Back to the Future: Use of Percentage Fee Arrangements in Common Fund Litigation

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One court observed several years ago: "To the old adage that death and taxes share an inevitable character, federal judges may be excused for adding attorney's fees cases."1 Under the "common fund" doctrine, one accepting the benefits of litigation prosecuted by another is equitably bound to share proportionately in the costs of the litigation.2 The doctrine most commonly applies in class action cases involving a monetary recovery.3 Although attorney fees are usually the most significant charge against a common fund, the early cases largely ignored the method for calculating fees.4 Recently, the methodology for calculating fees has become increasingly controversial.

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2. The doctrine has its roots in the simple notion of equity that one who accepts the benefits of litigation should share the cost of producing that benefit. In Trustees v. Greenough, 105 U.S. 527 (1882), the Court held that when one beneficiary of a trust successfully sued the trustee for waste of trust assets, all beneficiaries of the trust were bound to pay their ratable share of the fees incurred. Id. at 533-35. The Court soon expanded the doctrine in holding that the fee request could be made by counsel (as opposed to the client who had actually incurred the fees). Central R.R. & Banking Co. of Georgia v. Pettus, 113 U.S. 116, 124-25 (1885). In Boeing Co. v. Van Gemert, 444 U.S. 472 (1980), the Court held that the available "fund" included monies of unlocated class members who did not actually receive the benefit upon which the common fund fee claim was based.

3. The recovery need not be made solely through the litigation. In City of Klawock v. Gustafson, 585 F.2d 428 (9th Cir. 1978), a federal official decided, as a result of litigation brought by a city, to provide relief identical to that obtained in the litigation to other municipalities which were similarly situated to the litigant. Although no "fund" was created before the court, and the other municipalities were not parties, the Ninth Circuit required the other municipalities to share in the fees incurred by the City of Klawock in obtaining the original decision. Id. at 432.

4. In Greenough, the petitioner sought reimbursement of the fees she had actually paid. 105 U.S. at 529. The Court did not inquire into the amount of the fee claimed. In Pettus, the Court determined the fee by setting "reasonable compensation." 113 U.S. at 128. It determined this amount to be 5% of the amount recovered. Id.
Historically, common fund attorney fees were calculated as a percentage of the fund.\(^5\) Attorney fees were thus determined almost exclusively by reference to the result obtained by the lawyer. In response to criticisms that this method of setting fees resulted in awards disproportionate to the efforts expended in generating the recovery,\(^6\) trial courts shifted to fee methodologies that instead focused on the efforts of counsel in obtaining the recovery.\(^7\) Under these methodologies, effort was measured by hours expended by counsel.

A growing perception exists that hourly based fee methodologies have their problems as well. Recently, the United States Courts of Appeal for the Third and Ninth Circuits evaluated alternative fee methodologies.\(^8\) In evaluating hourly based fee methodologies, the reports cited excessive hours, duplicative or unjustifiable work, early settlement disincentive,


\(^6\) See, e.g., City of Detroit v. Grinnell Corp., 495 F.2d 448 (2d Cir. 1974) [hereinafter Grinnell I], appeal following remand, 560 F.2d 1093 (2d Cir. 1977). In Grinnell I, the trial court had awarded a 15\% fee on a $10 million recovery. 495 F.2d at 452. The Second Circuit rejected the award as "excessive" and as displaying "too much reliance on the contingent fee syndrome." Grinnell I, 495 F.2d at 468. It noted that the "bitterest complaints . . . from laymen" regarding lawyers and the legal system concerned "windfall fees and feather bedding," all of which also resulted in criticism of class action litigation. Id. at 469. Many of the same criticisms are now advanced against hourly fees. In re Fine Paper Antitrust Litig., 98 F.R.D. 48, 67 (E.D. Penn. 1983).

On a subsequent appeal following remand, the court explored in greater detail its concern with the percentage fee. Although the "lead" counsel who principally benefitted from the percentage award had conducted brief settlement negotiations that led to the creation of the fund, he had little to do with the actual prosecution of the case. Grinnell II, 560 F.2d at 1096-97, 1101. The case did not present an uncharted excursion into legal territory or grave risk of loss, because government agencies had previously brought cases in which much of the legal work had already been performed. Id. at 1096, 1101.

\(^7\) See infra notes 16-17. The shift to hourly fee methodologies has not been complete. As recently as 1984, the Supreme Court indicated that common fund fees should be based on a percentage of the recovery:

Unlike the calculation of attorney's fees under the "common fund doctrine" where a reasonable fee is based on a percentage of the fund bestowed on the class, a reasonable fee under § 1988 reflects the amount of attorney time reasonably expended on the litigation.


lack of flexibility and predictability, and an increased burden on the judicial system as disadvantages to this method of setting fees. Both reports approved the use of percentage fee arrangements in common fund cases.

It is well known that class counsel truly manage the prosecution and/or settlement of class litigation. Furthermore, class clients seldom are advised of the level of fees incurred during the course of the litigation. The only review of the hours expended over years of litigation is at the end of the process, when the fee applications are submitted to the court.

The premise of this Article is that common fund litigation will be most efficiently and beneficially prosecuted if attorney fees are awarded under a methodology that makes parallel the interests of counsel in the fee award and of the class in the recovery. The Article examines the historical uses of the percentage fee, the development of and problems with, hourly based methods of computing fees, and the renewed trend toward the use of percentage fee awards. It concludes that, unlike hourly based methodologies, percentage fee arrangements align the interests of counsel with the interests of both the class and the judicial system. The judicial return to percentage fee arrangements is a good idea that will result in prompt, efficient, and economic disposition of class action litigation.

I. PERCENTAGE FEES IN THE UNREGULATED MARKETPLACE AND THE SEARCH FOR ALTERNATIVES

A. The Problem and the Shift to Hourly based Methodologies

Under a contingent percentage fee arrangement, a lawyer takes a percentage of the recovery as his compensation. Such


10. The fees in a common fund case are most frequently awarded at the end of the litigation. In the event of a class action settlement, notice of the settlement is provided to the class. Fed. R. Civ. P. 23(e). The notice advises the class of the terms of the settlement. It will typically state that an award of fees and expenses will be sought, although it seldom provides much detail concerning the fee request. For most class members, this notice is the first and only contact they will have with the settlement of the litigation and the fee setting process.

11. A percentage fee agreement may have a range of percentages under various circumstances. The percentage of fee may be based on the stage of the proceedings at which the recovery is obtained, generally increasing as the litigation progresses. The theory of such an arrangement is that the risk, amount of lawyer time invested, and delay in payment all increase as the case progresses, and that, therefore, a higher
an arrangement is entrepreneurial and focuses on the results obtained for the client, without direct consideration of the efforts expended by counsel. Although the lawyer's efforts are not explicitly considered in calculating the fee, an implicit premise of percentage arrangements is that the lawyer's efforts will be reflected in the results obtained, and by virtue of the lawyer's self-interest, these efforts will be proportionate to the potential recovery.\textsuperscript{12}

Under the percentage fee method, fees in class action litigation generally ranged from 20-25 percent of the recovery.\textsuperscript{13} The percentage method of setting fees was simple in application and also provided a measure of certainty. However, it was perceived that percentage fee arrangements provided recoveries disproportionate to the efforts expended.\textsuperscript{14} Such disproportion resulted from several factors, including a percentage that was too high in light of the difficulty, risk, amount at stake, or anticipated length of the litigation.\textsuperscript{15} A prompt disposition of the case could create the impression that counsel labored neither long nor hard on the case, while still collecting a substantial fee.

