ¶ 64,585 at 73,200 x (over 30 private class actions commenced following indictment of defendants); *In re* Cement and Concrete Antitrust Litigation, 437 F. Supp. 750, 751 (J.P.M.D.L. 1977) (19 actions follow civil action brought by Arizona Attorney General after year-long investigation conducted by him).

In other instances, private actions have piggybacked on an earlier but inconclusive investigation by a governmental agency. The *Fine Paper* litigation discussed in this article is such a case, as the Federal Trade Commission began its investigation of the industry in 1977, but ultimately decided to take no action. *See In re* Fine Paper Antitrust Litigation, 685 F.2d 810, 816 (3d Cir. 1982). In other cases, the government sued but was unable to result, the private attorney general does not seem to broaden the scope of law enforcement, but rather only intensifies the penalty. Typically, the sequence begins with an SEC injunctive action or an antitrust indictment, which within a brief period elicits a horde of plaintiffs' attorneys — sometimes numbering well over 100 — all seeking to participate in a private class action, the allegations of which largely parallel and sometimes literally parrot those set forth in the agency's complaint.[17] Although cases can be found in which private enforcement did precede public enforcement, these cases are rare and generally involve special factors, such as a particularly sizable plaintiff capable of affording the costs of litigation.[18]

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obtain relief, while the private plaintiffs were ultimately successful. *See, e.g.*, *In re* Plywood Antitrust Litigation, 655 F.2d 627, 636 n.2 (5th Cir. 1981) (describing refusal of Ninth Circuit to uphold FTC administrative law judge), *cert. granted*, 102 S. Ct. 232 (1982). For a discussion of the successful settlement of this private action (for $165 million), see "Plywood Makers Agree to Settle Antitrust Suit," Wall Street Journal, December 15, 1982, at 3, col. 1.

The speed with which the private bar can mobilize its resources in order to piggyback on a governmental action also deserves special comment. In one recent case, the court noted that "within twenty-four hours after the filing of the indictment, numerous civil suits were brought" and a plaintiffs' executive committee was in the process of formation. *See* United States v. Roblin Industries, Inc., 1980-81 Trade Cas. (CCH) ¶ 63,644 at 77,486 (S.D.N.Y., Nov. 21, 1980).

17. To give some recent examples:

(1) in *In re* Corrugated Container Antitrust Litigation, 80 F.R.D. 244 (S.D. Tex.1978), 48 law firms submitted fee petitions for a total of $48,216,309. *See* Lempert, "Antitrust Lawyer Hopes Fee Will Confirm Vision," Legal Times, May 17, 1982 at 1, col. 1;

(2) in *In re* Folding Carton Antitrust Litigation, 415 F. Supp. 384 (J.P.M.D.L. 1976), 57 plaintiffs' law firms eventually sought fee awards;

(3) in *In re* Fine Paper Antitrust Litigation, M.D.L. 323 (E.D. Pa. March 3, 1983), 33 law private firms plus the attorneys general of eight states submitted fee petitions on behalf of 160 individual attorneys requesting fees totalling over $20,000,000. *See* Bruck, "Harold Kohn Against the World," The American Lawyer, January, 1982, at 28-32;

(4) in *In re* Armored Car Antitrust Litigation, 472 F. Supp. 1357 (N.D. Ga. 1979), 20 law firms (consisting of 85 attorneys) submitted fee petitions totalling $1,287,500. *Id.* at 1380, 1384. Twenty-two attorneys in *Armored Car* claimed hourly rates in excess of $125 per hour. *Id.* at 1385. For other recent cases, see *In re* Sugar Industry Antitrust Litigation, 433 F. Supp. 1122 (J.P.M.D.L. 1977); *In re* Equity Funding Corp of America Securities Litigation, 375 F. Supp. 1378 (J.P.M.D.L. 1974).

18. In at least two recent cases, the government's action appears to have been based on earlier detective work undertaken by a private enforcer. The decision in United States v. United States Gypsum, 438 U.S. 422 (1978), is essentially the result of efforts by a large private plaintiff (Texas Gypsum), which, beginning in 1961, sought to convince governmental agencies to undertake an investigation into price-fixing in the gypsum wallboard industry. Meeting with no success, it filed its own treble damage action in 1962, and obtained a settlement. A governmental investigation begun in 1966 eventually led to a grand jury inquiry in 1971 and an indictment in 1973. *See* United States v. United States Gypsum Company, 383 F. Supp. 462, 465-68 (W.D. Pa. 1974). Similarly, private plaintiffs initiated the prosecution of price-fixing in the gas meter industry. A civil action was filed by private plaintiffs in 1978, and eight months later an indictment followed. *See In re* Gas Meters Antitrust Litigation, 500 F. Supp. 956, 957 (E.D.Pa. 1980). For other class actions alleging

This phenomenon of "free riding" by the private plaintiff on governmental enforcement efforts is by no means without social utility: First, it does escalate the penalty structure above the modest fine schedules that are authorized by law (and nullified by inflation). Absent these private actions, the monetary penalties for antitrust and securities fraud plainly would be insufficient to deter.[19] Second, it often may be more efficient for public agencies to concentrate on detection (an area where they have the comparative advantage because of their superior investigative resources) and leave the actual litigation of the case to private enforcers, who are frequently more experienced in litigation

price-fixing that have no visible connection with a prior governmental proceeding, see In re Bristol Bay, Alaska, Salmon Fishery Antitrust Litigation, 424 F. Supp. 504 (J.P.M.D.L. 1976); *In re* Alcoholic Beverages Litigation, 95 F.R.D. 321 (E.D.N.Y. 1982); *In re* Beef Industry Antitrust Litigation, 419 F. Supp. 720 (J.P.M.D.L. 1976).

Nonetheless, it is highly questionable whether any of these cases truly represent an instance of enforcement by a "private attorney general" as that term is used in this article — an attorney who is largely unconstrained by any client. In the *Gypsum* litigation, the facts reduce in essence to the simple truth that a large firm simply brought suit against others in its industry who it had reason to believe were engaged in price-fixing; in *Gas Meters*, the principal plaintiffs were large electric utilities, who were clearly capable of monitoring their own attorneys. The *Bristol Bay* and *Alcoholic Beverages* cases do involve small plaintiffs, but they essentially concern local disputes of which the plaintiffs presumably were fully informed. In addition, the individual plaintiffs already were organized into a larger umbrella organization (a fisherman's cooperative in the *Bristol Bay* case) which made collective action simpler and thus solved the inherent "free rider" problem. In short, none of these cases involve a private attorney, unaided by a substantial client having knowledge of the relevant industry or a deep pocket, who investigated and successfully prosecuted an antitrust class action involving price-fixing or similar covert activities without relying on an earlier governmental proceeding or investigation. Such a case remains remarkably hard to find.

19. The disparity is striking between the modest financial penalty that the criminal law can exact and the much greater damages that private actions regularly produce. The maximum fines under the antitrust law (authorized in the case of a criminal conviction) are $1,000,000 in the case of a corporation and $100,000 in the case of an individual. 15 U.S.C. § 1 (1976). Yet, in *Corrugated Container*, 80 F.R.D. 244 (S.D. Tex 1978), the corporate defendants have agreed to pay nearly $500 million and the requested fee award is $47 million. *See* Mieher, "Group of Antitrust Lawyers Riles Clients, Opponents by Seeking $50 Million in Fees," Wall Street Journal, October 21, 1982, at 31, col. 4. The history of antitrust enforcement shows that only modest penalties have been imposed. *See* K. ELZINGA & W. BREIT, *supra* note 2, at 54-62. In only 27% of the cases from 1967 to 1970 did the Department of Justice even seek the modest maximum fine then authorized by law. *Id.* at 61. Between 1965 and 1969, the average fine in antitrust cases was only $116,622. Posner, *A Statistical Study of Antitrust Enforcement*, 13 J.L. & ECON. 365, 392 (1970).

This pattern is not unique to the antitrust context. As I have argued elsewhere, low penalties tend to characterize public enforcement of law, because (1) courts show great reluctance to impose penalties that achieve little compensatory purpose, (2) the public enforcer is interested more in the political value of a victory (while the profit-motivated private enforcer cares almost exclusively about the damages), and (3) public enforcers can be lobbied politically to settle for a modest penalty if a more severe one would arguably force lay-offs, plant closings, or corporate insolvency. *See* Coffee, "*No Soul to Damn; No Body to Kick: An Unscandalized Inquiry Into the Problem of Corporate Punishment*, 79 MICH. L. REV. 386, 405-12, 434-48 (1981).

tactics.[20] In practice, this pattern of public agency reliance on private actions has become standard in SEC enforcement litigation, and it also has characterized some recent antitrust prosecutions.[21] Thus, although some have characterized such "tag along" private enforcement actions as "parasitic,"[22] it may be more accurate to describe the relationship between public and private enforcer as symbiotic. Nonetheless, some disturbing evidence dealing with antitrust class actions suggests that the deterrent threat of the private attorney general has been blunted. This evidence seems to show that private litigated judgments are few, cheap

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20. For example, if there are economies of scale associated with the investigation or detection of a given offense, public enforcement may be more efficient. In addition, the social investment in investigative institutions, such as the FBI or the SEC, is already a sunk cost. Thus, the phenomenon noted by Professor Dooley, *supra* note 15, that insider trading cases always begin with a governmental action, seems best understood in this light: economies of scale exist in the sense that the New York Stock Exchange is uniquely positioned to detect unusual trading activity, and it will typically notify the SEC, which can commence an investigation and issue subpoenas to gather relevant evidence at a lower cost than private enforcers.

But it does not follow that the government is the best or cheapest prosecutor once the initial evidence is gathered. Private attorneys, motivated by profit, may work harder or be more experienced than the public attorney within a large bureaucracy. Indeed, private enforcers typically are alumni of some public enforcement agency (e.g., the SEC, the Antitrust Division of the Department of Justice, or a U.S. Attorneys' Office).

21. For example, in the *Corrugated Container* litigation, the government indicted the corporate defendants, who were acquitted by a jury in 1979. But in the one subsequent civil case that came to trial, the private plaintiffs obtained a jury verdict against the Mead Corporation for an estimated $700 million in damages plus attorneys' fees. *See* Lempert, *supra* note 17, at 10, col. 1. Similarly, in *Fine Paper*, there was a prior governmental investigation, but no action was taken based upon it. *See In re* Fine Paper Antitrust Litigation, 685 F.2d 810, 816 (3d Cir. 1982) (noting "ultimately inconclusive investigations by the Federal Trade Commission and United States Department of Justice" as the triggering cause of the private litigation). In the *Plywood* case, discussed *supra* note 16, the government initiated the action but was unable to secure relief, yet private plaintiffs eventually secured a $165 million settlement. Thus, it is oversimple to assume that the tendency for the government to initiate the action renders private plaintiffs irrelevant. Indeed, the normal practice used by the Enforcement Division of the Securities and Exchange Commission is to initiate the complaint and then settle with the defendants in a relatively painless consent decree under which the defendants agree not to violate the securities laws in the future, but acknowledge no wrongdoing or liability in the instant case. These "go-and-sin-no-more" settlements have little inherent deterrent value, but they signal to the plaintiff's bar that an attractive case is available. Moreover, the defendant seldom dares to litigate with the agency, because a judgment (as opposed to a consent order) would have res judicata effect in the subsequent damages actions. *See* Parklane Hosiery Co. v. Shore, 439 U.S. 322 (1979). Thus, the relationship between public and private enforcers serves the public enforcers' interest as well. Whether this relationship between public and private enforcers is optimal can be debated, but to the extent that one believes that government agencies either (1) are sufficiently constrained by budgetary limitations as to be unable to hire an adequate number of enforcement attorneys, or (2) have difficulty in retaining highly skilled attorneys in litigating positions, then, notwithstanding its follow-the-leader posture, the efforts of the private bar cannot be dismissed as useless.

22. Dooley, *supra* note 15, at 16.

settlements are common, and the typical settlement recovery is below even the level of the compensatory damages alleged by the plaintiffs (despite the existence of a treble damages penalty).[23] Such evidence is consistent with a diagnosis that the private enforcer tends to accept inadequate settlements.

The problem then is two-fold: First, when the private attorney general becomes a "free rider," society loses the promise that Judge Frank's theory held out: that private resources would supplement public efforts in the detection of law violations by bringing actions that otherwise would not have been initiated. Second, the ability of private law enforcement to create a credible penalty structure is undercut if the private watchdog can be bought off by tossing him the juicy bone of a higher-than-ordinary fee award in return for his acceptance of an inadequate settlement.

To say this is not to challenge the basic theory of private law enforcement, which still seems sound on grounds of efficiency, fairness, and the need for the legal system to maintain a stable system of signals. Private enforcement is potentially more "efficient," because only the successful attorney is compensated and because private enforcement may be able to mobilize and reallocate its resources more quickly than the public enforcer, who is confined within a bureaucratic setting.[24]

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23. *See* DuVal, *supra* note 15, at 1327, for the following conclusion: "Judged by results, the class action has proved a rather feeble engine of antitrust enforcement." DuVal's findings from his empirical study of private antitrust litigation in the Northern District of Illinois include the following salient points:

(1) In his sample, no litigated judgment was entered in favor of a class, even though defendants often won, and a significant percentage were settled with the named plaintiff for a "relatively small amount." *Id.*

(2) "The available data suggest that for the most part . . . [in the cases surveyed] defendants have been required to pay out an amount substantially less than the damages allegedly suffered by the class or classes injured" *Id.* at 1329.

(3) "[W]hile the results in class actions . . . [in this study] have been far from impressive, the availability of the class action remedy has enhanced private enforcement efforts to a limited extent." *Id.* at 1332.

This data must be interpreted cautiously. Despite this "warts and all" portrait of the private attorney general, the real issue is, as always, "what are the alternatives?" DuVal's finding, that there was at least some positive impact (even if an insufficient one to generate adequate deterrence) should remind us that it is premature to abandon private enforcement unless there is a superior alternative at hand which will be actually implemented.

24. The legislative history of the Fee Awards Act shows that Congress believed that private enforcement would normally be cheaper than public enforcement and that the private attorney general was thus a means of saving taxpayer funds by "limiting the growth of the enforcement bureaucracy." *See* Senate Report No. 94-1011, 94th Congress, 2d Sess., *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 5908, 5911 (June 29, 1976). *See also* Shadis v. Beal, 685 F.2d 824, 832 n. 12 (3d Cir. 1982). In the strict economic sense, private enforcement cannot be described as more efficient simply because the unsuccessful private attorney is not compensated. Although he receives no payment, a cost is still imposed on

Private enforcement also is potentially "fairer" because the private plaintiff does not have the same built-in advantage as the public prosecutor or regulatory agency, to whom courts have a tendency to defer. Nor may the private plaintiff stretch or change the rules to fit the needs of its case (as public agencies have been known to do).[25]

Equally important, private enforcement also performs an important failsafe function by ensuring that legal norms are not wholly dependent on the current attitudes of public enforcers or the vagaries of the budgetary process and that the legal system emits clear and consistent signals to those who might be tempted to offend. Absent private enforcement, potential defendants would have a considerably stronger incentive to lobby against public enforcement efforts or to seek to curtail funds to public enforcement agencies. Ultimately, private enforcement helps ensure the stability of legal norms by preventing abrupt transitions in enforcement policy that have not been sanctioned by the legislature.[26] Finally, there is nothing inevitable about the current pattern in which the private plaintiff piggybacks on the government's efforts. Counter-examples can be cited even within the context of antitrust enforcement where the government instead piggybacked on private enforcement.[27]

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society by his activities because resources are consumed unproductively. Still, this lost opportunity cost falls not on the taxpayer but on the unsuccessful enforcer. Thus, the allocation of the cost differs significantly.

25. Also, private enforcers cannot force settlements in weak cases by threatening the *in terrorem* penalties of incarceration or the public censure associated with a criminal conviction. Although the public prosecutor lacks any profit motive that might lead him to bring weak or marginal cases for their nuisance value, a prosecution can be motivated by ideological, political, and careerist motives, and it is an open question as to which set of perverse incentives is more dangerous. For a vigorous assertion of the thesis that public enforcers do so bend and twist the law to achieve their regulatory objectives, see R. KARMEL, REGULATION BY PROSECUTION: THE SECURITIES EXCHANGE COMMISSION VERSUS CORPORATE AMERICA (1982).

26. For example, between 1975 and 1982, the SEC sharply reduced the number of actions it brought against accounting firms; in 1975, 23 cases were initiated and, as of August 10, 1982, only one. *See* Hudson, "SEC Goes Easier on Accountants, Relying More on Self-Regulation," Wall Street Journal, August 10, 1982, at 29, col. 4. Absent private enforcement, this deregulation, which appears to have resulted as much from budgetary cutbacks as from changes in political philosophy, might result in under-enforcement of the antifraud provisions of the federal securities laws.

27. For example, widespread price fixing in the gypsum wall board industry was first revealed in a private treble damage action; later, the government began its own investigations. *See* United States v. United States Gypsum Company, 383 F. Supp. 462, 465 (1974). Another obvious example was the government's lengthy (and ultimately unsuccessful) prosecution of IBM. For years, the government's attorneys piggybacked on the work of the private plaintiffs (chiefly, Control Data) whose more experienced attorneys undertook the major discovery and document review work. Although the government lost, Control Data obtained a favorable settlement. *See* Brill, "What to Tell Your Friends About IBM," American Lawyer, April, 1982, at 12, col. 1.

Indeed, because only the private attorney general has the spur of the profit motive to encourage him and because he typically learns his trade during an early apprenticeship within the field of public enforcement (either in a regulatory agency or a U.S. Attorney's Office), one might logically expect private enforcement efforts to dwarf those of public agencies, as young public attorneys general would mature into older, more skilled private ones, with the public agency chiefly serving as the prosecutor of last resort for unprofitable cases and novel legal theories.[28] Instead, we see today a very different spectacle, one resembling the Oklahoma land rush, in which the filing of the public agency's action serves as the starting gun for a race between private attorneys, all seeking to claim the prize of lucrative class action settlements, which public law enforcement has gratuitously presented them.

If the consequences of such comic-opera spectacles were limited to the participants, there might be little cause for concern. But a more troublesome consequence of the current chaos has been increased judicial skepticism about the social utility of litigation conducted in this manner. In response, courts have begun to narrow and limit substantive statutory rights, seemingly because of their distaste for the process by which such rights are enforced. To be sure, dissatisfaction with the performance of the entrepreneurial plaintiffs' attorney is not the only reason for this erosion. Courts understandably resent the burdens these cases place on them; class and derivative actions are typically complex and time consuming, proceed at a glacial pace, and tend to proliferate a variety of collateral issues. In addition, our legal culture has always been ambivalent about the bounty hunter, accepting him at critical junctures as a necessary evil, but harassing and restricting him at other points in an entirely inconsistent manner.[29] As at least a partial result of these interrelated factors, recent Supreme Court decisions in the fields of antitrust and securities law have imposed new standing

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28. Public enforcers may have very different incentive structures from private enforcers, with the result that they may tend to concentrate on those cases likely to generate greater publicity and political visibility. Public enforcers also may be more interested in the importance of a legal precedent and thus more willing to seek to break new legal ground, because of the psychic income associated with such a victory. In contrast to private enforcers, public enforcers may be less interested in the financial damages recoverable, because money damages do not automatically correlate with greater visibility or the establishment of new precedents.

29. Professor Rhode states the underlying value conflict well: "A fundamental premise of American adjudicative structures is that clients, not their counsel, define litigation objectives." Rhode, *Class Conflicts in Class Actions*, 34 STAN. L. REV. 1183 (1982). The American Bar Association's Code of Professional Responsibility clearly embodies this view in Ethical Consideration 5-1, which states:

"The professional judgment of a lawyer should be exercised, within the bounds of the law, solely for the benefit of his client and free of compromising influences and loyalties and evidentiary hurdles in the path of the plaintiff.[30] Symbolically culminating this trend was the Supreme Court's *Alyeska* decision, which rejected the "private attorney general exception" to the "American rule" and thus prohibited fee shifting in the absence of express legislative authorization.[31] This result, only a few years after the Court's unusual award of *interim* attorneys' fees in *Mills v. Electric Auto-Lite Co.*,[32] shows the pendulum has swung from Frank's early optimism to a current pessimism about the utility of the private attorney general.

Accordingly, if one believes that the concept of the private attorney general remains valid, it is important to diagnose what has gone wrong. In overview, this article will argue that the incentives today held out to the private attorney general are both inadequate and counterproductive in terms of the social interests that private enforcement of law is intended to serve. To understand this contention, it is essential to understand first how the most distinctive feature of the private attorney general model affects the litigation and settlement process. Put simply, the hallmark of the private attorney general is that as a practical matter he is unconstrained by the dictates or interests of a specific client. How does the attorney's "emancipation" from his client change the outcome from what would obtain were the client in a better position to control his attorney? This article's answer is that four consequences tend to follow from the necessarily weak control that the

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. . . [H]is personal interest . . . should [not] be permitted to dilute his loyalty to his client." MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-1 (1971).

Acceptance of the plaintiff's lawyer as an entrepreneur who performs a useful social service by generating deterrence arguably conflicts with the traditional priority assigned to the client. *See Developments in the Law — Class Actions*, 89 HARV. L. REV. 1319, 1577-78 (1976). This basic tension crops up in a number of areas; one example involves the ability of the attorney to advance litigation expenses to his client. If the litigation is to be controlled solely by the clients, then logically the client should be the one ultimately responsible for its costs. Conversely, if the client is just an historical artifact and the lawyer-entrepreneur is the real party in interest in the large antitrust class action, then the attorney should be permitted to fund the litigation. Symptomatically, current law compromises: Disciplinary Rule 5-103 (B) permits a lawyer to advance expenses "provided the client remains ultimately liable for such expenses." MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 5-103(B) (1971). The Kutak Commission has proposed a liberalization of this rule under which the client need not reimburse the attorney if the action is unsuccessful, but must reimburse him out of the proceeds of any settlement. *See* Findlater, *supra* note 6. Continuing controversy seems likely, because there is a basic conflict here about the nature of the lawyer's role. Some accept and some reject the "view of the lawyer as a calculating entrepreneur regulated by calculating judges." *See* Leubsdorf, *supra* note 4, at 481.

