STATE OF MINNESOTA DISTRICT COURT
SECOND JUDICIAL DISTRICT
COUNTY OF RAMSEY

THE STATE OF MINNESOTA,
BY HUBERT H. HUMPHREY, III
ITS ATTORNEY GENERAL,

and

BLUE CROSS AND BLUE SHIELD OF MINNESOTA,
Plaintiffs,

v.

PHILIP MORRIS INCORPORATED;
R.J. REYNOLDS TOBACCO COMPANY; BROWN & WILLIAMSON TOBACCO CORPORATION;
B.A.T. INDUSTRIES P.L.C.; LORILLARD TOBACCO COMPANY; THE AMERICAN TOBACCO COMPANY;
LIGGETT GROUP, INC.; THE COUNCIL FOR TOBACCO RESEARCH -- U.S.A., INC.; and THE TOBACCO INSTITUTE, INC.,
Defendants.

October 28, 1994

Case File No. C1-94-8565

STATE OF MINNESOTA'S MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' JOINT MOTION TO PROHIBIT PROSECUTION OF THIS ACTION PURSUANT TO UNLAWFUL CONTINGENT FEE AGREEMENT

The State of Minnesota, plaintiff, respectfully submits this memorandum of law in response to the defendants' Joint Motion to Prohibit Prosecution of This Action Pursuant to Unlawful Contingent Fee Agreement.

I.

INTRODUCTION

The Attorney General of Minnesota -- by constitution, statute and common law -- is entrusted with broad powers to protect the public interest of the State of Minnesota and enforce its laws. Given the imposing scope of his duties, the Attorney General has been granted expansive discretion over the particular means by which he fulfills these responsibilities.

Over the years, in an effort to augment the resources of the office and fully protect the interests of the State, Attorneys General of Minnesota -- past and present -- have routinely exercised their discretion to appoint outside counsel from the private sector, known as special attorneys.

The defendants, by bringing this motion, seek to vitiate the Attorney General's discretion to execute the powers and duties of his office. Their attack on the retainer in the present case is so sweeping that it strikes at virtually every special attorney appointment of recent times. The defendants also specifically attack the use by the State of a contingent fee appointment, arguing that it is unconstitutional and creating the impression that such a retainer is unique and unprecedented. These are peculiar arguments to be asserted, as they are, by various law firms which have entered into numerous retainers with the State -- all of which would be void under the present arguments by these same firms.

Most incredibly, many of these same firms also have entered into retainers with the State *on a contingent fee basis*. In addition, the attorney who signed the present motion for defendants was formerly Chief Deputy of the Office of the Attorney General and, as such, was personally responsible for supervising contingent fee retainers with special attorneys on behalf of the State of Minnesota.

Apart from the self-serving inconsistency of their position, the defendants' arguments are fundamentally flawed as a matter of law.

The defendants assert three arguments. First, defendants argue that a special attorney's right to compensation is coextensive with that of the Attorney General, and therefore a special attorney may only be compensated in the same manner as the Attorney General. This argument would invalidate virtually all appointments of all special attorneys, who are by necessity compensated on a different basis from the Attorney General. Moreover, defendants base this argument on a statute which, on its face, applies only to state officers and employees, not the private sector. Second, defendants argue that the current retainer is an unlawful appropriation of state funds. However, defendants fail to cite significant precedent from the Supreme Court of Minnesota, which is decisive on this issue. Finally, defendants argue that the current retainer would in some manner violate their due process rights to a fair proceeding. However, the cases upon which defendants rely overwhelmingly focus on contingent fees for either prosecutors in criminal cases or judicial officers. These decisions are wholly inapposite in the present case, where there is no risk

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that these proceedings -- in which the State is a litigant in a civil action -- will unfairly prejudice defendants.

Moreover, the defendants' argument that the State will conduct this litigation in such a way as to unfairly disadvantage an industry with unlimited power and resources is preposterous. The cigarette industry has an unblemished record of evading liability for the death and disease caused by its products. This is due in large measure to the untold millions of dollars the industry pours into litigation. Indeed, the industry has acknowledged that it uses the vast disparity of resources between itself and its opponents to achieve success. As these defendants well know, the State of Minnesota would be unable to contest this industry on anything approaching an even playing field without a contingent fee agreement with its chosen counsel. Simply stated, the industry's motive behind the present motion is not to challenge the retainer but to rid themselves of this lawsuit altogether. Apparently, in defendants' view, the only fair arrangement for this litigation is for it never to proceed to the merits.

II.

STATEMENT OF FACTS

A. The Present Special Attorney Appointment

This lawsuit was commenced by the Attorney General, on behalf of the State of Minnesota, pursuant to his authority under Minn. Stat. §§ 8.01, 8.31, 325D.09-15 (Unlawful Trade Practices Act), 325D.43-45 (Deceptive Trade Practices Act), 325D.49-66 (Minnesota Antitrust Law), 325F.67 (False Statement in Advertising Act), and 325F.69 (Prevention of Consumer Fraud Act). In addition to the statutory claims, the State of Minnesota has asserted common-law claims for restitution, unjust enrichment, and breach of undertaking of a special duty.

