LITIGATION

FEE COUNSEL—THE ANTIDOTE FOR COLLUSIVE CLASS ACTION FEE AGREEMENTS

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Without the contingent fee, class action litigation in the United States would not exist, and millions of consumers and investors would be denied well-deserved redress. Because of the contingent fee, however, class action lawyers often receive excessive compensation for their representation, usually at the expense of their clients. The reason for this anomaly is three-fold: (1) the "client" in class action litigation is poorly positioned to supervise class attorneys; (2) the vast majority of class actions are resolved before trial with settlements that include "clear-sailing" provisions (agreements by defendant not to contest a specified fee); and (3) the current system lacks adequate controls to safeguard the class from collusive fee agreements.

In enacting the Class Action Fairness Act (CAFA) last year, Congress took a major step toward fixing the problem of abusive class action settlements by restricting the use of coupons rather than cash as compensation for class members.[1] The one abuse that continues unabated, however, is the collusive setting of exorbitant counsel fees that end up being paid for by class members out of a "common fund."[2] Because the defendant has no economic incentive to oppose the fee, the reviewing court is denied a full airing of the merits of the fee claim. Class action complexities and the time pressure created by burgeoning litigation dockets further complicate the district court's challenge in ruling on class counsel's fee request. Objectors often add to the court's burden rather than assist the court because they too are seeking a piece of the action. In many cases, the result is speedy approval of fee applications following cursory judicial review at both the trial and appellate levels.

One possible solution to this problem is the appointment of "fee counsel." A fee counsel is an experienced class action litigator whose sole responsibility is to review the fee application from a neutral vantage point. A seasoned class action litigator is almost uniquely able to evaluate the reasonableness of a fee request by considering, among other things, the degree of skill and risk involved in prosecuting the case and the uniqueness of the legal theories involved. If the parties are informed early in the process that fee counsel will be called upon to opine on the fee petition, they will likely be deterred from the kind of overreaching often found in common fund settlements.

This article describes the problems inherent in common fund settlements and proposes the appointment of "fee counsel" to protect the interests of the class by insuring that the Court has adequate information to assess the reasonableness of plaintiffs' attorneys' fees.

I. The Absence of a True Attorney-Client Relationship Undermines Effective Review of Fee Applications

In the traditional attorney-client relationship, the attorney's fee is agreed upon before representation begins. In the case of personal injury or other consumer litigation, the attorney is willing to invest in the outcome of the litigation and accept a fee on a contingent basis. At the outset, the fee arrangement is explained to the prospective client, who can agree to it, negotiate different terms, or hire a different lawyer. Individual plaintiffs often remain involved in the litigation as it progresses in order to ensure the best possible outcome. Since the fee is determined before the litigation commences, it is not an issue at the time of settlement. Full disclosure, client involvement, and a client with a real interest in the outcome of the litigation are the hallmarks of the attorney-client relationship that are lost in the class action setting.

Class action litigation turns this relationship on its head. In most class actions, it is the lawyer, not the client, who is the prime mover behind the class action and who has the greatest interest in the litigation.[3] The named plaintiff, or "client," is often sought out by the attorney and perhaps even promised a reward of a few thousand dollars to play the designated role. The putative class members rarely learn about the litigation until receiving notice of the settlement or other outcome of the litigation. Thus, as long as plaintiffs' counsel can persuade the court that the benefits conferred upon the class are fair and reasonable, counsel has free rein to seek the highest fee award attainable.

In the case of common fund settlements, which constitute the majority of class action settlements, defendants have little incentive to restrain the amount of the fee since it has no impact on the ultimate cost of the settlement. Even assuming that fee negotiations are conducted separately from negotiations over the terms of settlement as ethics rules require, there is no adversary process to inhibit the calculation of fees. The district court is left to conduct its own analysis of the sought-after fees to protect the interests of the class, a task few courts have the time or resources to do in a rigorous way.

A clear-sailing clause—an agreement on the defendant's part not to challenge the fee request—can further compromise a settlement's integrity. Such clauses effectively leave a court to its own devices in assessing a fee request.