30. *See, e.g.*, Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976); Santa Fe Industries v. Green, 430 U.S. 462 (1977); TSC Industries v. Northway, 426 U.S. 438 (1976); Touche Ross & Co. v. Redington, 442 U.S. 560 (1979); Transamerica Mortgage Advisers, Inc. v. Lewis, 441 U.S. 11 (1979).

31. Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240 (1975).

32. 396 U.S. 375, 396 (1970).

client can exercise over the attorney in complex class and derivative actions, and together these consequences weaken and potentially cripple private enforcement of law by means of the private attorney general:

1. *The Factor of Risk Aversion*—Because the lawyer as bounty hunter has reason to be more risk averse than the clients he represents, his relative independence from his client implies also a greater danger of inadequate settlements, which in turn undercuts the deterrent threat of the law. For example, assume that in a given case, the plaintiff has a fifty-fifty chance of securing a one million dollar judgment. If the plaintiff is risk neutral, he will accept a $500,000 settlement (which simply reflects the fifty percent probability of an adverse judgment), but if he is risk averse he will accept less (although if he is a risk preferrer, he will demand more than $500,000 to settle).[33] Why should the attorney be more risk averse than his client? As others have recognized,[34] the private attorney general typically has more at stake than his client, for whom the recovery may be de minimis on an individual basis. If the attorney has invested years of effort, the litigation may represent the most important asset (albeit a contingent one) on his personal balance sheet. In addition, where the attorney has borrowed to finance the litigation, he literally may face insolvency if the judgment were for the defendant.[35] In short, once we recognize that the private attorney gen-

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33. For a fuller discussion of risk aversion and its impact on the enforcement of law, see Breit & Elzinga, *Antitrust Penalties and Attitudes Toward Risk: An Economic Analysis*, 86 HARV. L. REV. 693 (1973). *See also* ELZINGA & BREIT, *supra* note 2, at 120-29.

34. In Alleghany Corp. v. Kirby, 333 F.2d 327, 347 (2d Cir. 1964) (dissenting opinion), *aff'd per curiam en banc by equally divided court*, 340 F.2d 311 (2d Cir. 1965), *cert. denied*, 383 U.S. 28 (1966), Judge Friendly put the matter succinctly:

> The plaintiff stockholders or, more realistically, their attorneys have every incentive to accept a settlement that runs into high six figures or more regardless of how strong the claims for much larger amounts may be . . . . [A] juicy bird in the hand is worth more than the vision of a much larger one in the bush, attainable only after years of effort not currently compensated and possibly a mirage.

See also Saylor v. Lindsley, 456 F.2d 896, 899-900 (2d Cir. 1972) (Friendly, J.):

> There can be no blinking at the fact that the interests of the plaintiff in a stockholder's derivative suit and of his attorney are by no means congruent . . . . The risks in proceeding to trial vary even more essentially. For the plaintiff, a defendant's judgment may mean simply the defeat of an expectation, often of relatively small amount; for his lawyer, it can mean the loss of years of costly effort by himself and his staff.

35. For example, in *In re* Corrugated Container Antitrust Litigation, 80 F.R.D. 244 (S.D. Tex. 1978), the lead plaintiff's counsel, Stephen Susman, was obliged to separate from his original law firm and form a new firm with several of his partners who were also active in the case; they then financed the litigation through a $400,000 bank loan. *See* Lempert, *supra* note 17, at 11, col. 1. It is not surprising that a law firm would break up over a decision whether to invest the firm's resources so heavily in a single high-risk action. The new law firm that Susman and several of his co-partners formed to continue the litigation invested

eral is an entrepreneur, who assesses costs and benefits in the same manner as do other economic decision-makers, then we must realize that the more substantial his investment, the greater his probable level of risk aversion and the higher his vulnerability to a settlement offer which would be rejected by a risk-neutral decision-maker. Although defendants also may be risk averse, their greater size, financial resources, and ability to insure or seek indemnification creates an imbalance — which predictably tilts the bargaining in their favor.

Risk aversion produces not only inadequate settlements that undermine the deterrent value of private enforcement, but also fosters responsive counter-strategies by the private enforcer that are equally destructive to the utility of private enforcement of law. If the private enforcer is risk averse and therefore will not gamble his time and effort on an extended litigation, his most logical strategy is to bring a high volume of cases, thereby spreading his risk, but in consequence investing relatively little time or effort in any single case. Exactly this pattern of high caseload coupled with little investment in case preparation seems to characterize some areas of private enforcement; for example, defendants' attorneys have long complained that the plaintiffs' bar in derivative actions tends to file a large number of actions based on only a cursory familiarity with the underlying transactions.[36] To the risk-averse plaintiffs' attorney, this strategy is efficient because a high volume of cases may give him a greater certainty of the same economic reward through multiple small settlements than does an equivalent investment of time in a single action of greater merit.[37]

75% to 80% of its time during its initial year in the *Corrugated Container* case and received little other income. *Id.* To do this, one has to have a fairly high level of risk tolerance (or a very optimistic view of the litigation odds), and in most law firms there will be many unwilling to take such a gamble or subsidize those attorneys who are so willing. Hence, it is difficult for plaintiffs' attorneys to associate with a firm having a large diversified practice and able to carry the high-risk litigation during its pendency. The author is also familiar with other examples in which plaintiffs' law firms have fissioned over similar issues.

36. Of course, plaintiffs' lawyers will dispute this characterization, and it is not the point of this article to associate greater virtue with either side in the litigation. Yet, as a result of a number of conversations with both plaintiffs' and defendants' attorneys who engage in derivative action litigation, I have heard recurrent reports of some specific plaintiffs' attorneys who do file a high volume of such litigation in the hopes of obtaining a few quick settlements. In the parlance, these attorneys are derisively called "pilgrims" (because they believe in "early settlements"). Some defendants' attorneys in Delaware have asserted to me that one or two plaintiffs' firms active in that jurisdiction may account for as much as 25% (or more) of the pending derivative actions in the Delaware Chancery Court. Whether or not this is exaggerated, it is an economically rational (if undesirable) response to the problem of risk aversion which a solo practitioner or small firm must regularly face.

37. Portfolio diversification is a standard economic method to reduce volatility risk by reducing the variance associated with an expected return so that the expected return is made more certain. If, for example, the plaintiff's attorney could be certain of a 50% return on a

Still, although a strategy of risk diversification through a high-volume, low-intensity practice makes sense for the individual attorney, its overall social utility is highly dubious, because it both fills the courts with actions of questionable merit and encourages the stigmatization of plaintiffs' attorneys as "strike suiters." The critical point here is not the propriety of such behavior, but the evident social interest in encouraging alternative means of reducing risk aversion that do not produce socially harmful consequences. Based on this diagnosis, this article will offer a specific prescription that relies on the standard answer of economic theory to the problem of risk aversion — namely, portfolio diversification. Here, this means permitting and encouraging the plaintiff's attorney to diversify his portfolio in a manner that permits him to accept a higher level of risk and to concentrate intensively on the single case, rather than scattering his attention diffusely.

2. *The Danger of Collusion*—The possibility of collusive settlements grows in direct proportion to the attorney's "independence" from his client. The naked self interest of the bounty hunter lies in his fee, not the recovery to the class. As others have said many times, the parties can find a variety of means by which to trade a low settlement for a high attorney's fee, once the client becomes only a distant bystander to the litigation.[38] To say this is not to claim that plaintiffs' attorneys systematically subordinate the class recovery to their own fee, but it is to say that the plaintiff's attorney is subject to a serious conflict of interest — one that can distort the settlement process and reduce the

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$1,000,000 class action, he would not settle for less than $500,000 (discounted to present value), and he would reject the much lower settlement that would be accepted by a risk-averse decision-maker who cannot afford the all-or-nothing gamble that a trial imposes on him. For a concise introduction to the concepts of expected return, variance, and risk aversion, see W. KLEIN, BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES 145-55 (1980).

Several means are possible by which to reduce risk through risk diversification, but some of these are inconsistent with the policy objectives of the private attorney general. For example, the high-volume, low-yield practice discussed above reduces variance but converts the private attorney general into the "strike suit" extortionist of the defendant's lore. Alternatively, the attorney can associate with a firm having a diversified practice, but this is difficult to achieve if the firm's partners are reluctant to subsidize the lengthy litigation. For an example of a firm fissioning under this strain, see *supra* note 35. A third means of reducing variance is fee-sharing or work-sharing agreements among plaintiffs' attorneys, so that reciprocal participations are exchanged. This concept is discussed *infra* in the final section of this article. *See infra* text accompanying notes 148-152.

38. With respect to the dangers of private or "sweetheart" settlements in representative actions, Judge Friendly has been particularly outspoken. *See supra* note 34. *See also* Handek, *The Settlement and Dismissal of Stockholders' Actions — Part I*, 22 SW. L.J. 767, 768-70 (1968); Rosenfeld, *An Empirical Test of Class Action Settlement*, 5 J. LEGAL STUD. 113 (1976).

deterrent effect of private litigation — whenever the determination of the fee award is not made a sufficiently direct function of the size of the recovery so as to align the interests of the private enforcer with those of the class he purports to represent.[39] As will be seen, the existing incentive structure does little to assure such an alignment but does much to prevent it.

3. *The Absence of Property Rights in the Action*—The effective absence of the client also creates a problem of nonexcludability: because no practical means exist by which the typically large class can select or reject its own attorney, multiple attorneys volunteer to serve as counsel to the class by filing separate parallel actions. These actions are then consolidated by the courts, and in the complex bargaining process that necessarily follows to choose the lead counsel, the bounty established by the state to reward the private enforcer is divided among them and thus diluted. As a result, the individual attorney lacks a sufficient incentive to invest time or money in the preparation or development of private actions; he cannot be assured of being able to capture the expected return (the fee award) because he cannot exclude other attorneys who may wish to join in the action.[40] In economic terms, this is a classic problem of inadequately specified property rights — the private attorney is in the same position as an inventor who knows he cannot patent an invention that he forsees or a prospector who cannot stake out a legally binding claim. In such situations, one cannot reasonably expect the inventor or prospector to invest the same effort in search and discovery as they would if they could be assured of the ability to reap the full economic return from their invention or discovery.[41]

39. An important qualification is necessary: The attorney cannot perfectly align his interests with those of the client that he represents. Both the hourly rate formula and the percentage-of-the-recovery formula have their characteristic deficiencies. *See* Clermont & Currivan, *Improving the Contingent Fee*, 63 CORNELL L. REV. 529, 536 (1978).

40. As will be discussed *infra*, the court generally will not deplete the settlement fund in order to pay attorneys' fees below some minimum level. Existing practice strongly suggests that there is some maximum percentage of the fund that the court will give to the attorneys (usually in the 20% to 30% range). *See* Mowrey, *Attorney Fees in Securities Class Actions and Derivative Suits*, 3 J. CORP. LAW 267, 343-48 (1978). Thus, the more attorneys who enter the action (either as intervenors or through consolidation of parallel actions), the more this de facto percentage ceiling on fees will tend to reduce the fees obtainable by the initial entrants. In addition, because lead counsel has a disproportionate voice in determining who is paid attorneys' fees, the political process surrounding his selection in effect becomes a struggle over the allocation of this economic return. As a result, the nonexcludability of late entrants opens up a political bargaining game over the allocation of the attorneys' fees, and this in turn chills the incentive to invest time or effort in the first instance by the initial private enforcer.

41. For a discussion of this general problem, see Kitch, *The Law and Economics of Rights in Valuable Information*, 9 J. LAW & ECON. 683 (1980).

4. *The Disparity in Search Costs*—A fourth characteristic of private litigation in which the linkage between the attorney and his client is tenuous is that high and uncertain "search costs" are connected with such litigation. The point here is not simply that it is difficult to discover or prove that covert activities such as price-fixing or insider trading have occurred, but that the attorney without a "true" client lacks the initial source of information that the attorney has in other forms of litigation — the data that his client provides him.[42] Self-serving and incomplete as client revelations often may be, they at least supply a valuable starting point and save effort; with them, the attorney has only to verify; without them, he must play private detective. Without a client to tell him what has happened and faced with high search costs, the lawyer as bounty hunter still has one cheap source of information—the government, which provides him with free information in the form of indictments, complaints, official reports, and investigations.[43] Not only is such information free, but the government also may make it incontestable through the operation of the familiar principles of collateral estoppel if there has been a prior proceeding that resulted in a judgment.[44] In short, the government subsidizes the bounty hunter by in effect telling him how and where to find his prey.

When we integrate the foregoing four factors — (1) risk aversion, (2) the potential for collusion, (3) an inadequate system of property rights, and (4) the disparity in search costs — we generate a simple model that has substantial predictive power by which to explain contemporary patterns in class and derivative actions. Together, these factors explain: why the private enforcer rides the government's coattails and seldom initiates his own cases (because of factors (1), (2), and (4)); why antitrust settlements seldom produce recoveries that exceed simple compensatory damages despite the treble damages provision of the antitrust laws[45] (because of factors (1) and (2)); and why some recent class actions have had a hundred or more attorneys representing the plaintiff's side (because of factor (3)). Concise as this statement is, it still leaves much out (as all models inevitably do). This article does not insist that an abstract model can explain everything of interest (either to the bar or to a policy planner), nor does it deny that complex institu-

42. Significantly, the few cases in which private antitrust enforcement preceded a governmental proceeding were those in which there was an active client who supplied the attorneys with the relevant data. *See supra* notes 18 & 27.

43. *See* Reich, *supra* note 2, at 1065 ("Plaintiffs' counsel can increase their revenues . . . by depending upon the government to undertake test runs of liability in advance.").

44. *See* Parklane Hosiery Co. v. Shore, 439 U.S. 322 (1979).

45. *See* DuVal, *supra* note 15, at 1329 (finding that defendants in his study had paid "substantially less than the damages allegedly suffered by the class . . . .").

tional arrangements must be examined in detail before appropriate reforms can be safely proposed. Indeed, this article's principal concern is with the application of theory to practice. Thus, its central thesis is two-fold:

(1) on the *theoretical* level, the foregoing factors explain why the private attorney general model is not working as intended; and
(2) on the *applied* level, our existing structure of legal rules and practices compounds the dilemma at the critical junctures, either by aggravating the problem or by blocking logical reforms.

Before proceeding to analyze the perverse incentives that current law has generated, it is important to limit the foregoing analysis to the context in which it is intended to apply. There are today two basic types of private attorneys general: the "ideological" and the "entrepreneurial." The former is typically organized into "public interest" law firms, is financed by foundations or membership donations, and tends in general to be faithful to, and closely controlled by, the social and political groups that he is serving. The latter is our true "bounty hunter," motivated by the financial recovery obtainable, rather than by psychic income, and effectively beyond the control of the typically large and amorphous class of clients that he seeks to represent. The entrepreneurial attorney has considerable reason to regard his fellow plaintiffs' counsel as more his competitors than his colleagues, because they are all engaged in a race to claim the prize which in effect has been offered them by the prior governmental proceeding or investigation. This article addresses only this latter context and does not intend that its analysis should be applied to attorneys who are either motivated by political or ideological goals or employed by organizations able to direct their efforts. Nor does its analysis apply in those areas of litigation where the client is effectively able to control his attorney (such as in the non-class action private antitrust action) or where other factors (such as low search costs) produce a very different incentive structure than that discussed above.[46]

Today, it is clear that in some areas of litigation — private anti-

46. For example, few would deny that the private attorney general has won significant victories (both financial and precedential) in securities fraud actions. *See, e.g.*, Escott v. Bar Chris Construction Corp., 283 F. Supp. 643 (S.D.N.Y. 1968); Gould v. American-Hawaiian S.S. Co., 535 F.2d 761 (3d Cir. 1976). In these cases, the plaintiff class was both numerous and widely dispersed, but search costs were low because the likelihood of a legally cognizable injury was signalled by the decline in the market price of the issuer's stock. The intelligent private enforcer therefore had substantial reason to believe that an investigation by him would disclose the omission of a material fact (or material misstatement) that would support a successful class action. Indeed, a catastrophic decline in market price virtually assures the private enforcer that there must somewhere be an actionable disclosure violation.

trust class actions, securities class actions, shareholder derivative actions, and mass tort and product liability cases — the "entrepreneurial" private attorneys general predominate, while in other areas — civil rights, environmental law, and poverty law — the "ideological" private attorneys general are the principal players. This dichotomy may not last much longer. As foundation support for public interest law wanes and as more attorneys become acquainted with the substance of (and profit potential in) fields such as environmental law and employment discrimination, one would expect to see a migration of "entrepreneurial" attorneys into these latter fields. The field of employment discrimination probably already represents an intermediate case in which the plaintiff's attorney is substantially motivated by economic considerations, but also is constrained by the smaller size of the plaintiff class and the typically intense interest of at least some of the injured plaintiffs in these actions.

Thus, few prophecies seem as safe as the following one: if we fail to come to grips with the deficiencies in the current regulation of the private attorney general, these same problems eventually will appear in those fields of law now dominated by the "ideological" private attorney general. Ultimately, the choice is either a rehabilitation of the private attorney general concept, or a continued trend toward judicial winnowing of class and derivative actions, as courts impose more procedural and evidentiary hurdles on the plaintiff because of their dissatisfaction with the cases they see brought before them.

II. THE PROBLEM OF PERVERSE INCENTIVES

Courts today regulate the lawyer as bounty hunter at four principal stages: (1) at the class certification stage, the court determines if the representation is adequate and the case sufficiently manageable so that it may proceed as a class or derivative action;[47] (2) the court approves the selection of a lead counsel from among the contending plaintiffs' counsel and thereby has at least potential control over the organization and staffing of the action;[48] (3) the court approves the settlement pro-

47. *See* FED. R. CIV. P. 23(a)(4). Of course, Rule 23 mandates that the court make a number of other determinations as well, but the issue of adequacy uniquely goes to the character of the representation and so affords an opportunity for regulation of the lawyer as bounty hunter. *See* Cullen v. N.Y. State Civil Serv. Comm'n, 566 F.2d 846, 848 (2d Cir. 1977); National Ass'n of Regional Medical Programs v. Mathews, 551 F.2d 340 (D.C. Cir. 1976), *cert. denied*, 431 U.S. 954 (1977). Discovery is normally permitted to a party with respect to the issue of counsel's adequacy. *See, e.g.*, Stahler v. Jamesway Corp. 85 F.R.D. 85 (E.D. Pa. 1979).

48. *See* MANUAL FOR COMPLEX LITIGATION § 1.92 (5th ed. 1981); *see also* Goodbody, *Complex and Multidistrict Litigation*, 3 CLASS ACTION REPORTS 71, 73-74 (1974). This area

posed to it by the parties;[49] and (4) the court determines the attorneys' fees to be paid a successful plaintiff's counsel and thereby in effect sets the bounty.[50] Classically, the third stage has been the one designed to protect the legal system from improper settlements that benefit the plaintiffs' attorney, but not his clients. But by most accounts, judicial scrutiny of the settlement's adequacy has proved to be a weak reed on which to rely. As Judge Friendly has said, once the adversaries lock arms to present the settlement to the court, "all the dynamics conduce to judicial approval of the settlement."[51] This is not to say that courts cannot detect improper settlements (for plainly they have done so),[52] but that any system that depends upon extraordinary vigilance by judges is inferior to one that by structural redesign minimizes the existing incentives for collusion and delay.

Accordingly, this article will focus on the stages of fee determination and case organization where existing practices most exacerbate the theoretical problems earlier discussed. At these stages, the current incentive structure, it will be argued, tends to:

(1) foster de facto collusion between the adversaries;
(2) encourage a Dickensian level of delay and duplication on the level of his famous *Jarndyce v. Jarndyce*;[53]

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is not directly addressed by statute or by the Federal Rules of Civil Procedure, but MacAllister v. Guterma, 263 F.2d 65 (3d Cir. 1958) is often cited as recognizing the court's authority to appoint a "lead counsel" who would have substantial control over the plaintiff's side of the litigation. *See id.* at 68-69 (dictum). *See also* Vincent v. Hughes Air West, Inc. 557 F.2d 759, 773 (9th Cir. 1977); *In re* Air Crash at Florida Everglades, 549 F.2d 1006, 1017 (5th Cir. 1977). A sample order establishing the powers of such appointed lead counsel is set out in 1 J. MOORE, MOORE'S FEDERAL PRACTICE, MANUAL FOR COMPLEX LITIGATION § 1.92-I (2d ed. 1981).

49. For the governing standards to be used under FED. R. CIV. P. 23(e), see MANUAL FOR COMPLEX LITIGATION § 1.46 (5th ed. 1981).

50. For the currently governing "lodestar" standard, see *infra* notes 56-63 and accompanying text.

51. Alleghany Corp. v. Kirby, 333 F.2d 327, 347 (2d Cir. 1964) (dissenting opinion), *aff'd en banc by an equally divided court*, 340 F.2d 311 (2d Cir. 1965), *cert. denied*, 383 U.S. 28 (1966).

52. *See, e.g.*, Jamison v. Butcher & Sherrerd, 68 F.R.D. 479 (E.D. Pa. 1975); Fistel v. Christman, 133 F. Supp. 300 (S.D.N.Y. 1955); Krasner v. Dreyfus Corp., 500 F. Supp. 36 (S.D.N.Y. 1980). Although appellate courts will often grumble about irregularities in the settlement process, they are hesitant to reverse, and fond of concluding that the policy considerations weigh heavily in favor of upholding settlements. *See In re* Corrugated Container Antitrust Litigation, 643 F.2d 195 (5th Cir. 1981), *cert. denied*, 102 S. Ct. 228 (1982); Materson v. Pergament, 203 F.2d 315, 330 (6th Cir. 1953), *cert. denied*, 346 U.S. 832 (1953). *Cf.* In re General Motors Corp. Engine Interchange Litigation, 594 F.2d 1106 (7th Cir. 1979), *cert. denied*, 444 U.S. 870 (1979).

