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Lawyers as lawmakers, privilege, and agency

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This essay is dedicated to the memory of my good friend, colleague, and mentor, Larry Ribstein.

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ABSTRACT

Class action lawyers do not merely represent clients, they also make law, an observation explored by Kobayashi and Ribstein in "Class Action Lawyers as Lawmakers." Kobayashi and Ribstein observe that a class action lawyer's inability to internalize all the benefits of her innovation may lead to underinvestment in lawmaking, which they describe as a public good. But privileged groups may produce public goods, and where production of the good also enhances the probability that a supplier of the good will be compensated for her production, as may be the case in the selection of counsel in class action suits, there can even be overproduction. Under some circumstances, such overproduction is possible even where production is facilitated by freeriding. Moreover, if there is underinvestment in class action lawmaking, a more general, and potentially greater, cause is inherent in the lawyer–client relationship, namely that the lawyer bears the full cost of litigation but must share the benefits, if any, with the client.

1. Introduction

There has been much debate in our society over whether class action lawsuits are forces of good or evil. On the one hand these suits permit the collective vindication of rights that would go unenforced if left to individual action. On the other hand, class action lawsuits may be powerful weapons wielded by the plaintiffs' bar to extort settlements from blameless defendants.

The contrast between these positions is familiar. There is, however, a less well-known question about the merits of class action suits, one that turns on whether they generate adequate law. It is to the latter, more obscure question that this paper is devoted.

Class action lawsuits are complicated enterprises driven by plaintiffs' lawyers whose work product can serve as a basis for de facto lawmaking in the litigation for which the work is prepared and in future, similar cases. This is an observation made in an important article, Class Action Lawyers as Lawmakers, by Bruce Kobayashi and the late (and great) Larry Ribstein.[1]

As Kobayashi and Ribstein explain, "[j]udges and legislators alone may lack adequate incentives to engage in efficient lawmaking."[2] The authors note that, by contrast, private lawyers "are the primary consumers of law and accordingly have a significant stake in the content of legal rules."[3] Nevertheless, Kobayashi and Ribstein observe, the lawyers' incentives are imperfect. "The problem is that law is a public good, so that lawyers face a significant freerider problem in investing time and other resources in law-creation."[4]

In their analysis of this freerider problem, Kobayashi and Ribstein, focus on the case of class action lawsuits. Class action complaints, Kobayashi and Ribstein note, require "extensive development of facts and legal theories." Class action pleadings, therefore, "can play an important role in setting the stage both for the trial and for any ultimate appeal," where courts may adopt in whole or in part the lawyers' proposed findings and conclusions, an event the authors believe is particularly likely in a class action suit, given the inherent complexity and amount that is frequently at stake.[5] "Even if such cases settle quickly, these complaints can develop facts and legal theories that can be used in subsequent cases [and thus] have significant lawmaking potential." Despite the importance of these pleadings, and despite the remuneration available to lead counsel in a class action suit, Kobayashi and Ribstein conclude that "lawyers creating class action complaints may invest a socially suboptimal amount of resources because they do not internalize all of the pleadings' potential lawmaking benefits."[6]

Although Kobayashi and Ribstein recognize that the problem they identify is present in any private litigation, where future litigants "are free to use any publicly disclosed facts, litigation documents or precedents,"[7] they see a special impediment to optimal lawmaking in class action suits, particularly securities lawsuits:

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[1] Kobayashi and Ribstein (2004).
[2] Kobayashi and Ribstein (2004, p. 734).
[3] See note 2.
[4] See note 2.
[5] Kobayashi and Ribstein (2004, p. 735).
[6] Kobayashi and Ribstein (2004, p. 736).
[7] See note 6.

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> In a class action, the complaint-drafter may be unable to capitalize on his efforts *even in the current case*. Plaintiffs' lawyers often prepare class action complaints in effect "on spec," without knowing who the court will ultimately select as counsel for the class. Once an initial or early complaint has been filed, other lawyers might copy and file it on behalf of other plaintiffs. This problem is exacerbated in federal securities fraud class actions governed by the Private Securities Litigation Reform Act ("PSLRA"), which requires filing a public notice upon the initial filing of a claim. One of these copycat lawyers might then be appointed lead counsel [and would then earn class attorney's fees]. This potential for appropriation of work product ... dilutes the lawyer's incentives in preparing the complaint ... .[8] (Emphasis added.)

The authors conclude that "the effect of this incentive problem may be underdevelopment of legal theories through case law as compared to a system in which the parties fully internalized the lawmaking benefits of class action pleadings."[9] To the incentive problem, Kobayashi and Ribstein propose a solution. After considering the benefits and costs of various potential intellectual property interests for the drafter of an initially filed class action complaint, Kobayashi and Ribstein propose that the drafter be granted a share of the attorneys' fees should a copying firm be selected as lead counsel and win such fees. This would not be a perfect solution, the authors understand, but would, in their view, be a positive development.