Some settlements even give defendants a reversionary interest in the fund after distribution to class members. Reversionary interests create an incentive for counsel on both sides to inflate the face value of the settlement in order

to gain court approval of a correspondingly high counsel fee knowing that the actual pay-out to class members will be substantially smaller.

II. Current Situation: Judicial Review of Attorney Fee Claim

The prevailing regulatory response to unrestrained attorneys' fees in class settlement is to require judicial scrutiny of the settlement proposal.[4] CAFA armed the courts last year with specific authority to limit attorneys' fees to a fair percentage of the actual value (as distinguished from face value) received by class members in a non-monetary or coupon settlement.[5] This should discourage the inflation of attorneys' fee awards based on the face value of coupons that few class members will realistically want to redeem. It will not, of course, place any restraints on negotiated fees in common fund, cash settlements.

Federal Rule of Civil Procedure 23 requires court approval of all class action settlements. The trial judge is required to provide "a thorough. . .review of fee applications . . .in all class action settlements."[6] Indeed, the court should "exercise the highest degree of vigilance in scrutinizing [a] proposed settlement[]."[7] The "need for close judicial scrutiny of fee arrangements" is especially "acute" in cases involving common fund agreement.[8] The financial incentives for both the defendant and plaintiffs' lawyer present a "danger. . . that the lawyers might urge a class settlement at a low figure or on a less-than-optimal basis in exchange for red-carpet treatment for fees."[9] Since 1985 courts have been applying "heightened scrutiny" to settlements that include clear-sailing provisions.[10] The application of this standard has resulted in the unilateral reduction of attorneys fees in certain cases.[11] So too have appellate courts occasionally exercised vigilance in the area of fees because of their impact on the class, sometimes adding their perspective that district courts should obtain the help of an expert to assist with the fee analysis.[12]

In one case that presents a fairly typical situation, the Third Circuit remanded a fee approval petition for reevaluation and rebuked the district court for its cursory review of the agreed upon fee award and its failure to make "its reasoning and application of the fee-awards jurisprudence clear." The Third Circuit called to the district court's attention the availability of a court-appointed fee expert to assist it in the performance of its duties.[13] Appellate decisions like the Third Circuit's are praiseworthy, but comparatively rare. The reality is that most fee awards go unchallenged at all levels of the court system for reasons explained herein. The trial court's review of attorneys' fees that are part of a comprehensive settlement package is clearly not an effective check on unchallenged attorneys' fee provisions, as illustrated by the occasional appellate reversals of fee awards and the widespread sense of outrage over fees that are not commensurate with class recovery.[14]

The greatest obstacle to judicial intervention is lack of judicial resources. District court dockets are notoriously crowded, which means that judges have correspondingly less time to devote to each individual case. Federal Rule of Evidence 16(a)(5) goes so far as to state that "[because settlement] eases crowded court dockets and results in savings to the litigants and the judicial system, settlement should be facilitated at as early a stage of the litigation as possible." Approving a proposed settlement clears a crowded docket while rejecting it prolongs the litigation. The court faces only a small risk of reversal for settlement approvals, but rejections are likely to be appealed. As one judge noted when approving a particularly controversial settlement: "[i]n deciding whether to approve this settlement proposal, the court starts from the familiar axiom that a bad settlement is almost always better than a good trial."[15]

The lack of adversarial sparring over fees often leaves courts without the information they need to evaluate a lawyer's assertions in support of his fee request. Judges presiding over settlement proceedings are removed from their normal adjudicatory role and assume a managerial role—but a managerial role that can only really be effective if the parties make a true adversarial presentation. But in a typical fairness hearing, plaintiff's counsel urges approval of the fee, defense counsel stands silent concerning the fee, and the settlement waits on judicial approval.[16] "The court can't vindicate the class's rights because the friendly presentation means that it lacks essential information."[17] The court is left to scrutinize the fee on its own, searching out the relevant information to do its job—information that may be readily available to, but not forthcoming from, the defendant.

