Professional Responsibility & Legal Education

Attorneys' Fees in Class Actions: The Problem Remains

*By Jack Park**

In 2005, as a member of a plaintiff class in a securities lawsuit, I objected to the attorneys' fee component of a proposed settlement. Over my objection, the court approved a settlement that resulted in a class counsel's recovery of a contingency fee of 25% (plus expenses) from a settlement fund of $80 million—a figure that represented a multiplier of 4.7 on the "lodestar" figure derived by multiplying the hours worked by the typical fee. Put differently, class counsel would have had to have worked far more hours at their regular billing rate to receive that amount in fees.

Notwithstanding my lack of success, I think it worthwhile to reflect on this experience for two reasons. First, the attorneys' fee component of class action settlements has been the subject of substantial debate in recent years. One question that has been discussed is whether attorney fee awards are increasing. Secondarily, the debate continues because Congress did not address attorney fees to any substantial extent in the Class Action Fairness Act of 2005.[1]

In this article, I will use my experience to describe the practice of attorney fee litigation in the class action context. Without suggesting that it is typical, I will discuss my experience as an objector, first setting out the ethical background for determining the reasonableness of an attorney's fee. Then, I will describe the Xcel litigation and the district court's consideration of the claim for attorney fees and expenses. Finally, I will try to put my experience and this lawsuit into the broader context. In my judgment, it is only by objecting that unnamed class members can bring their interests before the courts, and they should pursue this avenue.

The Ethical Background

This discussion, like any discussion of attorneys' fees, takes place against the backdrop of the rules of legal ethics. Rule 1.5 of the ABA Model Rules of Professional Conduct requires that the fees and expenses charged by an attorney not be "unreasonable."[2] Rule 1.5 further provides:

> The factors to be considered in determining the reasonableness of a fee include the following:
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> (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
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> (2) the likelihood, if apparent to the client, that acceptance of the particular employment will preclude other employment by the lawyer;
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> (3) the fee customarily charged in the locality for similar legal services;
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> (4) the amount involved and the results obtained;
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> (5) the time limitations imposed by the client or the circumstances;
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> (6) the nature and length of the professional relationship with the client;
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> (7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and
>
> (8) whether the fee is fixed or contingent.[3]

In that regard, Rule 1.5 permits the use of contingent fees where they are not otherwise prohibited, and likewise requires that they be reasonable.[4]

These ethical rules prompt several observations. Ultimately, the Rule 1.5 factors should not be considered in a vacuum, but, rather, as they play out in the market.

First, an attorney's hourly billing rate presumptively reflects that lawyer's skill and experience as measured by the applicable market.[5] To the extent that skill and experience may be subsequently taken into account in leveraging an enhanced fee, either directly or by pointing to results, a measure of double-counting would appear to be going on.[6] We should expect a lawyer who bills at a higher hourly rate to achieve good results, and paying that lawyer at those rates goes a long way toward compensating that lawyer adequately. Likewise, even when engaging in discovery and preparing dispositive motions in a particular case is "particularly time-consuming or demanding... that fact would be captured in the number of hours expended on the litigation, and the plaintiffs' counsel would be compensated accordingly in any fee award."[7]

Second, Rule 1.5's focus on the client's perception that his case may preclude other employment by the lawyer is incomplete, because the lawyer is a party to that transaction. Even though some cases may consume a disproportionate amount of time or effort, the lawyer should be in a better position than the prospective client to anticipate them. In lawyer-driven litigation like securities, redistricting, and institutional reform litigation, the lawyer who does not expect to do a large amount of work is likely inexperienced. Rather than looking at the client's perception of the preclusive effect of a proposed lawsuit, the reasonable expectations of an experienced lawyer should be imputed to the lawyer.