The courts reacted to the perception that percentage fee awards resulted in unreasonable fees by adopting alternative fee methodologies. These approaches are called the "\textit{Lindy}" (or "lodestar") method\textsuperscript{16} and the "\textit{Screen Extras}" method.\textsuperscript{17}

\footnotesize{percentage is necessary to adequately compensate counsel. These arrangements are referred to in this Article as "stage sliding scales." The agreement may also reduce the percentage as the amount recovered increases. The theory of such an arrangement is that the effort expended in obtaining any recovery will diminish proportionately as the recovery increases, and that, therefore, a lower percentage of the upper bracket of recovery is necessary to adequately compensate counsel. These arrangements are referred to in this Article as "recovery sliding scales."}

\footnotesize{The \textit{Third Circuit Report} recommends using both the stage and recovery sliding scales. 108 F.R.D. at 256. This Article suggests that such arrangements may cause more problems than they solve. See infra part III(B)(3).}

\footnotesize{12. In establishing or approving the percentage, counsel and the court should of course be cognizant of the potential hours involved in prosecuting the case. As will be explored more fully, one benefit of percentage arrangements is that they shift the risk of excessive hours from the class to the lawyer. See infra Part III.(A).}

\footnotesize{13. See \textit{Legal Therapeutics}, supra note 5, at 665. The amount can range lower. See infra note 93.}

\footnotesize{14. See supra note 6.}

\footnotesize{15. Id. "Disproportion" is, of course, a relative concept. If the mere fact that highly competent counsel have been retained by the class promptly results in a more favorable attitude towards settlement by a defendant, a handsome fee to that counsel may be appropriate. Counsel are, of course, a limited resource, and "proportion" can only be determined by reference to market factors.}

Because the primary concern was that the awards were out of proportion to the efforts expended by counsel, courts devised fee methodologies measured by the time-value\textsuperscript{18} of those efforts.

**B. Application of Hourly Rate Methodologies**

Under the *Lindy* formulation, the court begins the calculation of a "reasonable fee" by determining a lodestar amount. This amount consists of the hours reasonably incurred, multiplied by a reasonable hourly rate. This lodestar historically was adjusted through "multipliers" to reflect special circumstances of the case, including factors such as the contingent nature of the agreement, risk of the case, quality of work, exceptional results, and the delay in receipt of payment. Multipliers were positive (increasing the lodestar) or negative (decreasing the lodestar).

*Screen Extras* involved consideration of many of the *Lindy* factors, but differed somewhat in its application. No mathematical formula was used; rather, the court considered the following factors:

1. Time and labor required;
2. Novelty and difficulty of the questions involved;
3. Skill requisite to perform the legal service properly;
4. Preclusion of other employment by the attorney due to acceptance of the case;
5. Customary fee;
6. Whether the fee is fixed or contingent;
7. Time limitations imposed by the client or the circumstances;
8. Amount involved and the results obtained;
9. Experience, reputation and ability of the attorneys;
10. Undesirability of the case;

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17. Johnson v. Georgia Highway Express, Inc., 488 F.2d 714 (5th Cir. 1974); Kerr v. Screen Extras Guild, Inc., 526 F.2d 67 (9th Cir. 1975), *cert. denied*, 425 U.S. 951, (1976) (adopting the *Georgia Highway* approach). The Ninth Circuit's *Screen Extras* and Fifth Circuit's *Georgia Highway* approach are referred to in this Article as the *Screen Extras* approach, because the Article deals with the Ninth Circuit's evaluation of fee methodologies.

18. City of Detroit v. Grinnell Corp., 495 F.2d 448 (2d Cir. 1974), *appeal following remand*, 560 F.2d 1093 (2d Cir. 1977). As used in this Article, "time-value" is the product of the number of hours reasonably expended by the professional multiplied by an hourly rate.
(11) nature and the length of the professional relationship with the client; and
(12) awards in similar cases. 19

Based on these factors, the court sets the fee.

Although phrased differently, the Screen Extras methodology operated much like the Lindy/lodestar approach. The first and most important consideration under Screen Extras is the "time and labor required." 20 This factor closely parallels the lodestar under Lindy. Under Screen Extras, enhancements or reductions of the fee that reflect the remaining factors are then made from this base. 21

Courts have traditionally ignored the distinctions between fee shifting claims, by which the fee is recovered from the opposing party in addition to the substantive recovery, and common fund fees, where the fee is paid from the fund recovered. There are, in fact, substantial differences. 22 Common fund fees are based on equitable notions of sharing litigation costs that benefit a group of people. Statutory fee schemes, on the other hand, are intended to encourage private enforcement of statutory rights. 23 Statutory fee shifting cases are thus not always "group" actions, as common fund cases necessarily are. 24 In the statutory fee shifting case, there is an adversary—the defendant—from whom the fee is sought. This is not so in the common fund, by which the case is managed by the plaintiffs' counsel and the defendant has little interest in or knowledge of how much of a fee is paid from the fund. 25 The amount of the common fund sets a limit on a common fund recovery, but is also a measure of the success obtained. Statutory fees, on the other hand, may exceed the amount recovered; the amount recovered may not be an indicator of success in cases of intangible rights. Although the courts have not always distinguished the two fee situations, 26 this Article deals

20. Id. at 717.
21. In re Manoa Finance Co., 853 F.2d 687 (9th Cir. 1988); Wood v. Sunn, 852 F.2d 1205 (9th Cir. 1988). The Ninth Circuit Committee apparently perceived significant differences between Lindy and Screen Extras. It specifically rejected Lindy, Ninth Circuit Report, supra note 8, at 3, while recommending retention of the Screen Extras approach as Circuit policy. Id. at 3-4.
22. 3 H. NeWBERG, CLASS ACTIONS § 14.03 (1985).
24. See Blum, 465 U.S. at 900 n.16.
only with the common fund fee awards.

Recently, the U.S. Supreme Court formulated a hybrid of Lindy and Screen Extras for calculating a “reasonable” fee in statutory fee shifting cases.27 Under this hybrid, the lodestar is the initial calculation; this amount “is presumed to be the reasonable fee.”28 The presumption is a “strong” one,29 from which the court should depart only in “rare” or “exceptional” cases.30 Adjustments to the fee should apparently occur under the Screen Extras methodology, reflecting the Court’s concern with the use of multipliers.

II. HOURLY BASED FEE METHODOLOGIES—ALL THAT GLITTERS IS NOT GOLD

In common fund cases, use of hourly based methodologies has generated problems more serious than those they were designed to resolve. These problems arise from the following: (i) The high degree of control that counsel has over the management and disposition of class litigation; and (ii) the fact that no client typically pays or advances the fees of counsel during the conduct of such litigation.31

Because hourly based fee methodologies focus on the hours devoted by counsel, counsel’s interest in managing the litigation can result in maximizing hours and extending resolution of the litigation, as opposed to obtaining the best, quickest, and most efficient result for the clients. Instead of the 20-25 percent recoveries under percentage fee methodologies, courts are asked to award 40 and 50 percent in attorney fees from

31. These factors are less of a problem in statutory fee shifting cases, in which the court is asked to award a fee not from a common fund, but from the losing party. See supra note 25. In such a case, the lawyer has typically represented a “real” client who has made the ultimate litigation decisions, and may have paid the fees during the course of the litigation. In addition, in a statutory fee case, the defendant has a direct interest in limiting the amount of the fee. Cf. Evans v. Jeff D., 475 U.S. 717 (1986) (defendant conditioned settlement on no liability for fees). The Third Circuit Report recommended use of percentage fee agreements in fund-in-court cases, and retention of the Lindy approach in statutory fee cases. Third Circuit Report, 108 F.R.D. at 255-56. A useful contrast in the consideration between the two situations appears in 3 H. Newberg, Class Actions § 14.03 (1985).
enormous recoveries.\textsuperscript{32} Because the common fund attorney fees are paid from the substantive award, such high percentages significantly reduce the recovery by class members. In addition, the litigation may well be both prolonged and expanded, resulting in reduced and delayed recoveries by class members.

