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Spitzer Strains out Grasso While Swallowing Camels

by Hans Bader

Recently, New York Attorney General Eliot Spitzer brought suit against former New York Stock Exchange Chairman Richard Grasso for violating a state law that bars officers of not-for-profit corporations from accepting too high a salary. Spitzer, however, is now faced with a difficult question: Why is he targeting Grasso after he sought billions to compensate the lawyers representing New York State in its suit against the tobacco companies?

Regardless of what you think of Grasso, Spitzer's filing the lawsuit brings to mind a biblical proverb that cautions against "straining out gnats while swallowing camels."¹ Indeed, the \$140 million Grasso received pales in comparison to the \$625 million that Spitzer approved for those few law firms that handled the state's tobacco lawsuit.²

Spitzer is suing Grasso under New York State's Not-For-Profit Corporation Law, which states that an officer's compensation should be "reasonable" and "commensurate for services performed."³ Spitzer's argument is plausible, given that Grasso's pay was so huge that it exceeded the NYSE's net income in 2001 and 2002.⁴ But Grasso has his counterarguments, and a court will ultimately decide whether his pay was excessive.

Unfortunately, no court will have the opportunity to make a similar judgment on the millions paid to the lawyers in New York's tobacco lawsuit. In 2000, Spitzer testified

¹ See Matthew 23:24 (New International Version).

² See Tom Perotta, *NY Judge Chosen for Spitzer's Suit Against Grasso*, N.Y. Lawyer, May 27, 2004; www.nylawyer.com/news/04/05/052704d.html.

³ See, e.g., Barrie McKenna, *Spitzer Sues Grasso to Recover "Rigged" Pay*, Toronto Globe and Mail, May 25, 2004, at B1; www.theglobeandmail.com; Jonathan D. Glater, N.Y. Times, *Grasso Case Could Drag On For Years*, Akron Beacon Journal, May 27, 2004; www.ohio.com/mld/ohio/business/8771533.htm.

⁴ Justin Lahart, *Grasso's Pay Topped Most Peers', Drained Profit*, Wall Street Journal, June 2, 2004, at C3.

in support of the attorneys' request for a staggering \$1.25 billion in fees.⁵ Those lawyers were hired by Spitzer's predecessor, Dennis Vacco, in 1997 to continue a pending lawsuit against Big Tobacco, ostensibly to recover money spent by the state treating tobacco-related illnesses.⁶

This lawsuit mirrored those already filed by 18 other states.⁷ Two of those suits yielded billion-dollar settlements *before* New York's lawyers were even hired.⁸ The lawyers' job, therefore, was hardly daunting: New York's settlement with the major tobacco companies mimicked, word-for-word, the agreement already entered into between several states and the tobacco companies.⁹

Of the \$1.25 billion requested, an arbitration panel awarded the attorneys \$625 million in fees for that single case—a rate of at least \$13,000 an hour.¹⁰ Judge Charles Ramos tried, at least temporarily, to block the payment of the fees, seeking to enforce the ethics code governing lawyers, which says that a fee may not be unreasonably large.¹¹ But a state appellate court found for Spitzer's office and the attorneys, holding that the tobacco settlement stripped Judge Ramos of jurisdiction to investigate the fees.¹² (Ironically, Spitzer's suit against Grasso has been assigned to that very same trial judge.¹³)

So why does Spitzer view \$140 million as unreasonably high compensation for a stock exchange executive over a period of years, but consider more than four times that amount reasonable for lawyers handling a single case?

⁵ See *State of New York v. Philip Morris*, No. 400361/97 (N.Y. Super. Ct., N.Y. County, Comm. Div. Oct. 22, 2002) at 7-8;

<http://www.courts.state.ny.us/reporter/slips/16262.htm> (check links; it's hard to access the second one) <http://www.nycourts.gov/comdiv/Law%20Report%20Files/January%202003/Tobacco.htm> (referred to in this paper as the Trial Court decision); Andrew Tilghman, *Tobacco Case Legal Fees Under Fire*, Albany Times Union, Oct. 14, 2002 ("Attorney General Spitzer . . . has expressed support . . . for the fees awarded").

⁶ Trial Court Decision at 4-5.

⁷ Attorney General Vacco, *Timeline of the Tobacco Settlement*; www.lawpublish.com/timeline.html; *Tobacco Case Legal Fees Under Fire* (quoting Assemblyman Grannis's observation that this was just a "copycat" lawsuit, and Judge Charles Renfrew's dissenting observation that "the tide in the tobacco wars had [already] turned" before New York even brought its lawsuit); see Trial Court Decision at 9.

⁸ Trial Court Decision at 9, citing Judge Renfrew's dissent at 2 (Mississippi and Florida already settled); Frontline, *Inside the Tobacco Deal: Timelines: States' Medicaid lawsuits*; <http://www.pbs.org/wgbh/pages/frontline/shows/settlement/timelines/medicaid.html>.

⁹ See *State v. Philip Morris*, 179 Misc.2d 437, 440 n.3, 686 N.Y.S.2d 564, 566 n.3 (N.Y. Sup. Ct. 1998) ("courts in thirty-four states . . . have approved [the identical] settlement").