Third, law firms that take on a portfolio of clients and matters spread the risk that any attorney will take on litigation that consumes a disproportionate of time and other resources.[8] Those law firms, and lawyers generally, know how to turn down business that does not offer a reasonable likelihood of success and remuneration.[9]

The Xcel Litigation

By notice dated January 14, 2005, I was advised of the proposed settlement of class actions involving claims made on behalf of the purchasers of the common stock of Xcel Energy, Inc., between January 31, 2001 and July 25, 2002.

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Xcel Energy is a public utilities holding company that, through its subsidiaries, was serving electrical and natural gas retail customers in twelve western and midwestern states. I was a member of the class because I had purchased shares of one of Xcel Energy's predecessors and had participated in the dividend reinvestment program. No doubt notice of the class action had been published somewhere (in a publication I do not read), notice of the settlement was published too (again, in publications I do not read), and the litigation was discussed in Xcel's annual reports, but the notice of January 14, 2005 was the first notice I received of the lawsuit and my plaintiff status.

Xcel Energy's difficulties arose from its NRG subsidiary, which had been created in 1989 to tap into the domestic and international market for independent power production. NRG bought, built, and operated power plants, funding its operations with debt that was paid from the proceeds of sales of power in the competitive wholesale market. Before 2002, NRG's operations were sufficiently profitable that Xcel sold some 26% of the stock to the public.[10] Market conditions changed in 2001, however, and, as the prices for independently generated power fell, NRG had trouble handling its debt load. In December 2001, Moody's placed NRG's credit rating, then investment grade, on review for potential downgrading.[11] The problem was that, if NRG were downgraded, it would have to post cash collateral that it did not have, and, if it did not post the collateral, it would be in default. The district court observed: "As NRG's liquidity problems worsened, the market began showing signs of reduced confidence in the IPP [Independent Power Producer] sector as a whole."[12]

Xcel took steps to assist NRG, including committing additional capital and purchasing the public shares of NRG to bring it back in house. NRG's problems continued, however, and Xcel was dragged down with it. At the beginning of the class action period, Xcel's stock sold for $25.47 per share, and, as of June 3, 2002, it sold for $21.20.[13] By July 1, 2002, Xcel's stock was selling for $15.93 a share, and it was still $15.00 per share at the close of business on July 15.[14] Finally, the problem became public. On July 25, 2002, Xcel Energy revealed that its credit facilities contained a cross-default provision, such that, if NRG defaulted, Xcel would be called on to cure that default and might, in turn, be in default on its covenants with its lenders. Put differently, NRG's problems threatened to drag Xcel down too.

Xcel held a conference call with analysts the next day. The price per share declined from its July 25 close of $11.94 to $7.55 on July 26, and to $5.66 the following day, before rebounding. Ultimately, the uncertainty was cleared up, but not without cost, after Xcel severed its relationship with NRG and negotiated a release of the cross-default provision in exchange for concessions that increased its cost of borrowing and limited its access to credit funds. In addition, Xcel cut its dividend in half.[15]

The first lawsuit alleging violations of the Securities Exchange Act of 1934 and SEC Rule 10b-5 was filed on July 31, 2002. That lawsuit named Xcel and its former president and CEO, its CFO, and the former Chair of its Board as defendants. The plaintiffs alleged that the defendants made false and misleading statements relating to the relationship between Xcel and NRG and the effect of NRG's problems on Xcel. In short order, thirteen more securities actions were filed, as well as an action on behalf of holders of NRG Senior Notes, a shareholder derivative action, and two ERISA lawsuits. After the lawsuits were consolidated and class representatives appointed, the defendants moved to dismiss the complaint. The district court granted that motion in part and denied it in part.[16] After reviewing the documents produced by the defendants and engaging in mediation, but before any depositions were taken, the parties reached a settlement under which the defendants would pay $80 million to the securities plaintiff class and $8 million to the ERISA plaintiff class. Class counsel for each of those classes would receive 25% of the fund plus expenses.

