

## The Expert's Corner

### WHY THE PERCENTAGE METHOD?

William B. Rubenstein\*

I am often asked, in my capacity as an expert witness in fee matters, to explain to courts why the percentage method is preferred to the lodestar. There is a plethora of writing on this subject in both the academic literature and case law, so I find it surprising that it is still something that lawyers feel that they need to explain to judges. But many judges come anew to class action law generally, and/or to fee matters specifically, and most of them have no particular prior exposure to this debate. I thought it might therefore be useful to publish a pared down version of the arguments in favor of the percentage method; what follows is taken from a declaration I recently filed in a fee case in California, though stripped of most of its footnotes and of the facts of the particular case. It nonetheless summarizes the best arguments for the percentage approach, while at the end noting some balancing thoughts. Most readers of this journal will be familiar with these arguments but might find the collection and presentation of them in this straightforward format useful in future cases.

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#### **FOUR ARGUMENTS IN FAVOR OF THE PERCENTAGE METHOD**

Courts employ one of two methods in arriving at fee awards in common fund class action cases – the lodestar method (which is essentially a variation on an hourly fee adjusted for the risk of the case) and the percentage method (which is essentially a variation on a contingent fee in that it awards counsel a fee in relation to the benefit achieved for the class). The percentage method is strongly preferred in common fund class actions. More than a quarter century ago, the United States Supreme Court described common fund cases as those in which “a reasonable fee is based on a percentage of the fund bestowed on the class.”<sup>1</sup> Thus, the Federal Judicial Center’s *MANUAL FOR COMPLEX LITIGATION, FOURTH* states that “After a period of experimentation with the lodestar method . . . the vast majority of courts of appeal now permit or direct district court to use the percentage-fee method in common fund cases.”<sup>2</sup>

Courts and commentators have identified a variety of reasons that the percentage method is favored over the lodestar method. Four of these – ease of administration, alignment of interests, efficiency, and encouragement of private policing – are particularly salient.

#### *Ease of Administration*

*The first reason* that the percentage method is favored over the lodestar method is ease of administration.

*The pain of the lodestar.* In applying the lodestar calculation, “petitioning attorneys must present detailed time records of the hours expended by each lawyer indicating the nature of the particular work done by each.”<sup>3</sup> The reviewing court must then scrutinize the hours spent on various tasks so as to

<sup>1</sup> *Blum v. Stenson*, 465 U.S. 866, 900 n.16 (1984).

<sup>2</sup> FEDERAL JUDICIAL CENTER, *MANUAL FOR COMPLEX LITIGATION, FOURTH* §14.121 at 187 (2004) (citations omitted).

<sup>3</sup> Charles Alan Wright, Arthur R. Miller, and Mary Kay Kane, *FEDERAL PRACTICE AND PROCEDURE: CIVIL* 3d §2675.1 (1998) (hereafter “*Federal Practice and Procedure*”).

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ensure that the work was necessary and the hours well-spent.<sup>4</sup> The court then takes the amount of time that counsel spent on the matter and multiplies that by an hourly fee rate, generally set as the “prevailing rates charged in the community for similar work.”<sup>5</sup> A leading procedural treatise explains that, “this calculation alone can result in a very detailed inquiry as it requires the court, particularly in complex, multiparty, national litigation, to determine hourly rates for lawyers with varying expertness, doing different work in different parts of the country.”<sup>6</sup> Once the hours are multiplied by the rate, a “lodestar” is established. If that were not complex enough, in common fund cases, the lodestar can then be adjusted either upward or downward (by a whole or fractional “multiplier”) based on a variety of other factors, including the risk counsel incurred, the skill they demonstrated litigating the case, and the quality of the results achieved. The lodestar method therefore requires a court to scrutinize the hours spent by counsel in achieving the result in the case so as to ensure that a proper number of hours were billed, to determine an appropriate billing rate, to multiply the hours by the rate to ascertain the “lodestar,” and then to determine whether this lodestar should be altered by a multiplier based on a variety of different factors and, if so, what multiplier is appropriate to the task.