¹⁰ Trial Court Decision at 2; Andrew Tilghman, *Tobacco Case Legal Fees Under Fire: Albany – Judge Examines If \$14,000 An Hour Is Too Much for Lawyers*, Albany Times Union, Oct. 14, 2002.

¹¹ Trial Court Decision, at p. 4 (citing Rule 2-106 of the Code of Professional Responsibility).

¹² *State of New York v. Philip Morris*, 763 N.Y.S.2d 32 (N.Y. App. Div. 1st Dept., 2003) (referred to in this paper as the Appellate Decision) (available at www.courts.state.ny.us/reporter/slips/16262.htm), *rev'g State of New York v. Philip Morris*, No. 400361/97 (N.Y. Super. Ct., N.Y. County, Comm. Div. Oct. 22, 2002); *Tobacco Case Legal Fees Under Fire* (Spitzer's "office has joined with the attorneys involved in fighting [trial judge] Ramos's inquiry").

¹³ Tom Perrotta, *NY Judge Chosen for Spitzer's Suit Against Grasso*, New York Lawyer, May 27, 2004; www.nylawyer.com/news/04/05/052704d.html.

The dangers of excessive compensation were far greater in the tobacco lawsuit than in Grasso's case. Consider the reasons for Grasso's compensation: Under his tenure, NYSE traders earned millions of dollars in annual bonuses, and the value of a seat on the Exchange more than doubled.¹⁴ By contrast, as Judge Ramos pointed out, the tobacco lawyers' \$625 million fee was "unprecedented,"¹⁵ and the lawyers themselves acknowledged their fee request was "astronomical."¹⁶ No compelling reason was ever offered to justify the amount of the fee.

Moreover, as *The Albany Times Union* reported, the law firms that received those fees "were politically well-connected and regular campaign contributors" to state officials of both political parties, including Attorney General Vacco, whose office hired them. They gave "more than \$250,000 to New York politicians and their campaign organizations in the years preceding their selection," and more than \$200,000 thereafter.¹⁷ The tobacco lawyers in particular, and trial lawyers in general, are enormously influential, contributing millions of dollars to elect sympathetic candidates to political office and defeat lawmakers and judges who oppose their interests.¹⁸ An attorney general negotiating a lawyer fees provision in a tobacco settlement could easily succumb to the temptation to be overly generous to such lawyers.

Furthermore, the tobacco lawyers were suing on behalf of the state, whose representatives are supposed to enforce the law impartially rather than bring prosecutions to enrich themselves. We do not pay police officers for each speeding ticket they issue, or give IRS agents a share of the taxes they collect. The Supreme Court has long held that a state is not "an ordinary party to a controversy," and state attorneys have an "obligation to govern impartially" that other attorneys do not.¹⁹ Yet, the tobacco lawyers were allowed to recover billions of dollars in contingency fees under their deals with the state attorneys general.²⁰

The danger of excessive fees was aggravated because the state itself had little incentive to police the provisions of the tobacco settlement. The state, unlike a private litigant, could pass the exorbitant legal fees on to taxpayers (for example, by accepting a smaller settlement payment to the state treasury from the tobacco companies in exchange for generous lawyer fees provisions benefiting its politically connected attorneys).

¹⁴ Justin Lahart, *Grasso's Pay Topped Most Peers', Drained Profit*, Wall Street Journal, June 2, 2004, at C3; see also *Grasso Case Could Drag on For Year* (noting Grasso's claim that "the value of a membership seat [on the Exchange] nearly tripled, soar[ing] to more than \$2 million," during his tenure).

¹⁵ Trial Court Decision at 2.

¹⁶ Trial Court Decision at 8.

¹⁷ Andrew Tilghman, *Tobacco Case Legal Fees Under Fire*, Albany Times Union, Oct. 14, 2002.

¹⁸ See Justice Robert Young, Michigan Supreme Court, *Reflections of a Survivor of State Judicial Warfare*, Civil Justice Report, No. 2, at 5 (Manhattan Institute Center for Legal Policy, June 2001) (trial lawyers spent millions to defeat conservative state supreme court justices); Morton Kondracke, *Bush's Trial with the Trial Lawyers* (available at www.calahouston.org/bush.html) (Five of the Texas tobacco lawyers "gave the Democratic Party \$1.8 million").

¹⁹ See *Berger v. United States*, 295 U.S. 78, 88 (1935).

²⁰ Robert A. Levy, *The Great Tobacco Robbery*, Legal Times, Feb. 1, 1999, at 27.

In addition, lawyers' pay deserves more scrutiny than that of executives' because of the special privileges lawyers enjoy in the legal system. As Judge Ramos noted, the ordinary person is at risk, resulting in "the relationship of attorney and client [being] fraught with inequality in experience and legal sophistication."²¹ Limits on their fees are essential to prevent them from using their power to exploit the public.

Dick Grasso will have his day in court. But no court will ever get to review the tobacco lawyers' fees, which will remain an unchallengeable example of venality and greed.

²¹ Trial Court Decision at 2.