Pursuant to a Special Attorney Appointment, the Attorney General retained the law firm of Robins, Kaplan, Miller & Ciresi ("RKM&C") to provide legal services to the State in this action. Exhibit 1 to Affidavit of Roberta B. Walburn (hereinafter "Walburn Aff."). The Special Attorney Appointment specifically sets forth the basis of the Attorney General's decision to use a contingent fee in this case, stating:

> WHEREAS, cigarette smoking is the most preventable cause of death in our society;
>
> WHEREAS, cigarette smoking kills approximately 400,000 people each year in the United States (including more than 6,000 Minnesotans each year) -- more than the number of deaths caused by guns, drug use, and automobile accidents combined;
>
> WHEREAS, in addition to the human carnage, the economic costs of cigarette smoking, and, in particular, health care expenditures from smoking-attributable diseases, amount to an onerous burden to society and to the State;
>
> WHEREAS, the tobacco industry has been able to enjoy virtual immunity from its actions due to its economic and political power and its scorched earth tactics in litigation, reaping billions of dollars of profits from unconscionable activities and never to the knowledge of the Attorney General or the Special Attorneys paying any damages despite decades of litigation;
>
> WHEREAS, the Attorney General and the Special Attorneys believe that, despite the tobacco industry's past successes, the laws of the state of Minnesota were meant to apply to all entities, no matter how powerful;
>
> ***
>
> WHEREAS, the State acknowledges that the successful resolution of the Litigation will require the Special Attorneys to devote substantial resources (both temporal and financial) in furtherance of their undertakings;
>
> THEREFORE, due to all the complex considerations involved in the Special Attorney Appointment, the State and the Special Attorneys have agreed as follows:

Id. at 7-8.

The agreement proceeds to state that the special attorneys will assume all of the financial risk of the litigation for the State, including carrying the substantial costs of litigation. *Id*. at 8-9. The special attorneys will be entitled to compensation for fees and reimbursement for costs only if the litigation is successful. *Id*. at 9.

The Special Attorney Appointment also emphasizes that the Attorney General, as mandated by

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law, retains the ultimate authority over all aspects of the litigation, stating:

> This appointment may be terminated by the Attorney General at any time and for any reason.
>
> ***
>
> The Attorney General, as the chief legal officer of the State, retains final authority over all aspects of the Litigation that affect the State's claims.
>
> ***
>
> The Attorney General shall appoint delegates from his staff to monitor, review, and fully participate in the handling of the Litigation. The Special Attorneys shall consult and obtain the prior approval of a delegate concerning all policy and other major, substantive issues affecting the Litigation. . . Regular status meetings shall be held as requested by either a delegate or the Special Attorneys.

Id. at 3-4.

The appointment also states that the special attorneys "shall not be considered state employees and shall not be eligible for any state employee leave or other benefits except those expressly provided herein. . . ." *Id*. at 1.

B. Previous Contingent Fee Special Attorney Appointments

1. Types of Contingent Fee Appointments

The use of a special attorney appointment in the cigarette litigation is in accordance with the long-standing practice of Attorneys General, past and present, who have appointed outside counsel as necessary to augment the resources of the office. Affidavit of John R. Tunheim (hereinafter "Tunheim Aff."), at ¶ 3. As part of this practice, Attorneys General have for years utilized contingent fee appointments in appropriate circumstances. *Id*, at ¶ 4. In many situations, this type of compensation is the only feasible method by which the State of Minnesota, given its considerable budget restraints, can supplement its resources and employ private counsel. *Id*. Thus, percentage-based retainers have been used by Attorneys General in a wide variety of contexts. *Id*. Some examples include:

a. *Asbestos Litigation*: In 1984, the Attorney General retained special attorneys on a contingent fee basis to pursue claims arising out of the use of asbestos in state buildings. Exhibit 2 to Walburn Aff. In 1990, the same law firm was retained to represent the State in another round of asbestos litigation. *Id*.

b. *Consumer Fraud*: The Attorney General has retained special attorneys on a contingent fee basis in a consumer fraud action to collect on a judgment for restitution and attorneys' fees and costs pursuant to, *inter alia*, Minn. Stat. § 8.31, one of the statutes upon which the State has brought suit in the cigarette litigation. Exhibit 3 to Walburn Aff.

c. *Antitrust*: The Attorney General has retained special attorneys on a contingent fee basis in antitrust cases. Exhibit 4 to Walburn Aff.

d. *Workers' Compensation*: The Attorney General commonly retains special attorneys on a contingent fee basis to recover workers' compensation payments from third-party tortfeasors. *See, e.g.*, Exhibit 5 to Walburn Aff.

e. *Medical Assistance*: The Attorney General has retained special attorneys on a contingent fee basis to pursue lien and subrogation actions for Medical Assistance payments. Exhibit 6 to Walburn Aff.

f. *Bankruptcy*: The Attorney General has retained special attorneys on a contingent fee basis to pursue the State's claims in a bankruptcy proceeding. Exhibit 7 to Walburn Aff.