The Third Circuit Task Force and the Ninth Circuit Committee were commissioned in response to these problems. The Third Circuit Task Force was created to address "growing concern over the perceived deficiencies and abuses of the \textit{Lindy} formulation," and to "devis[e] and articulate its view of an optimum court-awarded fee system. . . ."\textsuperscript{33} The Ninth Circuit Committee arose out of a panel at a Ninth Circuit Judicial Conference in 1986. The committee, comprised of circuit, district, and bankruptcy court judges, private practitioners, public interest lawyers, and scholars, undertook "to review the procedures and methods used in awarding attorney fees."\textsuperscript{34} It surveyed the bench and bar for means of calculating fees and problems in the fee area. One year later, it presented its findings to the Ninth Circuit Judicial Conference.

After a review of the problems and abuses with \textit{Lindy}, the Third Circuit Task Force recommended as the "optimum court-awarded fee system" use of percentage fee arrangements in fund-in-court cases.\textsuperscript{35} Although the Ninth Circuit Committee recommended retention of the \textit{Screen Extras} approach as circuit policy, it endorsed the use of percentage agreements by district judges comfortable with them in common fund cases.\textsuperscript{36}

This section of this Article analyzes these reports and the deficiencies of hourly based methodologies. The perceived problem with percentage agreements was that they occasionally resulted in awards inconsistent with the efforts expended by counsel in prosecuting the claim. The shift to hourly based methodologies has resulted in fee awards arguably more consistent with the efforts of counsel, but inconsistent with the amount recovered.

Hourly based methodologies create an incentive to manage litigation so as to maximize the hours for which the counsel is to be compensated. This incentive results in a substantial

\textsuperscript{32} See infra text accompanying notes 41 and 49.
\textsuperscript{33} Third Circuit Report, 108 F.R.D. at 253-54. It bears noting that the \textit{Lindy} methodology originated in the Third Circuit.
\textsuperscript{34} Ninth Circuit Report, supra note 8, at 1.
\textsuperscript{35} Third Circuit Report, 108 F.R.D. at 253-54, 255.
\textsuperscript{36} Ninth Circuit Report, supra note 8, at 4-5.
divergence of the interests of counsel and the interests of the class because the factors driving the fee award differ from the factors driving the best recovery for the class. As the Third Circuit Task Force and the Ninth Circuit Committee noted,\textsuperscript{37} hourly based methodologies result in:

1. Churning, padding of hours, and inefficient use of resources;
2. unnecessarily prolonged litigation;
3. artificial, unrealistic, and manipulative application of the fee setting system;
4. lack of consistency and predictability;
5. judicial involvement in extended, burdensome and complex litigation concerning fees; and
6. fees at higher levels than would be awarded under percentage fee agreements.

Each of these criticisms is discussed below.

\textit{A. The Lodestar Calculation: Hours Times Rates Equals Delay, Waste, Diminished Substantive Recoveries, and an Added Judicial Burden}

Hourly based systems are at least initially premised on the following time-value calculation: "reasonable" hours expended multiplied by "reasonable" hourly rates. This seemingly simple formula creates a fee system that promotes excessive hours worked and high hourly rates.\textsuperscript{38}


\textsuperscript{38}The premise of this Article—that a fee system should be used that makes the interests of counsel and client parallel—may suggest that lawyers are only concerned with fees, or that all lawyers take advantage of the potential for abuse under hourly based methodologies. There is in fact a problem—there are some lawyers who take advantage of the system. That abuse was what led to the circuit court studies. Using a different system, which forces parallelism as opposed to conflict of attorney-client interests, will place limits on this potential for abuse. Second, even if lawyers are consciously devoted to their clients' interests, the conflicts inherent under hourly based methodologies can create either (i) a subconscious desire to serve one's own, and not one's clients', interests; or (ii) the appearance of such a conflict. Third, percentage fees shift the risk of waste and inefficiency from the class to counsel. \textit{See infra} note 94. Finally, the use of percentage arrangements will tend to decrease the costs (economic, social, and judicial) of class litigation. If fee arrangements are to be driven by the interests of any party, it should be the interests of the class and not of counsel.

Some have suggested that these problems can be dealt with if the court initially sets strict guidelines for reimbursement of fees and expenses, \textit{e.g.}, limiting compensation to a single attorney attending a deposition. However, this suggestion does not deal with the inefficient litigator who prolongs a one-day deposition into three days or who takes eight depositions when only one is necessary.
1. A Fee Recovery Based on Hours Reasonably Expended is Unworkable and Creates a Disincentive to Prompt Resolution of Litigation

The conduct and resolution of the Fine Paper Antitrust Litigation revealed a fee system gone awry. The decision in that case was the driving force behind the formation of the Third Circuit Task Force. Although the lawyers in the case were successful in obtaining settlements of over fifty million dollars, they submitted fee and expense requests totalling twenty million dollars, or 40 percent of the recovery. The trial court awarded approximately 4.3 million dollars in fees and 1.1 million dollars in expenses, slashing the applications by nearly 75 percent.

The decisions reveal, in gory detail, the serious abuses possible when fees are awarded under hourly based methodologies. They set forth a catalogue of horrors including: (i) management of litigation by committees of lawyers; (ii) allocation of work through systems of patronage and self-dealing, in which favors were granted in the form of assignment of responsibility for lucrative tasks or acquiescence in the hours claimed by others; (iii) padding of hours; (iv) assigning multiple lawyers to perform the work of one; (v) use of partners to do work more suitable for clerks or paralegals; and (vi) undertaking tasks that consumed enormous amounts of time but were of little utility or value to the class. The debacle in Fine Paper was by no means unique or unprecedented.

Cases involving multiple counsel result in the greatest

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41. *Fine Paper II*, 751 F.2d at 570-71. Fee petitions consumed 27 feet of pleadings. See id. at 601 n.1. Fee hearings were held on 41 days. See id. at 571.
42. Id. at 575.
44. Id. at 71, 712; *Fine Paper II*, 751 F.2d at 573.
46. *Fine Paper II*, 751 F.2d at 573.
48. Id. at 75-76. There were approximately 97,000 hours billed to the class. See id. at 70. About 85,000 of these hours (over 85% of the total) were spent after the original settlements (which comprised $30 million of the total of $50 million) were reached. See id.
49. Another example of abuse under *Lindy* (albeit in the context of a statutory fee award for a prevailing party) is Cunningham v. City of McKeesport, 753 F.2d 262 (3d Cir. 1985), a case challenging a city's negligent destruction of a house valued at $2,700. Counsel devoted 245 hours to discovery in the case, which was simple and
abuses under hourly based methodologies. The case "managers" permit overstaffing and excessive hours because the fee recovery is not capped by a fixed percentage of the recovery, but is instead limited only by the amount of the recovery. Thus, hourly based methodologies permit, if not encourage, multiple claims for the same work. Under those methodologies, counsel have an incentive to enter the case at every stage of the proceedings, even after substantial progress toward resolution of the case has been made.\textsuperscript{50} Express or implicit agreements to maximize fees result in innumerable layers of committee structure and bureaucracy. In \textit{Fine Paper}, some forty-one private law firms submitted claims for compensation.\textsuperscript{51} Some entered the case after a substantial number of the defendants had settled, and the class was already over-represented; nearly 88 percent of the hours claimed were recorded \textit{after} the initial settlements were reached.\textsuperscript{52}

A less frequently discussed problem is that of well-intentioned but inefficient counsel. Under hourly based methodologies, the class presumptively assumes the risk of inefficiency. This is because it is difficult for the court, based on a review of time records and a brief submitted by counsel, to determine whether a deposition was efficiently conducted or whether the discovery in question was necessary or of benefit to the class.

Hourly based methodologies encourage counsel to record increased hours, and to ignore hard judgments about whether and how the work should be done. Whether these hours were reasonable or necessary is not determined until it is too late—at the conclusion of the litigation when the work has already

straightforward. The Third Circuit reversed the district court's significant reduction of the fee requested, compensating all hours claimed for a $35,000 fee recovery.

