Class Action Counsel Fees

Will the Lodestar Ride Again?

by David H. Pikus

For well over a century, courts have wrestled with the challenge of compensating lawyers who have taken up the cause of a definable group of victims of a mass wrong, outside the concept of the normal attorney-client relationship.[1] To the lawyers themselves, and the advocates of the victims' causes, these attorneys are saviors who have taken the ultimate contingency risk. To the critics of class actions in the political and business worlds, they are mercenaries who have exploited nominal class members chiefly for their own financial benefit. And to the supposed dispassionate observers in the Judiciary and academia, they are barristers who deserve compensation no less or greater than necessary to provide the rewards and incentives for undertaking worthy causes.

The Common Fund Doctrine

The so-called "common fund doctrine," coupled with Fed. R. Civ. P. 23(e), authorizes the court to award fees and expenses to class counsel and certain other claimants in a duly certified class action.[2] The underlying rationale centers on the notion that counsel who create a common fund for the benefit of a class are entitled to compensation from that fund for their efforts and the risk they assumed.

The methodology for such compensation has taken a circular journey, in which the Third Circuit has played a leading role. In the early days of the common fund doctrine, attorneys' fees were generally awarded as a percentage of the recovery.[3] That preference shifted in the 1970s, as the federal courts became concerned that ballooning settlement numbers were generating excessive legal fees under the percentage system.[4]

Led by the Third Circuit, the courts shifted to the rate-based "lodestar" method.[5] Using this procedure, "the district court scrutinizes the fee petition to ascertain the number of hours reasonably billed to the class and then multiplies that figure by an appropriate hourly rate. Once that initial computation has been made, the district court may, in its discretion, increase the lodestar by applying a multiplier based on 'other less objective factors,' such as the risk of the litigation and the performance of the attorneys."[6]

As the broadening scope and complexity of litigation consumed ever-increasing legal manpower over the ensuing decades, the lodestar fell into disfavor. The Third Circuit commissioned a task force, which issued a report in 1985 that served as a catalyst for courts around the country to revert to the former percentage regime.[7]

The task force cited nine particular shortcomings in the lodestar formulation:

1. It increases the workload of an already overtaxed judicial system.
2. The elements of the process are insufficiently objective and produce results that are far from homogenous.
3. The process creates a sense of mathematical precision that is unwarranted in terms of the realities of the practice of law.
4. The lodestar is subject to manipulation by judges who prefer to calibrate fees in terms of percentages of the settlement fund or the amounts recovered by the plaintiffs, or of an overall dollar amount.
5. Although designed to curb certain abuses, the lodestar encourages lawyers to expend excessive hours, and, in the case of attorneys presenting fee petitions, engage in duplicative and unjustified work, inflate their 'normal' billing rate, and include fictitious hours or hours already billed on other matters, perhaps in the hope of offsetting

any hours the court may disallow.

6. The methodology creates a disincentive for the early settlement of cases. Because of the emphasis on hours worked, lawyers—including defense counsel who typically bill their clients on an hourly basis—have little or no incentive to settle cases at the earliest appropriate opportunity.
7. The lodestar does not provide the district court with enough flexibility to reward or deter lawyers so that desirable objectives, such as early settlement, will be fostered.
8. The process works to the particular disadvantage of the public interest bar.
9. Despite the apparent simplicity of the formulation, considerable confusion and lack of predictability remain in its administration.[8]

Courts similarly have contended that the lodestar creates a temptation for lawyers to run up the number of hours for which they could be paid, creates an unanticipated disincentive to early settlements and compels district courts "to engage in a gimlet-eyed review of line-item fee audits."[9]

In the wake of these critiques, the common fund cases completed their circular journey back to the percentage regime. By the turn of the latest century, the courts of appeals had fully restored the percentage method, some mandating its use,[10] others, including the Second Circuit, retaining the lodestar as an alternative.[11]