The legislature rarely enacts specific appropriations for any special attorney appointments, whether the appointments are pursuant to a contingent fee or per diem arrangement. Tunheim Aff. at ¶ 3. Instead, the funds to pay special attorneys typically come from general appropriations for state agencies or from funds created by the efforts of the special attorneys themselves. *Id*. In addition, on occasion the funds for special attorneys come from general appropriations for the Office of the Attorney General. *Id*.

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2. Contingent Fee Appointments of Firms Currently Representing the Cigarette Industry

The traditional practice of using contingent fees in special attorney appointments is well known to the law firms representing the cigarette industry in this case. Indeed, at least four of these defense firms, which have joined in the present motion, have been retained by the State on the basis of contingent fee appointments. These contingent fee retainers have been for bond counsel appointments in which compensation was based, at least in part, on a percentage of the fund created on behalf of the State:

a. Leonard, Street & Deinard was retained by the State as bond counsel for the Iron Range Resources and Rehabilitation Board for compensation that included a flat fee, plus a percentage of the bond offering, plus expenses. Exhibit 8 to Walburn Aff.

b. Faegre & Benson was retained by the State as bond counsel to the Minnesota Higher Education Facilities Authority for compensation based on a percentage of the bonds, plus expenses. Exhibit 9 to Walburn Aff.

c. Lindquist & Vennum was retained by the State as bond counsel to the Minnesota Energy and Economic Development Authority, the Minnesota Small Business Finance Agency, the Minnesota Higher Education Coordinating Board, and the Minnesota Agricultural and Economic Development Board. Exhibit 10 to Walburn Aff. All of these appointments provided that Lindquist & Vennum's compensation would be based, *inter alia*, on a percentage of the bonds, plus expenses. *Id*.

d. Dorsey & Whitney also has a long history of retention by the State as bond counsel for the Department of Finance, the State University Board, the Rural Finance Administration, and the Housing Finance Agency. Exhibit 11 to Walburn Aff. Many of the Dorsey & Whitney appointments, in addition to a percentage fee, also provided for a set minimum fee, plus expenses. *Id*.

Interestingly, within the past year, the Attorney General has abandoned the use of contingent fee appointments for bond counsel because such retainers, at least in some instances, produced fees well in excess of normal billing rates -- without a concomitant undertaking of risk by the firms. Tunheim Aff. at 1 5.[1] Most interestingly, Dorsey & Whitney -- which attacks a contingent fee in the present case -- argued fervently against this change to hourly compensation for bond counsel. In a memorandum to the Attorney General's office, dated October 1, 1993, Dorsey & Whitney extolled the virtues of the contingent fee and argued that compensation on a per hour basis would produce "a perverse result."

The memo stated:

> The system, while imperfect, has some advantages over an hourly compensation formula. First, the hourly approach penalizes experience and efficiency. If the firm invests in new technology as it comes along, and acquires additional experience and expertise in the relevant practice area, thereby permitting work to be done in less time (but often with increased quality) compensation decreases. On the other hand, if the firm does not apply state of the art technology and/or assigns less experienced personnel to the client (which certainly doesn't help quality), hourly time expended increases and compensation increases. *This is something of a perverse result and one which does not best serve the client*.

Exhibit 12 to Walburn Aff. at 1 (emphasis added). (*See also* Exhibit 13 to Walburn Aff., a November 18, 1993 letter from Warren Spannaus, former Attorney General and now a partner at Dorsey & Whitney, also requesting that the State continue to compensate the firm based at least in part on a percentage of the bonds.)

Another endorsement of the use of contingent fees in special attorney appointments comes from Byron E. Starns, the attorney who signed the present motion on behalf of all defendants and who formerly served as Chief Deputy of the Office of the Attorney General. Mr. Starns was Chief Deputy, the top administrative position in the office, from April 1974 to November 1979, while Warren Spannaus was

[1]As discussed below, the legislature also acted this year to restrict the use of contingent fee appointments of bond counsel. *See* Section III A, *infra*.

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Attorney General. Tunheim Aff. at ¶ 6. Then, as now, included among the duties of the Chief Deputy was the retention of special attorneys. *Id.;* Affidavit of Richard B. Allyn at ¶ 4.

During Mr. Starns' tenure, the Attorney General entered into a number of contingent fee appointments. *See, e.g.*, Exhibits 4 and 14 to Walburn Aff. In fact, while Mr. Starns was in charge, contingent fee appointments were used in antitrust and consumer fraud cases. *Id.* Despite this practice which he himself endorsed as a public servant, Mr. Starns now vociferously attacks the current retainer on behalf of The American Tobacco Company, his present client, and the rest of the cigarette industry. [2]

III.

ARGUMENT

a. The Attorney General Has Broad Authority to Compensate Special Attorneys by a Contingent Fee

The Attorney General is the chief law officer of the State and holds his office pursuant to a grant of constitutional authority. Minnesota Constitution, art. V, §1. By statute, the Attorney General is empowered to appear on behalf of the State whenever, "in the Attorney General's opinion, the interests of the state require it." Minn. Stat. § 8.01.