In a recent class action case involving a $13.8 million settlement, Chief Judge Richard M. Bilby, Chair of the Ninth Circuit Committee, recommended (as a special master) a fee and expense award of $5.4 million (38.9\% of the settlement) based on a request for $5.8 million (42\% of the settlement). \textit{In re} Seafirst Litig., No. C83-771R (W.D. Wash. Feb. 26, 1987) (Minute Order). Judge Bilby's fee recommendation was in the alternative, using both the \textit{Screen Extras} hourly based analysis and a percentage of the recovery. No percentage was negotiated at the outset of the case. Judge Bilby also used a recovery sliding scale that increased as the recovery went up. He did so based on a finding that plaintiffs had recovered more than the reasonable settlement value of the case. \textit{Id.} at 2. On review, the district court reduced the award of fees and expenses to $4.35 million (31.5\% of the settlement). Naye v. Boyd, No. C83-771R (W.D. Wash. Jan. 22, 1988) (as amended March 8, 1988).

\textsuperscript{50} See, \textit{e.g.}, \textit{Fine Paper I}, 98 F.R.D. at 170. \textit{See also supra} note 48 and accompanying text.

\textsuperscript{51} \textit{Fine Paper I}, 98 F.R.D. at 86-228.

\textsuperscript{52} \textit{See supra} note 48 and accompanying text.
been performed. These factors not only create a disincentive to manage litigation efficiently, but place the court in the difficult position of second-guessing counsel and disallowing hours after a substantial result has been obtained.

2. Reasonable Rates May Not be Reasonable, Predictable, or Reflective of the Value of the Service Rendered

The divergence in interests between the class and counsel under hourly based methodologies also appears in the determination of reasonable hourly rates. An hourly based methodology creates an incentive for attorneys with high billing rates (i.e., senior partners) to perform tasks for which their skills, training, expertise, and associated billing rates are not needed.\footnote{53} Hourly based methodologies create no incentive (other than \textit{ex post facto} court review) to make the highest and best use of the human resources available. Instead, they encourage use of the professional with the highest billing rate the court will or might allow to undertake the task.\footnote{54} If successful, this inefficiency reduces the recovery by the class.

A variety of methods of setting hourly rates are used. Some courts assign hourly rates lawyer-by-lawyer.\footnote{55} Other courts look to the status of a lawyer within a firm—e.g., partner or associate.\footnote{56} Others assign a rate based on the function performed—e.g., trial attendance or document review.\footnote{57}

Whether the rate is set by individual, status, or function, courts have struggled with determining "reasonable rates in the community."\footnote{58} In determining a rate for a particular attor-

\footnote{53. Again, \textit{Fine Paper I} provides the example of senior partners who submitted claims for time spent copying documents. \textit{Fine Paper I}, 98 F.R.D. at 178.}
\footnote{54. \textit{E.g.}, \textit{Fine Paper II}, 751 F.2d at 591-92.}
\footnote{56. \textit{See, e.g.}, \textit{Fine Paper I}, 98 F.R.D. at 83. The court also considered the experience, reputation, practice, and qualifications of the associates and partners in the firm. \textit{Id.} at 83 n.21.}
\footnote{57. \textit{See, e.g.}, United States v. Metropolitan Dist. Comm'n, 847 F.2d 12, 19 (1st Cir. 1988); Miles v. Sampson, 675 F.2d 5, 9 (1st Cir. 1982).}
\footnote{58. A recurring and troublesome issue is deciding for which community the determination of reasonableness of rates is made. The options appear to include the forum community standards, the attorney's home community standard (assuming counsel does not ordinarily practice in the forum community), and a national standard. \textit{See In re Agent Orange Prod. Liab. Litig.}, 611 F. Supp. 1296, 1326-27 (E.D.N.Y. 1985). The \textit{Third Circuit Report} recommends using established rates in accordance with those prevailing in the forum. \textit{Third Circuit Report}, 108 F.R.D. at 261. The Ninth Circuit Committee recommended use of the attorney's "normal" rate. \textit{Ninth Circuit Report}, \textit{supra} note 8 at 3. A similar question is whether historic or current hourly rates should be used.}
ney, the court considers a myriad of subjective factors, including the attorney's "standard" rate, her performance in the case, academic and professional background and experience, standing and reputation in the community, the difficulty or novelty of the issue presented, and the degree of contingency presented by the case. An individual attorney may have several billing rates, depending on the client, subject matter, and means and regularity of payment. Rates will increase over the course of the lawsuit. Some lawyers will have a special rate for class action or contingent work. Others will have no rate at all, because all of their work is on a contingent fee basis.

Under hourly based methodologies, counsel select a rate at the end of the case, at which point the rate may be applied to thousands of hours. Thus, the mere selection of the rate provides significant opportunities for manipulation of an hourly based fee system. In addition, it requires the court to scrutinize extensively the fee request and the background and practice of the claiming lawyer.

Thus, the consideration of hourly rates in an hourly based methodology necessarily leads to many of the same problems as the initial hours to be credited determination. It creates a disincentive for efficient use of resources and exacerbates the counsel/class conflict.

3. Multipliers Multiply the Problem

Similarly, the potential for increases to the time-value, whether through Lindy's multipliers or consideration of the Screen Extras factors, aggravated the problems outlined above. The temptation to pad or churn was made greater by the potential for multiple hourly rate recoveries. Equally troublesome was that the factors overlapped, resulting in the possibil-

Some courts have determined time-value based on only historic rates on the theory that such rates reflect the value of the service at the time it was rendered. Most make the calculation based on current rates, to compensate for delay in receipt of payment (interest) and lost purchasing power through inflation. Compare Copper Liquor, Inc. v. Adolph Coors Co., 684 F.2d 1087, 1096 n.26 (5th Cir. 1982) (prevailing practice is to use current rates) with New York Ass'n for Retarded Children v. Carey, 711 F.2d 1136, 1153 (2d Cir. 1983) (should use historic rates in civil rights cases).

The appropriate considerations for determining hourly rates are beyond the scope of this Article.


60. C. WRIGHT & A. MILLER, FEDERAL PRACTICE & PROCEDURE § 1803 (1984 Supp.).
ity of duplicative credit for the same aspects of the fee entitlement. For example, under *Screen Extras*, the first factor considered is the "time and labor required," 61 that is, time spent multiplied by hourly rates. The court was to make adjustments to this figure based upon factors such as novelty and difficulty of the question involved. 62 However, the novelty and difficulty of the issues are theoretically already reflected in the first factor—the time and labor required to develop and present the case. 63 Similarly, factors such as the level of skill required to perform the service properly and the experience, reputation, and ability of the attorneys involved will be reflected in the hourly rate used in the time and labor required calculation. 64

The Supreme Court substantially restricted the available multipliers because of the duplicative nature of the factors considered. 65 The effect of these decisions is to make the lodestar calculation the presumptive "reasonable fee," 66 with little prospect of enhancement through multipliers.

