The Expert's Corner

Percentage of What?

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It is well-established that counsel who secure a common fund or benefit for a class are entitled to a percentage of what they produced. To be sure, there is always a debate about what percentage that should be. A less apparent but growing problem concerns not what percentage should be used but rather what the fee should be a percentage of.

The obvious answer is that counsel should receive a percentage of the common fund that their work created. But the value of a common fund may be uncertain. The fund may consist of non-monetary benefits that must be monetized to assess its scope. More centrally, though, a critical unresolved issue is whether to set the size of the fund according to the monies *made available* by counsel's work or to the monies *actually claimed* by the class members. The two are not always the same.

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The fund may exceed the recovery because not all the plaintiffs come forward for relief or because not all can provide sufficient documentation to engender full relief. Three common methods exist for disposing of the leftover funds: (1) they can be distributed *pro rata* to the plaintiffs that did come forward; (2) they can be sent to third parties with interests similar to those of the class through a "*cy pres*" distribution; or (3) they can *revert* to the defendant.

Under the latter two methods, class members themselves receive only a portion of the total fund: what, then, should the fee be a percentage of? A recent Second Circuit decision ruled that the fee should be a percentage of the full fund, reversing a District Court decision that had set the fee solely as a percentage of the class members' recovery. *Masters v. Wilhelmina Model Agency, Inc.*, 473 F.3d 423 (2d Cir. 2007).

Masters was an anti-trust class action alleging price fixing of commission rates among modeling agencies. The settlement agreement established a fund of nearly $22 million. The agreement permitted the court to distribute unclaimed portions of the fund in its discretion. The District Court awarded the unused funds via the *cy pres* method to various eating disorder and women's health organizations. The Second Circuit remanded this portion of the opinion, implying that the District Court should have distributed the funds directly to the plaintiffs *pro rata* rather than to third parties via the *cy pres* method.

The District Court awarded counsel 40% of the roughly $9.3 million in *claims made by class members* against the fund; this $3.8 million amounted to only 17% of the $22 million *total fund*. The District Court held that to give counsel a percentage of the total fund would provide a windfall since the class itself did not realize the value of the total fund and since Congress seemed, in both the Private Securities Litigation Reform Act (PSLRA) and the Class Action Fairness Act (CAFA), to express a preference for the fee to be set as a percentage of recovery not availability.

The Second Circuit dismissed the statutory arguments as inapposite, in that the PSLRA did not apply to this antitrust action and that CAFA's only fee provision concerns coupon settlements, which this was not. Rather than relying on either statute, the Circuit concluded that counsel's work had created "[t]he entire Fund, and not some portion thereof" and hence counsel should be rewarded for that full accomplishment, even if some of the fund ends up via the *cy pres* doctrine going to non-class members.

In cases like *Masters*, where the residuary fund will either be re-distributed *pro rata* among the class members or sent to a third party via the *cy pres* method, awarding counsel a percentage of the total fund made available makes perfect sense. It captures the fact that the defendant has been disgorged of this amount of money regardless of where the funds end up. The small claims class action is primarily a deterrent device, not a compensatory one: the class members' claims are often so small that the cost of litigating them outweighs the recovery. Absent representative litigation (or government law enforcement) there would be no efficient means for stopping a wrongdoer from engaging in such conduct. Because this

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form of litigation primarily serves deterrent rather than compensatory purposes, it is logical to reward counsel for the amount of deterrence they have produced. That is the amount defendant has paid, regardless of to whom the money is paid or, for that matter, if it is simply taken from the defendant and shredded.

The reversionary fund presents a more difficult "percentage of what" problem because the defendant's disgorgement is no greater than what the class members take. Rewarding counsel with a percentage of a fund that was never claimed and went back to the defendant – and hence is largely illusionary – seems indefensible.

Nonetheless, I once testified as an expert witness that such an approach is reasonable – perhaps not ideal, but reasonable. To see why, consider the following example. Assume a $100 million fund is established, with counsel getting a 22% fee, or $22 million. Now assume that $16 million is actually distributed from the $100 million, with the rest reverting to the defendants. Counsel's fee ends up being larger than the class's actual recovery. This seems like a windfall out of proportion to the result achieved for the class.

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However, counsel did make the full fund available to the class and had they come forward, they would have received it. Moreover, if counsel is given a percentage of the recovery (say 30% of $16 million, or $4.8 million), defendants would have paid out a total of $20.8 million; by awarding counsel a percentage of the total fund, defendants paid out $38 million. What this means is that limiting counsel to a percentage of the class's actual recovery in a reversionary fund situation disgorges significantly less money over all, providing *defendants* with a windfall. All things being equal, it seems more defensible that class attorneys receive the excess than that defendants do, as it is likely they will reinvest it in future consumer cases. One of my students authored a law review note supporting this result. *See* Hailyn Chen, *Comment, Attorneys Fees and Reversionary Fund Settlements in Small Claims Consumer Class Actions*, 50 U.C.L.A. L. REV. 879 (2003).

The weakness in this approach is it arguably sets up a conflict between counsel and the class by creating an incentive for counsel to accept a settlement unlikely to yield a high claiming rate – e.g., a coupon – in exchange for being guaranteed a percentage of the fund made available, not claimed. Of course, this argues more generally against permitting the unclaimed portion of the fund to revert to the defendants. Funds that re-distribute the excess *pro rata* or *cy pres* are more transparent and hence setting a fair fee is more straightforward. Alternatively, counsel's incentives could be trimmed in a reversionary fund situation by requiring a minimum claiming rate, only after which they would be entitled to a fee.

The Supreme Court has never addressed the problem directly. In *Boeing Co. v. Van Gemert*, 444 U.S. 472 (1980), the Court appeared to embrace the percentage of the total fund method, but in so doing, the Court assumed that the defendant's liability was not contingent on the quantity of claims filed. Thus, alluding to reversionary funds that seem more illusionary than fund-like, the Court stated, "we need not decide whether a class-action judgment that simply requires the defendant to give security against all potential claims would support a recovery of attorney's fees under the common-fund doctrine." *Id.* at 480 n.5. Lower courts have split on how to approach true reversionary funds. *Compare Waters v. Intern. Precious Metals Corp.*, 190 F.3d 1291 (11th Cir. 1999) (percentage of total fund); *Williams v. MGM-Pathe Communications Co.*, 129 F.3d 1026 (9th Cir. 1997) (same), *with Strong v. BellSouth Telecommunications, Inc.*, 137 F.3d 844 (5th Cir. 1998) (percentage of actual recovery); *Wise v. Popoff*, 835 F.Supp. 977 (E.D.Mich.1993) (same).

While reversionary funds are hard cases, *Masters* was not. Because the full fund will be distributed in *Masters*, plaintiffs' counsel has disgorged that full amount from the defendants and the Second Circuit was correct to reward them accordingly. Ω