53. C. DICKENS, BLEAK HOUSE (1980 ed.). Dickens described this litigation thusly:

> Jarndyce and Jarndyce drones on. This scarecrow of a suit has, in course of time, become so complicated that no man alive knows what it means. The parties to it under-

> (3) produce a plaintiff's team that is often organized and run along the lines of a W.P.A. work relief project; and
> (4) result in a system-wide misallocation of effort under which the private attorney general restricts his role to that of a vulture feeding on the carrion left by public enforcers and seldom stalks his own prey.

These are strong statements and deliberately so. At the same time, however, this thesis does not assert that the concept of the private attorney general is doomed to failure, but only that we have designed a system whose principal features now ensure its own frustration. Interestingly, the legal rules that seem most responsible for this current dysfunction in private enforcement are of comparatively recent origin, dating from no more than a decade ago. Thus, the curious paradox is that just as our legal system has accepted the bounty hunter, it has correspondingly changed the rules in a way that frustrates the forces it unleashed. If all this suggests a somewhat schizophrenic quality to our legal system, it may well be a recurring characteristic of our legal culture that formal changes accepted on a doctrinal level are still frequently resisted and partially nullified on the less visible level where operational decisions are routinely made. Behind this phenomenon may lie such factors as cultural lag, bureaucratic resistance, and professional self-interest, but also it may be the case that this apparent paradox is the result of a stalemate under which the proponents of the private attorney general have won on the theoretical level but have been checked on the operational level. In short, our society's actual acceptance of the private attorney general may be more tentative and incomplete than it first appears.

> stand it least, but it has been observed that no two Chancery lawyers can talk about it for five minutes without coming to a total disagreement as to all the premises. Innumerable children have been born into the cause; innumerable young people have married into it; innumberable old people have died out of it. Scores of persons have deliriously found themselves made parties in Jarndyce and Jarndyce without knowing how or why; whole families have inherited legendary hatreds with the suit. The little plaintiff or defendant who was promised a new rocking-horse when Jarndyce and Jarndyce should be settled has grown up, possessed himself of a real horse, and trotted away into the other world. Fair wards of court have faded into mothers and grandmothers; a long procession of Chancellors has come in and gone out; the legion of bills in the suit have been transformed into mere bills of mortality; there are not three Janrdyces left upon the earth perhaps since old Tom Jarndyce in despair blew his brains out at a coffee-house in Chancery Lane; but Jarndyce and Jarndyce still drags its dreary length before the court, perennially hopeless.

Id. at 20.

A. *The Financing of the Private Attorney General: the Incentives For Collusion and Delay*

To understand why the incentives are today perverse, it is useful to begin with a brief historical background. Until the early 1970's, plaintiff's counsel in a class or derivative action was basically compensated under a "salvage value" or percentage-of-the-recovery formula, which typically awarded him somewhere between twenty percent and thirty-five percent of the financial recovery that his efforts produced for the class.[54] This exception to the normal "American rule" that each party must bear his own litigation expenses was based on the attorney's creation of a common fund, which principles of equity and unjust enrichment dictated could be assessed for his fee.[55] With the revision of the *Manual for Complex Litigation* in 1973, however, a new formula was proposed that essentially compensated the attorney based on the time he reasonably expended on the action.[56] In the *Lindy* and *Grinnell* decisions,[57] the Second and Third Circuits quickly adopted this "lodestar" formula, under which the number of hours the attorney reasonably expends in the action are multiplied by the attorney's normal hourly rate; and then, a "contingency bonus" may be added in the court's discretion, chiefly to compensate the attorney for the risk assumed by him in taking a contingent fee case.[58] Although each federal

54. *See* Hornstein, *The Counsel Fee in Stockholders' Derivative Suits*, 39 COLUM. L. REV. 784, 813 (1939); Mowrey, *Attorney Fees in Securities Class Actions and Derivative suites*, 3 J. CORP. LAW 267, 334-36 (1978). For a blunt holding that 20% of the recovery was a reasonable measure of the value of services rendered, see Pergament v. Kaiser-Frazer Corp., 224 F.2d 80, 83 (6th Cir. 1955). One author has concluded, after surveying some 60 decisions, that prior to the appearance of the lodestar formula in the 1970's, the standard percentage was between 20% and 30% for recoveries under $1 million and somewhat less when the recovery exceeds that level. *See* Mowrey, *supra*, at 337.

55. *See* Dawson, *Lawyers and Involuntary Clients: Attorneys' Fees from Funds*, 87 HARV. L. REV. 1597 (1974).

56. *See* MANUAL FOR COMPLEX LITIGATION § 1.47 (5th ed. 1981). For the conclusion that the 1973 revision of the *Manual* initiated the recent transition in the formula for the award of attorneys' fees, see W. CARY & M. EISENBERG, CASES AND MATERIALS ON CORPORATIONS 940-41 (5th ed. 1980).

57. *See* Lindy Bros. Builders, Inc. v. American Radiator & Standard Corp., 487 F.2d 161 (3d Cir. 1973) (*"Lindy I"*); Lindy Bros. Builders, Inc. v. American Radiator & Standard Sanitary Corp., 540 F.2d 102 (3d Cir. 1976) (en banc) (*"Lindy II"*); City of Detroit v. Grinnell Corp., 495 F.2d 448 (2d Cir. 1974).

58. Once this "lodestar" amount is computed, the court then moves to a second stage and determines if a bonus or "multiplier" is to be added to compensate the attorney for the risk he assumed and the deferral of his payment. For an in-depth analysis and critique of this element of the lodestar formula, see Leubsdorf, *supra* note 4. The Second Circuit's decision in *Grinnell* appears to have been the first appellate opinion explicitly to instruct trial courts to increase the contingency bonus in proportion to the risk of the litigation. *See* City of Detroit v. Grinnell Corp., 495 F.2d 448, 471 (2d Cir. 1974). Recent surveys have found the contingency bonus (or "multiplier") to have averaged around 50% (or 1.5 times the

circuit court today has its own slightly different phrasing of the lodestar formula[59] and a treatise could be written with respect to the subsidiary issues involved in its computation,[60] the more important fact is that in the vast majority of federal courts plaintiffs' attorneys are now compensated based on the time they expended (or claim to have expended), not on the recovery they obtained. This transition from a percentage formula to a time formula has an obvious impact on the incentives held out to the plaintiff's attorney: it creates an incentive to multiply the hours.[61] To paraphrase General Electric's old slogan, a lawyer's "pro-

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"lodestar" hourly base), but in some cases multipliers as high as 3.5 and 4.03 have been awarded. Leubsdorf, *supra* note 4, at 479 n. 36. *See also* Keith v. Volpe, 501 F. Supp. 403, 414 (C.D. Cal. 1980) (fee multiplied by 3.5 multiplier).

59. In particular, the Fifth Circuit uses a somewhat different approach under which the trial court is to consider 12 specified factors. *See* Johnson v. Georgia Highway Express, Inc., 488 F.2d 714, 71-19 (5th Cir. 1974). But the Fifth Circuit appears to have reinterpreted their approach so that it today is consistent with the *Lindy/Grinnell* standard. *See* Copper Liquor, Inc. v. Adolph Coors Co., 624 F.2d 575, 583 (5th Cir. 1980). *See also* Anderson v. Morris, 658 F.2d 246, 149 (4th Cir. 1981).

At least seven of the federal courts of appeals have now approved the award of contingency bonuses. *See* Leubsdorf, *supra* note 4, at 473 n. 1.

60. In particular, the following issues have given rise to a substantial volume of litigation:

(1) Should the "reasonable hourly rate" be judged by local community standards in the district court in which the action is brought, or by those of the community in which the attorney works, or by nationwide standards? The trend is toward the local community in which the action is brought. *Compare* Donnell v. United States, 682 F.2d 240 (D.C. Cir. 1982) (applying local standards) *with* Jorstad v. I.D.S., 643 F.2d 1305 (8th Cir. 1981) (vacating nationwide standard). Arguably, such a rule is neutral, but perhaps more importantly it also protects the court from local criticism, because it spares it the necessity of awarding large fees to higher-priced urban counsel while awarding only a lower hourly rate to local or regional firms.

(2) Should the hourly rate be the current one of the attorney or his historical one over the course of the action? There is currently a conflict among the cases. *Compare* Richerson v. Jones, 506 F. Supp. 1259, 1264 (E.D. Pa. 1981) (historical rate) *with In re* THC Financial Corp. Litigation, 86 F.R.D. 721 (D. Hawaii 1980) (current rate).

(3) What time should be disallowed? Disagreements exist as to whether hours spent in preparing the attorney's fee petition should be allowed. *Compare* Jorstad v. I.D.S., 643 F.2d 1305 (8th Cir. 1981)(allowed) *with* Seigal v. Merrick, 619 F.2d 160 (2d Cir. 1980) (disallowed).

(4) When is the time actually expended still unreasonable in light of the results obtained? *See* Copeland v. Marshall, 641 F.2d 880, 891 (1980) ("It does not follow that the time *actually* expended is the amount of time reasonably expended.").

(5) What sorts of time records should be required and how standardized and contemporaneous must they be? *See* Nat. Ass'n of Concerned Veterans v. Sec. of Defense, 675 F.2d 1319, 1327-28 (D.C. Cir. 1982) (detailed summaries based on contemporaneous time records required).

61. Defense attorneys have objected that as a result of the lodestar formula it now takes longer to settle a case because the plaintiffs' attorneys have an incentive to stretch out the negotiations. *See* Herzel & Hagan, *Plaintiffs' Attorneys' Fees in Derivative and Class Actions*, LITIGATION 25-26 (Winter 1981). To this claim, the economist may retort that the plaintiff's attorney has an opportunity cost the same as any other businessman and will not waste

gress" is now his most important product.

What prompted this transition from a percentage-of-the-recovery formula to a time formula? First and most important, federal judges had become embarrassed by the enormous fees that plaintiffs' attorneys had received in some much publicized antitrust treble-damage class actions. In the typical class action in which a governmental action precedes the private one, the conventional wisdom is that the plaintiff has only to "shoot fish in the barrel." Yet following the famous electrical equipment price-fixing case of the early 1960's, a percentage-of-the-recovery formula resulted in individual attorneys receiving fees estimated at around ten million dollars for a relatively brief investment of time in a simple case.[62] The chorus of protest at this result (much of it from self-interested defendants) made judges receptive to any formula that did not expose them to criticism for awarding a windfall profit.[63]

Second, a time formula was doctrinally attractive because it enabled the legal community to view the private attorney general not as a bounty hunter, but rather as simply a lawyer compensated in the same manner as other lawyers have been since time immemorial: on the basis of his hours of service to his client. Once again, the basic ambivalence of the legal community toward the bounty hunter surfaces here and makes a time-based formula intellectually inviting, because it permits collective repression of the dirty little secret that the bounty hunter has no real client. Scholars have suggested that the legal community has an

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hours pointlessly. But, the "normal hourly billing rate" of most attorneys is likely to be substantially in excess of their true opportunity cost because at that rate most attorneys have additional time available; thus, their hourly rate is not the equilibrating price that brings supply and demand into balance. Hence, even in the absence of fabricated hours or rates, there is an incentive to delay.

62. *See* Bruck, "Harold Kohn Against the World," *supra* note 17, at 29 (estimate of Harold Kohn's fee). Kohn is also quoted in this same article, estimating that his own fee was less than that of another counsel in the action, Milton Handler.

63. This sensitivity to the criticism that courts were awarding windfall profits is particularly evident in the *Grinnell* decision, which includes the following quotation: "For the sake of their own integrity, the integrity of the legal profession and the integrity of Rule 23, it is important that the courts should avoid awarding 'windfall fees' and that they should avoid every appearance of having done so." City of Detroit v. Grinnell Corp., 495 F.2d at 469 (2d Cir. 1974) *Grinnell I*, *quoted in* City of Detroit v. Grinnell Corp., 560 F.2d 1093, 1098-99 (2d Cir. 1977) (*Grinnell II*). The *Lindy/Grinnell* lodestar formula must be recognized as at least partially motivated by a judicial desire for self-protection. To be sure, a desire to minimize the appearance of unjust enrichment is a legitimate concern, and courts should guard their own prestige carefully. But ironically, *Lindy* and *Grinnell* have not much affected the amount of fees received by plaintiffs' counsel, at least in cases with recovery amounts of more than $1 million. *See* Mowrey, *supra* note 40 at 343-48. Rather, they have chiefly served to insulate courts from criticism about the amount of such fees. Understandable as a desire for self-protection is, it appears here to have been purchased at the price of both increasing the possibility of inadequate or collusive settlements and creating an incentive for dilatory tactics. In this author's view, this price has been much too costly.

essentially pre-industrial view of itself as in effect a cottage industry of individual craftsmen.[64] In this light, a time-based formula enabled the bar to maintain a nostalgic, but false, consciousness of itself as professionals performing in essentially the same way as the nineteenth-century English barrister.

Finally, the increasing popularity of nonpecuniary settlements in securities law actions and derivative suits created a need for a formula that looked to something besides the value of the relief secured, at least in those cases where the relief was intangible and not capable of easy valuation. During the 1970's the Supreme Court repeatedly emphasized the importance of disclosure to investors and in *Mills v. Electric Auto-Lite Co.*,[65] it used language which suggested that disclosure was a valuable benefit in itself, regardless of the fairness of the underlying transaction. *Mills* thus put the Supreme Court's imprimatur on the nonpecuniary settlement. These settlements became increasingly popular later in the decade as the result of both the challenges by "public interest" law firms to management's actions during the foreign corrupt payments scandals of the 1970's and the explosive growth of environmental litigation in which pricing the value of clean air, pure water, or preserved wilderness was simply not practical.[66] The next step in this development seems, in hindsight, inevitable given the intellectual ethos of the 1970's: liberal reform became exploited by those having ulterior purposes. Amidst the hyperbolic rhetoric of that era, it was difficult to recognize that a liberal-sounding idea, which made considerable sense

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64. Abel, *Toward a Political Economy of Lawyers*, 1981 WISC. L. REV. 1117, 1184-86 (1981).

65. 396 U.S. 375, 396 (1970). The *Mills* Court further noted: "In many suits under § 14(a), . . . it may be impossible to assign monetary value to the benefit." *Id.* Where this is true, a justification for a time formula certainly exists, although one can reasonably debate how often this is the case in the corporate and antitrust fields. In any event, this justification for use of a lodestar formula is overbroad when applied to those areas where the value of the benefit can be determined.

Prior to *Mills*, some courts had recognized in the context of derivative actions that a "substantial benefit" could be realized without a monetary recovery accruing to the corporation. *See* Bosch v Meeker Cooperative Light & Power Ass'n, 101 N.W.2d 423, 425 (Minn. 1960); Abrams v. Textile Realty Corp., 97 N.Y.S.2d 492 (1949). But these cases usually involved an injunction or other equitable remedy against an actual or threatened injury, whereas in *Mills* disclosure itself became the benefit.

66. A much-discussed case during this era was Springer v. Jones, Civ. Action No. 74-1455 F (C.D. Cal. 1974), which involved foreign payments made by Northrop and resulted in the appointment of new outside directors. *See* M. EISENBERG, THE STRUCTURE OF THE CORPORATION 175-76 n. 28 (1976). *See also* Herhily & Levine, *Corporate Crisis: The Overseas Payment Problem*, 8 LAW AND POLICY IN INT'L BUSINESS 547, 617-18 (1976). Without questioning the sincerity or idealism of those involved in these actions, this author believes the legacy of these decisions is at best mixed and probably unfortunate, because they invite the fabrication of an illusory "benefit" by which to justify the award of fees.

in one context, could be regressive in another.[67] Once entrepreneurial attorneys saw that legal fees could be justified on the basis of the corporate therapeutics contained in these nonpecuniary settlements, they too became enchanted with the potential of this formula. Today, in some states the nonpecuniary settlement appears to be becoming the prevalent form of settlement in derivative actions.[68]

Against this backdrop, it is possible to explain why and how the incentives for the private attorney general have become perversely misguided: The inherent potential for collusion between parties has been greatly enhanced by the recent acceptance of nonpecuniary settlements and by the transition away from a percentage-of-the-recovery formula. The potential for collusion, of course, is present in any class or derivative action, because an inherent conflict of interest exists between the attorney and the class he represents. The latter is interested in the size of the settlement; the former, in the size of his fees. Thus, to the extent the attorney regards only his own self-interest, he would prefer a $500,000 settlement out of which a $300,000 award of attorneys' fees would be paid, to a $1,000,000 recovery out of which only a $200,000 fee would be paid. To the attorney's clients, the second alternative is four times as profitable (on a net basis) as the first, but to the attorney the first settlement yields a fifty percent higher fee recovery.[69] Because the typical class in antitrust, securites, or corporate litigation is widely dispersed and receives only a de minimis recovery on an individual basis, its members typically have little ability or incentive to pay close attention to the case, and hence the defendant may be able to exploit this conflict simply by offering a higher award of attorneys' fees than could be obtained after a litigated victory for the plaintiff.

1. *Nonpecuniary settlements*—The inherent conflict of interest between the plaintiff's attorney and the class he represents predates any recent development, but it has been intensified by the advent of nonpecuniary settlements. These settlements in effect allow the parties to create a counterfeit currency with which to inflate the value of the settlement in order to justify a substantial fee award without the de-

67. The benefit in environmental litigation cannot be feasibly quantified and hence the lodestar formula is appropriate for that context.

68. The author has been informed by one Delaware counsel experienced in derivative litigation that nonpecuniary relief has become a standard part of most settlements in derivative actions in that all-important jurisdiction, and settlements that involve no cash contribution by the defendants to a setlement fund are now common.

69. The net recovery in the first case is $200,000 ($500,000 minus $300,000) and in the second case $800,000 ($1,000,000 minus $200,000, or four times the former net recovery); yet, the $300,000 fee in the first action is 50% greater than the $200,000 fee in the second action.

fendant incurring any counterbalancing loss. Increasingly, the pattern in derivative actions is for the action to be settled on the basis of nonpecuniary relief: a new audit committee is appointed, corporate by-laws are revised, some additional disclosures are made, and the claim for damages is dropped.[70] The corporation in whose name the action is brought (and not the individual defendants) then pays the plaintiff the reasonable value of his attorney's fee to compensate him for the "success" he has achieved.[71] The net result is that the plaintiff's lawyer is well paid, the defendant incurs only nominal financial liability, and the intended beneficiaries of the action — the stockholders — get very little, if anything.

In the economist's language, this is the perfect case of a nonzero-

70. For a representative case, consider the settlement in Weisberg v. Coastal States Gas Corp., 1982 FED. SEC. L. REP. (CCH) ¶ 98,716 (S.D.N.Y. June 16, 1982). In a derivative action alleging proxy rule violations, the settlement relief was exclusively nonpecuniary, consisting of revised corporate procedures and additional disclosures to shareholders. The two primary plaintiffs' counsel were awarded fees of $129,450 and $90,437, respectively, and the latter had earlier received an interim fee of $74,000 in the same action in 1978. In short, fees of nearly $300,000 are paid out by the corporation, but the benefit received in return consisted exclusively of corporate therapeutics. Although the experienced trial judge in that case was obviously concerned about the potential for a windfall and significantly scaled down the fees from the amount originally requested, the real problem here is the potential for inadequate and possibly collusive settlements based on an illusory benefit.

Such cases are not isolated examples. *See also* Fischman v. Wexler, 309 F. Supp. 976 (D. Del. 1970) (benefit found in "corporate therapeutics"); Tanzer v. Huffines, 345 F. Supp. (D. Del. 1972); Lewis v. Anderson, 1982 FED. SEC. L. REP. (CCH) ¶ 99,003 (9th Cir. 1982); ($110,000 awarded to plaintiffs' attorney, although derivative suit was dismissed, on grounds that shareholder ratification obtained as a result of the action was a substantial benefit); United Operating Co. v. Karnes, 482 F. Supp. 1029 (S.D.N.Y. 1980). Two experienced defendants' counsel have recently stated the issue well:

> Members of the bar who have engaged in the settlement of derivative-type litigation have experienced the contortion of creating a benefit "package" that will pass judicial muster, justify the payment of agreed counsel fees and cost the involved corporation 'as little as possible." It is submitted that the creativity in developing such a package does not serve to carry out the policies inherent in the substantial benefit doctrine, and further serve to encourage the strike suit.

Aronoff & Freeman, "Shareholder Derivative Actions — a Continuing Balancing Effort," National Law Journal, November 16, 1981, at 28, col. 2, *quoted in* AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE AND STRUCTURE: RESTATEMENT AND RECOMMENDATIONS 423 (Tentative Draft No. 1 1982). *See infra* note 119.

71. Derivative actions differ from class actions in that plaintiffs' attorneys' fees are actually paid by the corporation in whose name the action is brought rather than deducted from the settlement fund. This difference traces back to Sprague v. Ticonic Nat. Bank, 307 U.S. 161 (1939). As a result, derivative actions are more vulnerable to collusive settlements than direct class actions, because in a class action there is no mechanism by which the absent class members can be taxed for the fees of their self-appointed attorney. Thus, the attorney in a class action must be paid by some cash contribution by the defendants. But in a derivative action, the plaintiffs' attorney can be paid by the corporation, even if there is no cash contribution by the defendants. Ultimately, however, this is a difference of degree, rather than kind.

sum game, In a classic zero-sum game, such as poker, the total winnings exactly equal the total losses; any gain is at another player's expense. But in the nonzero-sum game, both sides can improve their positions. In the case of the derivative action, this is achieved by settling the action for only cosmetic relief and then causing the corporation, not the individual defendant, to pay a substantial fee for the negligible benefit the plaintiff has secured for it. Typically, the corporation will then also indemnify the defendant for his own litigation expenses. In effect, the costs of the litigation are foisted upon the absent shareholders. Against this backdrop, it is little wonder that courts have come to doubt the social utility of private enforcement litigation when they see the majority of such cases ending not with the bang of victory or defeat, but only the whimper of dubious settlements.

