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The Honorable Lee H. Rosenthal
United States District Judge
United States District Court
11535 Bob Casey U.S. Courthouse
515 Rusk Avenue
Houston, TX 77002-2600

The Honorable Mark R. Kravitz
United States District Judge
United States District Court
Richard C. Lee United States Courthouse
141 Church Street
New Haven, CT 06510

The Honorable John G. Koeltl
United States District Court
1030 Daniel Patrick Moynihan
United States Courthouse
500 Pearl Street
New York, NY 10007-1312

Re: Litigation Costs as a Percentage of Profits

Dear Judge Rosenthal, Judge Kravitz, and Judge Koeltl:

The Searle Civil Justice Institute (SCJI) provided research support for the Statement on the Litigation Cost Survey of Major Companies (the Survey) submitted by Lawyers for Civil Justice, the Civil Justice Reform Group, and the U.S. Chamber Institute for Legal Reform and presented at the 2010 Civil Litigation Conference in May. I understand that you and other participants are interested in further exploring what total litigation costs might look like as a percent of profits rather than revenues. This letter contains the results of the analysis conducted in response to your inquiry. Because the survey respondents each earn billions in revenues per year, the Survey presented relatively high total U.S. litigation cost amounts that translated to small percentages of U.S. revenues by company. The percentages thus potentially obscured the magnitude of total actual dollars spent on litigation costs. As another way to analyze the potential impact of dollars spent on litigation costs, the SCJI endeavored to determine whether total litigation costs could be compared to company profits rather than revenues given the information available.

Because the survey participants were neither asked to report total profits by year nor asked to identify themselves, the SCJI cannot determine the ratio of total litigation costs to profits directly. However, an indirect approximation for 2008 can be derived by using information reported by the survey respondents and publicly available information on the Fortune 200. Specifically, the Survey provides total U.S. litigation costs as a percent of U.S. revenues for 2000 through 2008 by respondent and *Fortune* provides global (U.S. plus international) profit margins by industry for the Fortune 200 going back to 1955.¹

Because the survey respondents were all members of the Fortune 200 as of 2008, it is reasonable to compare the total U.S. litigation costs as a percent of U.S. revenues by respondent for 2008 to the corresponding Fortune 200 industry profit margins.² In order to make this comparison, at least two large and important assumptions must be made:

1. Because the Fortune 200 reports the *global* profit margin by industry but the survey respondents reported *U.S.* litigation costs as a percent of revenues, in order to compare costs to profits, it must be assumed that the *global* profit margins by industry are reasonable proxies for the *U.S.* profit margins by industry.
2. It must also be assumed that the Fortune 200 industry profit margins approximate the actual profit margin for each survey respondent in 2008.

Although these two necessary assumptions may not always hold, for purposes of the following comparison, the SCJI assumes they do.

The SCJI began by calculating the Fortune 200 profit margins by industry for 2008.³ The 2008 litigation costs as a percent of revenues reported by each survey respondent were then divided by the corresponding industry profit margins to derive a comparison of litigation costs to profits. The results for the respondents were then averaged. An alternative, and more conservative, calculation of profit margins was also done by taking the Fortune 200 10-year average from 1999 – 2008 by industry.⁴ The results appear in Figure 1.

¹ http://money.cnn.com/magazines/fortune/fortune500_archive/full/1955/index.html

² For a discussion on the representativeness of the survey respondents to the Fortune 200, see *Litigation Cost Survey of Major Companies*, Statement submitted by Lawyers for Civil Justice, Civil Justice Reform Group, and U.S. Chamber Institute for Legal Reform at the 2010 Conference on Civil Litigation, May 10-11, 2010, at Appendix 1, 4-7.

³ In order to calculate the 2008 profit margin by industry, we took the profit (in millions) and revenue (in millions) from the largest 200 companies from *Fortune 500 Ranked Within Industries*, Fortune Magazine, May 4, 2009, at F-46.

⁴ In order to calculate the 10-year average profit margin by industry we took the profit (in millions) and revenue (in millions) from the largest 200 companies from each *Fortune 500* issue of *Fortune Magazine* from the years 2000-2009. For the tables and charts used to collect the data, see *Fortune 500 Ranked Within Industries*, Fortune Magazine, May 4, 2009, at F-46; *Fortune 500 Ranked Within Industries*, Fortune Magazine, May 5, 2008, at F-46; *Fortune 1000 Ranked Within Industries*, Fortune Magazine, April 30, 2007, at F-50; *Fortune 1000 Ranked Within Industries*, Fortune Magazine, April 17, 2006, at F-44; *Fortune 1000 Ranked Within Industries*, Fortune Magazine, April 18, 2005, at F-46; *Fortune 1000 Ranked Within Industries*, Fortune Magazine, April 5, 2004, at F-44; *Fortune 1000 Ranked Within*

