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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

AMERICAN BANKERS MANAGEMENT COMPANY, INC.

Plaintiff,

v.

ERIC L. HERYFORD, in his official capacity as DISTRICT ATTORNEY, TRINITY COUNTY

Defendant.

Case No. 2:16-CV-00312-KJM-KJN

PROPOSED BRIEF OF *AMICI CURIAE* THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AND PHARMACEUTICAL RESEARCH AND MANUFACTURERS OF AMERICA IN SUPPORT OF AMERICAN BANKERS MANAGEMENT COMPANY, INC.'S MOTION FOR PARTIAL SUMMARY JUDGMENT

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INTRODUCTION

This case addresses a troubling trend in our judicial system: increasingly, state attorneys general are delegating quasi-criminal enforcement powers to private attorneys who are litigating multiple claims against corporate defendants. In nearly every such case, including *The People of the State of California ex rel., Eric L. Heryford, District Attorney, Trinity County v. Discover Financial Services et al.*, No. 2:16-cv-00468-KJM-CMK ("the UCL Suit"), the private attorneys enter into a contingency-fee agreement with the state, under which they are to be paid only if they win; and if they do win, they are paid more and more for each additional dollar they recover. The problem with these arrangements is self-evident: they entrust the duty of impartially administering justice to attorneys with an overwhelming incentive to "win" the case – even if it is entirely bereft of merit. As a result of these pressures, the neutral forum assured to defendants by basic principles of due process is incurably tainted. Given the personal interests of counsel, defendants have no hope of persuading them to abandon a meritless case because the quest for a high-dollar recovery becomes the paramount consideration, no matter how unreasonable the case. The result is guaranteed litigation and, when the state prevails, highly inflated penalties, placing additional burdens on court dockets and harming American businesses.

American Bankers Management Company, Inc.'s ("American Bankers'") Memorandum of Points and Authorities in Support of Motion for Partial Summary Judgment correctly argues for a categorical rule against all such arrangements. As the memorandum makes clear, the United States Supreme Court's due-process precedents are incompatible with the retention of private attorneys on a contingency-fee basis. (*See* Pl.'s Mem. of P. & A. in Supp. of Mot. for Partial Summ. J. ("MSJ") at 7-17.) Therefore, the Court should enter partial summary judgment in American Bankers' favor, declare that the District Attorney has violated American Bankers' federal constitutional right to due process, and enjoin the District Attorney from employing private law firms to prosecute the UCL Suit under a contingency-fee agreement.

Amici Curiae The Chamber of Commerce of the United States of America and Pharmaceutical Research and Manufacturers of America seek to file this brief to supply the Court

with two additional points to guide its consideration. First, courts have acknowledged that a categorical bar on the use of contingency-fee counsel is appropriate in cases, like this one, that are quasi-criminal in nature, and decisions rejecting such a categorical bar have either arisen in cases of a different nature or simply failed to grasp the heightened importance of a categorical bar in quasi-criminal cases. Second, the growing use of contingency-fee counsel by state attorneys general in quasi-criminal enforcement actions around the country makes it all the more critical that the Court find the fee arrangement improper in this case. For these reasons, the Court should grant relief to American Bankers from the District Attorney's infringement of its rights.

ARGUMENT

I. A CATEGORICAL BAR AGAINST THE USE OF CONTINGENCY-FEE COUNSEL APPLIES IN QUASI-CRIMINAL CASES LIKE THIS ONE.

The District Attorney's retention of private, for-profit, contingency-fee counsel to prosecute a quasi-criminal case poses intractable due-process problems. The UCL Suit is brought in the name of the State; it seeks injunctive relief that would bar certain types of speech; and it seeks substantial penalties that, like criminal sanctions, are designed to punish and deter, and are not rooted in or limited by any damage ostensibly sustained by the State or its citizens. The need for neutrality is at its apex in such cases because any temptation to pursue self-enrichment rather than justice would subvert basic due-process protections. Accordingly, the use of contingency-fee counsel is inappropriate as a matter of due process – even if such arrangements might be permissible in other circumstances.

