

The Expert's Corner

THE AMERICAN LAW INSTITUTE'S NEW APPROACH TO CLASS ACTION ATTORNEY'S FEES

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The American Law Institute ("ALI") is in the midst of a project considering aggregate litigation practices in the United States. The effort will not culminate with a "restatement," but rather aims to develop Principles of the Law of Aggregate Litigation. There are four reporters on the project, led by New York University law professor Sam Issacharoff, and a group of thirty-seven formal "Advisers" comprised of lawyers from both sides of the aisle, state and federal judges, and class action scholars and experts (I am one of these Advisers). The group's current draft – Discussion Draft No. 2 (April 6, 2007) – has been vetted at several recent sessions and will likely move to a final draft within the next year or so.¹

Several aspects of the effort will interest class action fee observers. The draft itself is divided into three sections – the first provides a background to the *general principles* that underlie litigation aggregations; the second focuses on when *aggregate treatment of common issues* is called for; and the third and final section identifies principles applying to *aggregate settlements*. The aggregate settlement chapter contains two sections focusing on attorney's fees – one about class counsel's fee (§3.13), the other about objectors' fees (§3.08).

In this month's issue, I will discuss these attorney's fees provisions and in November's issue, the objectors' fees provision.

¹ It remains, nonetheless, a draft that neither the ALI's governing Council nor the membership of the Institute has taken a position on, so its views do not yet represent those of the Institute.

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CLASS COUNSEL'S FEES

The ALI draft expresses a presumption in favor of percentage fees and against lodestar-based fee awards; the lodestar approach is something that "may" be used as a cross-check on percentage awards and in those cases in which only non-monetizable injunctive or declaratory relief is sought or in which fee-shifting statutes insist upon lodestar. Otherwise, the draft's preference is that plaintiffs' counsel be awarded a percentage and that the percentage be of "both the monetary and nonmonetary value of the settlement." §3.13(b). The value of the settlement may encompass *cypres* payments under the ALI's approach, but may not encompass portions of funds that revert to the defendant at the end of the claiming period or coupons offered but not used by the plaintiff class. *Id.* Comment a.² This approach parallels the provision of the Class Action Fairness Act of 2005 ("CAFA") that limits percentage awards to a percentage of redeemed coupons.³

The ALI's suggested approach has several benefits, each most easily viewed by examining the three organizing aspects of the fee recommendations.

1. *Percentage vs. Lodestar.* If widely recognized, the ALI draft would put to an end the seemingly interminable debate about whether lodestar or percentage is a preferable fee method. If you read only caselaw, it would appear that there is a raging debate about whether lodestar or percentage is a better method (particularly in California). Interestingly, no heated dispute occurred at the ALI sessions I attended. The ALI's draft captures the spirit of the moment by succinctly identifying and defending the advantages of the percentage method and by placing on this method the imprimatur of the

² The draft also includes a recommendation that courts should be encouraged to set fee ranges early in a case based on the expected value of the litigation, if possible, and then to deviate from those ranges later only in exceptional circumstances. §3.13(d).

³ 28 U.S.C. §1712(a) ("If a proposed settlement in a class action provides for a recovery of coupons to a class member, the portion of any attorney's fee award to class counsel that is attributable to the award of the coupons shall be based on the value to class members of the coupons that are redeemed.")

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broad group of its participants. It would be a positive step forward if the ALI's final principles clarified once and for all the centrality of the percentage approach and relegation of lodestar to cross-check and other situations in which a percentage approach cannot be employed.

That said, this section of the ALI draft may be a bit curt in its handling of the percentage method for three reasons. First, an earlier section of the draft – in the introductory principles – discusses the fact that in “many” aggregate proceedings, “participants and lawyers agree on fees contractually,” and here the draft opines (in the Reporters’ Notes) that judges “should honor these private arrangements in the vast majority of cases.” §1.06, Reporters’ Notes, comment h. This contractual, private arrangement, approach is not mentioned when the draft actually gets to attorney’s fees in §3.13. Second, the earlier section goes on to note that these contractual arrangements tend to mimic market rates (which is the reason for embracing them); yet more broadly, this reference suggests that an approach to fees somewhat conceptually distinct from the contract, percentage, or lodestar approaches is a straightforward market approach.⁴ Again, this is nowhere mentioned in §3.13. Finally, some courts approach percentage awards differently depending on the size of the common fund, diminishing percentages as funds become mega-funds.⁵ Although embracing a percentage approach, the ALI draft never addresses this issue. Notwithstanding these omissions,⁶ section 3’s embrace of a percentage, not lodestar, starting point represents an important achievement of the draft.

2. *Cy pres*. Beyond the lodestar/percentage debate, §3.13 of the draft next picks up on the fact that an earlier section (§3.07) expressed a preference for *cy pres* awards in those circumstances where claim values are small and claimants difficult to identify, yet where a harm should be remedied. *Cy pres* awards in these circumstances, it is argued, appropriately disgorge money from defendants. Permitting class counsel to take a percentage of the *cy pres* award helps

⁴ The Seventh Circuit has repeatedly insisted upon this approach. See, e.g., *In re Synthroid Marketing Litigation*, 264 F.3d 712, 718 (7th Cir. 2001) (citing cases).

