

The Expert's Corner

BEWARE OF *EX ANTE* INCENTIVE AWARD AGREEMENTS

William B. Rubenstein*

Two cheers for me – in the January 2009 issue, I offered predictions concerning trends in fee awards. One of my predictions was that readers should keep an eye on class representative incentive awards. The amount of such awards seems to have crept up over the past few years and there were signs of courts' growing discomfort with them. My bottom line, highlighted in a box by my editors, read: "I doubt incentive awards will disappear anytime soon, but it will be worth watching whether or not they have capped out."

Lo and behold: on April 23, 2009, in *Rodriguez v. West Publishing Corp.*, 563 F.3d 948 (9th Cir. 2009), the Ninth Circuit struck another blow to incentive awards. I give myself but two cheers, though, because the Ninth Circuit's objection was primarily to the fact that plaintiffs' counsel had contracted to seek incentive awards along a sliding scale depending on the size of the settlement or judgment; the court was more upset by the *agreement* than it was by the sheer *size* of the award – so upset by the *agreement* that it voided (and remanded for further consideration) the attorney's fee award as well, possibly punishing the attorneys for entering into such a contract. After spelling out the details, I offer a few thoughts about the case – and on its meaning for future cases.

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THE DETAILS

The underlying case, filed in federal district court in Los Angeles in May 2005, was an antitrust class action against West and Kaplan, Inc., concerning an alleged agreement to restrict the market for bar preparation courses. The class consisted of all those who purchased BAR/BRI courses for the decade from 1997-2006. A settlement reached in 2007 created a \$49 million settlement fund. The settlement notice stated that class counsel would seek 25% of the fund as fees, \$25,000 incentive payments for four class representatives, and \$75,000 incentive payments for three other class representatives. As described by the Ninth Circuit:

It turns out that, as part of their retainer agreement, [some of] the named plaintiffs . . . had entered into an incentive arrangement with [initial counsel]. The incentive agreements obligated class counsel to seek payment for each of these five [named plaintiffs] in an amount that slid with the end settlement or verdict amount: if the amount were greater than or equal to \$500,000, class counsel would seek a \$10,000 award for each of them; if it were \$1.5 million or more, counsel would seek a \$25,000 award; if it were \$5 million or more, counsel would seek \$50,000; and if it were \$10 million or more, counsel would seek \$75,000. [Two other class representatives were not parties to these incentive agreements.]

Id. at 957.

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The federal district court (Real, J.) refused to grant these \$75,000 incentive awards, finding the very idea of a “sliding scale” incentive award to be contrary to the role of a class representative and to violate public policy. *See Rodriguez v. West Pub. Corp.*, 2007 WL 2827379 at *14-24 (C.D. Cal., Sept. 10, 2007). The Ninth Circuit summarized the District Court’s objections as follows:

[T]he district court held that the agreements were inappropriate and contrary to public policy for a number of reasons: they obligate class counsel to request an arbitrary award not reflective of the amount of work done, or the risks undertaken, or the time spent on the litigation; they create at least the appearance of impropriety; they violate the California Rules of Professional Conduct prohibiting fee-sharing with clients and among lawyers; and they encourage figurehead cases and bounty payments by potential class counsel. ***The court found it particularly problematic that the incentive agreements correlated the incentive request solely to the settlement or litigated recovery...*** It further observed that the parties’ failure to disclose their agreement to the court, and to the class, violated the contracting representatives’ fiduciary duties to the class and duty of candor to the court.

Rodriguez, 563 F.3d at 959 (emphasis supplied).

In affirming, the Ninth Circuit emphasized the highlighted passage above – the apparent disjuncture between the representatives’ interests and those of the class – writing:

[O]nce the threshold cash settlement was met, the agreements created a

disincentive to go to trial; going to trial would put their \$75,000 at risk in return for only a marginal individual gain even if the verdict were significantly greater than the settlement. The agreements also gave the contracting representatives an interest in a monetary settlement, as distinguished from other remedies [such as injunctive relief], that set them apart from other members of the class. Further, agreements of this sort infect the class action environment with the troubling appearance of shopping plaintiffships [sic]. If allowed, *ex ante* incentive agreements could tempt potential plaintiffs to sell their lawsuits to attorneys who are the highest bidders, and vice-versa. In addition, these agreements implicate California ethics rules that prohibit representation of clients with conflicting interests.

Id. at 959-960.

Although the Ninth Circuit found that the two unconflicted class representatives enabled the settlement to be approved notwithstanding these conflicted class representatives, *id.* at 961, it nonetheless vacated class counsel’s fee award and remanded the attorney fee to the district court for further consideration. *Id.* at 967-968. Specifically, the Ninth Circuit found that the fee agreements created a conflict between the class representatives, counsel, and the class, and that “[s]imultaneous representation of clients with conflicting interests (and without written informed consent) is an automatic ethics violation in California and grounds for disqualification,” *id.*, barring the right to fees for that portion of the representation.