The popularity of nonpecuniary settlements is not limited to the context of derivative suits. It is only more prevalent in this context because of the procedural quirk in derivative actions under which the corporation pays the legal fees of plaintiff's counsel (a factor which permits the individual defendants to escape without any cash contribution). But the same use of nonpecuniary relief to enable the adversaries to "hype" the value of the settlement and thereby to justify a substantial fee award recently has appeared in the antitrust context as well. In a recent price-fixing case involving real estate brokers in Montgomery County, Maryland, the adversaries agreed to a settlement under which the defendants would have made no cash payment to the victims of the conspiracy (notwithstanding the unique treble-damage provisions of the antitrust laws), but instead would have given eligible plaintiffs certificates redeemable for brokerage services at a five percent brokerage fee on the sale of their next home.[72] Needless to add, the plaintiffs' attorneys received not script, but cash. Ironically, a problem developed with this proposed settlement: other brokers, who were not defendants, protested it on the grounds that it would have created a monopoly and excluded them from the market.[73] As a result, the settlement was thus

72. *In re* Montgomery County Real Estate Antitrust Litigation, 1979-2 Trade Cas. ¶ 62, 860, at 78, 973 (D. Md. 1979). This case appears to have been a piggyback action that followed a prior criminal trial. The central allegation was that the participant real estate brokers conspired to raise their commission rates from 6% to 7%; thus, the 5% rate was in theory a discount. Defendants also agreed to pay $350,000 to cover costs and attorneys' fees.

73. *See* Latimer, *supra* note 13, at 1573-74. The obvious problem for the other nondefendant brokers was that a 5% commission, rather than being necessarily a penalty, was a price discount that could attract additional business. On a large enough volume it might produce a gain, rather than a loss, for the defendants in the same manner that high volume discount stores tend to outcompete small retailers. Eventually some 100 nondefendant real estate brokerage firms agreed to be bound by the settlement. In effect, the court appears to have put in place a formal price tariff (i.e., the 5% rate) which otherwise

revised in order that nondefendant brokers could also be bound by the same terms. Thus, despite a prior criminal conviction and the substantial liability that the treble-damages provisions of the antitrust laws create, the only cash payment made by the defendants was for plaintiffs' attorneys fees.

The future of nonpecuniary settlements seems depressingly bright. It is easy to imagine other cases in which a counterfeit currency could similarly be invented: in environmental impact cases, a few trivial disclosures could be made in an amended impact statement in return for a substantial award of fees to counsel; similarly, in an employment discrimination case, the plaintiff's attorney could agree to settle for revised testing procedures, corporate employment quotas, and similar relief, but no financial damages. The more important injury in settlements of this sort is not to the goal of victim compensation,[74] but to that of deterrence, because inadequate financial penalties (particularly when combined with the minimal fines that public agencies can levy) signal that the law lacks credible sanctions and therefore can be violated with relative impunity. To state it bluntly, the ultimate danger is that the corporate law-breaker will know that, even if detected, it can bribe the plaintiff's attorney — who represents the real threat of financial sanction — through the medium of the nonpecuniary settlement coupled with a high fee award.

2. *A time-based formula*—Alone, the nonpecuniary settlement represents only a modest danger, because if the court senses that the relief obtained was only cosmetic, it can award only a trivial attorneys' fee,

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would have probably been per se illegal. In fairness to the court, it did hear considerable evidence as to both the limited solvency of the brokerage firms and the value of the script certificate; eventually, it determined that this value was approximately $790, whereas it found that the average loss was between $566 to $682. These figures are, however, necessarily speculative, and the case may stand more as an example of how a hard-working coalition of adversaries can undercut the deterrent threat of a treble-damages penalty. Certainly , it seems symptomatic when those not sued wish to be bound by a settlement. Once again Judge Friendly's dictum about all forces conducing toward the approval of the settlement appears confirmed.

In contrast, see *In re* General Motors Corp. Engine Interchange Litigation, 594 F.2d 1106 (7th Cir. 1979) *cert. denied*, 444 U.S. 870 (1979), for a decision exhibiting more skepticism about a primarily nonpecuniary settlement. There, the primary benefit of the settlement was an extension of the warranty on those Oldsmobiles, Buicks, and Pontiacs equipped with lower-priced Chevrolet engines. The Circuit Court rejected this settlement, in part because of the "irregular conduct of the negotiations leading to the settlement." *Id.* at 1130-31.

74. In cases such as the *Montgomery County Real Estate Brokerage Litigation*, the compensatory loss to the individual plaintiff is relatively small. The larger the class, the more trivial the individual recovery becomes. The *Montgomery County* litigation confirms DuVal's earlier noted finding in his empirical study that damages in antitrust class actions seldom approach simple compensatory damages. *See* DuVal, *supra* note 15, at 1329.

even though it approves the settlement. But here, the second perverse incentive connected with fee awards enters the picture: The transition from a percentage-of-the-recovery formula to a time-based formula, such as the dominant "lodestar" formula, not only encourages the plaintiff's attorney to be dilatory, but provides the adversaries with a method by which they can assure themselves that the desired fee will be awarded if the settlement is approved. Let us suppose that a derivative action is filed and the adversaries quickly agree in January to a nonpecuniary settlement. A quick settlement cannot justify a high fee award under the lodestar formula. But if the parties do not present the settlement to the court until the following December, plaintiff's counsel can expend sufficient time during the interval to justify the desired fee award under the lodestar formula.[75] Of course, the time so expended may be largely pointless, being consumed by discovery, motion practice, and other makework that is not intended to advance the litigation, but only to justify the pre-determined settlement.

The onus here should not fall exclusively on the plaintiff. Collusion requires two sides, and the defense attorney has an equal interest in procrastination in order to maximize the hours, because he also can charge his own client and on a more current basis. Indeed, the defendant is the prime beneficiary, because the ultimate result is a cheap settlement, even if his own legal fees are increased. Only the nominal client loses, because in a nonzero-sum game, shareholders are the absent party whose losses fund the winnings. To sum up, the mechanical nature of the lodestar formula permits the adversaries to predict the court's fee award and in effect to manipulate it by manufacturing the hours invested.[76]

These assertions that the current system for financing the "entrepreneurial" plaintiff's attorney encourages collusion and fabricated time sheets are obviously serious. In some cases, they may properly be taken to reflect on the ethics and professional integrity of those involved. Precisely for this reason, however, it is important to emphasize

75. This is not simply a hypothetical possibility. Several attorneys have told this author that they have seen settlements postponed until sufficient billable time was generated. For such a statement (made by a fellow panelist at the 1982 ABA Annual Convention), see the comments of Patrick Kittredge as quoted in "Fee Problems in Class Actions," California Lawyer, October, 1982 at 76, col. 3. One federal trial judge has indicated to the author that it is often clear to the court when this is occurring, because disputes cease, the parties begin to cooperate, and yet no settlement is immediately forthcoming.

76. In contrast, under the predominant formula used prior to the formulization of the "lodestar" formula, the court retained considerable discretion and could approve the settlement, but then award only modest fees where it believed the relief secured was not that important. For the looser criteria formerly used, see Angoff v. Goldfine, 270 F.2d 185, 189 (1st Cir. 1959). *See also supra* note 54.

that the process is more likely to involve tacit collusion than actual explicit deals by which low settlements are swapped for high fee awards. In effect, the parties can signal to each other by a discrete "body english" that they are prepared to accept a settlement below that which a purely arm's-length negotiation would achieve. Indeed, both sides might be sincerely shocked at the suggestion that their settlement was in any respect improper or collusive. But, so long as the plaintiff's attorney is subject to a conflict of interest (which is present whenever the fee award is not primarily a function of the settlement's value), the usual processes of rationalization and self-justification will produce settlements that are well below those that would result from a purely adversarial discounting of the litigation odds.

The only essential precondition to a collusive settlement is that both sides understand that the plaintiff's fee award will be a function of the time expended. Given such an understanding (which the lodestar formula supplies), they need not even negotiate over the fee. Instead, the defendant's counsel can offer what normally would be an unattractively low settlement; plaintiff's counsel can respond that he needs time to evaluate it and does not feel he could accept it without first undertaking adequate discovery to test the strength of his case. This polite dialogue is implicitly understood by both sides to mean that once plaintiff's counsel has run up the requisite hours, the settlement will be approved. Typically, defense counsel need only agree not to oppose plaintiff's requested fee award, as to which he is economically indifferent in any event because it typically comes out of the aggregate settlement and is not in addition to it. If the plaintiff has properly maintained his diaries and time sheets and can present them in a voluminous file to the court, the likely judicial reaction is to avoid controversy and accept them more or less at face value. Even if the court does reduce the hours claimed by, say twenty-five percent, this reaction can also be anticipated and discounted in advance; the plaintiff has only to delay the settlement further and overbill by the percentage he expects to be disallowed in order to obtain the fee he expects.

In short, the collusion is structural, rather than conspiratorial. Add to this pattern the relatively greater level of risk aversion that characterizes plaintiff's counsel, and the dynamics of the settlement process begin to tilt more and more in the direction of inadequate settlements that cannot generate substantial deterrence.

B. *The Organization of the Action: The Fallacy of Democratic Control and the Incentive for "Free Riding"*

Equally serious problems surround the organization and control of the plaintiff's side of the case in class and derivative action litigation. In overview, current practices, as sanctioned by the *Manual for Complex Litigation*, encourage the large class action to be organized through a log-rolling political coalition, in which implicit vote-buying and other tactics reminiscent of Tammany Hall politics have become commonplace. At bottom, this phenomenon occurs because the underlying assumption is that the plaintiff's side of the case should be democratically organized on the basis of an election in which each participating plaintiff's firm has a vote. This democratic fallacy, however, has resulted in a Gresham's Law effect under which bad attorneys tend to drive out the good, as those most capable of fulfilling the role of the private attorney general find the expected economic return dissipated by "free-riding" plaintiffs' attorneys. In consequence, to the extent that the best of the plaintiffs' bar find themselves in effect taxed by the worst, they will not undertake the substantial efforts and search costs necessary to investigate and develop new cases. Instead, they will pursue only those cases where intervention by additional plaintiffs' attorneys is unlikely or where the search costs are low (such as the governmentally initiated antitrust action). Thus, we come full circle back to our original diagnosis that the private attorney general today does not supplement public law enforcement, but only piggybacks on its efforts. Stated in more colloquial terms, the bounty hunter will not hunt if he must share the bounty with a posse that never truly joined in the chase. The larger the posse grows, the greater the dilution of the expected return and the greater incentive there is for the more skillful bounty hunter to look for new territory where he can work on his own.

This capsule summary, of course, requires qualification and elaboration, but at the outset a fundamental irony should be noted. In principle, one would expect that the adversaries in a litigation should fight, while those on the same side of the case should cooperate. Yet in class action litigation as conducted today, the reverse is sometimes occurring: the incentives associated with the financing of class action litigation tend to encourage collusion between the adversaries, while the incentives associated with the organization of such actions tend to encourage disputes among the plaintiffs' attorneys and permit only a wary cooperation among them.

To understand why this has happened, it is necessary to take a closer look at the behind-the-scenes process by which class and derivative litigation is organized. In a major antitrust, securities law, or mass tort class action, dozens of plaintiffs' attorneys often appear, and, as an administrative necessity, control of the case must be centralized in a lead counsel. As with the criteria for fee awards, the legal status of this central figure — the lead counsel — has only been resolved within the last decade.[77] By informal practice, the plaintiffs' attorneys meet and elect both a lead counsel and an executive or steering committee. Although the court having jurisdiction over the action has the authority to select the lead counsel, the *Manual for Complex Litigation* instructs the court, where possible, to let the plaintiffs' attorneys choose their own lead counsel on the apparent premise that the members of this fraternity know each other better than the court does and therefore they should be allowed to choose their own spokesman.[78] Typically, the very first pre-trial order will designate lead counsel and a steering committee.[79] The lead counsel then distributes work assignments among the various plaintiffs' attorneys, which in turn means that each individual attorney's ability to bill hours depends as a practical matter on the favorable disposition of the lead counsel.[80] The centrality of lead counsel's role means that there is often a spirited contest to determine who will occupy this position. In a major case, the process can resemble a political convention: vote-trading occurs, compromises are struck, and promises of favorable work assignments are made in return for support.[81]

This process of vote-trading, however, cannot be truly analogized to a political convention because of one critical difference: meaningful restrictions on voting eligibility are lacking. Whereas the delegates to a political convention are limited in number and selected by their constit-

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77. The position of lead counsel grew out of an earlier practice of appointing "liaison counsel" and is essentially a child of the *Manual For Complex Litigation*. As *Moore's Federal Practice* notes, the "recommendations contained in [Section 1.92 of the *Manual for Complex Litigation*] are credited with establishing the definition 'lead counsel' who 'would have greater responsibilities than had previously allocated to 'liaison counsel'. . . ." 1 J. MOORE, MOORE'S FEDERAL PRACTICE, MANUAL FOR COMPLEX LITIGATION § 1.92, at 107 n.226 2d ed 1981. *See also In re* Air Crash Disaster at Florida Everglades on December 29, 1972, 549 F.2d 1006 (5th Cir. 1977).

78. The *Manual* provides: "While the court should not, in the absence of exceptional circumstances, select and appoint lead counsel, the court can request the parties to select such counsel and encourage the use of judicial power." MANUAL FOR COMPLEX LITIGATION § 1.92, at 121 (5th ed. 1981).

79. For a sample order, see 1 J. MOORE, MOORE'S FEDERAL PRACTICE, MANUAL FOR COMPLEX LITIGATION § 1.92-II (2d ed. 1981).

80. Among the powers conferred upon lead counsel is the scheduling of depositions and related discovery practice. Typically, lead counsel will assign members of the plaintiffs' team to conduct these depositions. An individual plaintiffs' attorney not assigned by lead counsel to conduct the deposition is still free to attend or to ask questions, but because his presence at the deposition is duplicative, his ability to convince the court that his time was "reasonably" expended is open to serious doubt. In short, those not assigned to a task by lead counsel are likely to be seen as superfluous volunteers.

Case law has also recognized that those assigned leadership positions by lead counsel are entitled to a higher multiplier with respect to their time. *See In re* Equity Funding Corp. of America Securities Litigation, 438 F. Supp. 1303, 1337-38 (C.D. Cal. 1977).

81. *See infra* notes 101-108 and accompanying text.

uents, any attorney with an eligible client can as a practical matter join the class action.[82] Put simply, this means that the ballot box can be stuffed. Once an election contest for lead counsel develops, each side can call upon allies to intervene in the action solely for the purpose of voting. A norm of reciprocity underlies this process: a candidate for lead counsel in one action can ask allies to intervene in his action to elect him in return for a corresponding favor in an action where they are seeking a prominent position as a lead counsel or committee chairman.

Initially, the purpose underlying this pattern of reciprocity was to deter new entrants; the fraternity of experienced plaintiffs' attorneys would conspire to outvote the nonmembers who might typically intervene in actions brought in their jurisdictions.[83] Although the real effect of democratic procedures in the organization of class actions was to raise a barrier to entry, this process did not necessarily interfere with the efficiency of the private attorney general because those within the club were typically better able than most regional firms to conduct this complex form of litigation. But as practices have evolved, specialists in the organization of class actions have now appeared on the scene. These specialists engage not in the usual preparatory work of discovery

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82. In practice, this will occur whether or not the attorney in the "tag along" action wishes his action to be consolidated. Under the rules of the Judicial Panel on Multi-District Litigation, separate class actions involving common questions of fact will be referred to a single judge. *See* J.P.M.D.L. Rules 9 and 10, 65 F.R.D. 253, 259-60 (1975). If a governmental investigation or a grand jury proceeding has preceded the private action, the multiple actions almost inevitably will be referred to the court in which the prior governmental or criminal action was heard or is pending. Although this is logical, its effect is to produce a political convention in which any attorney whose action is consolidated can vote. For example, in *Fine Paper*, fifteen separate class actions, filed in eight different federal courts, were transferred to the Eastern District of Pennsylvania. *See In re* Fine Paper Antitrust Litigation, 446 F. Supp. 759 (J.P.M.D.L. 1978).

Once such a convention becomes forseeable, an incentive then arises to file additional actions which do not enlarge the class or add new plaintiffs or causes of action, but enable the attorney or his allies to gain votes. *See* Bruck, *supra* note 17, at 29 (quoting Harold Kohn to the effect that his rivals in *Fine Paper* were encouraging attorneys "who don't know where the courthouse is" to enter the action).

83. The modern history of multiplaintiff class actions essentially dates back only to the electrical equipment cases in the mid-1960's. Until relatively recently, the plaintiffs' bar that specialized in these cases was relatively small and its members knew one another well. *See* Bruck, *supra* note 17, at 19 (detailing interrelationships). More recently, as new firms not based in New York, Philadelphia, or Chicago have entered the field, major control fights have erupted at the outset of the litigation. For example, in the *Corrugated Containers* case, a group of Houston-based "Young Turks" seized control of the action away from Harold Kohn and his allies by convincing the Judicial Panel on Multi-District Litigation to transfer it to Houston, where the criminal action had been filed. *See* Lempert, *supra* note 17, and Bruck, *supra* note 17 (describing the rivalry between Susman and Kohn). *Fine Paper* is distinctive not only in its fierce rivalry, but also in that the dispute there began after the settlement, instead of at the transfer stage where the contest is usually waged.

or motion practice, but instead concentrate on political brokerage and coalition building.[84] The appearance of such specialists raises the danger that what was once only an exclusionary practice may now have become an extortionate one, in which competent plaintiffs' lawyers are compelled to pay a tribute to these new lawyer-politicians.

The clear and present danger here is that current practices governing the organization of the large case may result in the worst of the plaintiffs' bar taxing the best. Unable to capture the economic benefits from detecting violations of law, the "entrepreneurial" private attorney general is today in much the same position as a prospector who, having discovered gold at Sutter's Mill, must still strike a bargain with late-arriving prospectors in order to perfect his claim to the discovery. From an *ex ante* perspective, this state of affairs necessarily dulls the incentive to invest time and effort. In consequence, instead of developing his own cases, the "entrepreneurial" attorney tends to tag along in the wake of public law enforcement actions to feast on the spoils. More a hyena than a lion, he is so in substantial part because our legal system inhibits his ability to retain the fruits of his own labors.

C. *A Case Study: The* Fine Paper *Litigation*

To restate the argument to this point, this article has contended that the legal rules and practices that today regulate private attorneys general (1) foster implicit collusion between the adversaries, resulting in inadequate settlements; (2) encourage delay, fabrication of billable hours, and duplication of efforts; and (3) produce "free riding" by "tag-along" plaintiffs' attorneys, thereby diluting the economic incentive to develop new actions.

Although anecdotal evidence supporting this thesis can be obtained from almost any attorney who specializes in the field, more impressive evidence has now become available in the form of a detailed case study — the *Fine Paper* litigation. Initially, *Fine Paper* was an ordinary antitrust class action: filed in 1977, it was the last of several private antitrust actions brought against the manufacturers of paper products; here, the defendants were the major manufacturers of stationery and quality printing paper.[85] By 1980, the adversaries had

84. In substance, this is the charge that Harold Kohn has directed against members of the "Chicago Group," who he claimed were themselves not competent to handle the case. *See* Bruck, *supra* note 17, at 29. *See also infra* note 101 and accompanying text.

85. Several reported decisions have been generated in the litigation, all dealing with preliminary procedural matters. *See In re* Fine Paper Antitrust Litigation, 446 F. Supp. 759 (J.P.M.D.L. 1978); *In re* Fine Paper Antitrust Litigation, 82 F.R.D. 143 (E.D. Pa. 1979). In addition, a final decision has been rendered with respect to a different class (the vertical conspiracy plaintiffs). *See In re* Fine Paper Antitrust Litigation, 685 F.2d 810 (3d Cir. 1982).

agreed to an initial settlement totalling fifty million dollars plus interest.[86]

At this point, the real fight over the spoils began among the thirty-three separate plaintiff firms and eight state attorneys general that constituted the plaintiffs' side of the case. Collectively, some 160 individual attorneys sought fees totalling twenty million dollars out of the fifty-million-dollar settlement fund (which with interest totalled sixty-two million dollars).[87] This request that approximately forty-percent of the recovery (before interest) be allocated to the attorneys appears to have intensified a pre-existing conflict among the lead counsel. Because a forty-percent fee award would be unusually high, it should have been evident to the participants that either some fee requests would be disproportionately reduced or most would be scaled back on a pro rata basis. Thus, those who submitted reasonable requests were in a sense the potential victims of those who most inflated their claimed time. The conflict then erupted: Harold Kohn, co-chairman of the plaintiffs' executive committee and perhaps the best known antitrust litigator in the country, asked the court to place a ten million dollar ceiling on the attorneys' fees, of which two million dollars would go to his firm.[88] Tactically, such a move may have made Kohn appear the moderate statesman, who was alerting the court to overreaching by his colleagues. Not surprisingly, it infuriated his fellow plaintiffs, who, if fees were to be limited, did not want them disproportionately captured by Kohn. They reacted by challenging Kohn's own two-million-dollar fee petition.

Now comes the first truly dramatic development in the case: Harold Kohn, the acknowledged master of this form of litigation, ex-

86. *See* "Warfare: Fine Paper Filings Tell Tales of Struggle Within Plaintiffs' Camp," Legal Times of Washington, December 7, 1981, at 1, col. 1.

