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Contesting Attorneys' Fees In Class Actions

A Public Pension Fund Fiduciary Responsibility

Consistent with the mission of the Advocate *to present articles from individuals active in the institutional investor community that represent widely varying points of view, we publish the below article written by Gerald Gornish.*

By Gerald Gornish

Mr. Gornish is the Chief Counsel of the Pennsylvania Public School Employees' Retirement System. The views expressed herein are the views of the author only and do not necessarily reflect the views of the Pennsylvania Public School Employees' Retirement System or the Commonwealth of Pennsylvania.

In a recent edition of this newsletter, Peter M. Saparoff offered many sound suggestions to institutional investors regarding actions they should take in cases in which they are not lead plaintiff to be certain they are fulfilling their fiduciary duties.

One action he did not include, which I believe institutional investors have a responsibility to consider, is a close review of the attorneys' fees sought by counsel for the plaintiff class when a case settles. Institutions should review both the *percentage* of recovery and the *amount* of attorneys' fees requested in each case, and object to them where they appear excessive. Indeed, while the Saparoff article addresses the difficulties involved in second-guessing the *amount of a settlement* in which an institution has not been intimately involved during negotiations, the *reasonableness of a fee* sought by counsel can more easily be evaluated by institutions by comparing it to the firm's lodestar.

I say this fully recognizing that courts have justifiably moved away from utilizing a lodestar approach to determining the *amount* of attorneys' fees to be awarded. Courts have asserted that doing so converts their role into bean counters and encourages class counsel to inflate the amount of work devoted to the case. Add to that an hourly rate that is not commonly the product of negotiation since it is not the basis on which plaintiff's counsel is typically compensated in these cases. Be that as it may, the lodestar — with all its deficiencies — still represents the only quasi-objective basis to check the reasonableness of the amount sought under a percentage contingency.

Why is the lodestar relevant? Think about it. Most successful corporate law firms bill on an hourly-rate basis and are generally delighted to receive their undiscounted hourly rates. Even if class counsel receives nothing in 50% of the cases counsel undertakes, a strictly mathematical solution would provide only for two times the lodestar to make counsel whole. A simple lodestar multiple calculation and comparison will thus provide a quick method of determining whether the fee sought seems presumptively fair or whether further review is necessary.

In addition to the percentage sought and the lodestar multiple, the institution should ascertain if there is any feature in the case that makes it other than a plain vanilla securities litigation matter, which would justify either a higher or lower percentage or lodestar multiple. Factors to consider have been developed in such cases as *In re Prudential Ins. Co.,* 148 F.3d 283, 336-40 (3d Cir. 1998) and *Gunter v. Ridgewood Energy Corp.*, 223 F.3d 190, 195-96 (3d Cir. 2000). Any questions as to the appropriateness of the fee can and should be directed to class counsel, virtually all of whom, in my experience, have been very forthcoming with details and explanations. If they do not respond, a request for discovery under Fed. R. Civ. P. 23 (h)(2), would be appropriate.

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Will such efforts, including the filing of objections, produce a benefit to the class? I believe so. There is both academic and anecdotal support.

Although courts initially latched on to the personal injury model of a one-third contingent fee, often producing a tremendous windfall to class counsel, the advent of the mega cases, commencing with *Cendant*, demonstrated the unreasonableness of those high percentages and served also to put the brakes on automatic court approval. Indeed, whereas in 2000, an article on legal fees by Keith L. Johnson and Douglas M. Hagerman pointed out that the average fees in securities class action matters was about 31% of recoveries, with the growth of public pension and other institutional lead plaintiffs, the mean has declined considerably.

A recent study by Professor Michael A. Perino (*Markets and Monitors: The Impact of Competition and Experience on Attorneys' Fees in Securities Class Actions*, St. John's University School of Law Legal Studies Research Paper Series, Paper #06-0034 (Jan. 2006)) found that attorneys' fee requests and awards have dropped significantly since public pension funds began to take the lead role in securities class actions. He determined that between April 1997 and May 2005, the mean attorneys' fee was approximately 20% of the total recovery pool in cases with a public pension fund lead plaintiff compared to 27% in cases of other lead plaintiffs.

It has also been demonstrated by Theodore Eisenberg and Geoffrey P. Miller, *Attorney Fees in Class Action Settlements: An Empirical Study,* 1 Journal of Empirical Legal Studies 27-78 (2004), that the mean fee in common fund cases is well below the widely quoted one-third figure; they calculated the mean fee in class action data sets between 1993 and 2002 as 21.9% and the mean for securities cases at 24.1%. They also observed, as one would expect, that the percentage of recovery decreases as the amount of the settlement rises. They go so far as to claim that client recoveries generally explain the pattern of awards better than the lodestar and even suggest that the time and expense of a lodestar calculation may be wasteful.