Yet even this broad grant of statutory authority does not fully define the scope of the Attorney General's powers. The Supreme Court of Minnesota has repeatedly emphasized that the powers of the Attorney General are not limited to those granted by statute. For example, in *State ex rel. Young v. Robinson*, 101 Minn. 277, 112 N.W. 269 (1907), the Supreme Court stated:

> The office of Attorney General has existed from an early period, both in England and in this country, and is vested by the common law with a great variety of duties in the administration of the government. *The duties are so numerous and varied that it has not been the policy of the Legislatures of the states of this country to attempt specifically to enumerate them.* Where the question has come up for consideration, it is generally held that the office is clothed, in addition to the duties expressly defined by statute, with all the power pertaining thereto at common law. From this it follows, that *as chief law officer of the state. he may. in the absence of some express legislative restriction to the contrary. exercise all such power and authority as public interests may from time to time require*. He may institute, conduct, and maintain all such suits and proceedings as he deems necessary for the enforcement of the laws of the state, the preservation of order, and the protection of public rights. *We have no statutory restrictions in this state*.

112 N.W. at 272 (emphasis added) (citations omitted).

Similarly, in *Slezak v. Ousdigian*, 260 Minn. 303, 110 N.W.2d 1 (1961), overruled in part by *Christensen v. Minneapolis Municipal Employees Retirement Board*, 331 N.W.2d 740 (1983), the Supreme Court stated:

> [The Attorney General's] powers are not limited to those granted by statute but include extensive common-law powers inherent in his office. He may institute, conduct, and maintain all such actions and proceedings as he deems necessary for the enforcement of the laws of the state, the preservation of order, and the protection of public rights. He is the legal officer to the executive officers of the state, and *the courts will not control the discretionary power of the attorney general in conducting litigation for the state*.

110 N.W.2d at 5 (emphasis added). *See also State by Humphrey v. Ri-Mel. Inc.*, 417 N.W.2d 102, 112 (Minn.

[2] In addition to the four law firms listed above, Gray, Plant, Mooty, Mooty & Bennett ("Gray Plant") also has enjoyed appointments as special attorneys, albeit not on a contingent fee basis. *See* Memorandum of Law in Support of the State of Minnesota's Motion to Disqualify. As with the other law firms, the Gray Plant appointments would be invalid under the broad arguments now asserted by these firms. While the motive for the present motion is apparent, the authority of these law firms and these defendants to bring this motion is not. The law firms -- which have accepted the benefits of similar appointments from the State -- are equitably estopped from challenging the lawfulness of the Special Attorney Appointment in the present litigation. *See Larx Co. v. Nicol*, 224 Minn. 1, 28 N.W.2d 705 (1947); *First & Farmers' State Bank v. Crosby*, 191 Minn. 566, 256 N.W. 315 (1934). In addition, the defendants have no standing. Defendants attempt to rely upon Minn. Stat. § 481.09. However, this statute relates to challenges to an attorney's authority and not to the manner in which his or her fees are paid. Moreover, the fact that this Court may have the inherent power to address this issue does not endow defendants with standing.

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Ct. App. 1987) (Attorney General has power to bring action even in absence of express statutory authority); *State ex rel. Schmidt v. Youngquist*, 178 Minn. 442, 227 N.W. 891, 892 (1929) (Attorney General "is practically without legislative restriction.").

In the current case, the Attorney General has a broad grant of statutory authority to retain special attorneys pursuant to Minn. Stat. § 8.02, which provides:

> The Attorney General shall have power to employ such assistance, whether lay, legal, or expert, as the attorney general deems necessary for the protection of the interests of the state through the proper conduct of its legal business.

Minn. Stat. Ann. § 8.02, subd. 1 (West Supp. 1994). Significantly, there. is *no* express restriction upon the Attorney General's discretion to determine the method of compensation for special attorneys appointed pursuant to this statute.

By contrast, where the legislature has intended to impose a restriction, the legislature has provided an express limitation. For example, earlier this year the legislature acted to restrict the use of contingent fees for bond counsel. 1994 Session Laws, Chap. 533, § 1 (to be codified at Minn. Stat. § 481.21). This new statute sets forth various factors to consider in awarding fees to bond counsel, including "the time and labor required," "the extent of the responsibilities assumed and the results obtained," and "the sufficiency of assets properly available to pay for the services." However, in accordance with the same concerns as noted above regarding the inappropriateness of percentage awards for this particular type of legal service, the 1994 statute concludes that, "The fee must not be based primarily on a percentage of the amount of the bonds or obligations sold." *Id*.[3]

In the present case, defendants acknowledge that the special attorney appointment is pursuant to Section 8.02. *See* Memorandum in Support of Joint Motion at 6. Yet despite the absence of any restriction on the Attorney General's discretion to use a contingent fee in Section 8.02, defendants maintain that an "implicit" prohibition exists in this statute. *Id*. at 8. In an attempt to support their argument, defendants cite to two other statutes, Minn. Stat. §§ 8.09 and 8.10. *Id*. However, these obscure statutes merely provide another rare example of a specific restriction on the discretion of the Attorney General, not unlike the example cited above for bond counsel. Sections 8.09 and 8.10 are companion statutes, passed for the limited purpose of hiring attorneys to recover from the United States monies spent "on account of raising and equipping troops employed . . . in aiding to suppress Indian hostilities. . . ." Exhibit 15 to Walburn Aff. These statutes provide that compensation for special attorneys retained to collect monies from the United States "shall be 25 percent" of the sums collected. *See* Minn. Stat. § 8.10. Instead of enlarging the discretion of the Attorney General, as argued by defendants, these two statutes specifically restrict the overall grant of power to the Attorney General to retain special attorneys, as set forth in Section 8.02. Thus, in cases against the United States pursuant to Sections 8.09 and 8.10, the Attorney General cannot compensate special attorneys on anything other than a 25 percent contingent fee; compensation on a hourly basis, for example, would be prohibited.