I joined six other individuals and entities in objecting to the proposed settlement. In my letter, dated March 17, 2005, I noted that, as of then, securities class counsel had not filed a fee application. They did so on or about March 21, 2005. In addition, I objected to the anticipated hourly rate, noting that a lawyer who billed at $1,000 an hour would have to bill 20,000 hours to produce a bill of $20 million. I noted that counsel for plaintiffs in civil rights cases in Alabama customarily identified an hourly rate of $300 or less. I also objected to the use of a multiplier that would be used to back into the requested award; I anticipated that counsel would calculate the lodestar, determine what multiplier was needed to turn the lodestar into the award, then defend the multiplier. I further recommended that the court cut the contingency fee in half, to 12 ½%, which would result in an award of $10 million plus expenses. Again, because I filed my objection before class counsel filed their fee application, my objections were necessarily general.

In their fee application, class counsel for the Xcel securities plaintiff class reported spending some 10,400 hours of time on the case. When multiplied by hourly rates ranging between $250 and $650 for lawyers and $60 and $195 for paralegal time, the resulting lodestar figure was $4,255,949.[17] A multiplier of 4.7 was required to turn that figure into $20 million. Class counsel contended that the results they achieved and the difficulty of the case justified the multiplier. They also showed that, by reference to the results in other class action settlements, neither the 25% contingency nor the 4.7 multiplier was remarkable.

The district court overruled the objections and awarded the requested fees and expenses to counsel for the securities and the ERISA plaintiff classes.[18] The court reasoned that the contingency of 25% comports with awards in similar cases, courts in other securities cases had approved multipliers in excess of four, and the 25% contingency was not unreasonable when cross-checked against the lodestar figure and the multiplier. With respect to the last, the cross-checking, the Eighth Circuit merely uses the lodestar to cross-check the contingency.[19]

Attorneys' Fees in Class Actions

This experience, typical or not, prompts consideration of several of the common criticisms of class action practice. In particular, it raises questions about the attorney-client relationship and the reasonableness of the attorney fee award. There has been a debate about whether such awards are rising, but the real question may be whether anything limits them. And, whether there are limits or not, how should class members respond to notices of settlement?

Bill Lerach, one of the more prominent class counsel, has famously said, "I have the greatest practice in the world because I have no clients. I bring the case. I hire the client. I do not have some client telling me what to do. I decide what to do."[20] As a general matter, the rules of legal ethics leave tactical decisions to the lawyer. So, in theory at least, the lawyer has plenty of latitude. Even so, those pesky clients have a say in the formation of the relationship and need to be kept informed, and some clients are peskier than others. And, whether clients are pesky or not, class counsel cannot completely dispense with them.[21] In a class action, class counsel form a relationship with a class representative, and those class representatives, deemed capable of adequately representing the unnamed class members, make the strategic decisions.[22]

In a 2003 Working Paper, Theodore Eisenberg and Geoffrey Miller suggested that, notwithstanding claims to the contrary, attorney fee awards in class actions were not increasing.[23] In a 2004 program at the American Enterprise Institute, the participants, including Eisenberg, discussed possible limitations in the data, noting an apparent absence of cases from state courts and so-called "magnet" jurisdictions.[24] Paul Rubin, from Emory University, further suggested that the maximum of the range would become the mean, something that might be bearing out in practice.[25] In Xcel, for example, class counsel justified their 25% contingency by pointing to, among other things, the Third Circuit's reliance on a declaration by John Coffee, from Columbia Law School, suggesting that the average recovery in securities actions involving settlements greater than $10 million was 31%, and percentage recoveries between 25% and 30% were "fairly standard" in cases involving settlements between $100 and $200 million.[26] Class counsel also pointed to awards in other cases that purported to show that their 25% contingency and the resulting multiplier of 4.7 were not out-of-line. With the district court's ruling upholding that multiplier, these and other class counsel can point to it to justify their own multipliers in future cases.