While endorsing the role of the district judge as fiduciary for absent class members, courts have also recognized that evaluation of a fee award is not a task for which judges are particularly well suited. "It is no insult to the judiciary to admit that a court's expertise is rarely at its most formidable in the evaluation of counsel fees."[18] Accordingly, the trial court is given wide latitude in determining whether to enlist the aid of a special fee counsel or expert in assessing the fee petition. "A district court that suspects that the plaintiffs' rights in a particular case are not being adequately vindicated *may* appoint counsel. . .to review or challenge the fee application."[19]

III. Third Party Participation in Class Settlements

The need for objective, third party input in the fee determination is beyond dispute. However, the only meaningful third party input in the typical case comes from objectors, and, far from restraining plaintiffs' attorneys' fees, objectors may actually raise them. Objectors increase the costs of class litigation by delaying the approval of a proposed settlement, increasing settlement expenses borne by the parties, and postponing the class' receipt of its award. Occasionally these increased costs may be justified because they lead to heightened judicial scrutiny of settlements. Too often, though, the actions of objectors yield no benefit to the class and may even be harmful. The same pecuniary interests that motivate class counsel often explain why objectors' counsel become involved in a case. In many

instances, therefore, objectors cannot be relied upon as an effective safeguard against excessive fee agreements.

Time and again, courts have expressed frustration at the time wasted on account of objectors, who put forward duplicative or faulty information as they rush to claim a share of the common fund. One case involved a "canned" set of objections that named a defendant not involved in the case and concerned points unrelated to the subject matter of the litigation, leading the court to observe that the goal of "professional objectors who seek out class actions" is "to simply extract a fee by lodging generic, unhelpful protests."[20] In another class action, the court sorted through a complicated factual scenario about an objector's alleged contributions and concluded that one of the objector's statements was "at least somewhat hyperbolic at best, and somewhat false at worst."[21] In *Vollmer v. Publishers Clearing House*, the appellate court voiced its frustration with the objecting counsel who knew nothing about the terms of the proposed settlement and "demonstrated great unfamiliarity with the nature of his complaint."[22]

The fees sought by objectors may deplete the money available to the class.[23] At the same time, the objector process has been called an "extortion game" by commentators[24] who have also pointedly observed that "fee objections are pointless. . . . [T]heir only purpose is to enrich strategic objectors who threaten to 'hold up' settlements by appealing unless they are paid to disappear."[25] In a class action against Louisiana-Pacific Corporation that alleged a failure of building siding materials, a mediator awarded a $400,000 fee to objectors who didn't surface until after a $375 million settlement (that included a $25 million fee award to class counsel) had been negotiated.[26] The objectors' appeal of the excessiveness of the fee award was withdrawn when they were bought off with an increased fee of $1 million for their last minute entry to the settlement.[27] The fee was defended by the court, which observed that "it was better to get finality than to hold the settlement up any further."[28]

This is not to say that all objector action springs from improper motives, nor does all objector action necessarily impede the class action process. Many objectors are motivated to intervene upon discovering clearly collusive settlements that deprive class members of the real benefits of their causes of action. Public interest groups, such as Public Citizen and the Trial Lawyers for Public Justice, are "beneficial objectors" who represent parties' true interests without any desire to frustrate the class action process. Yet these groups have limited resources and their actions, by no means insubstantial, are too small in number to be primary safeguards for the class. The Federal Judicial Center has found that in cases where objections were filed, more than 90% of the settlements were approved without change.[29]

In addition to private objectors, government agencies have become players in class action litigation. The Federal Trade Commission has challenged proposed class attorneys' fees awards and, since 2002, has filed six briefs opposing proposed class settlements for excessive fees or insufficient benefits to class members. State attorneys general are also active in protecting their citizens from exploitive class action settlements. Recognizing the importance of this role, Congress included in CAFA a provision requiring notice of proposed class action settlements to the appropriate state or federal regulatory official within 10 days of court filing. Nonetheless, given the limited resources available to government agencies to do their job, the involvement of government authorities in the settlement approval process will never be sufficient to adequately police the excessive attorneys' fee deals that are so common in common fund settlements.

