The Expert's Corner

The Puzzling Persistence of the "Mega-fund" Concept

William B. Rubenstein*

In two recent large settlements, both from the U.S. District Court in the Southern District of New York, the judges considered how the size of a fund should affect the percentage of the fee award. Interestingly, their approaches deviated, with one court having granted counsel a standard 33% (albeit of the net, not gross, fund) while the other granted counsel less than half of that - 15.25% - because of the size of the fund. These competing decisions pose two questions: How have courts approached so-called mega-funds? And how should they do so?

THE RECENT CASES

The Currency Conversion Fee Antitrust Litigation

In litigation involving claims against VISA and MasterCard alleging that these companies failed adequately to disclose the existence and amount of currency conversion fees charged to its customers and conspired to fix these fees at the same rates, Judge William H. Pauley, III approved $51.25 million in fees from a $336 million settlement.[1]

Putting aside the discussion of attorneys' fees momentarily, what may be the most remarkable aspect of this case is its remarkably high claiming rate. In March 2007, the parties and the court engineered an initial notice program, sending out 25 million notices as inserts into its customers' credit card bills, resulting in class members filing only 80,000 claims; that meant that less than one-third of 1% of the class claimed. The court then sent out a second notice which reflected a restructured claiming program in which class members could claim, as the simplest option, a flat $25 award. This adjusted settlement structure and second round of notice resulted in more than 10 million class members filing claims – yes ten *million*, or about 40% of the class. The notice program was so successful that all of the claims had to be reduced pro rata, with the $25 claimants actually expected to receive $15-17.

> ***"there is simply no reason why plaintiffs' counsel should be awarded a percentage of their expenses in addition to being reimbursed for those reasonable expenses."***
> **— Judge Shira Scheindlin**

Class counsel initially requested $86 million in fees, representing approximately 25.5% of the settlement fund and a lodestar multiplier of 2.69. The court instead awarded $51.25 million, representing15.25% of the fund and a lodestar multiplier of 1.6. The court arrived at this reduction after reviewing the Second Circuit's *Goldberger* factors, all of which seemed to support the requested award but one: the fact that other courts in the Second Circuit have awarded lower percentages in "mega-fund" cases.[2] The court stated:

1 *In re Currency Conversion Fee Antitrust Litig.*, ___ F.R.D. ___, 2009 WL 3415155 (S.D.N.Y. 2009).

*William B. Rubenstein, a law professor at Harvard Law School, specializes in class action law; he has litigated, and regularly writes about, consults, and serves as an expert witness in class action cases, particularly on fee-related issues. Professor Rubenstein's work can be found at www.billrubenstein.com. The opinions expressed in this article are solely those of the author. Kristin Hucek, Harvard Law School Class of 2011, assisted in the preparation of this column.

2 The other factor that appeared to motivate the court's reduction here was the high claiming rate: the court noted that because counsel's fee came out of the fund, a lower fee meant more money for the class, which seemed particularly important given that the high claiming rate had reduced each class member's take. There is, of course, some irony in the fact that a high claiming rate justified a lower fee award, in that courts are typically

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> Applying the *Goldberger* factors, this Court concludes that a total attorneys' fee of $51,250,000 is reasonable and appropriate. This represents a recovery of approximately 15.25% of the Fund without interest and when cross-checked against the loadstar results in a 1.6 multiplier. This award should adequately compensate Class Counsel for their time and effort, the risks they faced in this case, and the high quality of their representation, and is within the range of awards in "mega-fund" cases.[3]

Because of the size of the fund, therefore, Judge Pauley reduced the percentage fee – even though the requested 25% fee would have yielded a multiplier (2.69) not wildly high. In short, Judge Pauley appeared to identify the fund size, not the lodestar/multiplier, as the key touchstone in the fee award.

The IPO Securities Litigation

In litigation settling 309 coordinated securities class actions and concluding more than eight years of litigation, Judge Shira Scheindlin approved $170 million in fees (and $47 million in expenses) from a $586 million fund.[4]

Putting aside the discussion of attorney's fees momentarily, it is interesting to note that class counsel had sought $195 million in fees, or a third of the *gross* settlement fund, but that Judge Scheindlin awarded counsel a third only of the *net* settlement. This presents another variation of my recurring "percentage of what" theme.[5] In awarding a percentage of the net, not gross, settlement fund, Judge Scheindlin stated that "there is simply no reason why plaintiffs' counsel should be awarded a percentage of their expenses in addition to being reimbursed for those reasonable expenses."[6] This adjustment seemed pertinent given the high level of expenses – $47 million – in this long-running litigation, but it is typically a minor detail in most class suits where expenses are generally much smaller. Indeed, there is little law on this point, though one federal court has noted that the net approach maximizes plaintiff recovery and encourages class counsel to limit expenses.[7]

Judge William H. Pauley appeared to identify the size of the fund, not the lodestar/multiplier, as the key touchstone in the fee award.