Due process includes the right to an impartial tribunal and to prosecution by a lawyer for the government whose judgment is unclouded by any financial or other personal stake in the outcome. *See Tumey v. Ohio*, 273 U.S. 510 (1927); *Marshall v. Jerrico, Inc.*, 446 U.S. 238 (1980). Pursuant to this principle, Supreme Court decisions have adopted a "categorical" rule against the use of prosecutors who have a financial incentive to obtain a conviction – be they government attorneys or private, retained counsel – a rule that other courts have extended to quasi-criminal enforcement actions. (*See* MSJ at 7-8.)

Despite the clarity of the Supreme Court's "categorical" approach, some courts have concluded that attorneys general may retain private counsel on a contingency-fee basis as long as the attorney general retains "control" of the litigation. (*See id.* at 8.) But even these courts have recognized that a categorical bar on such arrangements remains necessary in quasi-criminal enforcement proceedings like this one. In *People ex rel. Clancy v. Superior Court*, 705 P.2d 347 (Cal. 1985), for example, the City of Corona, California, sought to enjoin a bookstore from selling sexually explicit materials. The City hired outside counsel to prosecute abatement actions under a public-nuisance theory, *see id.* at 348-49, agreeing to double the private firm's hourly rate if the City prevailed (as long as the court ordered the losing party to pay the City's attorneys' fees). *Id.* at 350. The California Supreme Court rejected this arrangement, finding that the retention agreement "[o]bviously" gave outside counsel "an interest extraneous to his official function in the actions he prosecutes on behalf of the City." *Id.* at 351. The court held that such an interest was "antithetical to the standard of neutrality that an attorney representing the government must meet when prosecuting a public nuisance abatement action." *Id.* at 353.

As part of its rationale, the court explained that the abatement proceeding closely resembled a criminal prosecution, in which principles of neutrality and impartiality are of paramount importance. *See id.* at 352-53 & n.4. In particular, both in *Clancy* and in a subsequent case describing it, the California Supreme Court emphasized that the suit at issue:

- Was "brought in the name of the People," *id.* at 352-53, and "on behalf of the public," *County of Santa Clara v. Superior Court*, 235 P.3d 21, 34 (Cal. 2010);
- Sought not compensatory but injunctive relief, which would impinge upon "the continued operation of an established, lawful business," *Santa Clara*, 235 P.3d at 32;
- "[I]mplicated both the defendants' and the public's constitutional free-speech rights" because the materials at issue "involved speech that arguably was protected in part," *id.* at 32-33; and
- Claimed a "'remedy [that] is in the hands of the state,'" *id.* at 33 n.10 (quoting *Clancy*, 705 P.2d at 353), and "carried the threat of criminal liability," *id.* at 33.

Based on these characteristics, the California Supreme Court determined that the close relationship between the nuisance action and a criminal proceeding "supports the need for a neutral prosecuting attorney," and "***[a]ny*** financial arrangement that would tempt the . . . attorney to tip the scale cannot be tolerated." *Clancy*, 705 P.2d at 352-53 (emphasis added). The court therefore disqualified the counsel.

Years later, when the same court embraced the control test in a different case, it was careful to point out that *Clancy*'s categorical bar would continue to apply in quasi-criminal cases. In *Santa Clara*, 235 P.3d 21, the California Supreme Court confronted another nuisance action, this time by various municipalities against former manufacturers of lead paint. *Id.* The municipalities sought to have the manufacturers remove or pay for the removal of lead paint. *See id.* at 25, 34. The court concluded that *Clancy*'s rule of "automatic disqualification" was "unwarranted" because the cases differed in nature. *Id.* at 31-32. Specifically, in *Santa Clara*:

- "[W]hatever the outcome of the litigation, no ongoing business activity [would] be enjoined" since the manufacture of lead paint had already been illegal for decades, *id.* at 34;
- "[T]he *remedy* [would] not involve enjoining current or future speech" and thus could not "prevent defendants from exercising any First Amendment right or any other liberty interest," *id.*;
- The suits posed "neither a threat nor a possibility of criminal liability," *id.*; and
- The proposed remedy would "result, at most, in defendants' having to expend resources to abate the lead-paint nuisance they allegedly created" – "the type of remedy one might find in an ordinary civil case." *Id.*

