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SECOND CIRCUIT REVIEW

ATTORNEY'S FEE AWARDS IN COMMON FUND CASES

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Second Circuit Review: Attorney's Fee Awards in Common Fund Cases

In the five years since Congress enacted the Private Securities Litigation Reform Act of 1995,[1] practitioners and commentators alike have debated whether plaintiffs in common fund cases serve as true client-principals, or as "figureheads" facilitating the "quest for attorney's fees."[2] In this month's column, we discuss *Goldberger* v. *Integrated Resources Inc.*,[3] which marks the Second Circuit's entry into this debate.

In *Goldberger*, an opinion written by Judge Joseph M. McLaughlin, and joined by Judges Chester J. Straub and Robert D. Sack, the Second Circuit held that either the "lodestar" or "percentage of recovery" methods may appropriately be used to calculate attorney's fees in common fund litigation. Under the "lodestar" method, the district court determines the number of hours actually and reasonably billed to the class, and then multiplies that figure by an appropriate hourly rate. Once the initial computation has been made, the district court may, in its discretion, increase the lodestar by applying a multiplier based on "less objective factors" such as the risk of the litigation and the performance of the attorneys.[4] Under the "percentage of recovery" method, the court sets some percentage of the recovery as a fee (often 25 percent), based upon the same "less objective" factors used to determine the lodestar multiplier.[5]

Goldberger vests district courts in the Second Circuit with sweeping authority to exercise discretion in awarding attorneys' fees from a common fund.[6] Accordingly, the Second Circuit ruled in *Goldberger* that the district court did not abuse its discretion by awarding only 4 percent of a $54 million settlement recovery ($2.1 million) based upon counsel's "lodestar" of hours actually and reasonably billed. The district court was not required to award 25 percent of the recovery ($13.5 million), or to apply a multiplier enhancement to counsels' lodestar.

Background of the Case

Goldberger arose from the securities litigation involving Michael Milken of Drexel Burnham Lambert Group Inc. in the 1980s. Criminal and civil enforcement proceedings alleging securities fraud against Milken and Drexel had resulted in guilty pleas, fines, and restitution.[7] The primary defendant in *Goldberger* was Integrated Resources Inc., a financial services company that had defaulted on over $1 billion in short-term debt and which allegedly was aided and abetted by Milken and Drexel in a scheme to defraud investors.[8] When the prices of Integrated's publicly traded securities plummeted, a group of plaintiffs' law firms immediately filed lawsuits on behalf of the putative class, alleging violations of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Milberg Weiss Bershad Hines & Lerach LLP and Abbey, Gardy & Squitieri LLP were designated co-lead counsel.

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Four separate settlements eventually were reached with Integrated and the codefendants, generating a total recovery for the Integrated class of over $54 million. It fell to District Judge Shirley Wohl Kram to award attorney's fees, and Judge Kram appointed Michael D. Hess as a special master to review the fee application.[9] Special Master Hess's initial Report and Recommendation recommended that counsel receive 25 percent of the settlement recovery, or $13.5 million, but Judge Kram directed Mr. Hess to revise his recommendation and to base any fee award on counsels' lodestar.[10] Mr. Hess's second Report recommended a lodestar of just over $1.4 million, after eliminating various charges he found to be excessive, but permitted counsel to bill for their then-current hourly rates — even though the actual billing period spanned three and one-half years preceding the fee petition.[11]

Judge Kram adopted Mr. Hess's recommendation on the theory that then-current rates were justified in order to compensate counsel for the delay in payment. Judge Kram, however, reduced the lodestar to approximately $1.3 million, citing "'over 80 instances where the time records of Milberg Weiss, indicating meetings and telephone conferences with cocounsel, do not correspond with the time records of other counsel.'"[12] Judge Kram also declined to award a multiplier enhancement.

Following plaintiffs' counsels' second fee application, which requested 25 percent of a $32 million collateral settlement, Judge Kram appointed David H. Pikus as a special master. Mr. Pikus issued a Report and Recommendation recommending a lodestar award of $865,326, which likewise excluded perceived excessive charges and did not include a multiplier. Judge Kram adopted Mr. Pikus' recommendation, holding that "'an enhancement multiplier for the results achieved and risks borne by Plaintiffs' Counsel would likely result in their overcompensation.'"[13] For the two fee applications combined, the district court awarded counsel approximately $2.1 million.

Second Circuit Reviews Precedent

The Second Circuit began its review of Judge Kram's ruling by discussing the American Rule, which requires litigants to pay their own attorney's fees and expenses. Under an exception to that rule, attorneys who create a common fund from which members of a class are compensated for a common injury may seek a recovery-based "reasonable fee" from the court.[14] This "reasonable fee" is calculated using either the "1odestar" or "percentage of recovery" method.