87. A detailed analysis of the fee petitions submitted by the plaintiffs' attorneys in *Fine Paper* is set forth in a multi-volume document entitled "Report of Class Member Objectors in Support of Their Objections to the Petitions for Attorneys' Fees and expenses by Class Counsel," prepared by Weil, Gotshal & Manges [hereinafter cited as the "Weil, Gotshal Report"]. Harold Kohn has also supplied the author with copies of the motions he filed objecting to the award of attorneys' fees. For ease of reference however, all citations will be to the Weil, Gotshal Report. In total, the thirty-three private law firms and eight state attorneys general sought $20 million in attorneys' fees plus over $1 million in expenses for over 70,000 attorney hours and 25,000 paralegal hours expended by some 160 plaintiffs' attorneys over a three-year period in an action having but a single class of plaintiffs. Weil, Gotshal Report at 1, 3-17. Although the size of this effort — nearly 100,000 hours by attorneys and paralegals — obviously raises basic questions about the efficiency and costliness of private enforcement as compared with public enforcement, this article attempts no comparative assessment but instead focuses on the degree to which current legal rules encourage and ensure such excessive effort and inefficiency.

88. *See* Bruck, *supra* note 17, at 29.

plained in a lengthy submission to the court that his colleagues' fee applications were inflated and not made in good faith.[89] He documented his charges with considerable specificity. In particular, he alleged that one faction of lawyers had conspired to seize control of the litigation in order to divide the benefits as patronage. Once in power, they had multiplied hours unnecessarily and had reciprocally agreed to approve each other's inflated fee applications. He added that they had sought to secure his consent by inviting him to raise his own fee application, but he had refused. Kohn's bombshell led to an even more unprecedented development: fifteen giant corporations, all major purchasers of fine paper (among them Exxon, IBM, and Xerox), intervened in the action to object to exorbitant fees on the grounds that their interest as claimants in the recovery was depleted by the unjustified size of the legal fees.[90] Through their counsel, the New York firm of Weil, Gotshal & Manges, they undertook an extensive study and audit of the fee applications filed by the plaintiffs. By cross-checking different attorneys' fee applications, they produced evidence which appeared to suggest fraud, the filing of false statements, and deliberate duplication of effort.[91]

To the plaintiffs' bar, this claim by a group of "Business Roundtable" corporations (for whom the total damages in the case would not have materially improved their aggregate gross revenues) that they

89. *Id.* In a letter to the author dated October 24, 1981, which enclosed these motion papers, Mr. Kohn further advised me that he believes "the Lindy formula is ill-advised and should be disregarded as soon as possible." (Copy of letter on file with Maryland Law Review).

90. The fifteen objectors were, in the order they appear on the Weil, Gotshal Report: Xerox, Prudential, Mobil, Time, Texaco, General Electric, Allied, IBM, Union Carbide, Exxon, McGraw-Hill, General Motors, AT&T, GTE, and Owens-Illinois. These corporations had filed claims to share in the settlement fund based upon total purchases by them of over $675 million, an amount, they claimed, that represented 6% to 7% of the total claims filed by class members. Weil, Gotshal Report at 1 n.1.

91. The basic methodology of the Weil, Gotshal Report involved "horizontal" and "vertical" audits of the fee applications of the plaintiffs' attorneys. The horizontal audits sought to detect duplicative work by cross-checking fee applications to show that an excessive number of attorneys were engaged in the same task at the same time and the vertical audits examined the individual fee petitions for overstaffing and evidence of fabricated hours. Weil, Gotshal Report at 84-101, 204-09.

The most dramatic evidence suggesting fraud and false statements concerns the testimony of one plaintiff's attorney, Stewart Perry, who claimed in an affidavit filed at the apparent request of Weil, Gotshal to have been told by a lead counsel to pad his hours in return for his services in finding a valuable witness. This alleged statement and other aspects of the testimony were hotly denied by those alleged to have offered him this reward. *See* Lempert, " 'Fine Papers' Lawyer Saw Dream Become Nightmare," Legal Times of Washington, December 7, 1981, at 9, col. 1.

From the standpoint of this article, the allegations of fraud are of limited relevance to a policy analysis, and no attempt is made herein to assess them.

were concerned that their share of the recovery was being depleted by excessive attorneys' fees was absurd on its face; from their perspective, the obvious motive behind this intervention in a fee dispute was harassment.

In March of 1983, the District Court handed down its long-awaited opinion, which adopted in substance the essential allegations of the Weil, Gotshal Report and in consequence scaled down the requested fees by nearly eighty percent from twenty million dollars to slightly over four million dollars.[92] In terms even more vehement than those used by Weil, Gotshal, it announced that its "inquiry had given substance to the worst fears of the critics of the class action device — that it is being manipulated by lawyers to generate fees."[93] Finding the fee petitions "grossly excessive on their face" and evidence that the plaintiffs' bar was becoming a "class action industry," the court documented in voluminous detail the practices used to inflate the fees.[94]

Although many will read its persuasive opinion as proof that law and entrepeneurship do not mix, the most important findings in the opinion suggest the converse — namely, that collusion had replaced competition within the plaintiffs' bar and was responsible for the greater part of the abuse shown to have occurred:

First, of the 100,000 hours claimed to have been invested by plaintiffs, the majority of these hours were expended after the initial settlement was tentatively reached.[95] Put simply, such post-hoc efforts sound

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92. *In Re* Fine Paper Antitrust Litigation, MDL 323, slip op. at 52, (E.D. Pa. March 3, 1983). Total fees of $4,343,103 were allowed plus expenses of $1,121,020. *Id*. The Weil, Gotshal Report had implicitly recommended a fee award of $4.5 million. *Id.* at 34. Thus, the court was even more severe than it had been urged to be by the intervenors. In particular, the court awarded a 1.5 multiplier for time expended prior to the initial settlements, but permitted no multiplier thereafter. In addition, the firm of Specks & Goldberg, which the court described as having "primary responsibility for all the wasted hours, duplication and gross inefficiency which has marked this case from its inception" was subjected to a "negative multiplier" of .5. *Id*. at 49-50. In short, 50% of the time deemed to have been legitimately expended by this firm (whose senior partner was co-lead counsel) was disallowed as a penalty.

93. *Id.* at 52.

94. *Id.* at 3. The burden that these fee hearings imposed on the Court deserves special attention. Some 41 hearing days, consisting of 73.5 courtroom hours were consumed by these hearings plus another 10 courtroom hours on related hearings over the fee petitions, thus making for a grand total of 83.5 courtroom hours. By contrast, the trial of the principal litigated case (the "majority states case") in the same proceeding consumed only 198 courtroom hours. *Id.* at 37 n.19.

95. *See* Weil, Gotshal Report at 21. The initial settlement was reached in September 1980. Yet, to cite one example, six Minneapolis firms entered the case after this settlement and submitted fee petitions totalling $1.5 million plus expenses. *See infra* note 101. A summary of the Weil, Gotshal Report, which condenses the essential evidence, appears in *The American Lawyer* issue of January 1982. *See* "Reading Moody's for $682 An Hour," The

suspiciously like the manufacture of billable time in order to reach a level that equals the maximum fee that the court might award under a percentage-of-the-recovery formula. Kohn had claimed that the case could have been litigated in 5,000 to 15,000 hours;[96] if his estimate is accepted, some eighty-five to ninety-five percent of the hours expended may have been unnecessary.

Second, and more important, this "makework" occurred within the context of a partonage system. What *Fine Paper* chiefly reveals is the mechanics of such a system. At its heart was a network of committees through which those favored by the lead counsel could institutionalize themselves in order to bill the time allotted to them as payment for their support. These committees held regular meetings, invariably well attended by plaintiffs' attorneys from across the nation, but produced little of discernible value to the litigation.[97] A good example in *Fine Paper* was the "Industry Analysis Committee," which in theory was supposed to develop data about market shares and the structure of industry pricing. Both Kohn and the Weil, Gotshal Report found the data developed by this committee to have been largely superficial and useless, consisting mainly of data compiled from earlier bibliographies, publicly available FTC reports, and the defendants' own annual reports.[98] The *American Lawyer* has had a field day with the fact that one senior attorney sought to bill $682 per hour for reading *Moody's* to compile a list of companies in the industry.[99] More revealing, however, was the elaborate hierarchy of committees and titles that developed within the plaintiffs' camp in *Fine Paper*. For every possible function, a

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American Lawyer, January, 1982, at 31 [hereinafter cited as "Reading Moody's for $682 An Hour"].

96. Weil, Gotshal Report at 21.

97. The work of the discovery committee is illustrative. Fifteen subcommittees were formed to undertake various tasks. Weil, Gotshal Report at 37. Approximately 1,049 hours were spent on discovery meetings, and 47 different lawyers spent 2,647 hours "coordinating" discovery. *Id.* at 148, 145. Approximately 1,984 of these hours were billed by partners. For example, two senior San Francisco attorneys conducted a deposition in Boston and charged rates that, after adjustments for multipliers, amounted to fees of $650 per hour and $450 per hour respectively, plus expenses. *Id.* at 141-42. Another deposition ran up a total cost to the class of $500,000. *Id.* at 202.

98. *See* Weil, Gotshal Report at 101-11. Throughout the litigation, Harold Kohn objected with particular vehemence to the activities of this committee, which in his view was simply employing fifteen or more lawyers in lengthy meetings to discuss publicly available data of limited value. *Id.* at 105-06. *See also* "Reading Moody's for $682 An Hour," *supra* note 95. In his opinion, Judge McGlynn agreed that this work was "basically useless" and disallowed the entire time spent by all participants on this committee. Fine Paper, slip op. at 42. Some 1,800 hours were disallowed. *Id.* at 41.

99. "Reading Moody's for $682 An Hour," *supra* note 95. The chairman of this committee nonetheless submitted a fee petition for $1,372,190 plus $59,299 in expenses. *See* Weil, Gotshal Report at 260.

committee was created, each with its co-chairman and subcommittee chairman. The end result was that everyone got a title. Why? As one legal newspaper has explained it:

> Titles were a valued commodity, since lawyers in 'leadership' roles can more easily petition the court for a fee 'multiplier,' allowing them to double or triple their normal hourly billings . . . . The discovery committee, for example, which had one chairman and three vice chairmen, had 15 subcommittees which in some instances had three and even four co-chairmen.[100]

All that appears to have been lacking was a plaintiffs' Entertainment and Prom Committee.

Yet to cite this evidence only as proof of incompetence or greed misses the main point: Why was this tolerated by lead counsel and the others in the case who did make valuable contributions? The answer

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100. *See* "Reading Moody's at $682 an Hour," *supra* note 95, at 31. Harold Kohn has alleged that his co-lead counsel, Granvil Specks, told him "everybody wants a title." Weil, Gotshal Report at 20-21. Apparently, nearly everyone got one, unless they were opponents of the lead counsel. The plaintiffs' side had two Co-Chairmen (Specks and Kohn), a four-man lead counsel team (all of whom could thereby call themselves "co-lead counsel"), and a 12-member Executive Committee. *Id.* at 26. Standing Committees were then appointed by the Executive Committee; these included the "Industry Analysis Committee," the "Discovery Committee," the "Rule 37 Committee" and a special team that worked on damage theories. *Id.* at 112, 129-30, 140-43.

One attorney held titles as a member of the Executive Committee, as Vice-Chairman of the Discovery Committee, as Chairman of a discovery subcommittee, and as a member of the trial team, enabling him to submit a fee petition with a multiplier of 3.25. *Id.* at 419. On an aggregate basis, the application of multipliers by the plaintiffs' attorneys in *Fine Paper* raised the fee request from the proposed $8 million lodestar amount to more than $20 million in total fees. *Id.* at 21. Thus, the average requested multiplier in *Fine Paper* was 2.50.

Another example of duplicative work was revealed by the way in which pre-trial conferences were held. Although the court admonished the plaintiffs' team to avoid duplicative hours in pre-trial conferences, most of the firms insisted on sending at least one representative to each conference. *Id.* at 90, 93. Judge McGlynn summarized the waste at this stage succintly:

> Counsel have billed at approximately one-half million dollars for 1,446 hours of preparation, travel and attendance at pretrial conferences. The class was ably represented at these conferences by lead counsel and except perhaps for their immediate assistants, the attendance of the other lawyers who merely sat and watched was superfluous.

Fine Paper, slip op. at 20. Yet another abuse was identified by the court:

> Work on the pretrial memorandum was one of the major boondoggles of this case. Fifty-one plaintiff's lawyers, including twenty-one partners from nineteen different law firms, and deputy attorneys general devoted a total of over 4,500 hours to the preparation of this Memorandum — especially extravagant figures considering it was going to be filed after the Majority States had already filed a similar document dealing with most of the same issues. Not only were these hours excessive, but many of the partner hours were poorly allocated because the same work could have been accomplished by associates and paralegals. Based on the fee petitions, the cost to the class for this one Memorandum is over $1 million.

Id. at 22.

appears to be that such meaningless work is assigned as a form of defensive patronage. In part the motivation for such an award of work was the threat of future opposition — a threat which became particularly credible in *Fine Paper* once a schism developed between the Kohn faction and a rival faction (known as the "Chicago Group") that shared control with Kohn on the executive committee.

As another illustration, the Weil, Gotshal report was extremely critical of the involvement in the case of a half-dozen Minneapolis firms, who entered the picture only after the initial settlement was reached and who, the report claimed, performed no significant services for the plaintiffs' team (but who nonetheless received substantial work assignments from lead counsel).[101] The real point, however, is not the waste, but the inherent vulnerability that motivates this kind of patronage. Any connected group of late entrants, such as the Minneapolis group in *Fine Paper*, poses a triple threat to those in control of the case: First, the newcomers could vote as a bloc so as to shift control in the case of a divided steering committee. Second, their collective opposition to a settlement could dissuade the court from approving it. According to some commentators, unanimity among the plaintiffs is of great importance, because any substantial dissension will seriously retard the process of judicial approval and cause a much more critical examination of the fee petitions.[102] Third, a dissenting group might even convince the court that they could reach a quicker or better settlement if given control of the case. Remote as this threat may seem, the modern history of class action litigation reveals several instances (ironically engineered by Harold Kohn on some occasions) in which newcomers have sought to take control of the case away from the incumbent plaintiffs' leadership by precisely this strategy.[103] Given the

101. *See* Weil, Gotshal Report at 179-203. Five of these six firms from Minnesota entered the case *en masse* in the spring of 1979. *Id.* at 180. Stewart Perry's affidavit, see *supra* note 91, indicates that they were induced to enter by the perception that they would be favored by those running the patronage system and would receive favorable committee assignments despite their lack of experience in the field. Although the favorable disposition toward them appears to have been partially motivated by their discovery of a critical witness who could testify to the existence of a pre-fixing conspiracy, it also appears to have been the product of their alliance with the "Chicago Group" in other cases and their agreement to drop out of another case. Weil, Gotshal Report at 181-82. Thus, the patronage system involves log-rolling between cases as well as within a particular case. Judge McGlynn also expressed dismay at the fact that eight firms "did not become involved in the case until well after the first $30 million in settlements were in the bank and the class had been certified." Slip op. at 20.

102. *See* Mowrey, *supra* note 40, at 292 (1978).

103. *See* Bruck, *supra* note 17, at 31-32 (describing Harold Kohn's attempts to assume control of *Corrugated Box*, *Equity Funding*, and *Eastern Sugar*). Allegedly, Kohn sought to settle with defendants in both the latter cases, even though he was not on the leadership

court's own desire to escape a burdensome and time-consuming litigation, such threats have credibility and thus promote defensive patronage.

Even more convincing evidence of the failure of the democratic political process as a basis for organizing the plaintiffs' litigation team lies in *Fine Paper's* demonstration of how easily the ballot box can be stuffed. In *Fine Paper*, it appears that attorneys not only intervened in the case in order to vote for their allies, but in some cases filed two complaints to get two votes.[104] In other instances, actions were filed on behalf of clients already protected by previous complaints simply to allow additional counsel "to get into the case."[105] Yet these late-arriving counsel often did not even file damage claims on behalf of their "clients" to entitle them to share in the settlement; they did, of course, file fee applications for themselves. In substance, these practices closely resemble the old machine politician's practice of "voting the graveyard." Indeed, even the rhetoric of the political campaign seems to have been borrowed: the leader of the "Chicago Group" appears to have campaigned for election as lead counsel on a platform that in sub-

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team of the plaintiffs. In this light, the patronage system is a response to the almost Hobbesian state of nature that sometimes seems to prevail within the plaintiffs' camp. *See also* Wolfram, *supra* note 15, at 294-98 (discussing abortive attempt by Kohn to reach a separate settlement in *Antibiotics* litigation).

104. For an example of a firm appearing on two separate complaints, see Weil, Gotshal Report at 418. At the initial organizational meeting, voting was conducted on both a "case basis" (one vote for each action) and a "counsel basis" (one vote for each law firm). *Id.* at 26. On this dual basis, it was decided to that each law firm would have one vote. *Id.* This eliminated the incentive to file multiple actions once a law firm had already appeared, but it created an incentive to add separate firms as co-counsel to a single action. Thus, one plaintiff client (Campbell Office Supply Company) was represented by five law firms. *Id.* One consequence of a one-attorney, one-vote rule was to eclipse the significance of the state attorneys general, who bitterly protested the use of this voting procedure. As the Deputy Attorney General of California, Mr. Michael Spiegel, pointed out to the trial court, the state representatives had incurred very significant damages, yet they were being excluded from the plaintiffs' executive and other committees by private attorneys who were representing clients who had sustained only minor injury, such as "a mom and pop greeting card store, [and] a fishmonger from Fort Bragg, California, who buys wrapping paper to wrap fish." Fine Paper, slip op. at 18. Beltedly, the trial court "recognized the force of Mr. Spiegel's argument." *Id.* at 19-20. One answer to this problem might be to certify the state attorneys general as a separate class. Alternatively, a weighted voting system could be used to cure the inequality that results when clients who have suffered only minor injuries are given equal voting power with those who have sustained major injuries. But the danger inherent in such a weighted voting system becomes apparent when one realizes that it might allow the same Fortune 500 companies, who intervened in *Fine Paper* to object to attorneys' fees, to seize control of the executive committee based on the dollar amount of their claimed injuries.

105. Weil, Gotshal Report at 21-22 (noting that complaints filed during the autumn of 1977 were on behalf of clients whose "interests were already well protected"). Yet many of these class representatives failed "even to file a proof of claim to share in the settlement fund." *Id.* at 22.

stance amounted to a promise of "jobs for all."[106]

The extent of the free riding visible in the *Fine Paper* case possibly approaches a record.[107] For only one class of plaintiffs, thirty-three law firms and eight state attorneys general offices, totalling some 160 attorneys, sought fees for their participation in the case. Yet some of the best known and most competent plaintiffs' litigators in the nation sought and were apparently denied any role in the case.[108] This should not be surprising. As in politics, a patronage system is the antithesis of a merit system. To the victors go the spoils: those plaintiffs' attorneys not elected to the steering committee or otherwise rewarded simply ceased to participate in the case, even though their reputations as excellent litigators in some cases far outshone many of those who were so elected.

The impact upon the exceptionally able attorney of a class action having a hundred or more plaintiffs' attorneys deserves special attention. If one assumes that any sensible court will not deplete the settlement fund unreasonably, a point must be reached (and probably early on) at which the fees received by the free riders do not further deplete the settlement fund, but instead come out of the pockets of the plaintiffs' attorneys who undertook the original investigative and preparatory work. Indeed, the empirical evidence suggests that courts resist allowing the aggregate fees to exceed a fairly constant percentage of the recovery.[109] The Weil, Gotshal Report implicitly supports this view, because it found that the major participants had "worked backwards" by picking a fee that they thought the court might award — here, twenty-five percent of the settlement fund — and then contrived to inflate the hours until they justified that percentage of the recovery on a

106. At the initial organization meeting, Granvil Specks, who was elected Co-Chairman with Kohn, announced as a "guiding principle" that: "There will be a fair and equitable allocation of work so that all plaintiffs' counsel can actively participate in the litigation." *Id.* at 26. In substance, this seems to translate into a campaign promise of "jobs for all."

107. *Id.* at 16. *Fine Paper* does not, however, set a record for the number of law firms involved. Some 57 law firms represented plaintiffs in the *Folding Cartons Antitrust Litigation* and sought fees of $17 million. *See* 1 J. MOORE, MOORE'S FEDERAL PRACTICE, MANUAL FOR COMPLEX LITIGATION § 1.47, at 91 (2d ed. 1981).

108. The Weil, Gotshal Report characterized these as the "'Have Not' Firms." Weil, Gotshal Report at 34. These included such well known plaintiffs' litigators as Gene Mesh, and the firm of Greenfield & Schoen. *Id.* at 35. Once he was denied executive committee membership, Mesh simply "dropped out of the case." *Id.* Although comparisons are necessarily subjective, this author's impression is that the "Have Not Firms" were at least as highly regarded within the plaintiffs' bar as any of the "Chicago Group." The trial court also found it "incredible" that Gene Mesh, Fine, Kaplan & Black, and Greenfield & Schoen were excluded while other less respected litigators were permitted to enter after the initial settlement. Fine Paper, slip op. at 21.

109. Mowrey, *supra* note 40, at 343-48.

time-formula basis.[110] If so, then the real injury is not that the parties "worked backwards" to achieve a result equivalent to that under a percentage-of-the-recovery formula, but that under such a ceiling, the appearance of each additional free rider results in a net wealth transfer from the existing group to him. In short, because the pie is limited, the addition of each new entrant results in a smaller share for those already in the case. This problem is particularly aggravated if the court attempts to scale back all fee requests pro rata to maximize the appearance of equality, and, from an *ex ante* perspective, this is a risk that must be weighed by an attorney who is considering whether to undertake a case requiring considerable investigation and preparation. As a consequence, the appearance of 160 lawyers in one case clearly implies that the incentives to the plaintiffs' attorney are vastly diluted over what they would have been had the court shut the door after the first five or ten attorneys had appeared.