IV. Solution: Implementation of a Fee Counsel

The criticism in recent years of fee awards in common fund class action settlements suggests just how ineffective the current system is: the class cannot supervise the class attorney, the class attorney is enabled to overreach, the defense is ambivalent about the fee calculation, objectors are often unhelpful, and the court's limited resources simply will not allow for adequate review of fee petitions. All of these factors, and the growing public focus on abusive fee settlements in class actions, suggest the need for a new approach to fee application approval—the appointment of fee counsel.

The legal basis for the retention of a fee counsel already exists. Rules 53 and 54 of the Federal Rules of Civil Procedure authorize the use of masters when fees and accounting are at issue.[30] Rule 23 specifically authorizes such delegation in the class action context: "The court may refer issues related to the amount of the award to a special master or to a magistrate judge."[31] The *Manual for Complex Litigation* states, "[i]f fee requests are extensive or vigorously contested, the court should consider appointing an expert under Fed. R. Evid. 706 or refer the applications to one or more special masters appointed under Fed. R. Civ. 53."[32] And the Court's authority to appoint a technical expert is also deeply rooted in case law.[33]

Capturing the essence of the need for fee counsel in common fund cases and endorsing the notion that courts need the help, Judge Posner commented on the absence of customary adversarial proceedings and said that class counsel are:

> like artists requesting a grant from the National Endowment for the Arts. Grant-making organizations establish non-adversarial methods for screening applications; perhaps we need something like that for cases like this. The appointment of a special master to advise the court is an obvious possibility, one frequently used in fee matters and especially appropriate in a case such as this that lacks an adversary setting.[34]

The January 2006 Report of the ABA Task Force on the Contingent Fee further supports the use of fee counsel, particularly in common fund settlements that include clear sailing agreements. While stopping short of recommending a prohibition against clear sailing agreements, the ABA Report urges the courts to "give serious consideration" to the use of the appointment of counsel for the class in connection with fee determinations.[35] After citing with approval a 1985 Third Circuit Report on Class Actions that includes a similar recommendation, the ABA Report offers the following suggestion: "There is no reason. . .why counsel for the class could not be appointed at the conclusion of the litigation to attempt, on behalf of the class . . .to provide an adversarial presentation on fees that might otherwise be absent."[36]

The complexity and breadth of the factors that the court must consider when analyzing the fee award in a common fund case virtually require the involvement of an expert with the time and expertise to conduct a "robust assessment of the fee award" and set forth a "reasoned basis and conclusion."[37] Some of these factors are quantitative, such as the size of the fund, the number of class members benefited, and the number and nature of the objectors.[38] Others, such as the complexity, duration and risk of the litigation and the difficulty of establishing liability and maintaining a class, require the expertise of a seasoned class action litigator. An experienced fee counsel is ideally suited to perform this role and increase the likelihood of appellate approval of the settlement and fee award.

Implementation of a fee counsel would not only ease the pressure on the judiciary, but would also speed the approval of settlements because the fee counsel's calculation would occur at the same time as the judge's review of the merits of the settlement. Additionally, plaintiffs' counsel may be more likely to present a balanced, well-documented fee application knowing that this separate inquiry would transpire.

V. Conclusion

To ensure that the class action mechanism remains an effective means of free and equal access to the courts, greater scrutiny must be paid to fee awards, especially now as the stakes have risen for all system participants. While the rules of the game have evolved to give more authority to courts to prevent other abuses, insufficient attention has been given to the problem of excessive attorneys' fees in common fund settlements. The use of fee counsel as described above can go some way toward closing this expanding loophole. Judicial review would be fortified, attorneys' fees would be reined in, and the settlement process would be more equitable for the class.

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Footnotes

[1] Public Law 109-2, 119 Stat. 4 (2005) (codified at 28 U.S.C. § 1712(a) (2005)).