Returning to the mega-fund issue, Judge Scheindlin began her consideration of objectors' arguments that in a mega-fund case, the percentage utilized should be lower than normal by noting that:

> [T]he Second Circuit recently quoted one of my previous decisions in reasoning that "a given fee award must follow a sliding-scale and must bear an inverse relationship to the amount of the settlement. Otherwise, those law firms who obtain huge settlements, whether by happenstance or skill, will be over-compensated to the detriment of the class members they represent."[8]

confronted with the converse situation – a low claiming rate yet a high fee request. I can't imagine class counsel will be pleased to hear that if their settlement structure and notice programs prove particularly potent, that result will be used to justify reducing their fee.

3 *Id*. at 19. In so holding, the Court cited the following cases with the following parentheticals: *Carlson v. Xerox Corp.,* 596 F.Supp.2d 400, 413-14 (D.Conn.2009) (awarding 16% of $750 million fund); *In re Air Cargo Shipping Serv. Antitrust Litig.,* 06 MDL 1775(JG), 2009 WL 3077396, at *16 (E.D.N.Y. Sept. 25, 2009) (awarding 15% of $85 million fund); *In re Qwest Commc'n Int'l Secs. Litig.,* No. 01-cv-01451-REB-CBS, 2006 U.S. Dist. LEXIS 71267 at *23 (D.Colo. Sept. 29, 2006) (awarding 15% of $400 million fund); *In re Freddie Mac Sec. Litig.,* No. 03 Civ. 4261(JES), slip op., at 1 (S.D.N.Y. Oct. 27, 2006) (awarding 20% of a $410 million fund).

4 *In re Initial Public Offering Sec. Litig.,* ___ F.Supp.2d ___, 2009 WL 3397238 (S.D.N.Y. 2009).

5 See, e.g., William Rubenstein, *Percentage of What?,* 1 Class Action Att'y Fee Dig. 63 (March 2007).

6 *In re Initial Public Offering Sec. Litig.,* 2009 WL 3397238 at *32.

7 *See In re Immunex Securities Litigation,* 864 F. Supp. 142 (W.D. Wash. 1994).

8 *In re Initial Public Offering Sec. Litig.,* 2009 WL 3397238 at *32 (quoting *Wal-Mart Stores, Inc. v. Visa U.S.A., Inc.,* 396 F.3d 96, 122 (2d Cir.2005) (quoting *In re Indep. Energy,* 2003 WL 22244676, at *6)) (internal quotations omitted).

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But Judge Scheindlin then distinguished her own quoted precedent, writing:

> Nonetheless, this principle cannot be considered in isolation without also reviewing the amount of work and time spent by counsel in this litigation. For those cases in which settlement is quick and the time and labor expended by counsel is low, a high percentage fee would be a windfall and therefore inappropriate. Thus, in *Goldberger* and other recent Second Circuit class action fee decisions, the Circuit affirmed awards of a low percentage fee, but noted that such fees represented positive multipliers to counsel's lodestar figures. This case is different. Here, counsel is requesting a high percentage fee, but that fee ($195 million) still represents a negative multiplier to the total adjusted lodestar as calculated by this Court ($202 million). There is therefore no real danger of overcompensation.[9]

Because of counsel's high lodestar, therefore, Judge Scheindlin approved a normal percentage fee notwithstanding the mega size of the fund. In short, she identified the lodestar/multiplier, not the size of the fund per se, as the key touchstone in the fee award.

THE MEGA-FUND CONCEPT

The Data

In the current (Fourth) version of the *Manual for Complex Litigation*, published in 2004, the Federal Judicial Center states that a fixed percentage award may yield a windfall fee in large fund cases:

> Accordingly, in "mega-cases" in which large settlements or awards serve as the basis for calculating a percentage, courts have often found considerably lower percentages of recovery to be appropriate. One court's survey of fee awards in class actions with recoveries exceeding $100 million found fee percentages ranging from 4.1% to 17.92%.[10]

More recent data can be found in the table on the following page, taken from a 2009 district court decision from Connecticut.[11]

These data points show that mega-funds sometimes, but not always, trigger lower fee percentages. The data alone do not directly address the question of whether lawyers who create mega-funds *should* be entitled to a smaller percentage of those funds.