The Second Circuit reaffirmed that a district court's "reasonable fee" determination will not be disturbed absent a mistake of law, clearly erroneous factual findings, or some other abuse of discretion.[15] But, as the Court acknowledged, its approach to the calculation of reasonable fees had "evolved in a somewhat circuitous fashion."[16] For most of the 20th century, the percentage of recovery approach prevailed, with the standard attorney's fee hovering around 25 percent of recovery. By the 1970s, however, some courts suggested that the percentage approach resulted in windfalls for enterprising lawyers at the expense of their

client-class.[17] Thus, in *City of Detroit* v. *Grinnell Corp.*,[18] the Second Circuit shifted course and began to mandate use of the lodestar method.[19] Expressing similar concerns about overcompensation, other circuits soon followed the Second Circuit's lead.[20]

The judiciary's focus on the lodestar approach led to the perception that plaintiffs' lawyers were motivated to run up their billable hours or avoid settling cases at the earliest appropriate stage.[21] Moreover, judicial resources frequently were wasted on a "gimlet-eyed review of line-item fee audits."[22] Thus, in 1984, the Supreme Court, in *Blum* v. *Stenson*, endorsed the "percentage of recovery" method in a footnote, observing that "under the 'common fund doctrine', a reasonable fee is based on a percentage of the fund bestowed on the class."[23]

This footnote prompted the Third, Eleventh and District of Columbia Circuits to mandate exclusive use of the percentage approach in common fund cases.[24] Seizing upon these decisions and Ninth Circuit precedent, plaintiffs' counsel in *Goldberger* argued that the Second Circuit should "junk" the lodestar method altogether, and mandate the percentage of recovery method in common fund lawsuits. Conceding that a circuit split had generated some confusion, the Second Circuit sided with six circuit courts that accorded district courts broad discretion to employ either a lodestar or percentage of recovery framework.[25] According to the Second Circuit, this approach was supported not merely by the weight of current authority, but also by various policy concerns of fairness, objectivity and administrability. The Second Circuit observed that no single method can claim to compensate plaintiffs' counsel equitably in all cases, without being over- (or under-) inclusive in application. Thus, the Court urged that the alternative methods not be viewed as mutually exclusive. For even where the percentage method ultimately is selected, the lodestar remains "useful as a baseline" and a "'cross check' on the reasonableness of the requested percentage." [26]

Benchmarking Lodestar

In *Goldberger*, plaintiffs' counsel argued that, once the district court had fastened on the lodestar method, it should have applied a multiplier of six. "To put it more bluntly, counsel continue[d] to assert that they were entitled to a 25 percent fee."[27] Plaintiffs' argument was predicated on the benchmark of 25 percent of recovery recognized in certain other jurisdictions. Specifically, plaintiffs' counsel argued that a 4 percent award was so far removed from that benchmark as to constitute an abuse of discretion.

The Second Circuit recognized that in certain jurisdictions 25 percent of recovery is a benchmark that generally should be awarded in common fund cases.[28] Indeed, the Second Circuit noted, courts in the Ninth Circuit must justify any departure from this benchmark by pointing to unusual circumstances.[29] Similarly, "district courts across the nation have apparently eased into a practice of 'systematically' awarding fees in the 25 percent range, 'regardless of type of case, benefits to the class, numbers of hours billed, size of fund, size of plaintiff class, or any other relevant factor.' "[30]

But while the Second Circuit deemed it a "commendable sentiment" that lawyers should have reasonable monetary incentives to bring cases in the public interest, it disagreed with the "essential notion" of a benchmark.[31] First, a benchmark could easily lead to routine windfalls for plaintiffs' counsel in cases where the funds recovered were substantial. More troubling, however, was the "principal analytical error" that there exists a substantial contingency risk in all common fund cases. The Second Circuit rejected this assumption by reference to empirical and anecdotal data. To begin with, the Court cited a study finding little recovery risk in securities class actions because virtually all such cases settle.[32] The Court then impeached plaintiffs' counsel with their own statements in a prior litigation that corroborated this empirical conclusion.