Under these circumstances, the court held that the attorney general's office could hire private counsel on a contingency-fee basis, but only if it retained "'*absolute and total control over all critical decision-making*.'" *Id.* at 36 (quoting *Rhode Island v. Lead Indus. Ass'n*, 951 A.2d 428, 475 (R.I. 2008)). Importantly, however, the court distinguished the case before it and underscored the vitality of *Clancy*'s rule of "automatic disqualification" in quasi-criminal cases. *Accord, e.g.*, David M. Axelrad & Lisa Perrochet, *The Supreme Court of California Rules on* Santa Clara *Contingency Fee Issue – Backpedals on* Clancy, 78 Def. Couns. J. 331, 342 (2011) ("The [*Santa*

Clara] court found the ***determinative*** factor in the case . . . to be the difference between 'the types of remedies sought and the types of interests implicated' in *Clancy* and in *Santa Clara*.") (emphasis added, citation omitted).[1]

Here, even if the Court were to conclude that a control test might be appropriate in some circumstances, *Clancy*'s categorical rule should apply in these circumstances. The UCL Suit, like *Clancy*, seeks injunctive relief that would stifle ongoing advertising and promotional conduct. (*See* MSJ at 15 (stating that the UCL Suit prays for an "injunction prohibiting what the District Attorney alleges to be 'deceptive' marketing and communications with cardholders").) Moreover, the requested injunctive relief implicates American Bankers' liberty interests. In *Clancy*, it was sufficient that the proposed injunctive relief would have affected speech that was "arguably . . . protected in part." *Santa Clara*, 235 P.3d at 32-33. Here, the liberty interest at stake is at least as strong, as there is no question that commercial speech is protected. (*See* MSJ at 15-16 ("'The First Amendment requires heightened scrutiny whenever the government creates a regulation of speech because of disagreement with the message it conveys. Commercial speech is no exception. A consumer's concern for the free flow of commercial speech often may be far keener than his concern for urgent political dialogue.'") (quoting *Sorrell v. IMS Health Inc.*, 131 S. Ct. 2653, 2664 (2011) (some internal quotation marks and citations omitted).)

The UCL Suit also involves a request for penalties – a remedy that (like the one in *Clancy*) rests exclusively in the State's hands. *See Santa Clara*, 235 P.3d at 33-35 (contrasting the state's exclusive remedies with ordinary compensatory relief, which is all that was sought in *Santa Clara*). The purpose of penalties is not to compensate but to punish and deter, giving them a quasi-criminal character akin to punitive damages. *See, e.g.*, *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538

[1] Other cases have acknowledged this same distinction. *See, e.g.*, *City & Cnty. of S.F. v. Philip Morris, Inc.*, 957 F. Supp. 1130, 1135 (N.D. Cal. 1997) ("This lawsuit, which is basically a fraud action, does not raise concerns analogous to those in the public nuisance or eminent domain contexts discussed in *Clancy*. Plaintiffs' role in this suit is that of a tort victim, rather than a sovereign seeking to vindicate the rights of its residents or exercising governmental powers."); *Lead Indus.*, 951 A.2d at 475 nn.48 & 50 (A categorical bar was inappropriate because "the case presently before us is completely civil in nature," but "we are unable to envision a criminal case where contingent fees would ever be appropriate[.]"); *Philip Morris Inc. v. Glendening*, 709 A.2d 1230, 1242-43 (Md. 1998) (distinguishing *Clancy* in part because "there are no constitutional or criminal violations directly implicated here").