FIGURE 1
Average Dollars Spent on Litigation Costs for Every \$1 of Profit Earned

	Using 2008 Profit by Industry	Using 10-year Average Profit by Industry (simple)	Using 10-year Average Profit by Industry (weighted)
All Reporting Survey Respondents	\$0.31	\$0.24	\$0.24
Reporting w/o Outliers and w/o Industries with Negative Profit Margins	\$0.21	\$0.19	\$0.18
Reporting w/o Outliers	\$0.18	\$0.16	\$0.16

The first column of Figure 1 shows that in 2008, when using the 2008 profit margin by industry, for each \$1 of profit earned, on average survey respondents spent between \$0.18 and \$0.31 on litigation costs. If all reporting respondents are averaged, \$0.31 is spent on litigation costs per \$1 of profits. However, in remaining consistent with the SCJI’s original analysis, removing the two outlier respondents reduces the rate to \$0.18 in costs per \$1 of profits.⁵ Further, since there is not a direct interpretation of the results for industries with negative profit margins, removing respondents in industries with negative profit margins suggests that the rate could be \$0.21 in costs for every \$1 of profits on average.

Columns 2 and 3 of Figure 1 show that in 2008, when using the more conservative 10-year average profit margin by industry, for each \$1 of profit earned, on average survey respondents spent between \$0.16 and \$0.24 on litigation costs depending on which respondents were included in the average. The range does not depend on whether the 10-year average profit margin by industry was a simple or weighted average.⁶

Industries, Fortune Magazine, April 14, 2003, at F-44; *Fortune 1000 Ranked Within Industries*, Fortune Magazine, April 15, 2002, at F-44; *Fortune 1000 Ranked Within Industries*, Fortune Magazine, April 16, 2001, at F-45; *Fortune 1000 Ranked Within Industries*, Fortune Magazine, April 17, 2000, at F-55. The rankings represent the year prior to the publication year.

⁵ The two removed outliers were companies that reported unusually high litigation costs as a percent of revenue in comparison to their peers, see *Litigation Cost Survey of Major Companies*, Statement submitted by Lawyers for Civil Justice, Civil Justice Reform Group, and U.S. Chamber Institute for Legal Reform at the 2010 Conference on Civil Litigation, May 10-11, 2010, at Appendix 1, 9.

⁶ The simple 10-year average profit margin by industry was calculated by taking the average of the profit margins from 1999 – 2008 for each industry. The weighted 10-year average profit margin by industry was calculated by summing the profits for 1999 – 2008 and dividing by the sum of the revenues for 1999 – 2008 for each industry.

Assuming further that all money not spent on litigation costs would go towards an increase in profits, on average survey respondents could have had expected increases in profits ranging from 15.7% to 31.1% depending on the profit margin and respondents considered. Figure 2 below shows the results.

FIGURE 2
Average Maximum Expected Increase in Profits

	Using 2008 Profit by Industry	Using 10-year Average Profit by Industry (simple)	Using 10-year Average Profit by Industry (weighted)
All Reporting Survey Respondents	31.1%	24.2%	23.5%
Reporting w/o Outliers and w/o Industries with Negative Profit Margins	20.6%	19.0%	18.4%
Reporting w/o Outliers	18.1%	16.2%	15.7%

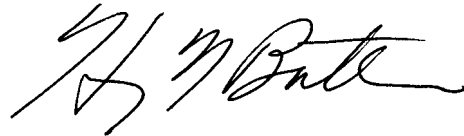
In 2008, when using the 2008 profit margin by industry, on average survey respondents could have had expected increases in profits ranging from 18.1% to 31.1%. However, using the more conservative 10-year average profit margins by industry creates a lower range of 15.7% to 24.2%.

Clearly this analysis can only provide a rough approximation for an estimation of litigation costs to profits. Should any of the assumptions above not hold, these calculated ranges could be even lower. That said, even if the estimates for the most conservative 10-year weighted average were arbitrarily halved the result would be litigation costs of \$0.08 to \$0.12 per dollar of profit earned.

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We hope that this additional analysis is useful to your deliberations and look forward to continuing our work on this front. Please feel free to contact me with any questions.

Respectfully,

A handwritten signature in black ink, appearing to read "H N Butler". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Henry N. Butler, J.D., Ph.D.
Executive Director
Searle Center on Law, Regulation,
and Economic Growth

cc: Professor Edward H. Cooper
Professor Richard L. Marcus
Professor Daniel R. Coquillette
Mr. Alex Dimitrief