The Policy Issues

The mega-fund concept addresses a fear that counsel securing a large fund and getting a customary 25%-33% fee will be getting a "windfall." The notion that the fee would be a windfall is best explained by reference to the lodestar – say with a $1 million lodestar, counsel produces a $10 million fund and is given a 25% fee of $2.5 million fee, that fee embodies a multiplier of 2.5; if the same $1 million lodestar produces a $50 million fund and a $12.5 million fee, the multiplier would be

9 *Id*. In an omitted footnote, Judge Scheindlin cited the following cases with the following parentheticals: *In re Nortel Networks Corp. Sec. Litig*., 539 F.3d 129, 134 (2d Cir.2008) (ruling that a district court's fee award of three percent of the fund or more than two times the lodestar was not an abuse of discretion); *Wal-Mart Stores*, 396 F.3d at 123 (noting that the 7.2 percent fee nevertheless represented a 3.5 multiplier on counsel's lodestar); *Goldberger*, 209 F.3d at 46 (noting that the four percent fee was equal to a positive lodestar multiplier).

10 FEDERAL JUDICIAL CENTER, MANUAL FOR COMPLEX LITIGATION (FOURTH) §14.121 at 188-189 (citing *In re Prudential Ins. Co. of Am. Sales Practices Litig*., 148 F.3d 283, 339-40 (3d Cir. 1998)).

11 *See Carlson v. Xerox*, 596 F.Supp.2d 400 (D. Conn. 2009). Note, the opinion reprints the "Top 26 Chart" from a report prepared by a retired federal judge submitted in support of the fee application. The chart contains an inconsistency in numbering two cases consecutively (14 and 15), which have identical settlement amounts, and then using the same number (24) for the last three cases, which also have identical settlement amounts.

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RANK	NAME	Settlement Amount	Fee Award
1	Enron	$7,227,390,000.00	9.52%
2	WorldCom	$6,133,000,000.00	5.48%
3	Tyco	$3,200,000,000.00	14.50%
4	Cendant (2000)	$3,166,000,500.00	1.73%
5	AOL/Time Warner	$2,500,000,000.00	5.90%
6	Nortel I	$1,142,775,308.00	3.00%
7	Royal Ahold	$1,100,000,000.00	11.88%
8	Nortel II	$1,074,265,298.00	7.74%
9	McKesson	$1,042,500,000.00	7.64%
10	Cardinal Health	$ 600,000,000.00	18.00%
11	Lucent	$ 517,000,000.00	17.00%
12	BankAmerica	$ 490,000,000.00	18.00%
13	Dynegy, Inc.	$ 474,050,000.00	8.73%
14	Adelphia Comm.	$ 460,000,000.00	21.40%
15	Raytheon	$ 460,000,000.00	9.00%
16	Waste Management II	$ 457,000,000.00	7.93%
17	Global Crossing	$ 447,800,000.00	16.04%
18	HealthSouth	$ 445,000,000.00	15.25%
19	Freddie Mac	$ 410,000,000.00	20.00%
20	Qwest	$ 400,000,000.00	15.00%
21	Cendant (2006)	$ 374,000,000.00	7.71%
22	Rite Aid	$ 319,580,000.00	25.00%
23	Williams Co.	$ 311,000,000.00	25.00%
24	Oxford	$ 300,000,000.00	28.00%
24	DaimlerChrysler	$ 300,000,000.00	22.28%
24	Bristol-Myers Squibb	$ 300,000,000.00	3.96%

12.5. Most courts would cringe at a multiplier of 12.5. Enter the mega-fund concept: by lowering counsel's percentage in the larger case to say 10%, the resulting $5 million fee reduces the multiplier from 12.5 to 5. Note that the guiding principle is "windfall" and the measuring stick of that windfall is likely the multiplier that a high fee award embodies, not the high fee award per se.

To judge the wisdom of the mega-fund, several observations are necessary.