The Court likewise questioned whether a fully informed group of plaintiffs, able to negotiate collectively, would agree to pay their lawyers a 25 percent fee on a multimillion-dollar settlement. Judge McLaughlin expressed skepticism that plaintiffs in common fund cases generally are fully informed or able to negotiate at arm's length, and thus reaffirmed that the district court must "serve as a guardian of the rights of absent class members."[33]

The Second Circuit also perceived practical obstacles to benchmarking the lodestar, since the adversary system essentially is suspended during fee proceedings. As the Court pointed out, once a settlement amount has been established, defendants have little interest in how those funds are distributed among counsel and their clients, and thus lack any incentive to oppose the fee.[34] Indeed, that same dynamic "creates incentives for collusion — the temptation for the lawyers to agree to a less than optimal settlement 'in exchange for red-carpet treatment on fees.'"[35] Ironically, even class members have little incentive to object: each member can gain only a small pro rata portion of any fee reduction.[36]

Thus, the quandary in *Goldberger* arises from the fact that the Court "cannot know precisely what fees common fund plaintiffs in an efficient market for legal services would agree to, given an understanding of the particular case and the ability to engage in collective arm's-length negotiation with counsel."[37] Accordingly, the Second Circuit required that a "searching assessment" be performed by the district court in each case based upon the circumstances of that case.[38] Under the particular circumstances in *Goldberger*, the Court concluded that a fee award of 4 percent did not constitute an abuse of discretion simply because it deviated materially from time-tested benchmarks.[39]

Lodestar Enhancements

As the Second Circuit stated in *Goldberger*, the district court's determination of a reasonable fee should be guided by:

- the time and labor expended by counsel;
- the magnitude and complexities of the litigation;

- the risk of the litigation;
- the quality of representation;
- the requested fee in relation to the settlement; and
- public policy considerations.[40]

Focusing particularly on the risk and quality of representation factors, the Second Circuit ruled that the district court did not commit reversible error in refusing to apply a multiplier to its 4 percent lodestar.

In so holding, the Second Circuit first noted that, while it had previously reversed district courts for overcompensating class counsel,[41] it had never found an abuse of discretion because a common fund award was "too stingy."[42] The Court declined to take that unprecedented step in *Goldberger* because:

- plaintiffs' counsel benefitted substantially from the work already completed by federal authorities during the criminal and civil actions against Drexel and Milken;
- "'there was no groundbreaking issue which loomed significant in this case;'"
- the risk of nonpayment was slim because most of the defendants either had deep pockets or adequate liability insurance;
- use of current hourly billing rates for work completed years ago adequately compensated counsel for the delay in payment; and
- use of high hourly billing rates compensated counsel for the quality of their representation and any risk they assumed.[43]

In addition, the Court rejected counsels' claims that they had overcome the high hurdle of proving scienter, finding that this "obstacle" was encountered by all plaintiffs in all Rule 10(b)(5) securities suits.[44] Moreover, because litigation risk is assessed at the time the case is filed, there was no risk in bringing "aiding and abetting" claims against Drexel and Milken simply because the Supreme Court abolished aiding and abetting liability in § 10(b) litigation years later.[45] The Second Circuit specifically concluded that there was low risk in *Goldberger* because, as the district court found, the case was "promising" from the very start.[46]

The Second Circuit also analyzed the quality of the representation in *Goldberger*. In particular, the Court recognized the success actually achieved by plaintiffs' counsel, and cited statements by District Judge Milton Pollack that counsels' work in related proceedings had been of the highest quality.[47] Commenting more broadly, the Court agreed with

plaintiffs' counsel that quality of representation is best measured by concrete results, through a comparison of the amount of possible recovery with the amount actually recovered.[48] According to the Court, however, the amount of possible recovery is not necessarily the amount of "provable" damages, but rather should be measured by actual market losses.[49] By that measure, plaintiffs' counsel did not achieve as superior a result as they claimed.

Furthermore, the Second Circuit reasoned that the size of a recovery does not necessarily correlate with the quality of the representation. After all, "'a large settlement can as much reflect the number of potential class members or the scope of the defendant's past acts as it can indicate the prestige, skill, and vigor of the class's counsel.'"[50] In this regard, the Court noted that Drexel and Milken had been convicted of conduct bearing directly upon the claims advanced in *Goldberger*. Not only did that aid plaintiffs' case "enormously," but a sizable portion of counsels' lodestar in fact had been based upon hours spent researching the records of these prior proceedings.[51] In any event, the district court *did* compensate plaintiffs' counsel for the quality of their representation by allowing them to recover billing rates at the high end of the prevailing market — in some cases as high as $550 per hour.[52]

The Second Circuit concluded its opinion in *Goldberger* by signaling the broad discretion it will accord district courts so that they most appropriately can determine reasonable attorney's fees in common fund cases — particularly where the district court respects the "preference for moderation."[53] The Second Circuit thus continues to harbor the "nagging suspicion" that plaintiffs' counsel in class action representations routinely are overcompensated. With its decision in *Goldberger*, the Second Circuit is attempting to remedy that problem and suggesting to district courts that they, too, move aggressively on this front, without fear of reversal.[54]

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ENDNOTES

1. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 107, 109 Stat. 737, 758 (1995).