One of the few surviving multipliers is for the contingency of receiving attorney fees. 67 This factor theoretically compensates counsel for the risk that the case will be unsuccessful and no fee will be paid at all. However, some cases deny "risk" multipliers where the litigation, although beneficial, was highly speculative and not of the sort courts wish to encourage. 68 Noting the inverse effect of risk multipliers—the

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61. See *supra* notes 19-20 and accompanying text.
62. *Id.*
64. The same problem of overlapping factors arises with use of multipliers under *Lindy*. Factors such as quality or difficulty of the questions presented are largely compensated in the lodestar calculation.
67. In *Delaware Valley*, a statutory fee shifting case, the Court rejected application of a contingency multiplier on the record before it. 107 S. Ct. at 3089, 3091. However, a majority of the justices held that Congress intended to permit contingency multipliers. *Id.* at 3089 (concurring opinion); *Id.* at 3092-94 (dissenting opinion).
flimsier the case, the higher the fee—these cases suggest that risk multipliers encourage "strike suits" of questionable merit.69

The Ninth Circuit Committee took the position that in the event of a quick settlement, the court should focus more on the result obtained than on the time taken to obtain that result.70 The Committee's view seemed to be that courts, in applying hourly based methodologies, have under-utilized multipliers to reward counsel for a prompt disposition of a case:

The problem of achieving an adequate fee award for the skilled litigator who rapidly and efficiently concludes a case is even more challenging. The Committee expresses a special concern that in some instances, however great the lawyer's accomplishments or outstanding the result, unless a substantial amount of lawyer's hours have been involved in producing that result there is a disposition by the courts to predicate fees on time rather than accomplishment. The effect of such a judicial approach, sanctioned by numerous appellate decisions dealing with lodestars and the reluctant acceptance of multipliers, creates a disposition on the part of lawyers to make certain that enough hours are logged to warrant a substantial fee. Obviously, this motive can be incompatible with the [objectives of] Federal Rules of Civil Procedure, Rule No. 1 [the speedy and inexpensive determination of every action].71

In practical terms, and in light of recent precedent, a court is unlikely to triple a fee award as a result of a prompt disposition. The recent trend away from multipliers, together with the fact that an important factor in adopting hourly based methodologies was overcompensation of counsel in quick cases, leave considerable uncertainty surrounding implementation of that recommendation.

Multipliers tend to enhance the perception that hourly based fee methodologies are subject to manipulation,72 and lack

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72. District courts may use multipliers to manipulate the fee to arrive at what the
certainty in their application. These three issues—the hours to be compensated, the rates to be used, and the use of multipliers—all affect the amount of the fee. Yet there are other, less quantitative problems with hourly based methodologies.

B. Settlement Conflicts

Hourly based methodologies create ethical problems when, for example, a defendant includes in a settlement offer a specific fee recovery or a limitation on fees. Although courts have frowned on such simultaneous merits/fee discussions, the Supreme Court has held that a defendant can condition a settlement offer on an absolution of liability for fees. The ethical concern is that the lawyer may place his interest in the fee recovery ahead of the interest of the class in maximizing the recovery.

The conflict, if recognized, tends to discourage settlement. A defendant may legitimately seek to limit or obtain information regarding its total liability before entering a settlement. Limitations on such discussions make settlements more difficult because they restrict the scope of discussion, information that can be exchanged, and the boundaries of agreement.

C. Court Involvement in Fee Applications

Despite admonitions that a "request for attorney's fees should not result in a second major litigation," that is precisely what occurs under hourly based methodologies. This extensive litigation over fees is not only a burden to the court, but it delays distribution of the common fund to class members. Enhanced fee litigation occurs in large part because the court believes is an appropriate percentage fee. Cincinnati Gas, 643 F. Supp. at 149 (application of 2.48 multiplier yields a fee of exactly 15% of the recovery). Although this Article supports use of percentage arrangements, that use should be open, as opposed to sub silentio, and prospective, as opposed to retroactive.

75. Evans v. Jeff D., 475 U.S. 717 (1986). In large part, the Court was concerned with hindering settlement of litigation. Id. at 732-36.
77. This can be indirectly confirmed by examining the length of time it takes to resolve the fee claim, or the complexity of the decisions awarding fees. The decision on fees in Fine Paper, for instance, ran nearly 200 pages. See Fine Paper I, 98 F.R.D. at 48-237. The decision in Agent Orange, including the appendix, was 99 pages long. See In re Agent Orange Prod. Liab. Litig., 611 F. Supp. 1296-395 (1985).

The extended fee litigation that so characterizes hourly based fee petitions was
fee proceedings occur after the recovery by the class is determined. The court is required to review (typically for the first time) submissions based on perhaps thousands of time entries (assuming time has been recorded) spanning a period of years. It is too late to prevent wasted hours or misallocated work, and the court is reduced to reviewing the petition and denying the hours claimed for such work. Counsel, with the benefit of hindsight, will prepare an application based at least in part on the result obtained.

The potentially crushing burden on the court created by hourly based fee applications was made clear by the Agent Orange case. Counsel submitted a fee and expense recovery of $10.7 million dollars from a $180 million dollar award. The petitions for fees and expenses numbered 121 and filled two five-drawer legal-sized filing cabinets. The initial review was performed by five law clerks, who worked full time for three months, and the review consumed "thousands of court-personnel hours." The court resorted to percentage reductions for some classes of work, as opposed to an item-by-item or lawyer-by-lawyer review.

This burden, to produce a ruling on what Justice Brennan has described as "one of the least socially productive types of litigation imaginable," is one of the major defects of hourly based methodologies.

D. The Circuit Courts Suggest a Return to Percentage Agreements

After reviewing these problems, the Third Circuit Task Force recommended using a percentage fee agreement acceptable to both class counsel and the court. The Third Circuit
Report recommended that such an agreement be negotiated "at the earliest practicable moment," using an independent attorney to represent the putative fund beneficiaries in the negotiations. 84 The independent party is to negotiate the fee agreement "in an open and appropriately arm's length [transaction] . . . in the usual marketplace manner and submit the proposal for the court's approval." 85

In cases involving multiple plaintiffs' lawyers or conflicting claims of lawyers, the beneficiaries' judicially appointed representative might be asked to make a recommendation to the court based on both the economic considerations and the anticipated effectiveness of representation. 86 The report suggests that the fee agreements in most cases should include:

[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. In order to promote early settlement, the negotiated fee also could provide a percentage or fixed premium incentive based on how quickly or efficiently the matter was resolved. 87

The report suggests a "safety valve" to depart from an agreement that, in application, seems unfair. 88 The members of the Task Force expressed disagreement, however, over when such a safety valve could be employed. 89

The Ninth Circuit Committee was less detailed in its recommendations. All of the judges on the Committee had encountered problems with fee applications in common fund cases, particularly those cases of some duration. 90 Although it

84. The report does not define "earliest practicable moment" but assumes that it means after the pleadings are closed but before discovery is "fully" underway. Id. at 255 n.60. Some of the members of the Task Force felt that it was appropriate to delay negotiating agreement until the case was "better formed." Id. at 255 n.62.
85. Id. at 256.
86. Id. at 257.
87. Id. at 256 (footnote omitted). Judge Bilby, chair of the Ninth Circuit Committee, recently recommended use of a sliding scale that increased the percentage as the amount of recovery increased, based on his view that counsel settled the case for more than it was worth. See supra note 49.
89. Id.
90. Ninth Circuit Report, supra note 8, at 11. In cases governed by Screen Extras, the Ninth Circuit Committee suggested that the court monitor hours as the case progresses by requiring periodic submissions of time records. Id. at 11-12. These submissions, on an ex parte and confidential basis, would seem highly problematical. If the district judge closely monitors and uses the reports, there is a legitimate concern
did not adopt "as Circuit policy" a departure from Screen Extras, it noted the particular problems under hourly based methodologies when the interests of counsel and the class are not parallel:

In the course of our deliberations we noted on numerous occasions that at times tensions arise between the attorneys' interest in a basis for adequate fees and "the just speedy and inexpensive determination of every action" called for by Federal Rule of Civil Procedure 1. That tension arises because in some instances, however great the lawyers' accomplishments or outstanding the result, unless a substantial amount of lawyers' hours have been involved in producing that result, there is a disposition by the courts to predicate fees on time rather than accomplishment. The effect of such a judicial approach, sanctioned by numerous appellate decisions dealing with lodestars and the reluctant acceptance of multipliers, creates a disposition on the part of lawyers to make certain that enough hours are logged to warrant a substantial fee.

While the courts' review of fee applications can address this problem, a tension exists because the fee award results tend to emphasize hours worked (the tradesmen aspect of lawyering), to the detriment of results accomplished (the artisan aspect of lawyering). Further, this tension may cause courts to be more involved in the fee setting process than is desirable.