In short, Sections 8.09 and 8.10 have no bearing on the present case -- or any other appointments under Section 8.02. Nothing in Sections 8.09 and 8.10 refers to appointments under Section 8.02, much less expressly restricts the authority of the Attorney General under Section 8.02. Without such an express limitation, the Attorney General may exercise his full discretion to use a contingent fee retainer, along with other types of fee agreements which, in his judgment, are appropriate. *See, e.g., State ex rel. Young, supra* (Attorney General may exercise power "in the absence of some *express* legislative restriction") (emphasis added); *Slezak, supra* ("the courts will not control the discretionary power of the attorney general in conducting litigation for the state."); *State ex rel. Schmidt, supra* (Attorney General "is practically without legislative restriction").

Defendants also argue that *Bush v. Arrowood*, 293 Minn. 243, 198 N.W.2d 263 (1972), imposes stringent restrictions on the award of fees to special attorneys. However, this case applies only to the unique field of charitable trust law, and, in fact, has never been applied in any reported Minnesota decision outside of this limited context.

The narrow issue in *Bush* was the payment of attorneys' fees to the Attorney General or special attorneys out of the res of a charitable trust. The Court concluded that such a payment was prohibited -- but limited its holding to the singular setting of charitable trusts, where the Attorney General was compelled by a specific statutory mandate to appear and represent the beneficiaries. The Court's specific -- and narrow -- holding was:

[3]Thus, even in bond cases, a contingent fee may be a component of compensation, albeit not the primary method.

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> *We hold that* under the statutes of the State of Minnesota *the attorney general or his special counsel are not entitled to charge a charitable trust fund with attorneys' fees* incurred in representing the interests of the state in litigation involving that fund.

198 N.W. 2d at 271 (emphasis added).

The Court in *Bush* also cited Minn. Stat. § 15A.01, which prohibits state "officers and employees" from receiving compensation beyond their statutory authorities, and stated, as the defendants note in their brief, that the right of special attorneys to recover fees "is a derivative right and is coextensive with the right of the attorney general to make a similar recovery." 198 N.W.2d at 268. This broad *dicta*, however, was specifically restricted by the Court's actual holding, which was narrowly limited to a prohibition on charging fees against a charitable trust fund. *Id*. at 271.[4]

Section 15A.01 has no applicability in the present case. The purpose of this statute is, quite obviously, to ensure that public officials do not accept monies outside of their official salaries. Accordingly, the statute, on its face, applies only to state "officers and employees." In the present case, the Special Attorney Appointment specifically provides that RKM&C "shall not be considered state employees and shall not be eligible for any state employee leave or other benefits...." Exhibit 1 at 1. Thus, RKM&C's status is that of an independent contractor, and the provisions of Section 15A.01 relating to "officers and employees" are inapplicable.

Indeed, if defendants' argument -- that compensation for special attorneys must be confined to the established salaries for state officers and employees -- is taken to its logical extension, then virtually *all* special attorney appointments would be void and unenforceable. Special attorneys, by virtue of being in the private sector, do not -- and cannot -- receive a state salary, and under defendants' argument they could not receive any other type of payment since an "officer or employee" would not be entitled to such payment.

Under this construction, all contingent fee appointments would fall. So too would per diem appointments and appointments providing for lump sum payments. Of course, payments to bond counsel pursuant to the legislature's 1994 enactment, which provides that fees may be based in part on "the results obtained" and "the sufficiency of assets," would be proscribed. Indeed, the Attorney General's statutory power to retain special attorneys pursuant to Section 8.02 would be impossible to execute. These perverse results cannot have been the intent of the legislature. (*See* Minn. Stat. § 645.17, subd. (1), which provides that in ascertaining the intention of the legislature, one presumption is that, "[t]he legislature does not intend a result that is absurd, impossible of execution, or unreasonable.")

The implausibility of defendants' over-reaching argument is further underscored by the fact that it is presented in this motion by a number of law firms which have been -- and are currently -- retained pursuant to their own special attorney appointments, all of which would be void under their present arguments.[5]

B. Compensation of Special Attorneys From the Proceeds of Recovery is Not an Unlawful Appropriation of State Funds

Contrary to the assertions of defendants, the payment of a contingent fee is not an unlawful appropriation of state funds because these expenses, which are a necessary predicate to creating any recovery, must be set off prior to determining the amount of money which rightfully belongs to the State. Thus, these attorneys' fees will not be "paid out of the treasury" and are not "state money." *See* Minnesota Constitution art. XI, § 1 and Minn. Stat. § 16A.57, respectively.