Arguments like this are flawed because they do not represent the operations of the market for attorney services. Instead, they represent the actions of courts justifying awards to counsel, which are akin to the creation of hot-house flowers. The Eleventh Circuit has criticized this approach, observing, "Prior awards are not direct evidence of market behavior; the court is not a legal souk."[27] It also explained that, while there was some "inferential evidentiary value" to prior awards, giving them controlling weight over evidence of a lawyer's actual billing rates and practices "equates to [improperly] giving the prior awards issue-preclusive value against a party whose interests were not even arguably represented in the prior litigation."[28]

If awards are not increasing, it is not clear what restrains them. Certainly, the process does not. Class counsel and class representatives have an incentive to settle cases when the reward in hand exceeds the likely results down the road. Defendants have little incentive to object; they want to bind as many potential plaintiffs as possible and, having negotiated the settlement, have little incentive to upset any part of it.[29] And, courts have an incentive to dispose of cases.[30] None of these actors behaves irrationally when acting in this fashion. But, where does that leave the unnamed class members? They can object, but the plaintiffs' counsel want their money; the defendants want their deal and may have conveyed their silence; and the courts want the cases gone.

Objections are not easy. In my case, the hearing was in Minneapolis. The district court graciously allowed me to participate by telephone. But my anticipated recovery was tiny, and, more importantly, the process is skewed. My objection had to be postmarked before class counsel submitted their fee application. As a result, my objections were general, and, to the extent I objected to the fact that no fee application was filed, moot by the time of the hearing. I understand that, in their fee applications, counsel want to take objections into account, but that is not entirely fair to prospective objectors. The fee application should be filed before objections are due, and class counsel can address them at the hearing. Finally, objectors find themselves lonely because few class members will join them. As class counsel would have it, that reflects satisfaction with the deal, but I believe a measure of rational ignorance is at work. If class members see that they are getting something for nothing, and the process for objecting is not friendly to them, they will have little incentive to object.

In my judgment, lawyers who are members of plaintiff classes should consider objecting to awards that appear excessive. Lawyers have the experience to judge whether a requested award appears related to the recovery. So do institutional investors, several of whom objected to the attorney fee request in Xcel. Those institutional investors need to speak up and to choose their sides. In Xcel, several submitted written objections but none participated at the hearing. Furthermore, those institutional investors are frequently active plaintiffs, a fact which compromises their objections because they hire some of the class counsel who appear frequently. Still, lawyers and institutional investors have the ability to articulate serious objections.

Objecting may look like a futile act, but it is the only game in town. And it is the only way to be heard. Likewise, it is the only way of forcing the courts to carry out their responsibility to scrutinize proposed class action settlements.[31] By becoming the squeaky wheel, objectors may help to put limits on the operations of a class action system that needs them to further interests that are not theirs.

Endnotes

1 Pub. L. 109-2, § 2, Feb. 18, 2005, 119 STAT. 4. As codified, CAFA limits attorneys fees only with respect to settlements in which the class members receive coupons. 28 U.S.C. 1712. In such cases, CAFA links the recovery of attorneys fees to the value of the coupons redeemed. 28 U.S.C. 1712(a). When coupons are not redeemed, the award "shall be based upon the amount of time class counsel reasonably expended working on the action." 28 U.S.C. 1712(b)(1). "Nothing in this subsection shall be construed to prohibit application of a lodestar with a multiplier method of determining attorney's fees." 28 U.S.C. 1712(b)(2).

2 Rule 1.5(a)

3 *Id.*

4 Rule 1.5(c)

5 Comment 3.

6 *See* Ron Rotunda & John Dzienkowski, Legal Ethics: The Lawyer's

Deskbook on Professional Responsibility (2005), § 1.5-1(h), at 143 ("The lawyer may also consider his own experience, reputation, and ability. Lawyers who are twice as good as other lawyers are justified in charging twice as much as the other lawyers charge. A client can always conclude that the lawyer is not twice as good, and that client can go elsewhere for legal services.") Thus, we should expect better results from the lawyer or firm that charges a higher fee.