2. Ralph K. Winter, *Paying Lawyers*, *Empowering Prosecutors, and Protecting Managers; Raising the Cost of Capital in America*, 42 Duke L.J. 945, 984 (1993).

3. 2000 U.S. App. LEXIS 5152 (2d Cir. Mar. 28, 2000).

4. *Savoie* v. *Merchants Bank*, 166 F.3d. 456, 460 (2d Cir. 1999).

5. See, e.g., *Brown* v. *Phillips Petroleum Co.*, 838 F.2d 451, 454-55 (10th Cir.)

6. See *City of Detroit* v. *Grinnell Corp.*, 495 F.2d 448, 470-71 (2d Cir. 1974) (only lodestar method can "claim objectivity"); *cf. In re "Agent Orange" Prod. Liab. Litig.*, 818 F.2d 226, 232 (2d Cir. 1987) (Second Circuit has "adopted a lodestar formula for calculating fees" in common fund cases).

7. See *Goldberger*, 2000 U.S. App. LEXIS 5152 at *3; see also *In re Drexel Burnham Lambert Group Inc.*, 995 F.2d 1138, 1142 (2d Cir. 1993).

8. The plaintiffs also named as defendants some of Integrated's officers and directors, Drexel, Milken, and Touche Ross & Co., Integrated's outside auditor. *Goldberger*, 2000 U.S. App. LEXIS 5152 at *4.

9. See id. at *5-6.

10. See id. at *6.

11. See id.

12. Id. at *7.

13. *Goldberger*, 2000 U.S. App. LEXIS 5152 at *8.

14. Id. at *9-10.

15. See *M. Herman* v. *Davis Acoustical Corp.*, 196 F.3d 354, 356 (2d Cir. 1999); *Kirsch* v. *Fleet Street, Ltd.*, 148 F.3d 149, 172 (2d Cir. 1998); *In re Bolar Pharm. Co. Sec. Litig.*, 966 F.2d 731, 732 (2d Cir. 1992) (per curiam).

16. *Goldberger*, 2000 U.S. App. LEXIS 5152 at *12-13.

17. See, e.g., *Rosenfeld* v. *Black*, 56 FRD 604, 605-06 (S.D.N.Y. 1972); *Winkelman* v. *General Motors Corp.*, 48 F. Supp. 504 (S.D.N.Y. 1942), *aff'd sub nom.*; *Singer* v. *General Motors Corp.*, 136 F.2d 905 (2d Cir. 1943).

18. 495 F.2d 448 (2d Cir. 1974).

19. In *Grinnell*, the Second Circuit reversed and remanded a 15 percent fee award with instructions to conduct the "mathematical exercise" of calculating a lodestar, because that method alone could "claim objectivity." 495 F.2d at 470-71. Indeed, when the case returned several years later with a lodestar amounting to 10 percent of recovery, the Second Circuit again reversed the fee award as excessive. See *City of Detroit* v. *Grinnell Corp.*, 560 F.2d 1093, 1095, 1103 (2d Cir. 1977).

20. See, e.g., *Copeland* v. *Marshall*, 641 F.2d 880, 890 (D.C. Cir. 1980) (en banc); *Furtado* v. *Bishop*, 635 F.2d 915, 920 (1st Cir. 1980); *Grunin* v. *International House of Pancakes*, 513 F.2d 114, 128 (8th Cir. 1975); *Lindy Bros. Builders Inc.* v. *American Radiator & Standard Sanitary Corp.*, 540 F.2d 102, 112 (3d Cir. 1976) ("Lindy II").

21. See *Savoie* v. *Merchants Bank*, 166 F.3d 456, 461 (2d Cir. 1999); *In re Union Carbide Corp. Consumer Prod. Bus. Sec. Litig.*, 724 F. Supp. 160, 167-68 (S.D.N.Y. 1989).

22. *Goldberger*, 2000 U.S. App. LEXIS 5152 at *15.

23. *Blum* v. *Stenson*, 465 U.S. 886, 900 n.16 (1984).

24. See, e.g., *In re General Motors Corp. Liab. Litig.*, 55 F.3d 768, 821-22 (3d Cir. 1995); *Swedish Hosp. Corp.* v. *Shalala*, 1 F.3d 1261, 1271 (D.C. Cir. 1993); *Camden I Condominium Ass'n* v. *Dunkle*, 946 F.2d 768, 774 (11th Cir. 1991).