In other words, the recovery owing to the State of Minnesota cannot properly be determined until the attorneys' fees and costs associated with creating the fund in the first place are calculated and deducted. This was the conclusion of the Supreme Court of Minnesota in *Board of County Com'rs of Washington County v. Clapp*, 83 Minn. 512, 86 N.W. 775 (1901), a critical case which defendants fail to cite.

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[4]Moreover, in *Bush* the Attorney General was mandated to appear on behalf of the beneficiaries. *Id*. at 267. In contrast, in the present case the Attorney General is exercising his expansive discretion granted by the constitution, statutes, and the common law of Minnesota.

[5]Moreover, the fact that Attorneys General for years have retained these firms, as well as numerous others, as special attorneys under a variety of compensation arrangements, including contingent fee appointments, offers additional evidence of the lawfulness of this practice. *See City of St. Paul v. Hall*, 239 Minn. 378, 58 N.W.2d 761, 763 (1953) ("long acquiescence in the practical construction placed upon a statute by an administrative official is entitled to great weight in the construction thereof"); *Hennepin County v. Ryberg*, 168 Minn. 385, 210 N.W. 105, 107 (1926) ("For judges to reverse or nullify such a clear executive and legislative decision of such long standing would be to destroy confidence not only in the certainty of law but in official action thereunder.").

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In *Clapp*, a county appointed special attorneys to collect delinquent personal property taxes from an estate. The taxes in question had been levied for the benefit of the State and several governmental subdivisions, on whose behalf the county sought recovery. 86 N.W. at 776. The special attorneys were successful, and they deducted fees and expenses before paying the remainder of the recovery to the county. *Id*. at 775. The county brought an action to recover the withheld amount, arguing that all of the monies collected by special counsel belonged to the county, the State; and several other governmental subdivisions and was not subject to any set-off for attorneys' fees. *Id*. at 776. The Supreme Court rejected this argument and held that the State and its subdivisions were entitled only to the portion of recovery that remained *after* the expenses of the litigation, including attorneys' fees, were paid. The Court stated:

> [W]e do not consider the claim against the Bristol estate, afterwards merged into a judgment and converted into money, as funds, absolutely, of the different governmental subdivisions, until the proper amount was determined and ready for distribution. *That amount could not be determined until the expenses connected with its collection were known and deducted. The balance. whatever it was. should be credited to those several funds.*

Id. at 776 (emphasis added).

The Supreme Court based its decision on the principle of equitable liens or set-offs, noting that the funds would not have existed but for "the exertions of the attorney." The Court stated:

> It being admitted that the amount so retained was just and reasonable, respondents were not guilty of conversion or wrongfully diverting the money by paying themselves out of the fund which was legally applicable for that purpose. Such right of application existed under the common law by virtue of the relations of attorney and client, and we can see no distinction in that respect between a private party and a governmental subdivision such as the county. Such distinction did not exist at common law. *It may be termed the right of equitable lien or set-off. It must be noted that the doctrine is founded upon the fact that such fund is created by the exertions of the attorney. . .*

Id. at 777 (emphasis added) (citations omitted).

In light of the conclusion reached in *Clapp,* it was not necessary for the Supreme Court to reach the issue of appropriations. In short, once the conclusion is reached that the State's rights to a fund do not vest until "the expenses connected with its collection [are] known and deducted," *Id*. at 776, there are no monies in the state treasury and no state funds to be appropriated. *Compare State ex rel. Nelson v. Iverson*, 12S Minn. 67, 145 N.W. 607 (1914) (no appropriation necessary to pay money out of state treasury where title to money did not vest with State).[6]

Thus, the Supreme Court of Idaho has cited *Clapp* as authority in two cases which did directly address the appropriation issue under a constitutional provision similar to Art. XI, § 1 of the Minnesota Constitution. In the first case, *State of Idaho v. National Surety Co*., 29 Idaho 670, 2 A.L.R. 251, 161 P. 1026 (1916), the majority rejected the *Clapp* rule, which led to a lengthy and vigorous dissent. The dissent stated, "It is true no money can be drawn out of the treasury of the state without an appropriation, but the money represented by this judgment never was in the treasury of the state, and there is the distinction." 161 P. at 1035. The dissent cited *Clapp* with approval, stating that the conclusion of the Supreme Court of Minnesota is "precisely that contended for by the appellant . . . In that case it was held that the only part of the recovery which could be legally termed 'public funds' was the amount remaining after the expenses of litigation were paid." *Id*. at 1039. Decades later, the Supreme Court of Idaho moved closer to the Minnesota rule. In *State ex rel. Williams v. Musgrave*, 84 Idaho 77, 370 P.2d 778 (1962), the court rejected an argument that payment of a special attorney's contingent fee for workers' compensation subrogation cases was in violation of the prohibition against spending state funds without an appropriation. To achieve its result, the court narrowly construed the reach of its earlier decision in *National Surety*. *Id*., 370 P.2d at 785-86. The court also cited *Clapp* and another Minnesota case, *Regan v. Babcock*, 196 Minn. 243, 264 N.W. 803 (1936) as examples of "respectable authorities holding contrary to our decision in State v. National Surety Company" and as standing for the "theory that until the money actually reaches the state treasury it is not state money and only the remainder of the recovery after payment of expenses is state money . . . ." *Id*.[7]

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[6]Similarly, under Minn. Stat. §§ 8.31 and 15A.01, also cited by defendants, the attorney general may deduct "the expenses connected with its collection" before paying recovered monies into the state treasury. *See Clapp*, 86 N.W. at 776.