III. MODELS FOR REFORM

If existing legal rules and practices encourage collusion, delay, and free riding, what can be done? Although courts clearly sense that something is wrong, recent judicial efforts have focused primarily on tightening the procedural rules governing the computation and award of attorneys' fees.[111] The upshot of these decisions seems likely to be only a series of evidentiary and record-keeping reforms intended to prevent the fabrication of billable hours. Although rules requiring the filing of contemporaneous time records and similar measures are probably desirable, only modest expectations can be placed on such reforms.[112] In pursuing these limited reforms, courts appear still to be avoiding the central issue of the linkage between a time-based formula for the computation of attorneys' fees and the potential for collusion and inadequate settlements. So long as time equals money and the adversaries have an incentive to collude, various means predictably will

110. Weil, Gotshal Report at 39. Indeed, Kohn alleged that his rivals wanted to ask the court "for total fees in the amount of $18 million in the hopes of ultimately obtaining a $15 million award . . . ." *Id.* at 41.

111. *See supra* notes 12, 60.

112. Ultimately, such reforms will produce better documentation and more meticulous record-keeping; they may also prevent some instances of egregious fraud to the extent that such records must be filed on a contemporaneous basis during the course of the litigation. But so long as time equals money, attorneys will predictably learn to maintain better records, and the net improvement largely will be in the art of keeping legal diaries. To the extent that the court places a higher multiplier on some kinds of activities than on others, the result may even be counter-productive, as lead counsel will find it more difficult to persuade his fellow attorneys to engage in the less highly compensated but necessary activities such as document review.

be found by which a mutually beneficial deal implicitly can be struck that is based on nonadversarial criteria unrelated to the strength of the plaintiff's case. Moreover, if the judicial focus remains exclusively concerned with delay and duplication, it will miss the even more serious problems associated with the organization and staffing of the case.

Academic proposals have been even wider of the mark. One ambitious effort has argued that the contingency bonus awarded the plaintiffs' attorney subsidizes actions having a low probability of success, because the criteria for the award of this bonus instruct the court to take into account the risk incurred by the plaintiffs' attorney.[113] Thus, as the probability of success decreases, the risk, and correspondingly the bonus, increases. As a result, Professor Leubsdorf has argued, a perverse incentive arises to litigate weak cases. Cogent as this theory sounds within its four corners, it suffers from a tunnel vision focused exclusively on the contingency bonus; as a result, it overlooks the far more important perverse incentive to be dilatory that is built into a time formula. To the extent there is an incentive to litigate weak cases, it flows from other factors, such as (1) the ease with which the parties can collude under a time formula and pass the real costs of the litigation on to absent parties, (2) defendants' risk aversion, which motivates them to settle at some low figure rather than risk a substantial judgment; and (3) the desirability to the plaintiff of litigating a large volume of cases and thereby spreading his risk, rather than concentrating on a single large case.

Where then should reform begin? The starting point must be to recognize two truths: First, the problem is not simply that there are a few "bad apples" within the plaintiffs' bar who require closer judicial supervision, but it is rather a structural dilemma involving a skewed incentive structure. Second, it must be realized that all the problems discussed in this article are interrelated. More specifically, the incentive for collusion between the adversaries and the incentive for fabrication of time by plaintiffs' attorneys dovetail and reinforce each other, while the problem of free riding has an inverse relationship with

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113. *See* Leubsdorf, *supra* note 4, at 491-96. In practice, the average multiplier appears to be around 1.5. *See Attorney Fee Awards in Antitrust and Securities Class Actions*, 6 CLASS ACT. REP. 82, 84-121 (1980). On its face, this statistic means that on average any action having less than a 66⅔% probability of success is an economically unattractive investment because a 1.5 multiplier will not compensate for any greater degree of risk. Moreover, even if an action has a probability of success in excess of 66⅔%, the plaintiff's attorney must further consider the impact of deferral on the value of his fee. Because interest is not typically added to the fee award, a delayed payment to the plaintiffs' attorney is worth less than a current payment, with the margin between them being equal to the time value of money over the period of the deferral. The multiplier probably chiefly serves the function of compensating the attorney for this deferral. *See infra* note 116.

these other two. For example, if we made it more difficult for plaintiffs to enter a pending action, we would discourage free riding, but we might also encourage collusion — because the smaller plaintiffs' group would find it easier to settle with the defendants on the basis of their personal self-interest.

A course must therefore be steered between Scylla and Charbydis. This article will assess three basic models for reform, none of which exludes or is incompatible with the others. Indeed, each is a partial answer, and none is alone sufficient. In common, they attempt to rehabilitate the concept of the private attorney general, rather than to reject it on the premise that law and entrepreneurship do not mix.

A. *Model One: Setting the Private Attorney General to Watch the Private Attorney General — The Uncertain Lessons of* Fine Paper

"Who will guard the guardian" is an ancient problem, which applies with special force to the guardian who is motivated by profit. If we are to rely seriously on private enforcement of law, some means must be found to hold the private attorney general accountable. A possible response to this need is to institutionalize a role for a monitor at the settlement stage: a second-tier private attorney general, who would be rewarded for detecting inadequate settlements or excessive attorneys' fee applications or both. Essentially, this proposal would generalize the role performed by Weil, Gotshal in the *Fine Paper* litigation. Although Weil, Gotshal was clearly not acting as a risk-taking private attorney general (as it was retained by clients fully capable of paying it and directing its actions), there have been other recent cases in which intervening counsel have convinced the court that a proposed class action settlement was inadequate and thereby have caused a renegotiation and consequent increase in the settlement.[114] In such cases, the court has properly rewarded the intervening counsel on the grounds that its objection caused the increase in the settlement fund.

Is the solution to the problem of collusion this simple? Considerable skepticism seems necessary about both the cost and sufficiency of this answer, even though an enhanced role for such intervenors probably is desirable. One deficiency in this prescription is that collusion can extend beyond the initial parties and include such intervenors as well. Lead counsel can in effect "bribe" those plaintiffs' attorneys in a posi-

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114. *See, e.g.*, Seigal v. Merrick, 619 F.2d 160 (2d Cir. 1980). Similarly, in a lengthy litigation involving the Alleghany Corporation, objectors forced the settlement to be raised first from $700,000 to $1,000,000 and eventually to $3,000,000. *See* W. CARY & M. EISENBERG, CASES AND MATERIALS ON CORPORATIONS 979 (5th ed. 1980).

tion to intervene and object to the settlement by offering them a place on its team and lucrative "makework" assignments. This defensive patronage is no different in principle from the titles and fabricated assignments awarded by lead counsel to form a majority coalition and organize the steering committee. Of course, this suggestion that lead counsel will "bribe" potential intervenors by inviting them on board plaintiffs' team is intended not as literal description, but as a form of short-hand. The process would no doubt be more subtle: for example, lead counsel might invite the potential dissident to develop those legal theories that it believed had not been adequately explored on behalf of the plaintiffs' team. This would in turn involve billable discovery conducted at the request of lead counsel, which is more likely to be fully reimbursed by the trial court.

Arguably, the current pattern of one hundred or more plaintiffs' attorneys appearing to represent a single class may be at least partially attributable to a perception by the intervening counsel that lead counsel will feel obliged to offer them work assignments. In other words, if lead counsel's willingness to pay "bribes" through the medium of makework assignments becomes widely perceived, then this in turn invites extortion by outsiders. Thus, the "free rider" problem connects with the problem of collusion, because this perceived exposure helps attract the horde of "free riders," who themselves may have no intention of (or capacity for) litigating the case. Once again, the end result is the subdivision of the potential attorney's fee available to the competent plaintiffs' attorney — and ultimately the erosion of his incentive.

This vulnerability to collusion potentially could be reduced through institutional redesign. For example, the court at the outset could appoint one or more of the plaintiffs' attorneys to the role of devil's advocate and assign them the task of critiquing any proposed settlement or fee award. To preclude collusion, the devil's advocate would be denied the right to participate as a plaintiff's attorney, but would be compensated independently for his efforts as a watchdog monitoring his fellow plaintiffs' counsel. Alternatively, the court on its own initiative could appoint a special master (who would not be a member of the close-knit fraternity of plaintiffs' attorneys) to duplicate the extensive audits and cross-checks performed by Weil, Gotshal in the *Fine Paper* litigation. Both these alternatives, which each institutionalize a role for an official watchdog, would make it more difficult to bribe the potential objector into acquiescence, because his official position would preclude him from accepting the usual offer to join the plaintiffs' team as a high-level member. Bribery is ineffective here because the usual currency of work assignments would have no value to an attorney who was disqualified from joining the plaintiffs' team.

The difficulty with this reform is that it achieves its end only by compounding the already over-lawyered structure of class action litigation. Indeed, from almost any perspective, this reform is likely to aggravate existing problems. From the court's perspective, the imposition of a mandatory adversarial hearing in which a devil's advocate would be paid to attack the proposed settlement and fee award increases the procedural burden on an already over-worked court. The *Fine Paper* litigation is itself proof of this contention: Judge McGlynn spent forty-one hearing days listening to the rival factions challenge each other's fee applications and respond to the Weil, Gotshal Report.[115] This is an extraordinarily costly use of judicial time — particularly when the settlement itself was not in dispute. Yet once we decide to rely on an adversarial remedy, such a consumption of judicial time seems unavoidable because the dispute inevitably will be bitter and personal. Accusations of overbilling are inherently stigmatizing, and the lawyers' own reputations are in jeopardy. In this context, the "reform" of an institutionalized critic invites an interminable litigation, in which disputes about overbilling and excessive expenses will be bitterly litigated paperclip by paperclip.

From the perspective of the plaintiffs' attorney, this reform simply interposes one more round of adversarial hearings between him and eventual payment. Unlike the defense attorney, he is not paid on a current basis, nor is interest on the fee award required. Thus, delay has a high cost for him,[116] and an institutionalized monitor further exacerbates this problem by adding a new element of risk as well: having fought a typically large and better-financed team of defense counsel, he must now turn around and fight a fellow plaintiffs' counsel, who stands

115. *In re* Fine Paper Antitrust Litigation, MDL 323, slip op. at 3, 37 (E.D. Pa. March 3, 1983). *See also supra* note 94.

116. Under *Lindy*, no interest is added to the fee award, but rather this deferral is considered part of the contingency for which the multiplier is to be elevated. *See* Lindy Bros Builders v. American Radiator & Standard Sanitary Corp., 540 F.2d 102, 117 (3d Cir. 1976). *But cf.* Gates v. Collier, 616 F.2d 1268, 2172-79 (5th Cir. 1980) (interest added from date of original judgment). A problem with automatic inclusion of interest, however, is that such a rule would aggravate the existing incentive to be dilatory.

In *In re* Corrugated Containers Antitrust Litigation, 80 F.R.D. 244 (S.D. Tex. 1978), the plaintiffs' attorneys used Rice University Business School Professor Clifford Atherton to estimate the necessary multiplier to compensate them for the risk they had assumed. He found that simply to compensate plaintiffs' attorneys for the deferred payment during the course of that litigation, a multiplier of between 1.695 and 2.019 would be necessary (based on the Treasury Bill interest rate over the period). Thus, it is doubtful that existing multipliers even compensate for the time value of money, must less the risk premium involved. *See* "Affidavit of Clifford Atherton, Jr. Re Analysis of Appropriate Multiplier." *See also supra* note 113.

to profit by reducing his fee award. Such a two-front war is exhausting, as a number of the plaintiffs' attorneys have commented to me.

In summary, even the most ardent champion of litigation remedies must recognize that there can be too much of a good thing. Although the right of a class member to object to a settlement or fee award is not here questioned, it would be the height of folly to convert that right into a duty by mandating an obligatory devil's advocate. Instead the search must be for a more economical remedy that does not voraciously consume judicial resources or overbroadly chill plaintiffs' incentive.

B. *Model Two: Structural Redesign—Preventing Collusion Through Institutional Adjustments*

The principal alternative to an adversarial model is a structural one. Instead of seeking to prevent collusion by means of case-by-case intervention, a structural approach instead seeks to realign incentives and otherwise to eliminate the preconditions to collusive settlements. Collusion occurs when the adversaries are able to trade low settlements for high fee awards. To prevent this, several reforms are possible:

First and most obvious, we could return to a percentage-of-the-recovery formula for the determination of the fee award. At a stroke, this substantially realigns the private attorney general's incentives so that his private self-interest is congruent with his public role; "doing good" and "doing well" are less in conflict, because the more he increases the damages and thereby maximizes deterrence, the more he personally profits.[117]

This point is so simple and basic (and has been made so many times by others) that one wonders if there are any drawbacks to such a reform. One obvious objection is that a percentage formula works well when there is a common fund, but not so well when injunctive, equitable, or other nonpecuniary relief is sought. Of course, one might answer that this chilling effect on nonpecuniary settlements is itself a

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117. One qualification however, is necessary: A percentage-of-the-recovery formula may lead the private enforcer to prefer an early settlement that is not in the best interests of his client. For example, if a $3 million settlement were possible after six months of litigation, whereas an additional six months of effort would increase the settlement to only $3.5 million, the client who is compensating the attorney on a percentage-of-the-recovery basis (say 25% of recovery) would probably prefer that the attorney pursue the case for the extra six months (unless the additional half-million dollar recovery was less than the interest on the recovery over the interval during which the payment of the settlement was thereby deferred). The attorney, however, would only prefer to continue the litigation if the increase in the recovery exceeded the increase in his opportunity cost over that interval plus the lost interest on his fee over that same interval. For a close analysis of these considerations, see Clermont & Currivan, *supra* note 39, at 536, 543-46.

virtue, given the earlier-noted tendency for nonpecuniary relief to serve as a counterfeit currency by which to "hype" the value of settlement. But this argument should not be pushed too far. The value of corporate therapeutics is open to reasoned debate, and the Supreme Court in the past has given its endorsement to such relief.[118] Thus, on the principle that the tail should not wag the dog, it seems inappropriate to deny compensation uniformly to plaintiffs' attorneys for nonpecuniary relief simply because to do so sometimes may distort the settlement process.

A sensible compromise is possible: we could require the court to place an explicit price tag on the value of nonpecuniary relief, which would then be added to the aggregate financial recovery for the purpose of applying the percentage-of-the-recovery formula. This approach is the one that has been followed by the pending *Principles of Corporate Governance and Structure: Restatement and Recommendations*, which is now before the American Law Institute.[119] In essence, this approach places the burden on the court by exposing it to public criticism for overvaluing merely cosmetic relief; the issue is deliberately framed so that the court cannot duck the question of the extent to which the nonpecuniary relief had real value. In contrast, the time formula allows the court to evade this critical issue by focusing simply on whether a "substantial benefit" was produced and whether the attorney's time was reasonably expended. In effect, the time formula makes the issue of "substantial benefit" a "yes or no" question; yet, in reality, the critical issue is "*how* substantial was the benefit."

A second problem with a simple percentage-of-the-recovery formula is that it may aggravate the already marked tendency for the private attorney general to piggyback on public enforcement. If the same percentage of the recovery is applicable to actions that are initiated by the private attorney general as to those that are first begun by a public agency, it stands to reason that the lower risk, vastly lower search costs, and shorter deferral of payment associated with private actions that follow public ones will encourage private attorneys to tag along in the wake of cases initiated by public agencies rather than to develop original cases. The simple answer to this problem is to adjust

118. *See* Mills v. Electric Auto-Lite Co., 396 U.S. 375, 389-97 (1970).

119. *See* AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE AND STRUCTURE: RESTATEMENT AND RECOMMENDATIONS § 7.07(f) (Tentative Draft No. 1 1982) [hereinafter cited as ALI TENTATIVE DRAFT]. A pending revision of this section would require the court to "estimate, where practicable, the adverse consequences to the corporation or its shareholders generally" if such relief had not been secured. A standard of "clear and convincing evidence" is also required before such relief is deemed a substantial benefit to the corporation that can justify the award of attorneys' fees.

the percentage awarded so that it is higher when the private attorney initiates the action. Similarly, the lodestar's multiplier might also be adjusted to give a higher contingency bonus in such instances.[120] This proposal could be adopted by the *Manual for Complex Litigation* without legislation.

Still, it remains uncertain how much acceptance this reform is likely to receive from courts, given the entrenched status the lodestar formula has achieved.[121] Thus, an alternative solution, which might be more easily accepted by courts, would be to set a ceiling on a time formula equal to some maximum percentage of the recovery (say twenty-five percent in the case of actions not preceded by a public action, and otherwise ten percent). This proposal for a ceiling responds to two distinct problems that are associated with a straight percentage-of-the-recovery formula. First, the imposition of a ceiling responds to the political problem that originally induced courts to accept the lodestar formula: that a "windfall" fee award might otherwise be required, even in the case of a very quick settlement. Second, theorists have argued that a percentage-of-the-recovery formula tends to induce early settlements that fail to maximize the class recovery.[122] If this is so, a combination of a time formula and a percentage ceiling removes the incentive for these premature settlements without giving rise to a counter-incentive to be dilatory.

This possible compromise, however, requires that two basic problems be adequately addressed: (1) once again, how to prevent collusive settlements, and (2) how to prevent delay in the prosecution of the action so that the settlement is not deferred until the maximum ceiling is reached. Both these problems nevertheless seem capable of reasonably satisfactory solutions by means other than a percentage-of-the-recovery formula.

Because collusion requires some certainty on the part of the plaintiffs' attorney that the legal fees he expects will be awarded, notwithstanding the low settlement, one approach to eliminating collusion is to bar all discussion between the adversaries of the attorneys' fee until after the court has approved the settlment. This prophylactic rule in effect shifts the discretion over fee determination back to the court, because the parties are precluded from striking their own private bargain.

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120. The ALI TENTATIVE DRAFT, *supra* note 119, instructs the court in determining the size of any contingency bonus to consider, among other factors, "whether the action followed a prosecution or other proceeding in which the evidence was developed by public authorities or whether it was originally initiated by the plaintiff." *Id.* § 7.07 (a)(2).

121. The lodestar formula has received the apparent endorsement of at least seven of the federal courts of appeals. *See* Leubsdorf, *supra* note 4, at 473 n.1.

122. *See* Clermont & Currivan, *supra* note 39, at 543-46. *See also supra* note 117.

At present, when the adversaries strike such a deal, they lock arms and form a powerful coalition to present the settlement to the court.[123] In effect, the court faces the same problems that it does when presented with a plea bargain. If it rejects the settlement, it knows that a burdensome litigation will remain on its docket.

But this picture changes radically if any agreement as to the fee award, or even any discussion of it, is barred between the adversaries. To the extent such a rule can be enforced, collusion becomes more difficult: the plaintiff cannot hold the settlement hostage to the fee award nor can the defendant bribe the private attorney general. More important, the parties can no longer present the court with an integrated deal involving both the fee and the settlement, whose rejection would place the court in the untenable position of forcing parties to litigate who want to settle. The premise here is that judicial discretion is desirable; accordingly, by divorcing the fee award from the settlement we effectively increase the court's discretion to set the fee and thereby regulate the lawyer as bounty hunter. Ultimately, courts are capable of distinguishing a high quality performance by a plaintiff's attorney from an inferior one. If so, they can adjust the fee award to reflect this in a manner that is superior to a mechanical percentage-of-the-recovery formula. But courts can do this effectively only if they are not faced with a determined coalition of the parties seeking to secure its approval of a pre-packaged deal.

The legal basis for prohibiting joint resolution of the settlement and the fee award seems easily justified. Recent case law has begun to move in this direction and has in some instances found contemporaneous fee and settlement negotiation between the parties to be improper.[124] A number of decisions have also recognized that the plaintiff's attorney owes a fiduciary duty to the class or corporation in whose name he sues,[125] and this principle provides a conceptual underpinning for a prohibition on any linkage between the fee and the settlement. A recent ethics opinion by the Association of the Bar of the City

123. This, of course, is a paraphrase of Judge Friendly's much-quoted phrase in Alleghany Corp v. Kirby, 333 F.2d at 347.

124. *See* Prandini v. National Tea Co., 557 F.2d 1015, 1021 (3d Cir. 1977); Mendoza v. United States, 623 F.2d 1338, 1352-53 (9th Cir. 1980) (dicta), *cert. denied*, 449 U.S. 1042 (1980) Regalado v. Johnson, 79 F.R.D. 447, 451 (E.D. Ill. 1978); Obin v. District No. 9, Int'l Ass'n of Machinists and Aerospace Workers, 651 F.2d 574, 582-83 (8th Cir. 1981). Others have recommended a similar prohibition. *See* Rhode, *supra* note 29, at 1251 ("[T]o minimize the potential for financial bias, trial judges should enjoin counsel from negotiating fees pending settlement of substantive issues, absent explicit court approval."). *See also* Wolfram, *supra* note 15, at 293-98, for a case study.