7 Healey v. Leavitt, 485 F. 3d 63, 69 (2d Cir. 2007).

8 A firm's compensation policy may discourage its lawyers from taking on time-consuming litigation predicated on the recovery of fees and expenses from the defendant or a common fund under a fee-shifting statute or legal doctrine.

9 Elihu Root famously observed that "about half the practice of the decent lawyer consists in telling would-be clients that they are damned fools and should stop." That observation reinforces the notion that the lawyer's expectations should be considered when evaluating of the reasonableness of a fee.

10 In its 2000 Annual Report, Xcel stated that, in 2000, its 82% share of NRG contributed $0.46 per share to Xcel's earnings, up from $0.17 on a 100% share in 1999, and that it planned to offer more of NRG's shares to the public. The 2000 results were, in part, attributable to favorable conditions in the wholesale power market, but Xcel expected that NRG would produce almost 25% of its earnings in 2001. 2000 Annual Report of Xcel Energy, in author's possession. A second public offering was made in 2001.In the 2001 Annual Report, Xcel stated that, as of December 31, 2001, it owned 74% of NRG. 2001 Annual Report of Xcel Energy, at 18, in author's possession.

11 At that time, NRG was rated BAA with Moody's and BBB with S & P. Investments bearing those ratings are generally medium-risk, investment-grade securities, but downgrading them would put them in junk status. *See* "What is a Corporate Credit Rating," *at* www.investopedia.com/articles/03.102203.asp (last viewed August 1, 2007).

12 *In re Xcel Energy, Inc., Sec., Derivative, & ERISA Litig.*, 286 F. Supp. 2d 1047, 1051 (D. Minn. 2003).

13 Historical pricing data available on <www.bigcharts.com> (last viewed May 7, 2007).

14 *Id.*

15 Ultimately, on May 14, 2003, NRG filed a voluntary Chapter 11 bankruptcy petition. NRG emerged from bankruptcy, as one might expect for a company with power and cash generating facilities that were overburdened with debt, in December 2003. As part of NRG's reorganization, Xcel relinquished its interest in NRG and paid an additional $752 million in exchange for a complete release from NRG and its creditors. 2004 Annual Report of Xcel Energy, at Note 4 to Consolidated Statement, in author's possession.

16 The district court denied the motion to dismiss the securities actions and dismissed the claims of the noteholders. *In re Xcel Energy, Inc. Securities, Derivative, and ERISA Litig.*, 286 F. Supp. 2d 1047 (D. Minn. 2003). The district court also dismissed the shareholder derivative action. *In re Xcel Energy, Inc.*, 222 F. R. D. 603 (D. Minn. 2004). Finally, it dismissed the ERISA claims in part. *In re Xcel Energy, Inc.*, 312 F. Supp. 2d 1165 (D. Minn. 2004).

17 The lodestar figure for the ERISA class counsel, who wanted an award of $8 million, was $867,611.75 with a multiplier of 2.16 required to turn it into $8 million.

18 *In re Xcel Energy*, 364 F. Supp. 2d 980 (D. Minn. 2005). The district court also awarded a small amount to the counsel for the derivatives plaintiff class, which had reached a settlement while their appeal from the dismissal of their claims was pending in the Eighth Circuit.

19 *See* Petrovic v. Amoco Oil Co., 200 F. 3d 1140, 1157 (8th Cir. 1999).

20 *See In re Network Associates, Inc., Sec. Litig.*, 76 F. Supp. 2d 1017, 1032 (N.D. Cal. 1999) (quoting Attorney William S. Lerach).

21 In *Roe v. Alabama*, a case involving the counting of absentee ballots in the 1994 election for Chief Justice of the Supreme Court of Alabama, one of the class representatives died in December 1994. Counsel soldiered on, without discovering the death of their client until August 1995.