The Third Circuit has embraced the percentage method in common fund cases that have reached its docket since the task force issued its report 26 years ago.[12] But any jurists and lawyers who hoped for simplicity and certainty in the computation of fees were disappointed. For a time, it appeared that district courts would embrace a benchmark of 25 percent popularized within the Ninth Circuit and migrating elsewhere.[13] The emerging phenomenon of the so-called megafund, however, exposed the potential for unreasonableness inherent in a unitary percentage. A routine fee of $250 million for class action lawyers in a $1 billion case proved too much even for the Second and Third circuits, which had blazed the trail for the return of the percentage method.[13]

Struggling to harmonize the incentive function with the need for reasonableness of compensation, some district judges began experimenting with fee auctions.[14] These cases introduced market concepts into the selection of class counsel, by permitting prospective class counsel to bid for the assignment. This approach fell into local disfavor after criticism by the Third Circuit.[15]

Thus was born the tapered award. The courts began to use declining percentages, recognizing that a unitary percentage carried with it the prospect of overcompensating counsel at the expense of the class they purport to champion.[16] This involves use of a sliding scale, "allowing recovery of a given percentage of a certain amount of the fund, and decreasing percentages of subsequent amounts."[17] In a variation on this theme, one court awarded a *higher* percentage for the final tranche of recovery on the theory that counsel put themselves at risk, after receiving a generous and approvable offer, by successfully holding out for a settlement believed by objective observers to be unattainable.[18]

Yet another development of recent vintage has sparked renewed interest in the much-maligned lodestar. In the wake of the major corporate scandals that erupted during the past decade, some class actions resulted not in outsized monetary recoveries but, instead, in stipulated reforms in corporate boardrooms and executive suites.[19] The courts found themselves facing the dilemma of compensating counsel for results that are not easily measured in monetary terms. And what better tool to accomplish that task than the venerable lodestar, with its roots in market-based hourly billing rates?

Meanwhile, the lodestar itself has undergone a recent makeover of sorts. The Second Circuit has gone so far as to banish the term itself to the lexical dustbin.[20] The court replaced the word with the concept of a market-oriented "presumptively reasonable fee." This, in turn, fundamentally requires the court to establish an appropriate hourly fee that could be negotiated by a hypothetical thrifty client, while, at the same time, taking into account a variety of other factors, including reputational benefits inuring to counsel from success in the case.[21]

Conclusion

The revival of the lodestar in outcomes dominated by non-monetary relief raises a provocative question in this area of jurisprudence, with its history of shifts between hourly and percentage-based fee awards: If the lodestar yields a reasonable fee for the time and effort needed to expose the wrongdoing that resulted in corporate governance stipulations, why should the same methodology not be used for the same time and effort that resulted instead in a monetary recovery? Perhaps those who say the percentage method is really just a way to simplify the task of awarding counsel fees have a point. Time will tell whether the recent resort back to the lodestar is an isolated necessity, or the harbinger of another shift in fee jurisprudence.

Endnotes

1. *Trustees of the Internal Improvement Fund v. Greenough*, 105 U.S. 527, 536 (1881).
2. *See In re "Agent Orange" Product Liability Litigation*, 818 F.2d 216, 222 (2d Cir. 1987), *cert. denied sub nom., Schwartz v. Dean*, 484 U.S. 926 (1987).