*The pleasure of the percentage.* By contrast, the percentage method begins with a simple calculation: the size of the fund obtained for the class is simply multiplied by a commonly accepted percentage to set a benchmark fee for class counsel. While it is true that the court must ascertain the size of the fund and select a proper percentage, both of these calculations are generally far more straightforward than determining the right number of hours, proper billing rate, and appropriate

multiplier using the lodestar method.<sup>7</sup> The ease of administration of the percentage method saves valuable judicial resources, does not waste attorney or client time, and generally heeds the Supreme Court’s insistence that the “request for attorney’s fees . . . not result in a second major litigation.”<sup>8</sup>

### *Alignment of Interests*

*The second reason* that the percentage method is preferred to the lodestar method is that it generally aligns the interests of the attorneys with the interests of the class members represented by the attorney – in other words, it avoids a pitfall of the lodestar method which is that the hourly billing method exacerbates a conflict of interest that can arise between class counsel and the class they represent. To understand why, it is important to begin with the realization that class action litigation is distinct from normal client-driven litigation. In a typical client-controlled case, if the lawyer is pursuing ends that the client does not desire, or is dragging the case out beyond the client’s wishes, the client can simply fire her.

*The percentage method operates as an oversight mechanism monitoring class counsel in a way that the class members themselves cannot. In so doing, the percentage method serves the valuable function of ensuring that class counsel is pursuing the clients’ interests not their own.*

But a class action attorney is generally not monitored in the same way. While there might be a class representative whose job it is, in part, to oversee class counsel, typically the representative has a very small stake in the class case and thus scant incentive to spend time monitoring class counsel. Moreover, class actions are very complex and most lay clients will not have the expertise to oversee class counsel. Thus, class counsel is rarely constrained by the class representative

<sup>4</sup> As one federal judge explained:

When using the lodestar method, a judge must review the voluminous time records of a multitude of attorneys in order to determine the necessity and reasonableness of every hour expended. This inquiry is not only tedious and time consuming – it is also highly subjective, requiring that the judge second-guess the judgment of counsel as to whether a task was reasonably undertaken or the hours devoted to it were reasonably expended.

*In re Copley Pharmaceutical, Inc.*, 1 F.Supp.2d 1407, 1411 (D. Wyo. 1998).

<sup>5</sup> *Federal Practice and Procedure*, *supra* note 3, at §2675.1.

<sup>6</sup> *Id.*

<sup>7</sup> See *In re Copley Pharmaceutical*, 1 F.Supp.2d at 1411 (stating that “Simply put, it is much easier and far less demanding of scarce judicial resources to calculate a percentage of the fund fee than to review hourly billing practices over a long, complex litigation.”).

<sup>8</sup> *Hensley v. Eckerhart*, 461 U.S. 424, 437 (1983).

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in any significant way. That oversight will come primarily directly from the court overseeing the case and indirectly from the rules established to ensure that class counsel pursues the class's interests.

Fee rules provide the single most important incentive for class counsel. If class counsel's fee is set by an hourly rate, she has an incentive to run up as many hours as possible in the litigation so as to ensure a hefty fee, even if the additional hours are not serving the clients' interests in any way. With no real client oversight, moreover, class counsel can get away with this. The percentage method effectively shifts this incentive: under the percentage method, counsel has an interest in generating as large a recovery for the class as possible, as her fee increases with the class's take, while keeping her hours to the minimum necessary to do the job effectively. The percentage method operates as an oversight mechanism monitoring class counsel in a way that the class members themselves cannot. In so doing, the percentage method serves the valuable function of ensuring that class counsel is pursuing the clients' interests not their own.

### *Efficiency*

*The third reason* that the percentage method is favored follows from the second: because class counsel no longer has the incentive to run up hours so as to pad its fee request, the percentage method rewards efficiency. By contrast, according to a monograph published by the Federal Judicial Center, "if fees are based on the lodestar, plaintiff's counsel has no incentive to settle the case early – counsel continues to rack up fees by litigating the case."<sup>9</sup> By aligning class counsel's interests with those of the class, the percentage method has the salutary side effect of encouraging early settlements and hence of decreasing the social costs of litigation. This is important for a variety of reasons: it frees overburdened courts to turn substantive attention to other matters; it enables plaintiffs' attorneys to invest in a greater number of cases and thus to address greater instances of potential wrongdoing; and perhaps most importantly, it enables clients (both the plaintiff class and the defendant) to reach finality more expeditiously and hence turn their attention back to the substance of their pursuits.