25. See *Johnston* v. *Comerica Mortgage Corp.*, 83 F.3d 241, 244-46 (8th Cir. 1996); *In re Thirteen Appeals Arising Out of The San Juan Dupont Plaza Hotel Fire Litig.*, 56 F.3d 295, 305 (1st Cir. 1995); *Rawlings* v. *Prudential-Bache Properties, Inc.*, 9 F.3d 513, 516 (6th Cir. 1993); *Harman* v. *Lyphomed, Inc.*, 945 F.2d 969, 975 (7th Cir. 1991); *Paul, Johnson, Alston & Hunt* v. *Graulty*, 886 F.2d 268, 272 (9th Cir. 1989); *Brown* v. *Phillips Petroleum Co.*, 838 F.2d 451, 454 (10th Cir. 1988); see also *Savoie* v. *Merchants Bank*, 166 F.3d 456, 460 (2d Cir. 1999) ("the percentage-of-the-fund method is a viable alternative").

26. *Goldberger,* 2000 U.S. App. LEXIS 5152 at *20 (quoting *In re General Motors Corp. Liab. Litig.*, 55 F.3d 768, 820 (3d Cir. 1995)).

27. Id. at *23.

28. See id. at *24 (quoting *In re Pacific Enters. Sec. Litig.*, 47 F.3d 373, 379 (9th Cir. 1995)).

29. See id. (citing *Paul, Johnson, Alston & Hunt* v. *Graulty*, 886 F.2d 268, 272 (9th Cir. 1989)).

30. Id. at *24-25 (quoting *Court Awarded Attorney Fees*, 108 F.R.D. 237, 274 n.32 (1985)).

31. *Goldberger*, 2000 U.S. App. LEXIS 5152 at *25.

32. See id. at *27 (citing Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497, 578 (1991)).

33. Id. at *28 (quoting *City of Detroit* v. *Grinnell Corp.*, 560 F.2d 1093, 1099 (2d Cir. 1977) (internal quotation marks omitted)).

34. See id. at *28-29.

35. Id. at *29 (quoting *Weinberger* v. *Great N. Nekoosa Corp.*, 925 F.2d 518, 524 (1st Cir. 1991)).

36. See *Goldberger*, 2000 U.S. App. LEXIS 5152 at *29.

37. Id. at *25-26.

38. Id. at *26, *30-31. Citing empirical analyses, the Court observed that judges have traditionally discounted for economies of scale by awarding fees in the lower range of about 11 percent to 19 percent. "'Obviously, it is not ten times as difficult to prepare, and try or settle a 10 million dollar case as it is to try a 1 million dollar case.'" Id. at *26-27 (quoting *In re Union Carbide Corp. Consumer Prod. Bus. Sec. Litig.*, 724 F. Supp. 160, 166 (S.D.N.Y. 1989)).

39. See id. at *30.

40. Id. at *21 (quoting *Union Carbide*, 724 F. Supp. at 163).

41. See, e.g., *Kaplan* v. *Rand*, 192 F.3d 60, 72 (2d Cir. 1999).

42. *Goldberger*, 2000 U.S. App. LEXIS 5152 at *32.

43. See id. at *32-33.

44. See id. at *34-35.

45. See *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994) (abolishing aiding and abetting liability in Section 10(b) securities

litigation); see also *Goldberger*, 2000 U.S. App. LEXIS 5152 at *36-37 (litigation risk measured as of time case commenced) (citing *DiFilippo* v. *Morizio*, 759 F.2d 231, 234 (2d Cir. 1985)).

46. See *Goldberger*, 2000 U.S. App. LEXIS 5152 at *35. Moreover, not all risk is created equal. For example, the Second Circuit had previously employed public policy considerations to deny any contingency allowance in a case that was risky simply because of its "highly questionable merit." *In re "Agent Orange" Prod. Liab. Litig.*, 818 F.2d 226, 235-36 (2d Cir. 1987).

47. *Goldberger*, 2000 U.S. App. LEXIS 5152 at *38.

48. See id.

49. See id. at *38-39. The Court was hesitant to accept plaintiffs' expert report on the amount of "provable" damages, both because the expert report had not been tested through the adversarial process, and because valuation of damages in securities class actions is inherently susceptible to challenge. See id. at *39.

50. Id. at *39 (quoting *City of Detroit* v. *Grinnell Corp.*, 560 F.2d 1093, 1099 (2d Cir. 1977)).

51. See id. at *39-40.

52. See *Goldberger*, 2000 U.S. App. LEXIS 5152 at *41 (citing *Cities At A Glance: High and Low Hourly Billing Rates*, Nat'l L.J. (Dec. 21, 1998)).

53. Id. at *42.

54. Id.