U.S. 408, 417 (2003) (noting that punitive damages "serve the same purposes as criminal penalties"). Indeed, as the summary-judgment motion notes, the District Attorney has acknowledged that UCL civil penalties are intended to "punish" defendants. (*See* MSJ at 13 ("'Through this action, the State of California seeks civil penalties from Defendants to punish them for their wrongful conduct.'") (quoting the District Attorney's Motion to Remand in another UCL lawsuit, *People ex rel. Heryford v. Volkswagen of America, Inc.*, No. 2:15-CV-02254-MCE-CMK (E.D. Cal. Filed Nov. 9, 2015) (ECF No. 6)). And the penalties remedy is particularly prone to abuse. Ordinary compensatory relief is, by its nature, limited by the extent of damage actually sustained by the state or its citizens, reducing the risk of "governmental overreaching or economic coercion." *Santa Clara*, 235 P.3d at 34. But penalties are not so limited, affording essentially unbridled discretion to a private lawyer to seek to maximize the number and amount of penalties, regardless of any damage allegedly sustained. *See, e.g.*, Axelrad & Perrochet, *supra*, at 342 (noting that "a penalty that is not tied to an amount needed to cure or abate harm caused by the defendant" is a consideration weighing against the application of *Santa Clara*'s control rule).

In sum, basic principles of due process compel application of a per se rule against retention of private counsel on a contingency-fee basis, and permanent injunctive and declaratory relief are necessary and proper to remedy the continuing violation of American Bankers' constitutional rights.

II. THE USE OF CONTINGENCY-FEE COUNSEL IN QUASI-CRIMINAL ENFORCEMENT SUITS IS A GROWING PROBLEM THAT NEEDS TO BE ADDRESSED.

Permanent injunctive and declaratory relief from the District Attorney's improper retention agreement is especially necessary and important because the practice of outsourcing quasi-criminal litigation to profit-seeking attorneys is a recurring problem that reflects poorly on the judicial system. The UCL Suit is just one of a growing number of cases in which state attorneys general have abdicated their duties by delegating quasi-criminal enforcement power to self-interested private attorneys. These arrangements promote unseemly quid pro quo relationships between

government officials and private lawyers and undermine public confidence in the justice system, underscoring the need for strict judicial oversight.

Over the past few decades, contingency-fee arrangements have led to "the creation of a new model for state-sponsored litigation that combines the prosecutorial power of the government with private lawyers aggressively pursuing litigation that could generate hundreds of millions in contingent fees." Richard O. Faulk & John S. Gray, *Alchemy in the Courtroom? The Transmutation of Public Nuisance Litigation*, 2007 Mich. St. L. Rev. 941, 968. The genesis of this practice can be traced to litigation in the 1980s, when Massachusetts hired outside counsel on a contingency-fee basis to prosecute claims over asbestos removal. *Id.*

Since then, state attorneys general have used this model to mount aggressive enforcement actions against the entire spectrum of the business community. *See* Martin H. Redish, *Private Contingent Fee Lawyers and Public Power: Constitutional and Political Implications*, 18 Sup. Ct. Econ. Rev. 77, 80 (2010) ("In the last ten years, state governments have increasingly resorted to this practice in their efforts to pursue 'big money' claims against alleged tortfeasors."). For example, the state of Rhode Island employed outside counsel to sue former manufacturers of lead paint and pigment from 2003 to 2008. Leah Godesky, *State Attorneys General and Contingency Fee Arrangements: An Affront to the Neutrality Doctrine?*, 42 Colum. J.L. & Soc. Probs. 587, 589 (2009). Similarly, Oklahoma's Attorney General hired outside firms to sue poultry companies that allegedly polluted the state's waterways with chicken manure. *See id.* Additionally, attorneys general have entered into contingency-fee contracts with outside counsel to prosecute a wide range of lawsuits against the pharmaceutical industry, alleging failure to warn, fraudulent advertising or off-label promotion of prescription medications. *See* Lise T. Spacapan, Douglas F. McMeyer & Robert W. George, *A Threat to Impartiality: Contingency Fee Plaintiffs' Counsel and the Public Good?*, In-House Def. Q., Winter 2011, at 12, 14.