In view of the foregoing, the Committee has recommended that the district courts in the Ninth Circuit be encouraged to be innovative in the development of pre-negotiated contingent fee arrangements. To that end we endorse the concept set forth in Part 3 of the Third Circuit recom-

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on the part of defendants about ex parte reports by plaintiffs on the status of the case. If the reports are not regularly reviewed, they would seem to be of little use. The alternative would be to have another judge review the reports, which hardly seems efficient.

In a recent recommendation on a fee award, Judge Bilby of the Committee recommended a fee award based alternatively on hourly rate and percentage calculations. The percentages used (29% on the first $9.25 million of the recovery and 33% on the last $4.65 million of the recovery) were not negotiated beforehand. The result was a fee recommendation of $4.22 million, or 30.5% of the total $13.9 million recovery. On review, the district court rejected Judge Bilby's use of a percentage fee without consideration of the Screen Extras factors. Naye v. Boyd, No. C83-771R at 2-3 (W.D. Wash. Jan. 20, 1988) (Order re Attorneys' Fees). Applying the Screen Extras factors, it awarded a fee of $3.36 million, or 24.3% of the recovery. Id. (amended March 8, 1988).
mandations to those judges who feel comfortable in trying such arrangements.\textsuperscript{91}

The Committee felt it improper for the trial judge to be involved in the negotiation process, and recommended use of a magistrate "or other designated representative."\textsuperscript{92}

The Third and Ninth Circuit Court reports identified some of the serious deficiencies in hourly based methodologies. Hourly based methodologies have caused more serous problems than they were formulated to solve. These problems—from the amount of fees claimed, to the management of the litigation, to the involvement of the court—would be remedied by the use of percentage fee arrangements approved at the outset of the case. However, certain changes are appropriate in the approach outlined by the courts.\textsuperscript{93}

III. A WORKABLE PERCENTAGE FEE SYSTEM

A. Percentage Fee Agreements Offer Economic and Social Advantages

A fixed percentage fee arrangement provides parallelism between the interests of counsel and the class. Because the lawyer gets a percentage of the recovery of class members, her interest in the best net recovery (i.e., the amount of the fee, reduced to present value) for her fee will be achieved by getting the best net recovery for the class. This Article recognizes

\textsuperscript{91} Ninth Circuit Report, supra note 8, at 8, 10.
\textsuperscript{92} Id. at 10.
\textsuperscript{93} Because of the long lead time between filing of a class action case and published decisions on attorney fees, there are few reported decisions that fully implement the circuit court recommendations. There is, however, a definite trend in the decisions toward use of percentage arrangements. See, e.g., Brown v. Phillips Petroleum Co., 838 F.2d 451 (10th Cir. 1988) (approving non-negotiated fee of 16.5% based on Screen Extras); Pavlidis v. New England Patriots Football Club, Inc., 675 F. Supp. 707 (D. Mass. 1987) (approving fee of 26% of the recovery based on negotiated fee agreement that was published to the class); Howes v. Atkins, 668 F. Supp. 1021 (E.D. Ky. 1987) (40% fee awarded; hourly based recovery would have consumed common fund in its entirety); In re GNC Shareholder Litig., 668 F. Supp. 450 (W.D. Pa. 1987) (25% fee); Edmonds v. United States, 658 F. Supp. 1126 (D.S.C. 1987) (court approved request of 5% of recovery while finding that 10% would have been reasonable); In re Cincinnati Gas & Electric Co. Secur. Litig., 643 F. Supp. at 152 (S.D. Ohio 1986) (15% fee). See 3 H. NEWBERG, CLASS ACTIONS § 14.03 (1985). With the exception of Pavlidis, these percentages were not negotiated at the onset of the case. Despite the court's use of a percentage in Cincinnati Gas, 643 F. Supp. at 152, it is unclear whether the fee was awarded on a percentage basis or under a Lindy approach. The court performed a Lindy analysis, compensating all time at the requested rates with a uniform 2.48 multiplier to arrive at an award that was exactly 15% of the total. Id. at 153.
that class counsel actually manage class litigation. The beneficial effect of the parallel interest of a percentage arrangement is that if counsel is consciously or subconsciously self-concerned about maximizing the fee—be it from the perspective of risk, amount, or timing—that concern will result in the same judgment about the recovery for the class. This parallelism of interest encourages management of litigation to the benefit of the class and the judicial system.

Under a percentage fee arrangement, litigation is managed based on a "fixed budget"—that is, because the percentage is established at the outset, excessive lawyer hours do not increase the fee. Instead, excessive hours increase the "cost" (in the form of uncompensated hours) to the lawyers—if the case is won, they receive a lower profit; if the case is not won, they receive no recovery on a greater number of hours. Percentage agreements thus create an incentive to make the highest and best use of legal resources. Partners will not review documents if the fee is fixed and if an associate or legal assistant could do the work. More importantly, if counsel conducts the litigation inefficiently, the class does not pay more.94

This fixed budget will result in pursuit of various facets of the litigation (motions, discovery, trial) only if counsel believes it will substantially benefit the class to do so. Cases will be tried or settled based on counsel's self-interested analysis of the risk, delay, and expense of trial compared to the potential recovery for the class. Discovery will be sought if it is needed to obtain information or to create a record, not simply to churn more hours. To maximize these benefits, the percentage fee arrangements should be established at the outset of the case: only then will the need for efficient case management be clear.

Using percentage arrangements will also reduce litigation over fees. Percentage fees are simple of calculation, and do not require the mind-numbing sifting of thousands of time entries, evaluating each for the reasonableness of the time spent, whether the service benefitted the class, and the reasonableness of the rate charged. In addition, fees are determined at the outset of the case, and not based on ex post facto review.

All of these factors represent an efficient management approach that focuses on the true issues of the case. Disposi-

94. Pavlidis, 675 F. Supp. at 712 (although inexperienced counsel spent "wholly inappropriate amounts of time" on certain matters and there was duplication of effort, these factors do not weigh heavily in percentage arrangements).
tion of the case on the substantive (not fee) merits will serve to reduce the economic cost of class action litigation.

There are, however, non economic benefits to percentage arrangements as well. Percentage agreements provide certainty and a limit as to the portion of the recovery that will be consumed by fees. This permits notice of the amount of the fee to the class from the outset. This information will be of particular value in opt-out classes certified under Federal Rule of Civil Procedure 23(b)(3), for class members will know, when making a decision whether to opt out, how much of any recovery will be consumed by fees.

The conflict presented by simultaneous substantive and fee settlement discussions largely disappears under percentage fee arrangements. Since the fee arrangement will have been reached at the outset, counsel need not negotiate anything other than the total recovery. Thus any conflict between counsel's potential fee recovery and the substantive recovery will not arise.

Percentage arrangements should also result in more prompt distribution of a recovery to the class. Under hourly based methodologies, the most common way for fees to be paid is for the fee to be determined, deducted from the common fund, and then both the fee and the balance of the fund distributed. This requires determination of the precise amounts of the fund and fees and expenses before distribution of the fund. When the ultimate size of the fund is in question (because of resolution of remaining claims or defendants) or the size of the fee claim is in question (because of the application process or remaining work to be done), the only alternative under hourly based methodologies is to delay distribution or to dismiss the remaining claims.

Use of percentage fees, on the other hand, permits staged distributions, on a class member-by-class member or claim-by-claim basis. The appropriate percentage is simply deducted

95. There is not certainty, of course, as to the ultimate amount of the fee. Note that hourly based methodologies will not produce certainty as to either the ultimate amount of the fee or percentage of the recovery that the fee will constitute.