125. *See* Lewis v. Teleprompter Corp., 88 F.R.D. 11, 15 (S.D.N.Y. 1980); Certain-Teed Products Corp. v. Topping, 171 F.2d 241, 243 (2d Cir. 1948).

of New York also has recognized that the plaintiff may not hold the settlement hostage to the fee award.[126] Cases are scarce, however, because usually there is no one to object to the joinder of the two questions and appellate courts are reluctant to reverse elaborately negotiated settlements on what they probably still see as a technical point. In sum, we are today at the critical moment when ideas can take hold and when propositions can leap from the status of dicta to that of holdings in judicial opinions. In this context, Tentative Draft No. 1 of the American Law Institute's *Principles of Corporate Governance and Structure* expressly seeks to encourage such a transition by condemning contemporaneous fee discussions in derivative actions.[127]

Despite this trend, several objections remain to a prophylactic rule against contemporaneous negotiation of the settlement and the fee award: First, if a "lodestar" time formula is retained, the parties will know that time is money and that by delaying the settlement until sufficient time has run, they can justify the desired fee. As to pecuniary settlements, this danger cannot be wholly discounted although even here other means exist by which to prevent such delay. For example, one can give the defendant a means of discouraging such delay by disallowing time expended by the plaintiff's attorney after a reasonable settlement offer was made by the defendant, unless the ultimate outcome produced a more favorable result.[128]

Still, the more important impact of a bar on pre-judgment fee discussions is on nonpecuniary settlements. Here, there is little reason why the court must accept the attorney's time as having been reasonably invested when the settlement appears to it to have been a largely cosmetic one. In this case, the court would have considerable discretion and easily could reject the time it deems unnecessarily expended. To understand this important contrast, consider two hypothetical cases. In the first the settlement results in a one million dollar fund and the plaintiffs' attorneys present time records justifying a $250,000 fee. It

126. *See* Committee on Professional and Judicial Ethics of the Association of the Bar of the City of New York, Formal Opinion No. 80-94 (1981) *reprinted in* New York Law Journal, September 22, 1981, at 2, col. 1 (legal ethics precludes an attorney "from holding the settlement of the merits hostage" to the determination of the attorney's fee).

127. ALI TENTATIVE DRAFT § 7.07(b). Section 7.07(b) both forbids such contemporaneous negotiation and requires all parties and their attorneys to certify to it as to the absence of such discussions or notify it of any breach. Section 7.07, however, applies only to derivative actions.

128. One solution to reduce the incentive to delay under a lodestar formula is to disallow time expended after a settlement offer, if the ultimate recovery does not exceed the offered amount. The theory here is that post-offer time does not benefit the class unless it enhances the fund. Such a position is taken in modified form in the *ALI Tentative Draft*. *See* ALI TENTATIVE DRAFT § 7.07(d).

may well be the case that the court will accept such a fee with only modest scrutiny, because the court recognizes that the claimed time results in a roughly equivalent fee to that which would result under a percentage-of-the-recovery formula. Some empirical evidence suggests that courts do in fact limit the allowable time in just this manner so as to equate results under the two formulas.[129] But if the settlement were instead to provide for only a $500,000 fund and nonpecuniary relief consisting of revised disclosures and changed corporate procedures, there is considerable reason to believe that the court would not accept a $250,000 fee, even though technically justified by time records. To the extent that excessive fees are now received in nonpecuniary settlements, the decisive factor is probably the court's reluctance to upset the parties' settlement. Once the issue of the settlement's approval is divorced in time from the issue of compensation of plaintiff's counsel, the court could use its own discretion and reduce the fee.

A second objection to this proposal has been repeatedly raised by corporate defense counsel: quick, cheap settlements are, they have said, in the corporation's own interest. Particularly in the case of the derivative actions, they have claimed that the corporation is better served even in a frivolous case by settling quickly rather than by expending time and effort litigating to a successful conclusion.[130] Although this argument is premised on the debatable proposition that derivative actions are typically frivolous, this thesis is mistaken even within the four corners of its own assumptions. It misses the critical distinction between an *ex post* and an *ex ante* perspective.[131] If one looks only from an *ex post* perspective after the action is filed, then indeed the least costly response to a frivolous lawsuit may be to pay the requested bribe to settle it, rather than to litigate and eventually have it dismissed. But from an *ex ante* perspective, the focus should be on how to discourage the filing of frivolous law suits. Indeed, from such a perspective, a known willingness to pay bribes in the form of quick settlements irrespective of the merits simply encourages the filing of additional frivo-

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129. *See* Mowrey, *supra* note 40, at 334-48.

130. Several decisions have even recognized the termination of the litigation itself as a "substantial benefit" which can justify an award of attorneys' fees. *See* Weisberg v. Coastal States Gas Corp., 1982 FED. SEC. L. REP. (CCH) ¶ 98,716, at 93,589 (S.D.N.Y. June 16, 1982); Lewis v. Anderson, 81 F.R.D. 436, 439 (S.D.N.Y. 1978). For a critique of these decisions, see Aronoff & Friedman, *supra* note 70. From this article's perspective, this attempt to characterize the cessation of the litigation as a benefit involves impermissible intellectual bootstrapping, which will encourage the filing of nonmeritorious actions in the future.

131. This distinction is a critical one to economists and is typically missed by lawyers. It similarly can be used to explain why a passive response to a tender offer should maximize shareholder welfare. *See* Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1177 (1981).

lous actions. The game theorist, Thomas Schelling, has argued that the best way to resist extortion is to reduce one's flexibility in advance by adopting rules that forbid the *payment* of ransom or blackmail.[132] By so tying one's own hands, one communicates that one will resist the threat and so reduces the extorter's incentive to threaten. Correspondingly, a rule that denies defense counsel the ability to agree to a fee award until the settlement is first approved by the court both reduces the defendant's vulnerability to extortion while also preventing collusive settlements that enervate the deterrent threat of the private attorney general. Ultimately, collusion and extortion are related problems that require an integrated solution.

A third objection to a prohibition on discussion of the fee award before the final approval of the settlement is that a prophylactic rule may deny the defendant the ability to know his total liability at the time he enters into the settlement. That is, if the defendant agrees to settle for a specific amount *plus* payment of plaintiffs' attorneys' fees, he has a legitimate need to know the total sum he must pay; prohibiting him from obtaining this knowledge inhibits settlements and as a result consumes scarce judicial time with unnecessary litigation. Exactly this argument was acknowledged by the Supreme Court last term as a reason for not adopting a prophylactic rule (even though the Court also noted that the potential for abuse in contemporaneous fee award and settlement discussions was real).[133] But this problem largely answers itself: the Court's decision in *Alyeska*, prohibiting fee shifting in the absence of a statute, ensures that in the vast majority of instances the defendant will know his total liability without having to know the size of the fee award.[134] *Alyeska* in effect means that the bounty hunter must generally look for his compensation to the common fund that the settlement creates. Consequently, his only entitlement is to be compensated out of this fund, and not to be separately paid by the defendants.

132. T. SCHELLING, THE STRATEGY OF CONFLICT 37-42, 137-39 (1960).

133. *See* White v. New Hampshire Dept. of Employment Sec., 455 U.S. 445, 453-54 & n.15 (1982). Although the Court acknowledged that it was "sensitive to the concern" that prejudgment fee negotiations "could raise an inherent conflict of interest between attorney and client," it also recognized that "in considering whether to enter a negotiated settlement, a defendant may have good reason to demand to know his total liability from both damages and fees." *Id.* Thus, the Court concluded: "Although such situations may raise difficult ethical issues for a plaintiff's attorney, we are reluctant to hold that no resolution is ever available to ethical counsel." *Id.*

134. In Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240 (1975), the Court dealt only with the case where there was no common fund and declined to shift the fees to the defendant in the absence of a statutory authorization. If a common fund has been established, however, payment of attorneys' fees out of that fund does not increase the defendant's total liability. *Alyeska* does not reverse the traditional "common fund" rationale for awarding attorneys' fees. *See* Boeing Co. v. Van Gemert, 444 U.S. 472, 478-81 (1980).

Of course, defendants may be willing to compensate the plaintiffs' attorney over and above the settlement, by agreeing to shift the fee voluntarily. In that event, they would not know their total liability, absent contemporaneous discussion of the settlement and the fee award. But, as the *Manual for Complex Litigation* properly recognizes,[135] such agreements for separate payment are inherently suspect both because they mean that the plaintiff class would not know of a disproportionate fee award at the time it approves the settlement and because intervenors would have little incentive to challenge an excessive fee where its reduction would not increase the size of the net recovery to the class. Thus, in the last analysis, the objection that a ban on contemporaneous fee and settlement discussions would unfairly deny the defendant the ability to know his total liability is true only where fee shifting is authorized by statute. Because fees are not shifted in derivative or most securities law actions,[136] this objection has no application to these important contexts.

A final objection is that such a ban is simply unenforceable, because covert discussions will still occur. Highly competent attorneys also have commented to me that such a prohibition penalizes the ethical attorney, who will obey the proscription, and favors those who gain an advantage through its violation. Two responses to these claims are in order: First, the unfair advantage that accrues to the less ethical attorney is a problem common to most ethical prohibitions, and it has not proven an insurmountable barrier in other areas. Second, even if some rate of noncompliance is predictable, this does not deny that there is a marginal improvement. Moreover, the rate of non-compliance is likely to be lower than the cynic suspects. Particularly in the case of derivative actions, a substantial social and professional gulf separates the

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135. MANUAL FOR COMPLEX LITIGATION § 1.46 (5th ed. 1981). *See also In re* General Motors Corp. Engine Interchange Litigation, 594 F.2d 1106, 1130-31 (7th Cir. 1979), *cert. denied*, 444 U.S. 870 (1979).

136. In derivative actions, fees are paid by the corporation, not the defendants. *See* W. CARY & M. EISENBERG, *supra* note 114, at 938-43. Under the federal securities laws, fees are only shifted in the limited number of express causes of action, but not in the far more numerous cases that arise based on implied causes of action, such as under Rules 10b-5 and 14a-9. Thus, the Court's reasoning in *White*, 455 U.S. at 445, does not apply, and prejudgment discussions of fees similarly should be precluded. Although fee shifting is authorized under the antitrust laws, fees are not automatically shifted in antitrust settlements, because the Clayton Act's "successful prosecution" requirement is not satisfied by a settlement. *See In re* Armored Car Litigation, 472 F. Supp. at 1380. Thus, because settlements are more common than litigated judgments and fee shifting is not mandated with respect to settlements, the "common fund" rationale appears to overshadow statutory fee shifting, and it will be in the minority of cases that the considerations noted by the Court in *White* will apply. For a list of other instances where fee shifting is authorized by statute, see *supra* note 3.

plaintiff's attorney from the defense bar; little love is lost between them, and much of the defense bar still regards the role of the bounty hunter as illegitimate. This is important, because collusion requires an element of mutual trust, which is here absent. At least where a clear ethical prohibition exists, the transgression of which could result in professional sanctions, bitter adversaries will find it difficult to trust one another; moreover, the frequently large number of participants in such actions would also make it difficult to form a sufficiently encompassing conspiracy to negotiate the fee award in a manner that assured the plaintiff's attorney that there would be no objection. Here, any dissenter or intervenor could breach the understanding and challenge the fee. Finally, it is this author's perhaps naive belief that although attorneys do exploit gray areas of the law, relatively few will violate a clear ethical prohibition.

To sum up this section, if the concept of the lawyer as bounty hunter is to remain valid, some means must be found to prevent the bounty hunter and his prey from working out a private deal superior to the bounty offered by the state. A ban on fee discussions between them is a substantial step in this direction.

C. *Model Three: Creating A Property Right*

Currently, the filing of a major antitrust or securities class action brings other lawyers out of the woodwork — 160 in *Fine Paper*, 100 in *Armored Car*, and similar numbers in other cases.[137] The result is to chill the incentives held out to the private attorney general, because he must share the fruits of any efforts he undertakes with the horde of "free riders" who follow close in his heels. On the theoretical level, this situation is by no means unique; rather, it is a classic illustration of the economics of nonownership. If the patent system were abolished tomorrow, one might similarly expect to observe reduced investment in research and development. Few will invest either money or its close substitutes — time and effort — if the return on their investment must be shared with an unknown number of others. The nonexcludability of such "free riders" in turn helps explain why private attorneys general do not seek out new cases, but instead piggyback on the government's action. Indeed, the disincentives to the initiation of original private enforcement actions are even more forbidding, because in class action litigation the free riders possess some capacity to block the attorney who initially filed the action (either by voting as a group to seize control of the plaintiffs' steering committee or by objecting to the settle-

137. *See supra* note 17.

ment). These two factors — nonexcludability and the blocking position which new entrants potentially occupy — go far toward explaining the current deficiencies in the operation of the private attorney general.

This diagnosis leads to a fairly obvious prescription: confer a property right and cut off additional entrants to encourage the legal entrepreneur to undertake the search costs that are necessary for the discovery of new law violations. Obvious as this may seem to the economist, it predictably will sound outrageous to lawyers, for whom the idea of the lawyer as a fiduciary for his client is the wellspring of legal ethics. From this perspective, the concept of the lawyer as an entrepeneur who somehow "owns" the action sounds very dubious. Yet in truth, there is little operative conflict between the two perspectives on this point, because even the most zealous proponent of a normative view of the legal profession would have to concede that there is a need to limit standing at some point well before 100 attorneys separately appear to represent the same class. The real question then from either perspective is how to reduce this horde of "free-riding" attorneys to a realistic number. From the economic perspective, which sees the litigation as a form of property, the simplest answer would be a "first-come, first-served" rule, under which the first to file the action is awarded the property right. The deficiency in this prescription also may seem obvious: it creates a race to the courthouse, in which unqualified counsel may gain control over the action. Such races already occur today in the wake of an antitrust indictment, but the court is not under any obligation to award the control over the action to the first to file. Predictably, if the first plaintiff to file is represented by a young lawyer right out of law school, the court will select someone else as lead counsel.

How serious is this danger that a "first-come, first-served" rule might result in semicompetent counsel gaining control over the case? Arguably, even if such a rule awarded the case to a twenty-five year old novice, without prior experience, he could for a price be persuaded to turn the effective control of the action over to a more experienced counsel. Clearly, one must go beyond the initial assignment of rights and ask what happens next. Economists have asserted that, in a rational world, when transactions costs are low, the party possessing the property right will assign it to those who can realize greater value from it. This proposition, known as the Coase Theorem,[138] states that the initial allocation of property rights is essentially irrelevant so long as the parties are able to contract among themselves without substantial transaction costs. It predicts that so long as the parties can bargain, they will

138. *See* Coase, *The Problem of Social Cost* 3 J. LAW & ECON. 1 (1960).

work out an accommodation that maximizes the value of the property. Here, the theorem would predict that the less competent counsel who is appointed lead counsel will negotiate a fee-sharing arrangement with a more experienced counsel who would actually handle the case.

How valid is this generalization as applied to the rough-and-tumble world of litigation? One standard criticism of the Coase Theorem is that individuals have a tendency to overvalue their own ability.[139] If so, the initial assignment of property rights remains important because the parties would not transfer property rights to those able to maximize value insofar as they overestimate their own capacity. Once we introduce this psychological issue of subjective self-estimates, the special character of class action litigation tends to make it difficult to rely on the Coase Theorem. Trial lawyers have notoriously strong egos, and few objective standards exist by which to distinguish the best from the merely adequate. In addition, class action plaintiffs' lawyers exhibit a high tolerance for risk almost as a professional characteristic, because only those willing to devote years of effort on the chance of victory remain in the field. Other barriers exist to transfers of control over the case between attorneys. Such a transfer may be interpreted as an admission of inferiority on the part of the transferring attorney. To the extent that it injures his professional reputation, there is a significant transaction cost involved, and the Coase Theorem is then not applicable by its own terms.[140] In any event, the evidence from the *Fine Paper* case does not reveal any inter-lawyer transfers. In fact, some of the best known and most respected plaintiffs' attorneys in the nation were excluded from participation by the patronage system, while other attorneys without prior experience in the field or other apparent credentials were given substantial work assignments.[141] The implication is that those who get control hold onto the case, and delegate responsibility only sparingly.

A second reason for rejecting a "first-come, first-served" rule applies even if one believed that the case eventually would be transferred to those best able to exploit it: put simply, such a system effectively

139. The relevance of the Coase Theorem to law has been much debated. *See, e.g.*, Kelman, *Conscription Theory, Production Theory, and Ideology in the Coase Theorem*, 52 SO. CALIF. L. REV. 669 (1979); Spitzer & Hoffman, *Reply to Conscription Theory, Production Theory, and Ideology in the Coase Theorem*, 53 SO. CALIF. L. REV. 1187 (1980).

140. By its own terms, the Coase Theorem applies only in a world of zero transaction costs. Thus, if the attorney would suffer a loss in professional standing by assigning the case to a more experienced colleague, the payment must compensate him for that loss.

141. As the Weil, Gotshal Report notes, some very experienced firms were excluded from participation while others with little prior experience in the field were given substantial assignments even though they entered after the initial settlement. Weil, Gotshal Report at 34-36, 179-204.

imposes a tax on the most efficient in favor of those who win the race to the courthouse. Because a higher bounty increases the bounty hunter's incentive to seek out new cases, such a tax is undesirable in that it effectively reduces the net award that the legal system holds out to the most competent private attorneys general.

How then should lead counsel be selected? The simplest answer is probably best: the court should choose the two or three best counsel out of the available field and appoint them co-lead counsel.[142] In choosing co-lead counsel, the court might consider, in addition to sheer ability and experience, such factors as: geographic diversity (in order to minimize the danger of domination by a small club, which still could negotiate collusive settlements), the relative cost of such counsel (permitting a New York attorney to run an action to be tried in a Houston federal court is unnecessarily expensive), the ability of the attorney to finance extended discovery, other time commitments of the attorney, and the willingness of counsel to use paralegal employees to further minimize costs. Once the relevant criteria are thus defined, the potential conflict between the economic view of the attorney as entrepreneur and the normative view of the attorney as fiduciary evaporates, because by choosing the most competent counsel, we also best serve the interests of the client.

Now, however, comes a critical point: the team of co-lead counsel so chosen could then retain as many (or as few) additional counsel as they thought desirable and could distribute their legal fees among themselves on any mutually agreeable basis. These additional counsel, however, would possess no right to vote or otherwise revise the composition of the plaintiffs' steering committee. At a stroke, this disenfranchisement of the latecomer ends the possibility of patronage battles, because the subsequently intervening counsel is in effect made an associate in the plaintiffs' law firm, rather than a partner. In short, the governance structure is hierarchical, rather than democratic — a change that kicks the free rider off the bus.

Subsequently filed actions would continue to be consolidated with the principal action under the same rules as apply today, and intervention would similarly be permitted. But lead counsel would have effective control over the case (absent a showing of impropriety or

142. An economist might suggest that the case should be auctioned off among the plaintiffs' attorneys by having them bid in terms of the lowest attorneys' fee that they would accept. This course seems unsound for two reasons: (1) the attorney having the lowest opportunity cost would be the likely winner and he may have such a low opportunity cost because of a correspondingly low ability, and (2) if the bidding were in terms of percentage of the recovery, the winning low bidder might be less prepared to invest his funds in trial preparation and discovery and thus more likely to enter into an inadequate settlement.

inadequacy), and would make all work assignments. In short, the late-arriving attorney would have no inherent right to participate in the action on behalf of the same class or to bill his time to the settlement fund, unless lead counsel desired his participation.

Once freed from the defensive need to form political coalitions and campaign for office on a log-rolling platform of "jobs for all," lead counsel could negotiate with other plaintiffs' counsel for their services based on their relative merit. To be sure, personalities, egos, and reciprocity still may enter the picture, but predictably the "phantom" plaintiffs' attorney whose only speciality is in the politics of class action organization would be left out in the cold. Ultimately, the movement induced by this change in legal rules would be in the direction of an internally rationalized plaintiffs' "firm," paralleling the structure of the defendant's law firm.

This last point — that a more hierarchical form of organization is desirable on grounds of efficiency — deserves a closer analysis: At present, even where patronage battles are absent, class action litigation today is conducted on the plaintiffs' side through a network of contracting participants, who must negotiate among themselves over each step in the case. Friction is inevitable, and the process is slow. This division of labor is analogous to General Motors assembling its cars by contracting with thirty different firms for the constituent parts and negotiating each sub-assembly stage individually. Of course, General Motors does not do this; rather, it uses subsidiaries, which it can quickly and efficiently order to produce the parts it needs. Similarly, in the ordinary law firm, decisionmaking is also hierarchical: the partner instructs the associate what to do and does not need to bargain or to contract with him. In sum, this is efficient. As a general proposition, economists agree that individual firms exist as indivisible economic units because they outperform the slower, more costly process of market exchange.[143] In economic theory, the scope of a firm's operations is defined as that range within which the firm is more efficient than individual contracting relationships.[144]

The relevance of this seemingly abstract economic point about the

143. The classic statement of this theme is in Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

144. For a modern application of Coase's insight, see Williamson, *The Modern Corporation: Origins, Evolution and Attributes*, 19 J. ECON. LIT. 1537 (1981). Williamson emphasizes the "transaction cost economizing" theme in Coase's early work, and sees the modern corporation as a means of similarly reducing such costs below the level obtainable in the market. This article similarly suggests that transaction costs can be reduced by substituting a smaller network of firms for the strange amalgam of up to 50 or more separate law firms that today attempt to conduct modern class action litigation.

superiority of hierarchy to market with respect to interrelated economic activity is best understood when one listens to the complaints of lead counsel who have sought to administer the plaintiffs' side of a complex class litigation. Repeatedly, I have heard them complain of the impossibility of getting their subordinate attorneys to take specific assignments or to do work on schedule. In part, this is the product both of the patronage system which undermines their authority and the intricacies of the "lodestar" compensation system under which different tasks merit different contingency bonuses. Thus, the lead counsel finds that all the attorneys on his side of the case want to appear in court, but none wish to do preparatory work and few will attend depositions at a remote site.

This difficulty is predictable. In a system where the court allocates the legal fees, every attorney wants to be seen and known by the judge. If the allocation of the fees instead were assigned to co-lead counsel, their authority would be enhanced and the court's work load would be substantially reduced because it then would have only to set the aggregate fee (under either a percentage-of-the-recovery formula or a time formula with a ceiling). At bottom, the lead counsel's lack of authority over his colleagues is inefficient, a cause of delay, and an impediment to an effective private attorney general system. The optimal answer to this problem is to encourage the creation of a plaintiffs' firm, which would be organized along the same lines as an economic firm. In reality, there are substantial barriers to this development, given the ad hoc character of a single class action.[145] But a hybrid form — resembling a franchise system — could arise, under which lead counsel would assign divisible portions of the case (e.g., discovery with respect to particular defendants, brief writing, motion practice, etc.) to different firms under a clearly stipulated compensation formula. In contrast, lead counsel today is in the position of an electioneering politician, who constantly must promise jobs, favors, and patronage to his constituents, but who cannot fully deliver and so must dispense his patronage incrementally in response to pressure.