The breadth of the practice cannot be overstated: in one recent study of the 50 states and the District of Columbia, 36 attorney general offices reported using contingency-fee counsel. *Id.*[2] Such reliance on outside counsel can be expected to increase as state legislatures increasingly call on attorney general consumer-protection and Medicaid-fraud units to contribute to their own budgets or become self-funded. *See* Dave Boucher, *Attorney General Outlines Changes; Legislation Aims to Alter Way Official Handles Money from Settlements*, Charleston Daily Mail, Apr. 24, 2013, at P1A (referencing a bill passed by the West Virginia legislature that would take $7.46 million from the attorney general's Consumer Protection Fund and distribute it elsewhere in the state budget). This is all the more true because Congress has increasingly given state attorneys general authority to enforce federal laws.[3] And there will be no shortage of private lawyers eager to take on those representations. As one commentator noted in the Wall Street Journal:

> Trial lawyers love these deals. Even aside from the chance to rack up stupendous fees, they confer a mantle of legitimacy and state endorsement on lawsuit crusades whose merits might otherwise appear chancy. Public officials find it easy to say yes because the deals are sold as no-win, no-fee. They're not on the hook for any downside, so wouldn't it practically be negligent to let a chance to sue pass by?

Walter Olson, *Tort Travesty*, Wall St. J., May 18, 2007, at A17.

The growth of this practice has adversely affected the public's perception of the justice system. In particular, contingency-fee arrangements with private counsel create an opportunity for unseemly liaisons between public enforcement officials and private, profit-motivated lawyers. In Mississippi, for example, the Attorney General, Jim Hood, retained 27 law firms to represent Mississippi in 20 separate lawsuits over a five-year span, and "some of Mr. Hood's largest campaign donors are the very firms to which he's awarded the most lucrative state contracts." Editorial, *Lawsuit Inc.*, Wall St. J., Feb. 25, 2008, at A14.

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[2] This number does not include the use of contingency-fee counsel in the tobacco litigation during the 1990s. *See* Spacapan, McMeyer & George, *supra*, at 14.

[3] For example, state attorneys general are authorized to enforce the Truth in Lending Act's mortgage mandates, 15 U.S.C. § 1640(e), and the Health Insurance Portability and Accountability Act's privacy provisions, 42 U.S.C. § 1320d-5(d).

Concern over the effects of such liaisons has generated substantial criticism over the last few years. As one former attorney general who has been an outspoken critic of these liaisons observed, "'[t]hese contracts . . . create the potential for outrageous windfalls or even outright corruption for political supporters of the officials who negotiated the contracts.'" Adam Liptak, *A Deal for the Public: If You Win, You Lose*, N.Y. Times, July 9, 2007, at A10 (quoting Hon. William H. Pryor, Jr.).

Further, contingency-fee counsel have incentives that, under any "'realistic appraisal of psychological tendencies and human weakness,'" *Marshall*, 446 U.S. at 252 (citation omitted), create a structural conflict between the pursuit of justice and their personal interest in obtaining a substantial financial recovery. In particular, contingency-fee counsel "have a financial incentive to maximize money recoveries, an incentive that would be congruent with a client's interests in private actions but is frequently in tension with a State's public interest role." *Contingent Fees and Conflicts of Interest in State AG Enforcement of Federal Law: Hearing Before the Subcomm. on the Constitution of the H. Comm. on the Judiciary*, 112th Cong. 48 (2012) (testimony of James R. Copland, Director and Senior Fellow, Center for Legal Policy, Manhattan Institute for Policy Research).

These concerns, coupled with the threat to important due-process rights as highlighted in the previous section and in American Bankers' memorandum, underscore the importance of developing meaningful judicial limitations on the use of contingency-fee counsel by state attorneys general. At a minimum, the Court should hold that such arrangements are invalid in quasi-criminal enforcement suits like this one, in which the public's interest in seeing that justice is done and the defendant's interest in receiving the full protections of due process are at their apex. Absent such a standard, liaisons like the one here – between state attorneys general and private contingency-fee counsel – will continue unabated, fueling unreasonable verdicts, eroding public trust in judicial proceedings and undermining due process.

CONCLUSION

For the reasons set forth above and in American Bankers' memorandum, The Chamber of Commerce of the United States of America and Pharmaceutical Research and Manufacturers of America respectfully submit that the Court should grant American Bankers' Motion for Partial Summary Judgment; find that defendant Eric L. Heryford, in his official capacity as District Attorney of Trinity County, California, has violated American Bankers' federal constitutional right to due process; and enjoin the District Attorney from employing private law firms to prosecute the UCL Suit under the existing contingency-fee agreement.

Dated: March 14, 2016

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