### *Incentivizing Private Attorneys General*

*The fourth reason* that the percentage method is favored is that it is more likely to encourage class counsel to undertake class action lawsuits and thus furthers the important purposes served by class action attorneys, often called "private attorneys general." To see why, one must begin with the premise that most class action cases are for small amounts of money. Each individual client has been harmed a minute amount; no one client has enough at stake to pay a lawyer to file suit, and no lawyer will take a small claims case on a contingency basis since her recovery would be so small. Because small claim cases are generally not economically viable, they are often referred to as "negative value" cases. What that means is that a wrongdoer can reap significant benefits and escape any harm by causing small injuries to a large class of persons. The class is said to have a "collective action problem."

There are two common solutions to collective action problems. First, the government, funded by tax dollars, can pursue small-harm wrongdoers through criminal or civil litigation. However, the government is not well-funded to do so and, some argue, not well-situated to detect such harm. Thus second, because the government is unable itself to pursue all private wrong-doing, private lawyers must be incentivized to step in and pursue these important public policy ends. Private attorneys that pursue class action cases are referred to as "private attorneys general" precisely because of the essential law enforcement function that they provide. The function of private attorneys general is especially necessary in situations where the stakes for each class member and potential plaintiff are so small that individual litigation is unlikely – and yet the number of such cases so large that the government cannot pursue them all itself. Only through the efforts of private attorneys general will the law be enforced properly.

Because attorneys' fees are available based on the size of the class's full recovery, not based solely on the size of any individual claim, private attorneys, driven by entrepreneurial instincts, will undertake such litigation. The problem for such attorneys, however, is that they are investing their own capital – human and financial – in bringing the case. As such, they will tend to invest in cases that are safer investments or where their return is more certain in advance. The percentage method provides that certainty: it ensures class counsel that its fee will be tethered to the value that it produces for the

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<sup>9</sup> Alan Hirsch and Diane Sheehy, *AWARDING ATTORNEYS' FEES AND MANAGING FEE LITIGATION* 73 (2d ed. 2005).

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class. It enables class counsel to measure the likely reward with some certainty in advance. The lodestar method cannot achieve the same certainty: fees will hinge on close scrutiny of the hours used, the hourly rate will be set by a judge, a multiplier may or may not be awarded, and the whole process will take a very long time. If the public policy goals of small claims class actions are to be furthered, commentators nearly unanimously agree that the percentage method is the way to get lawyers to provide their services.

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- *enables clients...to reach finality more expeditiously and hence turn their attention back to the substance of their pursuits.*

### ***The Downsides of the Percentage Method***

The primary criticism of the percentage method is that the selection of what percentage to use can sometimes seem arbitrary. This criticism is less potent now that courts have worked with percentage awards for some time and standards have developed about what percentages are appropriate in different circumstances – for example, in cases involving extraordinarily large common funds (nowadays over \$1 billion), courts generally utilize smaller percentage awards, while in some circuits, courts insist that the percentage bear a resemblance to a “market” rate.

A second problem with the percentage method is that many courts undertake a “lodestar cross-check” when they use the percentage method so as to ensure that the percentage chosen

does not yield a rather arbitrarily large windfall for class counsel. The cross-check places the percentage award in the context of the number of hours worked and thereby provides a snapshot of the effective hourly rate that the litigation has generated. While the impulse to cross-check is therefore understandable, it simultaneously undermines each of the key advantages of the percentage method: it sweeps away ease of administration by reinstating a complex calculation; it misaligns counsel's and the class's interest by reinstating a need to pad hours; it makes litigation less efficient both because it drags out the fee dispute and because it creates the incentive to pad; and it makes counsel's award more risky, thus dampening the incentive class counsel has to invest their resources in such cases. This is not a problem of the percentage method *per se*, but rather a problem of how it is administered, or, perhaps, a problem that the percentage method remains somewhat distrusted such that courts feel hesitant to rely on it alone.

Finally, a third problem with the percentage approach is simply that in a variety of circumstances it is less easily administrable than is claimed. As noted, selection of a “right” percentage may be tricky. But it may also not be obvious what it is that the fee should be a percentage of – the class's take may be a common benefit, not a common fund, and thus has to be monetized to yield a number from which a percentage fee can be extracted; or the fund may revert and it may be unclear whether to take a percentage of the available fund or a percentage of the actual recovery.

Notwithstanding these limitations, in a straightforward common fund case, the percentage method, like the contingent fee in private individual retention contracts, works easily and works well.

### ***Conclusion***

Because the percentage method is easier to administer, because it aligns counsel's interests with those of the class, because it encourages efficient litigation, and because its predictability is likely to generate more private attorney general suits, it is the favored approach of courts and commentators.

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