145. An obvious obstacle is that a single case does not provide the same opportunity for economies of scale. Another problem is that most full-service integrated law firms find it difficult to subsidize contingent fee litigation by one or more of their partners. Inevitably, disputes arise over the allocation of the partnership income when some partners are receiving current fees from their clients while others are hoping for an eventual large recovery that is highly speculative. Because different individuals have different tolerances for risk, it is not unusual that most contingent fee litigation is conducted by small firms whose members share a common risk preference level. *See supra* note 35. But this characteristic small size also denies such firms the ability to achieve what this article will call full portfolio diversification. *See infra* note 148.

An important corollary of this reorganization of the plaintiff's side of the case is that it eliminates much of the current need for judicial supervision of plaintiffs' attorneys. A priori, there is no more need for judicial supervision of the internal relationships among the plaintiffs than there is of those among the defendants. Once an economic firm is established, those in control of it can decide the allocation of the proceeds with their "associates" either by employment contract, piece-rate systems, or some other means. In contrast, under the current lodestar system, the court must consume its scarce time reviewing each individual fee petition, each of which is in competition with every other petition (assuming that the court typically will not permit the aggregate attorneys' fees to exceed some maximum percentage of the recovery). The need for such paternalism vanishes once the "partners" appointed by the court can hire their own "associates." To be sure, the possibility of collusion still remains, but this only points up the desirability of appointing several lead counsel (who are not closely associated) and the continuing need for legal rules of the sort discussed under the preceding models for reform. Once a firm is created the court would need to focus only on the size of the aggregate attorneys' fees (as a proportion of the settlement) and not on its allocation.

Equally important, a judicial attitude of benign neglect should permit the plaintiffs' attorneys to engage in practices that are now forbidden but that are also highly efficient. Currently, "fee splitting" with attorneys not actively involved in the case is forbidden,[146] but, as the cases indicate, the practice seems to be common.[147] From an economic perspective, fee-sharing agreements with plaintiffs' attorneys not involved in the case are an efficient means of diversifying the risks incident to a litigation that necessarily will continue over an extended period.

As noted at the outset, risk aversion is one of the major factors that cripples private enforcement of law. Few attorneys are willing to bet their careers on a single case that can extend for a decade. Hence, inadequate settlements that do not reflect the litigation odds become likely. The classic answer of economic theory to this problem is portfo-

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146. *See* Lewis v. Teleprompter Corp., 88 F.R.D. 11, 17-19 (S.D.N.Y. 1980) (plaintiffs' attorneys found to have entered into an undisclosed fee-splitting agreement under which each attorney was to receive defined percentages of the recovery paid to lead counsel). In *Lewis*, the court in part objected to the failure of the parties to disclose to the court the substance of the fee agreement, a disclosure which was required by local court rules.

147. *See also* Kamens v. Horizon Corporation, 1981 FED. SEC. L. REP. (CCH) ¶ 98,007 (S.D.N.Y. May 26, 1981). In *Fine Paper*, there are also suggestions of this same practice. *See* Weil, Gotshal Report at 182 (alleged reciprocal trade of fees in one case for work in another).

lio diversification.[148] To understand this, consider the position of lead counsel in a major antitrust action that has just been initiated. He knows that the litigation may continue for years, during which time he will receive no legal fees, but must feed his family and pay his mortgage. The probability of eventual success may be good, let us say sixty percent, but there is still a forty-percent chance that he will lose, which would be an economic disaster for him. In short, he is forced to make an "all-or-nothing" gamble. In the "real world," where most of us are risk averse, this inevitably tempts him to accept an inadequate settlement.

Suppose instead that the same attorney could convert this single, undivided, "all-or-nothing" gamble into ten individual gambles which aggregated to the same amount. The difference is between a single coin flip of a silver dollar and ten coin flips of a dime; as we all know, the odds are high that over ten coin flips the results will be approximately half heads and half tails. In consequence, our plaintiffs' attorney can now more safely rely on the sixty-percent chance of success, because the variance associated with it has been virtually eliminated. He now knows that a sixty-percent chance of recovering ten million dollars under this latter procedure is worth six million dollars, because he has eliminated uncertainty by a strategy of diversification.

The critical point here is that portfolio diversification is as sensible and efficient a strategy for the "entrepreneurial" attorney as it is for other entrepreneurs generally. Any time one can reduce the variance associated with an outcome without incurring a reduction in the expected value of the outcome, such an opportunity should be ac-

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148. Portfolio diversification is essentially a means of reducing risk. Intuitively, one understands that it is unwise "to put all one's eggs in one basket." But the underlying logic of this point involves more than simply the truism that it is wise to hedge one's bets. Through the creation of a diversified portfolio, one may reduce the volatility risk associated with investments in other respects. For example, although the expected return of a portfolio is equal to the weighted average of the expected returns of the individual investments, the risk level of the portfolio is not necessarily the weighted average of the individual risks. *See* V. BRUDNEY & M. CHIRELSTEIN, CASES AND MATERIALS ON CORPORATE FINANCE 1151-55 (2nd ed. 1979). The standard reason why the aggregate risk level may be lower is that some risks are inversely related to each other: as one rises the other falls. This "co-variance" makes the portfolio's risk level lower than that of the average of its investments. Although the possibility of co-variance is less obvious where the portfolio's individual investments consist of lawsuits, it could still occur to the extent that legal decisions which reduce the prospect of success in one case raise that same prospect in another. Even if co-variance is not obtainable, the creation of a portfolio of investments in legal actions still means that the shape of the risk distribution that the attorney who goes to trial confronts is less bi-polar (i.e., a 50% chance of success and a 50% chance of failure), but instead begins to resemble the classic bell curve. Thus, the attorney should be less risk averse and more able to litigate on an equal footing with defendants.

cepted.[149] In abstract theory, the plaintiffs' attorney could achieve efficient diversification of his portfolio by trading participations with other attorneys. Actual syndications of lawsuits are rare, of course, but the simpler alternative which amounts to the same thing in the end is a norm of reciprocity: Attorney *X*, as lead counsel, could allow Attorney *Y* to participate in his case (and assign work to him) in return for Attorney *Y* doing the same in reverse in a case in which he is lead counsel. As long as both attorneys are actually involved in the litigation, such fee sharing should not constitute an ethical breach.[150] Indeed, this latter pattern of reciprocity describes existing practice, within the relatively close-knit antitrust plaintiffs' bar.[151] Although encouraging this

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149. In a world of risk averse decision-makers, a premium will be paid to avoid risk. For a concise explanation, see W. KLEIN, BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES 147-55 (1980).

150. Disciplinary rules forbid fee sharing among those not employed in the same office or firm, unless there is client consent and the division "is made in proportion to the services performed and responsibility assumed by each." *See* MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-107 (1971). In addition, local court rules often require disclosure of even permissible fee sharing agreements. In *Kamens v. Horizon Corporation*, the court did not object per se to fee sharing among attorneys associated in the case, but did reject such a sharing agreement where it would benefit the lead plaintiff more than the class he represented. This article does not attempt a close analysis of the proper scope of DR 2-107, but it plainly sets only an outer limit, rather than a precise standard. In cases where all the attorneys participating in the case agree to engage in fee sharing according to some negotiated formula, some decisions have taken a posture of judicial indifference with respect to the allocation of the fees among these attorneys. *See* Del Noce v. Delyar Corp., 457 F. Supp. 1051, 1055 (S.D.N.Y. 1978); Valente v. Pepsico 1979 FED. SEC. L. REP. (CCH) ¶ 96, 921 (D. Del. June 4, 1979); *In re* Magic Marker Securities Litigation, 1979 FED. SEC. L. REP. (CCH) ¶ 97, 116 (E.D. Pa. Sept. 16, 1979); *In re* Ampicillin Antitrust Litigation, 81 F.R.D. 395, 400 (D.D.C. 1978). Other decisions such as *Kamens* have questioned this "doctrine of judicial indifference to attorney fee sharing agreements" on the grounds that the *Lindy/Grinnell* lodestar formula contemplates judicial supervision and regulation of each attorneys' fees. *See* Kamens v. Horizon Corp., 1981 FED. SEC. L. REP. (CCH) ¶ 98,007 (S.D.N.Y. May 26, 1981).

The pending Kutak Commission's MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.5(e) (Final Draft 1982), would significantly revise DR 2-207. This proposal provides as follows:

> A division of fees between lawyers who are not in the same firm may be made only if:
> (1) the division is in proportion to the services performed by each lawyer, or, by written agreement with the client, each lawyer assumes joint responsibility to the representation; and
> (2) the client consents to the participation of all the lawyers involved; and
> (3) the total fee is reasonable.

Id. The commentary to the rule indicates that the required disclosure need not indicate the share that each lawyer is to receive. This revision would apparently permit fee-sharing agreements that are not in proportion to the services performed by the individual lawyer so long as written disclosure is made to the client, the client consents, and the total fee is reasonable.

151. Lewis v. Teleprompter Corp., 88 F.R.D. 11, 17 (S.D.N.Y. 1980), sets forth a percentage sharing agreement in explicit detail. But the better evidence is simply the recurrent

process of reciprocal exchanges will not alone produce efficient diversification, it should mitigate the intensity of the risk aversion.

What specifically must be done to permit efficient diversification? The answer is that very little need be done. Absent restrictions, the plaintiffs' bar can strike its own deals by which to diversify the litigation risks its members face.[152] At present, however, the lodestar formula impedes their ability to do so. For example, if Attorney *X* wished to trade a thirty-three percent interest in the antitrust class action he was trying for an equivalent interest in the securities class action headed by Attorney *Y*, this simple and sensible exchange transaction could most simply be effected by Attorney *X* working on Attorney *Y*'s litigation team, and vice versa. The risk thus is spread by this reciprocal work sharing. But if the fee award is challenged (as in *Fine Paper* and other recent cases), it may be difficult for Attorney *X* to justify his hours on Attorney *Y*'s case with the thoroughness that recent decisions interpreting the lodestar formula have begun to demand. In reality, the two attorneys have worked out a fee-splitting arrangement which is implemented through reciprocal work sharing, and neither expected much active participation from the other. Thus, the feasibility of these arrangements is inhibited by both the procedural rigor with which courts are now enforcing the lodestar formula and the likelihood of outside challenges to the fee award. If, however, we reverted to a percentage-of-the-recovery formula, there would be no need for the court to look over the shoulders of the plaintiffs, and outside challenges could be directed only to the *aggregate* level of the fees, not their internal allocation. In substance, the plaintiffs' bar would be free to split the pie as they saw fit and thus could more closely approximate efficient diversification.

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pattern of the same firms sharing steering committee leadership. Prior to the explosion in *Fine Paper*, Kohn and the "Chicago Group" had frequently cooperated on such a basis. *See* Bruck, *supra* note 17. A close working relationship also was evident in *Fine Paper* between Kohn and David Berger, another eminent Philadelphia plaintiffs' lawyer, to whom Kohn sought to direct work even though Berger had no client in the action. *See* Weil, Gotshal Report at 24.

152. There are three obvious routes toward diversification: (1) plaintiffs' lawyers can band together in firms, in which event neither the lodestar formula nor existing disciplinary rules pose any obstacle to intra-firm fee sharing, (2) they can enter into fee allocation agreements under which the fees will be shared according to a defined percentage regardless of how the court awards them (this is the fact pattern in *Lewis v. Teleprompter*), or (3) they can engage in reciprocal work-sharing arrangements. The latter two options are impeded to the extent that the court insists on allocating the fees and closely scrutinizes the time records. The former approach might then seem the logical one, but plaintiffs' firms have historically proven themselves to be unstable, either because of the clash of strong egos, the lack of continuing "institutional" business, or the difficulty of dividing equitably current and expected income.

In this light, patronage battles and the free rider problem are not the only reasons for the seemingly excessive number of plaintiffs who intervene in cases such as *Fine Paper*. An additional reason may be this need of the professional plaintiffs' attorney to spread his risks by diversification. But this goal is in no way inconsistent with the logic of the private attorney general; rather, it reduces the prospect of cheap settlements caused by the plaintiff attorney's inability to wage a protracted fight or to accept the risk of defeat. Denying the private attorney general the ability to limit his risk helps no one except the defendant.

To sum up, judicial recognition of the need for the plaintiffs in major class litigation to be organized as an economic firm, rather than as a political coalition, would entail several desirable results: (1) the true "free rider" would be quickly eliminated, (2) the court would be saved the time now wasted in resolving the inevitable disputes among contending plaintiffs' counsel and allocating the attorneys' fee among the horde of claimants, and (3) those running the case could reduce their exposure to risk by diversification based on reciprocal work assignment arrangements. In contrast, the contemporary lodestar system of close judicial oversight amounts to a heavy-handed form of regulation which is increasingly inconsistent with our society's preference for less paternalism and more reliance on market incentives.

IV. CONCLUSION

For the private attorney general, this is the winter of his discontent. Everyone — courts, commentators, and academics (including this author) — has a critical view of the private attorney general's current performance. But how do we improve his performance? To rescue the private attorney general, this article has suggested that we must save him from both his myopic admirers and his eagle-eyed enemies. It must be recognized that the bounty hunter does not perform well when certain conditions exist. Stated baldly, these are:

(1) When the bounty hunter can negotiate with his prey, the defendant may outbid the bounty offered by the state. This is essentially the problem that the lodestar formula and non-pecuniary settlements aggravate, although it persists in a less dramatic form so long as the adversaries have some power to trade low recoveries for high fees.

(2) If the entrepreneurial attorney cannot obtain something resembling a property right in the action, he will not invest time and effort, but instead will tag along in the wake of governmental enforcement pursuing the pot of gold that such actions ultimately bestow on someone. Even in these piggyback private actions, the incentive to the pri-

vate attorney general is still diluted by the intervention of a horde of superfluous attorneys. Thus, the sad irony is that we have successful private enforcement only when we need it least — namely, in those cases where the plaintiff's attorney has merely "to shoot the fish in the barrel" because of a prior action by public enforcers.

(3) To the extent that the private attorney general must defer payment and gamble on the outcome of the big case, he predictably will be risk adverse and in consequence will accept inadequate settlements.

In response to these structural limitations, one can condemn collusive settlements in moralistic terms or hope for more idealistic lawyers to take up the cudgels. But such efforts will accomplish little. What is necessary is a redesigned structure under which the principal plaintiff's attorney (1) *must* not negotiate his fee with the defendant, (2) *need* not negotiate with other plaintiffs' attorneys, (3) but *may* engage in reciprocal work sharing agreements with other attorneys. At least within the context of "entrepreneurial" litigation, a return to a percentage-of-the-recovery formula might be the simplest means to this end, but it is neither a necessary nor a sufficient condition in itself. Because the percentage would always be somewhat flexible to reflect a variety of factors, the possibility of collusion would remain as the defendant could still offer a higher percentage for an inadequate settlement. Alternatively, to the extent that a lodestar formula is retained, a prohibition on contemporaneous fee and settlement discussions, if coupled with some incentive to the plaintiff not to delay, and a ceiling phrased in terms of a maximum percentage of the recovery, may provide a satisfactory solution. Neither, however, will be effective unless the organization of the action is rationalized through rules that prevent political battles over the control of the cases. Even a "first-come, first-served" rule of priority is preferable to the current chaos.

Counter-intuitive conclusions also follow from this perspective which focuses on the incentives to the plaintiff's attorney. Generally, proponents of the private attorney general have advocated fee shifting whereby the losing defendant bears the plaintiffs' legal expenses. But so long as some implicit negotiation of the fee award is possible among the adversaries, fee shifting exacerbates the danger of collusion, and a "common fund" rationale for the fee award is therefore in this respect preferable. Moreover, fee shifting means that the defendant would not know his maximum liability if a prophylactic rule were adopted barring fee discussions during the settlement process. Because a prophylactic rule seems desirable, and only feasible if the "common fund" is taxed for the recovery, the case for fee shifting under the old "private attorney general" exception to the American rule is thereby weakened.

The recent critics of the lodestar formula have focused on the incentive it creates to be dilatory. True as this criticism is, it is a problem of secondary significance. The more important immediate deficiencies of the lodestar formula are two-fold: (1) it permits the plaintiff to assure himself of a fee with relative confidence even though his services have not rendered a substantial benefit to the class, and (2) it is at least mildly corrupting to the ethics of the system that all parties, including the court, are conspiring to permit this to occur. Arguably, the legal system can no more be a little bit corrupt than it can be a little bit pregnant.

Over the long run, the lodestar formula's vulnerability to abuse is its most serious weakness because it discredits the private attorney general as a concept. This vulnerability permits defendants to wage a continuing attack on the desirability of private enforcement. *Fine Paper* appears to have been only the first round in this warfare, and similar attacks on the integrity of the plaintiffs' bar have now been made in other much-publicized antitrust cases.[153] Although no one —including the self-appointed private attorney general — should be beyond critical scrutiny, the result is that the plaintiffs' attorney now must anticipate a two-front war before he can be compensated. First, he must win a substantive victory (either on the merits or by settlement) and then he must prove that he is not a crook when putative representatives of the plaintiffs' class, consisting of Fortune 500 corporations, seek to challenge his fee petition as inflated. Once again, the result is to chill his incentive. Thus, structural reform, such as some form of a percentage-of-the-recovery formula, is preferable.

Ultimately, the academic reformer has a duty to specify not only what the optimal solution is, but what the first tentative steps are that should be taken toward it. This author would recommend the following immediate reforms:

(1) Most clearly, the *Manual for Complex Litigation* should be revised so as to reverse its current position[154] and make the selection of lead counsel a judicial responsibility, rather than the subject of a political election. In addition, enhanced authority should be given lead

153. A challenge similar to that made by Weil, Gotshal's clients in *Fine Paper* has been made with respect to the requested attorneys' fees in *Corrugated Container*; again, the objectors are Fortune 500 corporations claiming that their share of the recovery is being dissipated through excessive attorneys' fees. *See* Mieher, *supra* note 19. (General Motors, Beatrice Foods Co., Esmark Inc., and 24 other corporations have hired counsel to challenge the fees). A related challenge was also made in *Armored Car* by the Atlantic Richfield Company and the Penn Central National Bank. *See In re* Armored Car Antitrust Litigation, 472 F. Supp. at 1381 n.20.

154. MANUAL FOR COMPLEX LITIGATION § 1.92 (5th ed. 1981).

counsel to control work assignments (and, if need be, to retain the services of additional attorneys not otherwise participating in the action).

(2) The lodestar formula should be substantially modified. This modification could be implemented through recommended guidelines set forth in the *Manual* specifying the maximum fee award (as a percentage of the settlement fund) that should be permitted under the lodestar formula. In particular, these guidelines should require the court to attempt to estimate the value of nonpecuniary relief and add the estimated value to the settlement fund before applying the percentage ceiling to limit the fee award justified on a time formula basis. This combination of a percentage-of-the-recovery formula as a ceiling and a time formula as a minimal requirement best avoids the deficiencies of either formula standing alone.[155]

(3) When the private action follows a prior governmental proceeding, a substantially lower percentage ceiling on the fee award should apply and contingency bonuses seldom would be appropriate. Distinctions, of course, would need to be drawn between actions that follow a judgment in favor of the government versus those that follow only the filing of the complaint.

(4) The danger of contemporaneous settlement and fee award negotiations should be highlighted, and, in those areas where fee shifting is not authorized by statute, it should be prohibited. Although this is best done as a matter of legal ethics, local court rules also could prohibit such discussions.

(5) When nonpecuniary relief constitutes the greater portion of the relief obtained, the *Manual* should advise both trial and appellate courts to exercise substantial skepticism in reviewing the adequacy of such settlements. In addition, intervenors should be given the fullest opportunity to show that they could obtain a better settlement.

These reforms could be implemented without legislation. Legislation, however, may be desirable in the antitrust field to revise the damage formula in the piggyback action.[156]

155. *See supra* text and accompanying note 122.

156. My proposal would be that only compensatory damages go to the plaintiff in such cases, with the remaining two thirds going to a crime victims' compensation fund. This keeps the penalty high for purposes of general deterrence but reduces the settlement fund to the class on which the fee award would be based under either a percentage-of-the-recovery formula or modified lodestar formula; thus, it assures a higher fee for a plaintiff-initiated case than for a "tag-along" action. *See* Coffee, *"No Soul to Damn; No Body to Kick": An Unscandalized Inquiry Into the Problem of Corporate Punishment*, 79 MICH. L. REV. 386, 434-40 (1981). If the plaintiff were still given treble damages but the fee award were based only on compensatory damages, the incentive structure would still be socially undesirable because it would remain possible for the client and his attorney to negotiate a contingent fee agreement so that the expected return from a piggyback action would remain high in pro-

Given the above reforms, what expectations can we reasonably have of the private attorney general as a mechanism of accountability? This is a broad question, and it is not this article's contention that the reforms here proposed will produce a panacea. Still other problems confound private enforcement of the law: Economies of scale may sometimes make the state the superior body for enforcing a particular statute or right; at other times, the need for prosecutorial discretion may actually make it desirable that private enforcers only follow in the wake of an initial action brought by a public agency. These issues are beyond the scope of this initial attempt at understanding what has gone wrong. This much, however, can be said with relative confidence: a mature legal system must recognize that the private attorney general is an entrepreneur who should be compensated and regulated accordingly. If it persists in the pretense that he is simply a lawyer representing a client, the *Fine Paper* debacle will be repeated again and again, and Dickens' *Jarndyce v. Jarndyce* will be read not as parody, but as documentary.

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portion to that associated with actions truly initiated by the private enforcer. Thus, awarding only compensatory damages to the plaintiff decreases the expected return for piggyback actions, while still maintaining a high penalty structure.