The Expert's Corner

The "Lodestar Percentage:" A New Concept For Fee Decisions?

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If you remember the size of the Tyco International mess – CEO L. Dennis Kozlowski had Tyco buy him an $18 million Fifth Avenue apartment, then spent another $5 million of shareholder money fixing it up by purchasing, for example, a $6,000 shower curtain – you won't be terribly shocked to hear that the fiasco gave rise to a securities class action that recently settled for $3.2 billion.[1] The court reports that this is the "largest cash payment ever made by a corporate defendant in the history of securities litigation" and "the second-largest auditor settlement in securities class action history." How much would you pay the attorneys who achieved such a settlement for the shareholders? A federal judge in New Hampshire approved a fee, including expenses, amounting to a grand total of . . . nearly $500 million. As I'm sure I've said before in these pages and doubtless will again: good work if you can get it. So good, in fact, that the court never actually came out and named the total it was awarding, preferring instead to reference it as a 14.5% fee (repeat after me: "four hundred and sixty four million dollars") and $29 million in expenses.

To be fair to class counsel, even if it is $464 million,[2] the attorney fee still amounts to but 14.5% percent of the fund, is supported by a lodestar cross-check embodying a multiplier of 2.697 (why not just call it 2.7?), and was recommended by two retired federal judges retained by lead counsel for that purpose.[3] The lodestar embodies about 500,000 $350 hours. That sounds like a lot of hours: for instance, if a hard-working associate logs 2,000 hours a year, that's 250 lawyer years. The Tyco case unfolded over a six year period, so that's about 40 lawyers working full-time on the case for those six years. Sounds high, until you hear the court's description of the magnitude of the case: "Co-Lead Counsel propounded over 700 requests for admission, documents requests, and interrogatories; participated in over 220 depositions in New York, Florida, Massachusetts, and New Hampshire; and reviewed some 82.5 million pages of documents produced by defendants." Given this scope, my quick back of the envelope analysis suggests a justifiable lodestar.

Of course, class counsel's fee request was based on the percentage method and counsel argued that both the percentage (14.5%) and the multiplier (2.69) were reasonable and consistent with acceptable fee awards in similar mega-fund cases. To support that conclusion, class counsel submitted a list of mega-fund securities cases to the courts (funds with more than $400 million) showing that counsel's fee in those cases ranged from 1.73-21.4%, with six cases above the requested 14.5% and 10 cases below it, hence putting the percentage here somewhere near the middle. Similarly, the court's decision encompasses a table showing multipliers in 12 other mega-fund securities cases ranging from 2.59 to 6.875, putting the multiplier here at the very low end of the range.

Notwithstanding its apparent reasonableness – and likely because of the whopping size of the nearly $500 million award – the fee attracted objectors, most significantly the Commonwealth of Pennsylvania State Employees' Retirement

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1 *See In re Tyco International Ltd.,* 2007 WL 4462593 (D. N.H., Dec. 19, 2007). This decision approved settlement with Tyco ($2.975 billion) and its auditor, PriceWaterhouseCoopers ($225 million). Claims against three individual defendants are transferred by the settlement to Tyco, with 50% of any net recovery from those individuals returning to this settlement fund.

2 The Final Order indicates that fees will be calculated as 14.5% of the net settlement fund, after deducting expenses. So, the actual fee will be a bit less than $464 million.

3 The judges were Abner Mikva, the retired Chief Judge of the D.C. Circuit, former White House Counsel, and Member of Congress; and Alfred M. Wolin, a retired federal district court judge from New Jersey. The process by which Lead Counsel retain retired judges to recommend a fee level seems novel (the judge called it "unique"). It also seems smart: the federal judge overseeing the settlement remarked that class counsel had not "unilaterally selected" the 14.5% figure, suggesting that the judge-selected fee level was more legitimate (even if the judges were surely paid well by counsel for their service).