Bottom line: the incentive award agreements infected the litigation because of the possibility that

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counsel would seek such an award and because of its size, which was not tethered to some relevant criteria (such as cost to, or performance of, the class representatives) but rather was bargained for *ex ante* in a manner tailored solely to the quantitative outcome of the case.

SOME REFLECTIONS

1. *Incentive Award Agreements Unlikely To Recur.*

The Ninth Circuit's decision casts such aspersion on incentive award agreements that one is unlikely to see class lawyers employing them in the future. But my guess is that this was an isolated incident in any event. Why? In the BAR/BRI case, the class was, by definition, composed of lawyers (or law students who failed the bar). These legally-informed would-be plaintiffs may have shopped among law firms for the best incentive award deal they could find. Such savvy and aggressive plaintiffs are unlikely to be found in most class suits (except perhaps in the securities area, but of course the PSLRA contains its own separate rules about lead plaintiffs and incentive awards).¹ For this reason, the incentive agreement situation is unlikely to be a recurring one in fact, even had the Ninth Circuit not discouraged it as a matter of law.² To be clear,

¹ Lead plaintiffs in securities cases are limited to recovering (beyond their *pro rata* share of the settlement or judgment itself) "reasonable costs and expenses (including lost wages) directly relating to the representation of the class to any representative party serving on behalf of a class," 15 U.S.C. § 78u-4(a)(4), and they must pledge that they received nothing more for providing their services. 15 U.S.C. § 78u-4(a)(2)(A)(vi).

² Both the Ninth Circuit and District Court in *Rodriguez* noted the anomaly of the situation. See *Rodriguez*, 563 F.3d at 960 ("Although we have not previously encountered incentive agreements"); *Rodriguez*, 2007 WL 2827379 at *18 ("This appears to be the first case in which a class representative entered into a contingency fee-type contract with class counsel from the outset whereby class counsel agreed to request a particular

though, my own sense is that the problem is not one of agreements *per se* but of agreements that pre-commit class counsel to pursuing awards, and especially to pursuing awards at set levels. I doubt either court would have been much concerned with a clause in a retainer agreement by which class counsel acknowledged the existence of incentive awards, but wrote the clause to caution the potential class representatives that such an award could not be guaranteed and that only at the conclusion of the matter could counsel determine whether it was legally appropriate to seek such an award – and for how much.

2. *It's Not Clear That Incentive Awards Are "Out of Control."*

I started my column with my January prediction that courts are growing uneasy about incentive awards. That conclusion is anecdotal, I admit. The best published empirical study on incentive awards is that compiled by Ted Eisenberg and Geoff Miller and published in a *UCLA Law Review* Class Action Symposium that I put together several years ago. See Theodore Eisenberg and Geoffrey P. Miller, *Incentive Awards to Class Action Plaintiffs: An Empirical Study*, 53 U.C.L.A. L. REV. 1303 (2006). That study suggests that incentive awards are granted in only about a quarter of class suits (28%) and that the average award per class representative is about \$16,000, with the median award per class representative being closer to \$4,000. *Id.* at 1308. These data don't suggest incentive awards are out of control – but they are taken from cases decided between 1993-2002. More recent data is regularly published in these pages; using incentive award on behalf of the class representative based on the amount of the ultimate recovery.").

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that data, my editors highlighted recent individual cases with larger awards in the notes to my January column, suggesting – though certainly not proving – that the trend is upward.

3. *The Law Is Remarkably Murky About The Proper Level of Incentive Awards.*

It'd be easier to assess whether incentive awards are out of control, or, as the Ninth Circuit has suggested, worrisome, if we had some shared sense of what incentive awards ought to be. Oddly, however, we do not. Generally, “the decision whether to award an incentive payment to a class representative, and the size of that award, is entirely within the trial court’s discretion.” *Rodriguez*, 2007 WL 2827379 at *14. Some courts have articulated factors and purposes, *see id.* at 14-15, but the precedent is rather thin. In the Eisenberg and Miller study discussed above, the authors helpfully distinguish between “reimbursing some or all of the representative plaintiff’s nonpecuniary costs” and “rewarding the representative plaintiff for superior service.” Eisenberg and Miller, *supra*, 53 U.C.L.A. L. REV. at 1307; *see also id.* at 1314 (noting that “incentive awards may reimburse representative plaintiffs for some or all of the costs of their service to the class” and/or “incentive awards may be used to reward representative plaintiffs for superior service to the class”).³

³ In a response to that study, Professor Richard Nagareda similarly distinguished two features of incentive awards: restitution and reward. *See* Richard A. Nagareda, *Restitution, Rent Extraction, and Class Representatives: Implications of Incentive Awards*, 53 U.C.L.A. L. REV. 1483 (2006). The restitutionary component is that which repays the class representative for the time she put into the case and for the risks (such as retaliation in an employment case) that she took in pursuing the matter; the reward component would be that which would pay the class representative for doing a good job.