My goal here is not to quibble with the determination by Kobayashi and Ribstein that shared attorneys' fees would mitigate underinvestment in class-action pleadings caused by freeriding, assuming that there is such underinvestment. Rather, I raise the theoretical possibility that there is no such underinvestment, and thus no consequent public goods problem. And I suggest that if there is a public goods problem, that problem should perhaps be attributed not to the copying of pleadings but to the division of awards between plaintiffs and plaintiffs' lawyers.

Part 2 below explains the speculation that the problem Kobayashi and Ribstein identify may not exist: because freeriding may facilitate competition among plaintiffs' lawyers for appointment as class action lead counsel. Part 3 discusses, briefly, the agency cost generated by the relationship between lawyer and client as compared with the cost generated by freeriding on pleadings. Part 4 offers a conclusion.

2. Public goods, privileged groups, and copying

A classic public goods problem exists when one bears the cost, but garners only some of the benefit, from production. Under some assumptions, Kobayashi and Ribstein describe a classic public goods problem. Imagine, for example, that a lawyer who considers an investment in a class action pleading anticipates that the pleading would be copied entirely and costlessly by the entry of an arbitrarily large number of competitors who would then, along with the drafter, have the same (arbitrarily small) chance of ultimate appointment in the case. Were these the circumstances, no lawyer would invest in the preparation of a complaint and the case would not be brought, even if meritorious.

Costless copying and free entry are not necessarily accurate assumptions, however. Imagine, for simplicity, that that there are only two law firms capable of competing for a class action suit and that one of them cannot cost effectively draft (but can copy) a viable complaint, while the other possesses the ability to draft such a complaint.[10]

Assume that the drafting cost to the more capable firm is $500,000 and that appointment as lead counsel would earn either firm an 80% chance of success (in judicial determination or settlement) and a fee equal to 30% of a $12.5 million award. (Assume that the appointed firm would receive no compensation for an unsuccessful suit and assume, again for simplicity, that the firm incurs no cost after the complaint is drafted.) That is, assume that, drafting cost aside, appointment as plaintiffs' counsel in the class action lawsuit is worth an expected $3.75 million to a law firm.[11] And assume, for simplicity, that nothing but the content of a complaint affects the probability that a firm will be selected as lead counsel.[12]

Under these assumptions, the firm capable of drafting competent pleadings on its own would have reason to invest in such pleadings even if the other firm would, by copying the filed complaint, have an equal chance of assignment as the class action's lead counsel. Specifically, the more capable drafting firm would expect from drafting a complaint: 0.5(0.8(0.3($12.5 million))) – $0.5 million = $1 million.

This result is, of course, inconsistent with a market driven by robust competition, as observed above. And the illustration here is a mere thought experiment, not an empirical analysis of the class action lawsuit industry.[13] Still, that competition might not drive all profit from appointment as class action lead counsel does not seem an unduly strong assumption particularly given the oft reported extraordinary, perhaps criminal, measures some law firms take to garner such appointment.[14]

The story of the more capable law firm in this illustration, persevering despite victimization by a free rider, is not a novel one. Long ago, Mancur Olson described a "privileged" group as one that includes at least one member in whose private interest it is to provide a public good for the group.[15] In the above illustration, the more capable drafting law firm has such a private interest and the class action complaint will be filed.

This said, it is not the case that the production of class action complaint implies the production of a *sufficient* class action complaint. The above illustration implicitly assumes that the characteristics of a complaint are fixed, but that assumption importantly deviates from reality. Indeed, Kobayashi and Ribstein do not deny that a class action complaint will be filed; they contend only that the lawmaking qualities of such complaints will be socially suboptimal. Just as the member of a privileged group might build only a rickety bridge over a river if the builder cannot exclude others without

[8] See note 6.

[9] See note 6.

[10] The assumptions made for the purposes of this illustration avoid a caveat to the prediction that a privileged group will produce a public good. The caveat is that when multiple members of the group would privately benefit from production, there is a possibility that each will refrain in hope that one of the others will not. This problem, recognized in the standard account, see Olson (1965), is beyond the scope of this discussion, which does not, in any case, include an assertion that the conditions are always present for the provision of socially desirable legal pleadings.

[11] Here and hereafter, whenever an expected value calculation is made it is assumed that all relevant parties are risk neutral.

[12] An incompetent firm incapable of original drafting would perhaps be unlikely to have an equal chance of appointment as lead counsel, as even an imperfectly informed court might screen such a firm in the selection process. Cf. Fisch (2003) (describing, though criticizing as inadequate, courts' attempts to assess quality of representation). And it is unlikely, of course, that an incompetent firm, once appointed, would have the same prospects for victory as the competent firm. But these are simplifying assumptions that motivate the freerider problem at issue. See also note 17 below.

[13] Beyond the simplifying assumptions used here for the sake of illustration, the competition among lawyers for appointment as lead counsel in a class action lawsuit is beyond the scope of this essay. For an analysis of such competition, see, e.g., Fisch (2003).

[14] Cf., e.g., Kobayashi and Ribstein (2007) (describing, though criticizing, a criminal case against a leading class action plaintiffs' law firm).

[15] See Olson (1965).