96. E.g., Pavlidis, 675 F. Supp. at 711.

97. See Ninth Circuit Report, supra note 8, at 5-6. See supra part II(B).

98. In Lindy, for instance, it appears that the distribution to the class was not made until after the five years between the settlement and the final ruling on fees. See supra note 77 and Lindy Bros. Builders, Inc. of Philadelphia v. American Radiator & Standard Sanitary Corp., 540 F.2d 102, 108 (3d Cir. 1976) (noting value of fund during remand proceedings).
from the amount distributed.\textsuperscript{99} In a case involving multiple substantive claims or multiple defendants,\textsuperscript{100} such distributions might occur when some, but not all, claims are resolved. A distribution to some, but not all, plaintiffs is also possible.\textsuperscript{101} This ability to distribute on an interim or partial basis is an important and flexible advantage of percentage fees.

In short, percentage fee arrangements offer significant economic and social advantages to fee awards under hourly based methodologies. They provide certainty, notice, and ease of administration. Because they can be implemented at the outset of the litigation, percentage agreements create an incentive for efficient, self-interested management of litigation. They reduce litigation over fees. They shift the risk of inefficiency from the class to counsel. All of these factors should result in lower costs for the class, as well as defendants and the judicial system.

Weighed against these benefits is the possibility of overcompensating counsel for a quick result. However, the hourly based experience has shown that "quick results" seldom occur if the alternative—fees based on hours—is used.\textsuperscript{102} Furthermore, a prompt settlement may reflect a strong case. In the strong case, the solution is to use a low percentage, not to convert to an hourly based fee.

\textbf{B. Considerations in Reaching a Percentage Fee Arrangement}

Although the circuit court recommendations are an improvement on hourly based methodologies, they nevertheless deal inadequately with certain practical problems in negotiating and implementing percentage fee agreements. This section explores those problems and proposes solutions to them.

The method proposed herein is for counsel to submit a


\textsuperscript{100} FED. R. CIV. P. 54(b) permits partial judgments on fewer than all of the claims presented or against fewer than all defendants.

\textsuperscript{101} Such a situation might occur when there are subclasses with claims resolved at different times, when the parties dispute the amount due particular plaintiffs, when a plaintiff cannot be located, or when delays in processing claims affect some, but not all, plaintiffs.

\textsuperscript{102} In \textit{Fine Paper}, for example, over 88% of the hours recorded (85,000 out of 97,000) occurred \textit{after} the major initial settlements were reached. 98 F.R.D. at 70.
percentage arrangement with the complaint, stating the lowest percentage under which counsel will prosecute the case. The percentage should be a "drop-dead" figure, with no renegotiation during class certification normally allowed. The agreement should ordinarily provide for a single percentage for the entire recovery regardless of when obtained, although sliding scales of percentages may be used when appropriate. The court should review the agreement, or if necessary, appoint an independent third party to meet with counsel and discuss the basis for the proposed arrangements. The agreement should specifically describe the work to be done, including any allocation of work among firms. The court may be called upon to allocate responsibility if there are conflicting claims to representation.

1. Negotiation of the Agreement After Commencement of the Action

Both circuit court reports recommended use of post-filing negotiation of fee arrangements. The Third Circuit Task Force recommended a process taking place early in the case, perhaps as soon as after the close of the pleadings. The Ninth Circuit Report suggests use of a designated representative to negotiate such an agreement at the "earliest possible time," also contemplating post-filing negotiation of the agreement.

Negotiation after the filing of the case presents substantial practical problems. One of the primary benefits of percentage fee arrangements is that they provide certainty and predictability. That certainty and predictability, however, also involve entrepreneurial risks and assessments by counsel. These factors, while beneficial for case management purposes once the agreement is in place, tend to create problems in the mid-case (or even early-case) negotiation of a fee arrangement.

Prior to starting a class action, counsel is required to meet with the clients, research the facts and law, develop a theory of the case, counsel the clients on whether to proceed, prepare pleadings (more than likely including a motion for class certifi-

103. See infra text accompanying notes 107-08.
104. Third Circuit Report, 108 F.R.D. at 255 n.62. Some of the judges on the task force would avoid negotiating an agreement at the pleading stage of the case, preferring to wait until the case was "better formed." Id.
106. See FED. R. CIV. P. 11.
culation with supporting materials), file the case, and deal with motions to dismiss or discovery matters (on the merits or regarding class certification). Preliminary injunctive relief may be sought. Appeals may be sought from rulings on any of the aforementioned items.

Each of the steps described can be a very substantial undertaking in major class litigation. Under hourly based methodologies, there was relative certainty regarding the basis for compensation, because the attorney knew her hourly rates, and could expect to recover for her time at that rate or even a multiple thereof. But, under the post-filing negotiation approach, counsel is asked to undertake considerable responsibility and expend significant resources without any idea of the ultimate fee arrangement for the case. If the fee cannot be "negotiated" (post-filing) to counsel's satisfaction, the class may be left without counsel, or a very substantial amount of work and enterprise by counsel may be wasted or unrewarded.

Taking a case on a percentage basis as opposed to an hourly basis involves much greater subjective judgment on the part of the lawyer. If counsel is to make the entrepreneurial judgment about whether a case is worth taking, he needs to know the percentage involved. Under the circuit proposals, counsel will be forced to incur tens (if not hundreds) of thousands of dollars in time and expenses without any idea of the ultimate stakes.

By submitting an agreement with the complaint, counsel at least presumptively creates an acceptable arrangement. Such an arrangement could be based on negotiations with class members. Upon presentation, the arrangement should be

107. FED. R. CIV. P. 23(c)(1) requires that the motion for class certification be filed as "soon as practicable after the commencement of an action." District court rules may require filing the motion within a fixed period of time. See U.S. DIST. CT. R. 23(f)(3) (W.D. Wash.) (90 days). The United States Claims Court requires the motion to be filed with the complaint. U.S. CL. CT. R. 23, 28 U.S.C.A. 228 (1968).

108. The analogy in the construction industry is a fixed price bid as opposed to a time and materials bid. Few contractors would agree to begin work on a fixed price contract without knowing the ultimate price. The Ninth Circuit described the contrast as between the "artisan aspect of lawyering" and "the tradesman aspect of lawyering." Ninth Circuit Report, supra note 8, at 8.

109. The assumption that class representatives are unable in all cases to adequately represent the class in fee negotiations is without foundation. Particularly in securities, antitrust, or representation of white collar employees, class representatives may be sophisticated individuals or institutions. Class members may have interests of which the court or counsel are unaware, but that can be dealt with in negotiations.
promptly reviewed by the court, or if it deems necessary, by an independent representative.110 In many cases, the reasonableness of the fee will be apparent on its face. The agreement should be either rejected or accepted as reasonable, but ordinarily should not be renegotiated.111 The nonnegotiability of the fee will encourage counsel to state, in the proposed agreement, the lowest percentage acceptable to complete the work. If counsel still proposes too high a percentage, the court may reject the proposal and counsel loses the representation.

2. Setting the Percentage

The Third Circuit Report does not set forth in detail how the percentage should be set. Instead, it indicates that the percentage should be negotiated "in the usual marketplace manner . . . in the same fashion as would any other attorney in a comparable situation."112 Historically, there has been little explicit discussion of how to calculate the appropriate percentage in advance of the litigation. Professor Hornstein observed that fees set by percentage commonly ran 20-25 percent of the award.113

The Third Circuit suggested that the following factors would affect the percentage:

[T]he amount of work contemplated, the nature of the work, the number of hours reasonably anticipated, the risks to be faced in the litigation, and the likelihood of winning and losing . . . .114

Other factors which should be considered in setting the percentage include:

110. As generally noted by both circuit court reports, the trial judge should not be involved in any fee negotiations. The approval process will require a full and frank disclosure of the strengths, and more importantly, the weaknesses, of the plaintiffs' case. That process should include a quantification of damages, with ranges and probabilities of obtaining a particular range. Not only do the attorney-client privilege and zealous advocacy provisions prevent such a disclosure to the trial judge, but defense counsel would strenuously oppose such ex parte discussions.

111. An exception could occur when, at the time of filing the complaint, counsel have been unable to obtain adequate information concerning the amount in controversy or the size or configuration of the class. Discovery may well reveal that, in light of these factors, the proposed fee is too high or too low.