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System and Public School Employees' Retirement System ("SERS/PSERS") and U.S. Trust.[4] The objectors' central argument was that the fee award should be compared not to mega-fund cases (over $400 million), but rather to "super mega-fund" cases – namely those with settlements exceeding $1 billion. Their argument rested upon the contention that in super mega-fund cases, "the size of the recovery is explained more by the size of the class than the work expended by counsel." Whether mega-fund or super mega-fund cases would be the comparative group mattered because in the six super mega-fund cases proposed as comparisons, counsel fees ranged from 1.73%-12%, with four of the six fees being less than 6% and only one being over 10%. By this standard, class counsel's 14.5% no longer was in a mid-range but all of a sudden was an outlier.

Judge Paul J. Barbadoro sided with class counsel, not the objectors, but he did not do so simply by saying that mega-funds, as opposed to super mega-funds, were the proper context. Rather, Judge Barbadoro acknowledged the power of the objectors' thesis – "that super mega-fund cases warrant lower percentage awards than smaller cases because they require proportionally less work" – noting that this "may well be true as a general matter." But, he concluded, that general proposition "does not hold in this case." How did he know that? Because, he opined, "the best measure of the effort required to produce a particular result in a given case is the lodestar." And, he continued, "[i]n this case, the lodestar *expressed as a percentage of the settlement amount,* is 5.38%." This figure, which Judge Barbadoro coined "the lodestar percentage," turned out to be "substantially higher [here] than the lodestar percentages for all but one of the super mega-fund cases." In other words, counsel worked a lot of hours to produce this fund, whereas counsel in the other super mega-fund cases worked fewer hours to produce those funds, so their "lodestar percentages" were lower. Judge Barbadoro demonstrated all of this graphically in a table and in a scatter plot with regression line, complete with a footnote defending the regression and its "Pearson's correlation coefficent." None of this appears to have sprung from either the parties' briefs or an expert witness. It seems to have emerged as an original contribution of the Honorable Paul J. Barbadoro, the holder of a Bachelor of *Arts* degree from Gettysburg College (1977).[5]

Which is not to suggest there is anything wrong with Judge Barbadoro's contribution. While lodestar-percentage appears to be a new idea –a Westlaw search came up with no hits for it – it is entirely defensible for one reason: it captures precisely the same concept that the multiplier would. Consider a $100 million fund with a fee request of $10 million, or 10%. If counsel worked a lot of hours to produce the $100 million fund, it won't need much of a multiplier to justify the $10 million fee; its multiplier will be lower than counsel that works fewer hours to produce the same $100 million fund yet asks for the same $10 million award. In other words, the lodestar percentage and multiplier vary indirectly: the more hours that are worked to produce a fund, the lower the multiplier and the higher the lodestar percentage; the fewer hours that are worked, the higher the multiplier and the lower the lodestar percentage. Judge Barbadoro could, therefore, simply have overruled the objections on the grounds that the multiplier counsel sought in *Tyco* was lower than the multiplier typically awarded in comparable super mega-fund cases, which it was.

Since the lodestar percentage is just the inverse of the multiplier, does it add anything to the literature to deploy it as a concept in fee cases? I would argue that it does not, but my argument is solely contextual. If we were at square one, we might invent either concept (multiplier or lodestar percentage) to use as a cross-check on the straight percentage method since they both do the same exact thing. The problem is, we're not at square one: courts have spent decades doing the lodestar cross-check by using a multiplier method. There are, therefore, several good arguments in favor of not retiring that approach in favor of Judge Barbadoro's lodestar percentage. One is inertia. A second is transaction costs – why re-educate judges and lawyers to employ this new concept when it is just another version of the one everyone already knows? Third, while there is not a wealth of empirical data on fees in class cases, what there is uses the accepted ideas of percentages, lodestars, and multipliers. Researchers or advocates would have to go back through all of that to re-calculate lodestar

4 Their objections were joined by the Public Employee Retirement System of Idaho and the West Virginia Management Board.

5 The Mikva/Wolin fee recommendation did contain this passage: "Collectively, Co-Lead Counsel and counsel in the Tyco Related Actions spent more than 488,000 hours on this litigation, resulting in an overall lodestar of $170,742,993.65. All indications are that this was time well spent. The lodestar is only 5.3% of the Settlement Fund." But this passing reference to the lodestar percentage contains none of the fancy analysis that Judge Barbadoro appears to have added on his own.