[2] Under the "common fund doctrine," a party that secured "a fund for the benefit of others, in addition to himself, may recover his costs, including his attorney's fees, from the fund itself or directly from the other parties enjoying the benefit." Savoie v. Merchants Bank, 84 F.3d 52, 56 (2d Cir. 1996).

[3] *See, e.g.*, Saylor v. Lindsley, 456 F.2d 896, 900 (2d Cir. 1972) ("[N]amed plaintiffs are essentially figureheads, merely the 'key to the courthouse door,'. . .who play no real role in directing the litigation.").

[4] Krell v. Prudential Ins. Co. of Am.(*In re* Prudential Ins. Co. Am. Sales Practice Litig. Agent Actions), 148 F.3d 283, 333 (3d Cir. 1998) (noting that a "thorough judicial review of fee applications is required for all class action settlements.").

[5] 28 U.S.C. § 1712 (a) (2005).

[6] *In re* GMC Pick-Up Truck Fuel Tank Prods. Liab. Litig., 55 F.3d 768, 819 (3d Cir.1995).

[7] Reynolds v Beneficial Nat'l Bank, 288 F.3d 277, 279 (7th Cir 2002).

[8] *In re* Agent Orange Prod. Liab. Litig., 818 F.2d 216, 224 (2d Cir. 1987) ("The test to be applied is whether, at the time a fee sharing agreement is reached, class counsel are placed in a position that might endanger the fair representation of their clients and whether they will be compensated on some basis other than for legal services performed.").

[9] Weinberger v. Great Northern Nekoosa Corp., 925 F.2d 518, 524 (1st Cir. 1991).

[10] Malchman v. Davis, 761 F.2d 893, 908 (2d Cir. 1985) (Newman, J., concurring); *see also, e.g.*, Weinberger v. Great N. Nekoosa Corp., 925 F.2d 518, 524-25 (1st Cir. 1991) (citing the Newman concurrence in *Malchman* and concluding that "heightened judicial oversight of this type of agreement [is] highly desirable"); *In re* Skinner Group, Inc., 206 B.R. 252, 262 n.14 (N.D. Ga. 1997) (citing Newman concurrence and observing that "inclusion of such a 'clear sailing' provision. . .merely justifies the Court's application of heightened scrutiny when evaluating the class counsel's ultimate fee request; it should not be read as an independent ground for withholding approval of the entire settlement"); Levit v. Filmways, Inc., 620 F. Supp. 421, 423-24 (D. Del. 1985) (acknowledging the "inherent dangers" of a clear sailing clause and quoting extensively from Newman concurrence).

[11] *See, e.g.*, *Levit*, 620 F. Supp. at 427; Duhaime v. John Hancock Mut. Life Ins., 989 F Supp. 375, 379-80 (D. Mass 1997).

[12] *In re* Cendant Corp. Prides Litig., 243 F. 3d 722, 727 (3d Cir. 2001).

[13] *Id.* at 735.

[14] *See, e.g.*, Miles Moore, *BFS Settles Nationwide Class Action Suit; Tire Maker to Modify Certain Models, Launch Education Program,* Rubber & Plastics News, Aug. 4, 2003 (citing the proposed settlement in *Shields v. Bridgestone/Firestone Inc.*, No. E-0167637, 2003 WL 22319083 (Tex. Dist. Ct. July 24, 2003), in which the court was presented a settlement in which members of the class received nothing and the lawyers would be awarded $19 million); Edward D. Murphy, *et al.*, *Conflict and Change; Maine's Employment and Price Levels Remained Stable Last Year, but its Economy Experienced Plenty of Turmoil*, Portland Press Herald, Jan, 4, 2004 (citing the settlement in *Ramsey v. Nestle Waters N. Am., Inc.*, No. 03 CHK 817 (Ill. Cir. Ct. 2003), in which customers received discounts or free water for 5 years while class counsel received $1.35 million in fees.).

[15] *In re* Warner Communications Sec. Litig., 618 F. Supp. 735, 740 (S.D.N.Y. 1985).