I respectfully disagree with this latter conclusion. The lodestar is the only quasi-objective basis for determining whether the fee is reasonable. I believe that their extrapolated conclusion from data in their study — based solely on the value of a case rather than the efforts and legal acumen that went into producing the result — is too facile with respect to what a *reasonable fee* should be.

Anecdotal results also support the proposition that the efforts of institutions have produced fee reductions. As members of the plaintiff class, including public pension funds, have begun to object to the higher fee percentages sought, the courts have begun to scrutinize these requests more closely and have often reduced the fees requested to amounts that are substantially less than the traditional one-third. This is not a universal result. The experience of my agency, which entails principally the submission of written objections in a number of cases, has produced both reductions (in fees) and rejections (of our objections).

Some recent successful cases:

In re Infospace, Inc. Sec. Litig., 330 F. Supp. 2d 1203 (W.D. Wash. 2004), the court, following receipt of objections from public employee retirement systems and argument by Wayne Schneider, Chief Counsel of the New York State Teachers' Retirement System ("NYSTRS"), awarded a fee representing less than 12% of the settlement fund of $34.3 million rather than the 25% fee requested;

In re Honeywell International Inc. Sec. Litig., Lead Case No. 2:00 CV 036 05 (DRD) (D.N.J. 2004) (in which my agency joined NYSTRS in an objection and presented oral argument), the fee request of 25% of a $100 million settlement was reduced to 20%;

In re Veritas Software Corporation Sec. Litig., Case No. C-03-0283-MMC (N.D. Cal. 2005) (in which my agency joined in an objection), the fee request of 23.23% was reduced to a fee of 17% of the settlement (representing nevertheless 4 times the lodestar).

In addition, the author has been successful in negotiating reductions in fees without the necessity of filing an objection after reviewing data and discussing the merits with class counsel.

Moreover, the courts have themselves begun to scrutinize requests and have lowered fees. See:

Klein ex rel Sicor Inc. v. Salvi, 2004 U.S. Dist. LEXIS 4844 (S.D.N.Y. Mar. 26, 2004), aff'd 115 Fed. Appx. 515 (2d Cir. 2004), where the court awarded a fee of 8% of the $10,750,000 settlement — a multiple of 1.43 times the allowed lodestar;

In re Twinlab Corp. Sec. Litig., 187 F. Supp. 2d 80, 88 (E.D.N.Y. 2002), where the court awarded a 12% fee on a $26.5 million settlement;

In re Cylink Sec. Litig., 274 F. Supp. 2d 1109, 1115-16 (N.D. Cal. 2003), where the court determined that a fee of 16% of $6.2 million was "fair, adequate and reasonable;"

And *In re Bristol-Myers Squibb Sec. Litig.*, 361 F. Supp. 2d. 229 (S.D.N.Y. 2005), where the court rejected a fee request of 7.5% of the $300 million settlement and instead awarded a fee of some $11 million (less than 4%), representing a lodestar multiplier of 2.29 times.

Professor Perino also suggests that courts should encourage institutional investors to file objections to excessive fees. He believes that objections may be particularly useful in smaller cases in which institutions are unlikely to participate as lead plaintiffs, noting that these are the cases in which objections aimed at reducing fees are likely to have the smallest impact, thereby providing a disincentive for public pension funds to take action. To remedy this he suggests fully compensating institutions for their

cost in pursuing such objections and to award them some greater portion of the savings and attorneys' fees.

I would disagree with giving a greater proportion of the savings to an objector by analogy to the PSLRA's prohibition against the lead plaintiff recovering more than other members of the class; but institutions should be entitled to reimbursement for their out-of-pocket costs. In the cases in which my agency has objected and successfully contributed to reductions in fees, we have not sought any reimbursement. Certainly if we incurred significant travel costs to attend a hearing, reimbursement would be appropriate; but for the most part we have relied on written objections or have appeared in District Courts that are within driving distance.

In conclusion, class counsel incur a risk in undertaking representation of the class and are entitled to reasonable compensation for doing so. Institutional investors have a fiduciary obligation to make sure the fees are, in fact, reasonable — whether as lead plaintiff negotiating the fee, as recent evidence suggests is the case, or as a member of the class objecting to the fee. To put it bluntly: every dollar paid to counsel is a dollar taken from the class. ■