⁵ See, e.g., *In re Chambers Development Securities Litig.*, 912 F. Supp. 852, 861 (W.D. Pa. 1995) (stating that “The Third Circuit Task Force on Court Awarded Attorney Fees recommends [a] sliding scale approach, stating (albeit in the context of a negotiated fee), that in ‘most instances, [arriving at the proper percentage] will involve a sliding scale dependent upon the ultimate recovery, the expectation being that, absent unusual circumstances, the percentage will decrease as the size of the fund increases.’”).

⁶ §3.13(d) and its associated comment hint at these issues when suggesting courts set fees based on expectations early in a case, but it reads as more of a timing mechanism than a fee-setting suggestion.

create the incentive for counsel to pursue such cases. The draft’s clarification of when *cy pres* awards are appropriate and its embrace of them in those circumstances is another example of the project’s ability to define and perpetuate current best practices.

3. *Actual vs. possible value*. Finally, the draft enters what I have previously labeled the “percentage of what?” debate by drawing the line at permitting fees for relief that is arguably illusory in nature. In particular, in reversionary fund situations, the draft states that plaintiffs’ counsel are entitled to a percentage of what is distributed but not a percentage of what reverts to the defendant. In coupon situations, the draft defines the settlement’s value as the “actual value of those coupons actually redeemed by class members . . .” §3.13, comment a. Finally, in an interesting illustration, the draft argues that relief that a defendant has agreed to afford a class before a lawsuit is ever filed and hence regardless of its filing (e.g., technical support for defective computers) “cannot be used in evaluating the actual value of the settlement to the class.” §3.13, illustration 2.

The draft’s handling of the “percentage of what” dilemma is debatable, but its approach is surely defensible. As I have explained in previous columns, I have less of an objection to plaintiffs’ attorneys getting a percentage of the full amount of a reversionary fund or the full value of coupon settlements – as opposed to a percentage of the value actually claimed or redeemed by the plaintiff class. Often, that will disgorge more money from defendants – albeit to class counsel not the class – than will the ALI’s approach.⁷ But the ALI’s preference for *cy pres* awards creates a way out of this dilemma for class counsel as it encourages them to push for *cy pres* settlements by awarding them a percentage of that money.

Nonetheless, there are two other possible hitches in the ALI’s approach. The first is one of timing: coupons are best for class members the longer the redemption period, while fees are best for counsel the quicker they can be collected. To make counsel wait until the end of a redemption period for their fee encourages them to limit the redemption period, though that hurts class members and likely cuts down the redemption rate. That, in turn, should encourage class counsel to negotiate for a longer period (as their fees run off the redemption rate) but it may not.

⁷ See, e.g., Hailyn Chen, *Attorneys’ Fees and Reversionary Fund Settlements in Small Claims Consumer Class Actions*, 50 U.C.L.A. L. REV. 879 (2003).

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A middle ground solution might be to award class counsel an interim fee at the end of the case perhaps equal to some percentage of their lodestar but then to award a "bonus" at the end of the redemption period based on the redemption results; for example, a fee multiplier could be based on the coupon redemption rate. This structure would create an incentive for class counsel to structure coupons or other non-monetary relief in ways that are most likely to be used by the class, yet not make them wait years to receive any reward for their efforts.

A second hitch in the ALI's approach is one of valuation: while fees are based on the "actual value" of coupons redeemed, this value can be ascertained in at least two distinct ways – from the plaintiffs' perspective or the defendant's. A plaintiff who redeems and uses a \$10 coupon realizes a \$10 gain. However, a defendant who issues a \$10 coupon for purchase of one of its products costing more than, say, \$50, may not actually suffer a \$10 loss. The coupon may have induced a sale that would not have happened otherwise, the \$10 diminishment in price may cost the company less, and whatever the cost, it may in fact be passed on to other consumers through price hikes. The draft appears to ascertain the "actual value" from the plaintiff's perspective (that is the language in the text of §3.13), but the Comment that follows cautions against inflating values and describes the value of coupon settlements as the "actual value of those coupons actually redeemed by class members or distributed through a *cy pres* remedy. . ." This Comment language doesn't specify assessing value from the plaintiff's perspective nor does it specify that the coupons "*distributed* through a *cy pres* rem-

edy" should be counted only if they were in fact *redeemed*. I suspect that these are drafting issues more than substantive ones and that the ALI aims to value from the plaintiffs' perspective based on coupons *actually used* by plaintiffs or by *cy pres* recipients. It is worth noting that this too (using plaintiffs' value not defendant's) is a choice, though, and one that arguably inflates the value of the settlement – albeit not as much as counting unredeemed coupons or reverted funds – over its actual costs to the defendant.

The ALI's preference that actual redemption be used as a baseline for fees should have a salutary side effect of making redemption rates more transparent. I have pushed the ALI to include transparency-producing recommendations in the black letter sections themselves (so far without success), as I believe such redemption rates should be readily accessible to class members, researchers, and the public.⁸ Though no section currently covers this, the fee section at least may contribute to its effectuation.

* * *

In sum, there is nothing radically novel about the ALI's approach. But this portion of its current draft is particularly succinct, well-written, and generally on target. It will likely have a positive impact on class action practices if and when it is adopted by the Institute itself.

Next month I look at the project's approach to objectors' fees – a more controversial issue about which the ALI draft stakes out an interesting position. Ω

⁸ See, e.g., William B. Rubenstein, *The Fairness Hearing: Adversarial and Regulatory Approaches*, 53 U.C.L.A. L. REV. 1435 (2006).

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