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percentages so as to develop acceptable ranges, etc. I applaud Judge Barbadoro for thinking hard about attorneys fees and I do not dissent from his outcome in the *Tyco* case. I just see little reason to re-invent a wheel that simply mimics the wheel that we have.

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A closing word about the *Tyco* case: Somewhat unrelated to the fees issue in this case is the manner in which it settled. One retired federal district court judge (Donald E. Zeigler, from my hometown of Pittsburgh) first presided over a failed mediation attempt. The parties then brought in another retired federal district court judge – Stanley Sporkin, from the District of Columbia – who had, before joining the bench, long been the Director of the SEC's Enforcement Division. Judge Sporkin's securities background surely gave him a leg up on the remarkably complex substantive issues in the case. But beyond that, Judge Sporkin invented his own mediation technique – he appointed high profile "advocates" for each side of the case and had them pitch their sides in multiple mediation sessions, "some lasting multiple days." Though Judge Sporkin's technique "did not immediately result in a settlement agreement," the court appears to credit it for, shortly thereafter, enabling the approved $2.975 billion cash settlement with Tyco to emerge, and thence an additional $225 million settlement (brokered by yet another retired federal judge, Nicholas Politan of New Jersey) with PriceWaterhouseCoopers. It is fair to say that this behemoth of a complex case might never have settled but for Judge Sporkin's inspired contributions.

I mentioned all of this for the simple purpose of making a shameless plug: I clerked for Judge Sporkin his first year on the bench (1986-1987), my first year out of law school. I therefore know first-hand how brilliant he is. I am certain that I learned more in one year in Judge Sporkin's chambers than I had in three years of law school; in fact, the proper comparison to my three years at Harvard Law School is probably one week in Judge Sporkin's chambers (and to think I was getting paid for that education rather than paying for it!). Judge Sporkin's genius is (at least) three-fold: first, his mind is like a laser beam that enables him to see through all of the underbrush and marginalia of any legal problem and cut, with amazing speed and precision, right to the heart of the matter. He could listen to lawyers argue for hours, head back seemingly half-asleep with boredom, then sit bolt upright and say, "So this case is about X," summarizing in one succinct sentence everything that the lawyers had needed hours to explain. Second, part of what enabled Judge Sporkin to accomplish this was his core concern for equity, not law: he let his instincts for right and wrong guide him, and once right was found, he imagined his task was to do it justice, not let it be smothered by legal technicalities. Third, Judge Sporkin married his razor sharp intellect and fairness radar with an uncanny understanding of human nature, one that enabled him to achieve often-miraculous compromises. I regularly witnessed cases in which the lawyers waltzed into chambers informing the Judge, "This case will <u>never</u> settle, your Honor," and then watched those same lawyers be ushered out a few short hours later carrying a signed agreement the Judge had penned on the back of an envelope.

To be sure, some of Judge Sporkin's settlement capabilities simply reflected the power he wielded as a judge, a power he was not hesitant to employ; but there are plenty of tough judges who produce scant results. What those who experienced Judge Sporkin as a bully missed was how carefully he assessed human negotiating situations, how much effort he put into structuring them properly, and how ego-less he was pursuing results. He didn't really care what the lawyers thought about him if he knew he got the job done and got it done fairly. Two examples: Judge Sporkin insisted principals be present at settlement negotiations, not just lawyers. His hunch was that the lawyers were more dogged than were the clients. He also insisted that money issues be put to one side and everything else settled first; his hunch was that if everything could be resolved, the money would follow. I never saw this method fail. Most settlers take precisely the opposite approach, wrongly assuming clients more dogged than their counsel, and errantly assuming that money is the heart of the dispute rather than realizing that it is often just a symbol of it. The *Tyco* settlement, as Judge Barbadoro explained, reflects a new method Judge Sporkin has developed for settling large complex class action lawsuits (and other complex matters). The *Tyco* decision identifies this method only in its skeletal form, as do I here. Yet knowing only that, I have not a moment's hesitation recommending Judge Sporkin to anyone, trying to settle anything.