[7]In *Regan*, the Supreme Court of Minnesota cited *Clapp* and reaffirmed the principle that a recovery does not become state funds until the expenses connected with its collection are deducted. 264 N.W. at 807. *Regan* also addressed the

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The United States Supreme Court also has recognized this principle. In *In re Paschal*, 77 U.S. (10 Wall.) 483 (1870), special counsel was retained by the State of Texas to recover on misappropriated bonds. The special counsel was successful by his "indefatigable exertions" and retained his fees out of the monies collected. *Id*. at 483. The State of Texas sought to compel the return of the retained fee<. However, the Supreme Court concluded that "when, as in this case, there exists a technical barrier to prevent the respondent from instituting an action against his client (for it is admitted that he cannot sue the State of Texas for any demand which he may have against it), it would seem to be against all equity to compel him to pay over the fund in his hands. . . ." *Id*. at 492. The Court further stated that "this court would be guided by what it deems to be the prevailing rule in this country; and, according to this rule we are of opinion that the respondent has a lien on the fund in his hands for his disbursements and professional fees in relation to the indemnity bonds. . . ." *Id*. at 496. *See also United States of America v. Equitable Trust Co.*, 283 U.S. 738, 744 (1930) ("It is a general rule in courts of equity that a trust fund which has been recovered or preserved through [the plaintiff's] intervention may be charged with the costs and expenses, including reasonable attorneys' fees, incurred in that behalf. . . .").

The sole case upon which defendants rely, *County of Beltrami v. Marshall*, 271 Minn. 115, 135 N.W.2d 749 (1965), does not compel a different conclusion. *Beltrami* involved the collection of traffic fines by a county pursuant to a specific set of state statutes. In fact, the statutes were so specific as to set forth precisely how the recovery would be split between the county and the state: three-eighths to the county and five-eighths to the state. 135 N.W.2d at 752. Another statute specifically addressed the taxing of costs. *Id*. The Supreme Court found that costs could not be taxed to the State because there was no appropriation and that, given the specificity of "the overall statutory pattern," this was not an appropriate case for a set-off. *Id*. at 753.

The decision in *Beltrami* is clearly distinguishable from the present case -- and *Clapp* -- where there are no specific statutes addressing the precise division of funds. *Beltrami* did not even cite -- much less overrule -- the decision in *Clapp*. Moreover, *Beltrami* did not involve the issue of attorneys' fees. Nor did *Beltrami* involve the creation of a fund for the State, in the same sense as *Clapp, In re Paschal*, and the present case. In *Beltrami*, the county was performing essentially ministerial and administrative duties for the State; in the present case, as in *Clapp* and *In re Paschal*, the creation of a fund will, in the words of the United States Supreme Court, require "indefatigable exertions." 77 U.S. at 483.

C. The Contingent Fee Appointment Does Not Violate Due Process

The defendants' final contention -- that the special attorney appointment will unfairly and unconstitutionally disadvantage one of the most powerful industries in the United States -- is wholly unavailing under the law and the circumstances of this case.

The defendants base their argument on decisions involving either criminal prosecutors or judicial and quasi-judicial officers, whose unique and powerful positions warrant the imposition of stringent restrictions on pecuniary interests. In the case of criminal prosecutors, the life and liberty interests of individual criminal defendants are manifest. In the case of judicial officers, a financial incentive would obviously present a danger of affecting the impartiality of the decision-maker. However, these special concerns have no applicability to plaintiff's counsel in a civil proceeding, particularly in the present case in which a contingent fee is the only practical means of even attempting to secure justice.

Indeed, the first case defendants cite in their memorandum as support for their contention actually underscores the limited contexts in which this particular due process analysis will apply. The case is *Marshall v. Jerrico. Inc.*, 446 U.S. 238 (1980), which involved the assessment by a government agency of civil penalties for violations of child labor laws. The defendant employer argued that the fact that the agency both assessed the penalties and retained the monies for its own purposes created "an impermissible risk and appearance of bias by encouraging the assistant regional administrator to make unduly numerous and large assessments of civil penalties." 446 U.S. at 241. The Court rejected this argument, stating:

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appropriation issue since a significant portion, and perhaps all, of the funds at issue from which the attorneys' fees would be paid had actually been retained by the State. *Id.* at 806, 808. Therefore, attorneys' fees would have to be paid by the state auditor drawing warrants from the state treasury. *Id.* The Court found that the constitutional prohibition on payments from the state treasury was not an obstacle to the payment of attorneys' fees because the plaintiffs' expenditures were necessary for maintaining trunk highways, which was covered by a standing appropriation. *Id.* at 808. The Court also dismissed the constitutional argument because the plaintiffs' actions would result in further savings to the highway fund. *Id.*

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> The rigid requirements . . . designed for officials performing judicial or quasi-judicial functions, are not applicable to those acting in a prosecutorial or plaintiff-like capacity.