[16] *See, e.g.*, Alleghany Corp. v. Kirby, 333 F.2d 327, 347 (2d Cir. 1964) (Friendly, J. dissenting) (noting "[o]nce a settlement is agreed, the attorneys for the plaintiff. . .link[s] arms with their former adversaries to defend the joint handiwork'), *aff'd en banc by an equally divided court*, 340 F.2d 311 (2d Cir. 1965); Kamilewicz v. Bank of Boston Corp., 100 F.3d 1348, 1352 (7th Cir. 1996) (Easterbrook, J., dissenting) (parties "may even put one over on the court, in a staged performance"). Scholars warn that the interests of attorneys putatively on opposite sides of the case may become so closely aligned following settlement that there is a significant danger of collusion.

[17] Kamilewicz v. Bank of Boston Corp., 100 F 3d 1348, 1352 (7th Cir. 1996).

[18] *In re* Cendant Corp. Litig., 182 F.R.D. 144, 150 (D.N.J. 1998).

[19] Gunter v. Ridgewood Energy Corp., 223 F.3d 190, 201, (3d Cir. 2000) (emphasis added).

[20] Shaw v. Toshiba Am. Info. Sys., Inc., 91 F. Supp. 2d 942, 974 (E.D. Tex. 2000).

[21] French v. Selden, 59 F. Supp. 2d 1152, 1160 (D. Kan. 1999).

[22] 248 F.3d 698, 704 (7th Cir. 2001).

[23] Christopher R. Leslie, *A Market-Based Approach to Coupon Settlements in Antitrust and Consumer Class Action Litigation*, 49 UCLA L. Rev. 991, 1047, n 293 (2002) (noting that too many cooks spoil the broth, and adding more attorneys depletes the settlement pool).

[24] Richard B. Schmitt, *Legal Beat: Objecting to Class Action Pacts Can Be Lucrative for Attorneys*, Wall St. J, Jan 10, 1997, at B1 (quoting Professor Susan Koniak who refers to objector participation as an extortion game).

[25] *See, e.g.*, Admin. Office of U.S. Courts, Civil Rules Advisory Committee Report 233 (quoting Professor Charles Silver).

[26] *Court Clears Accord in Louisiana-Pacific Class Action Lawsuit*, Wall St. J., Apr. 23, 1996, at A4.

[27] *Id.*

[28] *See* Schmitt, *supra* note 24 (quoting United States District Judge Robert E. Jones).

[29] Fed. Jud. Center, Empirical Study of Class Actions in Four Federal District Courts: Final Report to the Advisory Committee on Civil Rules 58 (1996).

[30] Fed. R. Civ. P. 53 (d)(3); Fed. R. Civ. P. 54 (d)(2)(D).

[31] Fed. R. Civ. P. 23(h)(4).

[32] Manual for Complex Litigation (Fourth) § 14.231 at p. 207 (2004).

[33] *See, e.g.*, Danville Tobacco Ass'n v. Bryant-Buckner Assoc., 333 F.2d 202, 208 (4th Cir. 1964) (stating that the term "'Master' was a misnomer. In truth [the appointee] did not serve as a master. . . . [T]he Court chose him as an expert for its guidance."); Scott v. Spanjer Bros., Inc., 298 F.2d 928, 930 (2d Cir. 1962) ("Appellate courts no longer question the inherent power of a trial court to appoint an expert under proper circumstances, to aid it in the just disposition of a case." (citing *Ex parte Peterson*, 253 U.S. 300 (1920))).

[34] *In re* Cont'l Ill. Sec. Litig., 962 F.2d 566, 573 (7th Cir. 1992).

[35] ABA Task Force on Contingent Fees, Report on Contingent Fees in Class Action Litigation 31 (Jan. 11, 2006).

[36] *Id.* at. 32.

[37] *In re* Rite Aid Corp. Sec. Litig., 396 F.3d 294, 302 (3d Cir. 2005).

[38] *See, e.g.*, *Gunter*, 223 F. 3d at 195 n.1.