3. *Winkelman v. General Motors Corp.*, 48 F. Supp. 504 (S.D.N.Y. 1942), *aff'd sub nom., Singer v. General Motors Corp.,* 136 F.2d 905 (2d Cir. 1943).
4. *See City of Detroit v. Grinnell Corp.*, 495 F.2d 448, 468 (2d Cir. 1974).
5. *See Lindy Bros. Builders, Inc. v. American Radiator & Standard Sanitary Corp.*, 487 F.2d 161, 167 (3d Cir. 1973).
6. *Goldberger v. Integrated Resources, Inc.*, 209 F.3d 43, 47 (2d Cir. 2000) (citations omitted); *see also*, *"Agent Orange" Product Liability Litigation*, *supra*, note 2 at 222 ("the court may, in its discretion, increase or decrease [the hourly fees] by examining such factors as the quality of counsel's work, the risk of the litigation and the complexity of the issues").
7. *Court Awarded Attorney Fees*, Report of the 3d Cir. Task Force, 108 F.R.D. 237 (Oct. 8, 1985).
8. *Id.* at 246-49.
9. *Goldberger, supra*, note 6 at 48-49; *see also*, *Kirschoff v. Flynn*, 786 F.2d 320 (7th Cir. 1986).
10. *E.g., Swedish Hospital v. Shalala*, 1 F.3d 1261, 1265 (D.C. Cir. 1993).
11. *See Goldberger, supra*, note 6 at 50; *see also In re Washington Public Power Supply System Securities Litigation*, 19 F.3d 1291 (9th Cir. 1990); *Rawlings v. Prudential-Bache Properties, Inc.*, 9 F.3d 513 (6th Cir. 1993).
12. *See, e.g., In re Prudential Ins. Co. of Am.,* 148 F.3d 283, 333 (3d Cir. 1998); *In re Cendant Corp. Litig.*, 264 F.3d 201 (3d Cir. 2001), *cert. denied sub nom., Mark v. Calif. Pub. Employees' Retirement System,* 535 U.S. 929 (2002); *In re Rite Aid Corp. Sec. Litig.,* 396 F.3d 294 (3d Cir. 2005); *In re AT&T Corp. Sec. Litig.*, 455 F.3d 160 (3d Cir. 2006).
13. *See Six (6) Mexican Workers v. Ariz. Citrus Growers*, 904 F.2d 1301, 1311 (9th Cir. 1990); *Mazola v. May Dep't Stores Co.,* 1999 WL 1261312 at *4 (D. Mass. Jan. 27, 1999) ("[t]he normal percentage awarded by federal courts is 20-30% of the value of the settlement, with 25% being a 'benchmark'").
14. *See Cendant*, *supra*, note 12 at 284 n.55 ("ordinarily, the percentage of a recovery devoted to attorneys' fees should decrease as the size of the overall settlement or recovery increases").
15. *See* Laural L. Looper and Marie Leary, *Auctioning the Role of Class Counsel in Class Action Cases: A Descriptive Study* (Fed. Jud. Ctr. 2001), *reprinted at* 209 F.R.D. 519 (2002).
16. *In re Cendant Corp. Litig.*, *supra*, note 12.
17. *See* Wayne Schneider, *Courts Don't Have to Award Excessive Fees to Incentivize Class Counsel in Federal Securities Class Actions*, 20 NAPPA Report 8, 8-9 (May 2006);); *In re Prudential Ins. Co. of Am. Sales Practices Litig.*, *supra*, note 12 at 339 (4.1 to 17.92 percent where recovery exceeds $100 million).
18. A. Hirsch and D. Sheehey, *Awarding Attorneys' Fees and Managing Fee Litigation* 49, 69 (Fed. Judicial Ctr. 1994) (*citing In re Fidelity Bancorp. Sec. Litig.*, 750 F. Supp. 160, 163 (D.N.J. 1990) (awarding 30 percent of the first $10 million, 20 percent of the next $10 million and 10 percent of any recovery beyond $20 million).
19. *In re AOL Time Warner ERISA Litig.*, 2007 U.S. Dist. LEXIS 79545 (S.D.N.Y. Oct. 26, 2007). The author served as special master in that case.
20. *Id.; see also*, *Unite Nat'l Ret. Fund v. Watts,* 2005 U.S. Dist. LEXIS 26246 (D.N.J. Oct. 27, 2005).
21. *Arbor Hill Concerned Citizens Neighborhood Assoc. v. County of Albany*, 493 F.3d 110 (2d Cir. 2007), *amended and superseded on other grounds by* 522 F.3d 182 (2d Cir. 2008).
22. *Id.* at 117-18. It remains to be seen whether the *Arbor Hill* concept will gain traction outside the Second Circuit. So far, the approach apparently has been adopted by only one court outside the circuit, the bankruptcy court in Hawaii. *See Hawaiian Airlines, Inc. v. Mesa Air Group, Inc. (In re Hawaiian Airlines, Inc.),* 2008 Bankr. LEXIS 1501, 49 Bankr. Ct. Dec. 127 (Jan. 22, 2008).

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