Id. at 248.

In the cigarette case, the risk of undue bias is non-existent. In *Marshall*, the government agency itself assessed the fines. In the present case, the assessment of damages and penalties will be left to the jury and the Court -- not the Attorney General or the special attorneys. Moreover, the Attorney General, who will not himself receive any portion of the fees, was careful to provide in the Special Attorney Appointment that he "retains final authority over all aspects of the Litigation," that his office shall "fully participate- in the handling of the Litigation," and that the special attorneys "shall consult and obtain the prior approval of a delegate concerning all policy and other major, substantive issues. . . ." Exhibit 1 to Walburn Aff. at 4.

The sole case cited by defendants outside of the criminal or judicial context *is People ex rel. Clancy v. Superior Court*, 39 Cal. 3d 740, 705 P.2d 347, 218 Cal. Rptr. 24 (1985), *cert. denied*, 475 U.S. 1121 and 479 U.S. 848 (1986). This case, however, decided by the Supreme Court of California, is not as sweeping in its indictment of contingent fee arrangements as defendants argue. Although *Clancy* held that a contingent fee was improper "under the circumstances," 705 P.2d at 348, the court was careful to note that:

> Nothing we say herein should be construed as preventing the government, under appropriate circumstances, from engaging private counsel. *Certainly there are cases in which a government may hire an attorney on a contingent fee to try a civil case*.

Id. at 352 (emphasis added).

Clancy involved a public nuisance abatement action brought against an adult book store by a private lawyer, who had been retained by a municipality. The Supreme Court of California found that the abatement action was sufficiently analogous to a criminal proceeding to warrant the prohibition of a contingent fee. Id. In striking contrast to this decision, the Supreme Court of Minnesota recently -- and emphatically -- rejected an attempt to impose the heightened protections of criminal law in a civil case.

In *State by Humphrey v. Alpine Air Products*, 500 N.W.2d 788 (Minn. 1993), the similarities to the present litigation were striking. Like the present case, *Alpine Air* involved a consumer protection action brought by the State of Minnesota. In fact, the civil penalties assessed in *Alpine Air* were imposed pursuant to Minn. Stat. § 8.31, the *same* statute under which the State seeks penalties in the cigarette litigation.[8] The defendants argued that the assessment of a civil penalty converted the action into a quasi-criminal proceeding and, therefore, the criminal standard of proof -- clear and convincing evidence -- was required. The Supreme Court rejected this argument, concluding that "*the Penalty* imposed in this case *was civil and not criminal in nature*." 500 N.W.2d at 792 (emphasis added).

The defendants in *Alpine Air* also contended, as do defendants in the cigarette litigation, that the protections of criminal law should apply because there was the potential for criminal liability under the same statutes. *Id*. at 793. The Supreme Court of Minnesota quickly dismissed this contention, stating:

> Possible criminal liability does not magically transform the standard of proof in a civil suit merely because it is based upon the same conduct.

Id.

Even more clearly, the mere fact that in this case the Attorney General used the word "prosecution" in referring to this action, as defendants repeatedly intone, does not "magically transform" this into a criminal proceeding.

Due process, of course, is not a fixed concept but must be evaluated in the context of all the circumstances. *See Connecticut v. Doehr*, 501 U.S. 1, 10 (1991). Under the circumstances of this case, the due process argument is, to say the least, remarkably hypocritical coming from an industry which has spent the last four decades gaining a reputation for scorched-earth litigation tactics. Indeed, the industry has boasted of its success in using these tactics to overwhelm its adversaries. As one industry lawyer wrote:

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[8]In the cigarette case, the State also seeks penalties for antitrust violations pursuant to Minn. Stat. § 325D.56. In *Alpine Air*, defendants were also found in violation of the antitrust statute but that ruling was not appealed to the Supreme Court. 500 N.W.2d at 790. In any event, for purposes of the due process analysis, there is no distinction between penalties under Section 8.31 and Section 325D.56.

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> [T]he aggressive posture we have taken in depositions and discovery in general continues to make these cases extremely burdensome and expensive for plaintiffs' lawyers, particularly sole practitioners. To paraphrase General Patton, the way we won these cases was not by spending all of [R.J. Reynold'] money, but by making that other son of a bitch spend all of his.

See Complaint at ¶ 40.

True, in the present case the plaintiff is not an individual victim, but the State of Minnesota (and its co-plaintiff, Blue Cross and Blue Shield of Minnesota). Still, the disparity of financial resources remains overpowering -- as matched against an industry which harvests billions of dollars a year in profits from domestic sales alone. *See* Complaint at ¶ 19.

IV.

CONCLUSION

It remains the mandate of the Attorney General, no matter how powerful the adversaries, to attempt to secure justice on behalf of the citizens of the State of Minnesota. In the present case, the Attorney General has exercised the discretion vested in his office by the constitution, statutes, and common law and has chosen the most effective manner of proceeding against this industry, all in accordance with long-standing principles of Minnesota law. Accordingly, the State of Minnesota respectfully requests that defendants' motion be denied.

Respectfully submitted,

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