1. *So What If Large Funds Trigger Large Multipliers? – Debunking "The Windfall."* What's wrong with counsel getting 25-33% of a mega-fund, even if it embodies a huge multiplier? A major justification for a common fund fee award is unjust enrichment – that if the class keeps 100% of the fund and doesn't reward counsel for securing it for them, the class is unjustly enriched. From this perspective, why should a class member in a large fund get off paying only 10% of her award to counsel for counsel's efforts while a class member in a normal fund has to pay 33%? If 33% is the amount that ensures against unjust enrichment, it's not clear why it doesn't do so all the time. A second major justification for a common fund fee award with a multiplier is to reward counsel for investing their time and effort on behalf of the class and hence to encourage them to do so again. If counsel spends $1 million and secures $100 million, why shouldn't they be rewarded 10 times as much as counsel who spends $1 million and secures $10 million? Putting these two points together – imagine investing say, your retirement account, with an investment adviser who would be paid a percentage of what she is able to secure for you. Now imagine she comes back one year with a 10% return on your investment and the next year with a 50% return – wouldn't you naturally be disposed to pay her 5 times as much the second year? Wouldn't it be peculiar to say "her return is so great we should drop her reward"? A concern that the "drop the agent's reward" approach raises is that the investment adviser would have little incentive to reap large rewards, a concern some courts have expressed in rejecting the mega-fund concept. In sum, even accepting the concept that large funds will necessarily embody large multipliers, it's not clear that is necessarily a bad thing.

2. *There's Not A Perfect Relationship Between Large Funds and Large Multipliers – Debunking the Correlation*. If huge multipliers are a concern, then

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using the "mega-fund" concept as a policing mechanism is rough justice at best. Class counsel might do a quick case, investing $100,000 in time and securing $10 million for a class. A 30% fee award of $3 million embodies a multiplier of 30. On the other hand, a team of attorneys might spend a decade securing $5 billion for a class (think *Fen-Phen*) but have invested $500 million of time in doing so, such that a 30% fee award of $1.5 billion embodies only a multiplier of 3. If a high multiplier is the measuring stick of a "windfall," then why not use the high multiplier regardless of the size of the fund rather than the size of the fund as a policing mechanism? The mega-fund concept poses several other related problems – first, what is the mega-fund threshold? $100 million? $300 million? $1 billion? Second, once the mega-fund threshold is achieved, what is the proper reduction? From a 25% benchmark to a 15% benchmark? 10%? 5%? How would we know? Some courts and commentators have approached these problems by seeing the mega-fund concept as more of a sliding scale, with the percentage decreasing as the fund size increases. This conceptualization relieves the burdens of identifying the mega-fund threshold and the mega-fund reduction with any precision. It may also capture some intuition that there's a direct correlation between dollars spent and dollars recovered. But as noted at the outset of this point, that correlation is not always so perfect, so the sliding scale mega-fund concept – though more elegant than the simple mega-fund model – remains rough justice as well, even if a bit less course.

3. *Explaining The Puzzling Persistence of the Mega-Fund Concept*. It strikes me that the mega-fund concept persists, notwithstanding the keener tool of the multiplier for reasons related to the percentage vs. lodestar controversy. In the triumph of the percentage method over the past 25 years, one of the strongest arguments for that method is that it relieves counsel of the work of submitting, and a court the work of reviewing, a lodestar. Without a lodestar cross-check, a straight percentage award has no measuring stick by which to assess whether it might be a "windfall" to counsel in multiplier terms (if "windfall" that is, see above). Because courts are wary of high fee awards generally, the mega-fund concept substitutes for the lodestar cross-check/multiplier idea by implanting in the midst of a straight percentage analysis a method for ensuring against what seem like extraordinary fee awards – simply cut the award as the fund increases. Given that the examples I offered above show the lack of a perfect correlation between fund size and multiplier, the mega-fund concept is rough justice at best. But if courts are to adopt a straight percentage approach without ever looking at a lodestar, the mega-fund concept supplies some governance mechanism on highly multiplied fee awards, while saving everyone the trouble of a lodestar review. Plaintiffs' firms generally prefer a percentage approach to a lodestar, of course, but they also seem to find that the mega-fund concept is too high a price to pay for that: they will generally fall back on submitting a lodestar in large cases to demonstrate a low multiplier and hence the inaptness of the mega-fund concept's application in their case.

* * *

In sum, if the idea persists that a highly multiplied lodestar constitutes, at some point, a windfall to class counsel, the multiplier itself is the best measuring stick of this. A mega-fund approach is a cruder means of getting at the idea, though its value is that it can be done on its face without the need for a lodestar analysis. My own bottom line is to be skeptical of the idea of the windfall in the first instance but, if "windfalls" are to be policed, to prefer the precision of the lodestar/multiplier as a measurement of such to the mega-fund measurement.