Generally, courts rely on the former not the latter in granting incentive awards, identifying the time spent by the class representative in participating in the litigation (such as in being deposed). (This is also the approach Congress took in the PSLRA. *See* note 1, *supra*.) But this is rough justice at best: it’s rare that courts require named plaintiffs to submit time sheets and appropriate hourly rates. If they did, one might expect to see a lawyer-class representative being reimbursed at a higher incentive rate than a carpenter class representative – but the District Court in *Rodriguez* balked at this very idea.⁴

While *reimbursement* is accomplished via “rough justice,” it is not clear that *reward* is accomplished at all. For starters, there’s an aversion to the concept itself. The PSLRA forbids it, and the District Court in *Rodriguez* expressed outrage that the class representatives might receive a “bounty.”⁵ Why? What would be wrong with rewarding the class representative for doing a good job?⁶ Perhaps nothing in theory, but the problem might be in operationalizing such an idea, as we are quite conflicted about what it means to do a good job as a class representative. The primary function of the

⁴ The trial court stated:

Three of the Class Representatives “billed” their time in .10 hour increments. . . . Even assuming all of the hours claimed are justified, the amount of time and effort spent by the Class Representatives does not justify an incentive award in the tens of thousands of dollars. Just because the Class Representatives in this case happen to be attorneys does not mean that the time they spent working as Class Representatives in furtherance of this litigation should be charged to the rest of the Class at \$250 an hour.

Rodriguez, 2007 WL 2827379 at *16.

⁵ *Rodriguez*, 2007 WL 2827379 at *21-22.

⁶ In fairness to Judge Real: in *Rodriguez*, the *ex ante* agreement tying the award solely to the level of recovery appeared disconnected from the question of whether or not the representatives actually performed well, as it measured that performance only in terms of the amount of money recovered – and this is the form of “bounty” to which Judge Real objected.

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representative is to monitor class counsel; but generally speaking, when class counsel and the class representative bring a disagreement to the court's attention, courts are as (if not more) apt to side with class counsel than with the class representative.⁷ We pretend that we want a strong monitor of class counsel, but we're not quite sure that we're comfortable with one when we find her and we rarely reward class representatives for being strong monitors.

Worse still, as Professor Nagareda writes:

[I]ncentive awards should reward high-quality monitoring but not low-quality monitoring. This qualitative dimension is more amorphous than notions of cost, however. An inquiry into monitoring quality would call for the court to

⁷ Indeed, the District Court in *Rodriguez* itself correctly stated that:

Multiple courts have approved class action settlements notwithstanding the objections of the class representatives. See, e.g., *Officers for Justice v. Civil Serv. Com.*, 688 F.2d 615, 631 (9th Cir. 1982); *Parker v. Anderson*, 667 F.2d 1204 (5th Cir. 1982) (affirming the approval of a settlement of an employment discrimination class action over the objections of 10 of the 11 named plaintiffs); *Maywalt v. Parker & Parsley Petroleum*, 864 F. Supp. 1422 (S.D.N.Y. 1994), *aff'd* 67 F.3d 1072 (2d. Cir. 1995) (granting final approval of a securities fraud class action over some 2,700 objections, including certain of the class representatives); *Boyd v. Cechile Corp.*, 485 F. Supp. 610, 624 (N.D. Cal. 1979) (approving a consent decree in an employment discrimination class action despite the fact that "[a]pproximately sixteen percent of the class, including three of the four named plaintiffs, have filed some opposition to the settlement"); *Olden v. LaFarge Corp.*, 2007 U.S. Dist. LEXIS 5954, at *40-41 (E.D. Mich. Jan. 29, 2007) (approving settlement without the support of any of the class representatives).

Rodriguez, 2007 WL 2827379 at *10-11.

grapple either explicitly or implicitly with a hard counterfactual comparison. The court would have to ask whether the monitoring done by a given class representative improved the conduct of the litigation on behalf of absent class members beyond some implicit baseline. Incentive awards might capture this qualitative dimension of monitoring only impressionistically.

Nagareda, *supra*, 53 U.C.L.A. L. REV. at 1488-89.

In sum, if incentive awards should not be set by pre-existing contract, then courts are apt to award them based on (1) the costs to the representative of serving in that capacity and (2) the quality of her performance. But the former numbers are calculated in a rough way at best, and we have no generally accepted manner of assessing the latter category at all. Given this state of affairs, courts tend to provide class representatives a lump sum of money that seems "about right" – say \$10,000-\$25,000 – and raise their eyebrows, looking for more justification, as the numbers creep up.

It is possible that courts might grow to believe that they can be more exact about all this, either seeking more concrete documentation of fact or attempting in some way to measure performance. But because so much more money is at stake in the *attorney's fee*, courts are likely to continue to pass on providing much greater attention to incentive awards, except in the peculiar cases like *Rodriguez*, which provided a perfect storm of a high award and a questionable *ex ante* agreement. Ω