22 Federal Rule of Civil Procedure 23(a) provides that, among other things, the class representatives must have claims that are typical of those of the unnamed class members, present questions of fact and law that are common to those of the rest of the class, and have no conflicting interests. In 2005, one serial plaintiff for a prominent securities class action plaintiffs' firm was indicted and accused of receiving more than $2.4 million for serving as the plaintiff in more than 50 securities class action lawsuits, and, in early 2006, another serial client of the same law firm admitted that he or members of his family were paid more than $2.4 million to act as plaintiffs. Payments like those alleged, which would not be shared with the unnamed class members, would align the lead plaintiffs' interests with those of class counsel rather than those of the class. *See generally* Margaret Little, *The Milberg Weiss Indictment*, Class Action Watch 3 (March 2007).

23 Theodore Eisenberg & Geoffrey Miller, Attorneys Fees in Class Action Settlements: An Empirical Study, New York University Center for Law an Business, Working Paper #CLB 03-23.

24 Have Attorney's Fees Risen in Class Action Settlements?, unedited transcript of program at American Enterprise Institute, February 20, 2004, *available at* www.aei.org/events/filter.all,eventID.753?transcript.asp (last viewed May 10, 2007).

25 *Id.* at 6.

26 Joint Declaration of Jack L. Chestnut and Sherrie R. Savett in Support of the Motion for FinalApproval of the Settlement and the Motion for Attorney Fees, Reimbursement of Expenses , and an Award to Lead Plaintiffs, at 69-70 (citing *In re Rite-Aid Corp. Sec. Litig.*, 396 F. 3d 294, 298, 303 (3d Cir. 2005). More recently, in *Vaughn v. American Honda Motor Co.*, No. 2-04CV-142 (TJW), in the United States District Court for the Eastern District of Texas, Marshall Division, a claim arising from alleged problems with the odometer on Honda vehicles that resulted in a small but improperly fast recording of mileage , class counsel submitted a declaration by Professor Charles Silver of the University of Texas School of Law, in which Professor Silver incorporated information about the sizes of multipliers employed that he received from Professor Eisenberg. *See* Plaintiffs' Application for Award of Attorneys Fees & Reimbursement of Expenses (No. 158) at Exhibit A, at 6-9.

27 Dillard v. City of Greensboro, 213 F. 3d 1347, 1355 (11th Cir. 2000).

28 *Id.* and 1355 n. 8.

29 In *Xcel*, counsel for the defendants agreed not to contest the fee application. Such "clear sailing" agreements are not illegal. *See, e.g.,* Waters v. Intern. Precious Metals Corp., 190 F. 3d 1291, 1293 n. 4 (11th Cir. 1999). As the court explained, such agreements give defendants a "more definite idea" of their total exposure. *Id.*, at 1292 n. 2 (citing Weinberger v. Great N. Nekoosa Corp., 925 F. 2d 518, 520 n.1 (1st Cir. 1991)). Such agreements, though, shift the burden to the court and to unnamed class members.

30 *Cf.* Alexander Tabarrok & Eric Helland, Two Cheers for Contingent Fees, 39, n. 44 (AEI Press 2005) ("Recent work by Helland and Klick has suggested that judges prove to be ineffective protectors of the plaintiff class, placing their own desire to clear the court's docket of the case before the interests of the nominal plaintiffs.") (citing Helland & Klick, "The Effect of Judicial Expediency on Attorney Fees in Class Actions" (FSU College of Law Research Paper No. 138, FSU College of Law, Law and Economics Paper No. 05-07)).

31 *Cf.* Reynolds v. Beneficial National Bank, 207 F. 3d 277, 279 (7th Cir. 2002) (The district court has a "judicial duty to protect the members of a class in class action litigation from lawyers for the class who may, in derogation of their professional and fiduciary obligations, place their pecuniary self-interest ahead of that of the class. This problem... requires district judges to exercise the highest degree of vigilance in scrutinizing proposed settlements of class actions.")