112. 108 F.R.D. at 256.

113. See supra note 5.

114. 108 F.R.D. at 256.
a. The amount of and timing of the potential recovery, and the reliability with which it may be predicted;

b. resources and experience of the lawyers;

c. responsibility and ability to advance expenses as well as extent of expenses;

d. market factors;

e. requirements for involvement of multiple firms, as well as the responsibilities of each firm;

f. whether sliding scales are used;

g. the identity of the defendant or defendants and the expected opposition to the case;\textsuperscript{115} and

h. other factors unique to the case.

To maximize the benefits of a percentage fee arrangement, it is important that the fee be established at the outset of the case. Although no mathematical formula can be set forth for determining the percentage, counsel should be prepared to justify the percentage by reference to these factors. A percentage outside the 20-25 percent range should be examined closely.

3. Sliding Scales: Forbidden Fruit in the Garden of \textit{Lindy}?

The circuit court reports each suggest presumptive use of both stage and amount sliding scales.\textsuperscript{116} Such scales disrupt the parallelism of interest that is one of the primary benefits of percentage agreements. Percentage arrangements should not include such sliding scales unless an objective basis for their inclusion can be demonstrated.

The theory behind stage sliding scales (by which fee percentages increase as the case proceeds) is that the percentage should increase to reflect the increased labor, delay, and risk associated with moving to the next stage of the litigation process. Such an arrangement can serve to recognize the additional effort or delay in payment required by a trial or appeal. However, it also tends to create the same divergence in inter-

\footnote{115. One advantage of hourly based methodologies is that defense counsel with an unlimited budget who engage in a "war of attrition" do not face counsel with a budget limited by a percentage of the recovery. Class counsel, under hourly based methodologies, were able to respond blow for blow with the expectation that each hour was potentially subject to compensation. Such is not the case under a percentage arrangement—the proportion of the fee is fixed, and a grinding defense only serves to consume the fee. For that reason, the court should consider the identity of the defendant or defendants (and their counsel) in approving the percentage.}

\footnote{116. See supra note 11. See also supra text accompanying note 87.}
est between counsel and the class for which hourly based methodologies have been criticized.

For example, if a stage sliding scale increases in the percentage if the case is not resolved prior to trial, it creates an artificial incentive to delay settling the case. Counsel may receive an acceptable settlement offer well before trial, but believe the same offer will be available after the start of the trial. Because of the increase in percentage, the stage sliding scale may encourage counsel to delay settlement until after the commencement of the trial. The result would be a waste of resources of the parties, the court, and the witnesses. The class incurs a delay in getting its funds, for which it must pay a higher fee.\footnote{117}

Recognition that stage sliding scales create an incentive to delay resolution of the case was perhaps the reason the Third Circuit recommended use of an incentive based on a quick and efficient resolution of the litigation.\footnote{118} Again, such an incentive creates a divergence of interests as substantial as those existing under Lindy. First, stage sliding scales typically increase percentages the further the case progresses. The Third Circuit’s recommendation of incentives for quick disposition would seem to turn this provision on its head by offering increased percentages at the early stage of the case. Such an arrangement could also exacerbate a frequent criticism of percentage fees: in a prompt disposition, the lawyer gets too much. Second, the “incentive arrangements” create the flip side of the above conflict, by encouraging acceptance of “quick and dirty” offers. Counsel may believe that an offer would be improved by pursuing discovery, motions, or trial. A fee agreement weighted in favor of early settlement encourages acceptance of the lower offer because the attorney’s own interest is served: she receives a higher percentage, without the risk, burden or delay of proceeding with the case.\footnote{119} Once again, the class loses: it gets a smaller settlement and pays a higher fee.

\footnote{117. It also seems appropriate to ask whether such a system again puts the class cart before the fee horse. If the case should not be taken to trial based on the pre-trial fee percentage, one must ask whether the class is served by proceeding to trial.}

\footnote{118. Third Circuit Report, 108 F.R.D. at 256. The Ninth Circuit Report describes as “challenging” the issue of adequately compensating counsel for a rapid and efficient disposition of the case. Ninth Circuit Report, supra note 8, at 9. This factor appeared to be key in its endorsement of percentage arrangements. Id. at 10.}

\footnote{119. The defense will be aware of this leverage, for the fee arrangement will be stated on the record. Thus, the defendants perhaps could be expected to submit a low offer.}
Recovery sliding scales which decrease the percentage of the fee as the amount recovered increases, are based on the concept that the marginal cost of obtaining the first dollar of recovery is significantly higher than the marginal cost of obtaining an additional dollar of the recovery. It may cost one hundred dollars to collect the first dollar of recovery, and ten cents to obtain the five millionth dollar of recovery. In addition, as the total recovery goes up, a flat percentage can create a huge fee. A one-third fee percentage on a million dollar recovery may result in a reasonable fee; a one-third fee percentage on a hundred million dollar recovery is much more likely to be unreasonable.

Two related factors need to be considered in the use of recovery sliding scales: (1) the percentage fee on obtaining the “last” dollar of recovery for the class cannot be reduced below the cost to counsel of producing that last dollar; and (2) counsel should have an adequate incentive to maximize the recovery. Decreasing the percentage diminishes counsel’s incentive to pursue vigorously the maximum recovery. In light of the difficulty in calculating the “cost” of pursuing the last dollar of recovery, the agreement should err on the side of well compensating counsel on the last dollar obtained.

In a case in which the recovery is relatively liquidated or predictable (e.g., a claim for back pay, or with respect to a security that has been rendered worthless), there does not seem to be a great need for a variable percentage depending upon the amount recovered. Rather, a flat percentage based upon the relatively settled estimate of the amount at stake seems appropriate. Such a percentage would be lower than the

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120. It should be noted, however, that after a point, the marginal cost of recovering another dollar in settlement will begin to rise again and will eventually exceed the marginal benefit to be gained by doing so. It is at this point that a rational attorney would settle.

121. Consider, for example, two alternative fee arrangements. One provides for a flat 15% fee. The other, using a recovery sliding scale, provides for a fee of 40% on the first hundred thousand dollars of recovery, 30% on the next four hundred thousand dollars, 20% on the next five hundred thousand dollars, 10% on the next million dollars, and 5% on any amounts recovered in excess of two million dollars. The recovery under the sliding scale fee will be greater than the flat percentage fee until the recovery exceeds 2.6 million dollars.

If a settlement offer of 2.5 million dollars is received, counsel has three times the incentive under the flat fee arrangement as opposed to the recovery sliding scale arrangement to pursue a 2.6 million dollar recovery. Counsel may well have difficulty justifying slavish efforts to increase the recovery if the recovery sliding scale has so diminished the marginal benefit of those efforts.
sliding scale would provide on the lower part of the recovery, but perhaps somewhat higher than the sliding scale percentage at the upper end of the recovery.

When the amount in dispute is not liquidated (e.g., an antitrust recovery dependent upon market conditions), the recovery may be estimated within a range, or it may not be subject to a reasonable estimate at all. In the former situation, a flat percentage may be negotiated, with the fee reliably predicted. In the latter, the range of fee cannot be reliably predicted, and a recovery sliding scale may be appropriate. It bears noting, however, that when damages are relatively uncertain, a fee agreement that well-compensates the last dollar of recovery will create the greatest incentive for counsel to pursue the maximum recovery for the class.

Sliding scales are not inherently useless. They do, however, encourage the very problems that led to the creation of the Third Circuit Task Force and Ninth Circuit Committee—management of litigation based on fee ramifications as opposed to maximizing the substantive recovery. A flat percentage, determined at the outset of the case, makes the interests of counsel and the class parallel: the fee will be maximized by maximizing the substantive recovery.

4. The Problem of Competing Lawyers

Perhaps the most difficult problem in class action cases arises when several lawyers vie for the same work. The response under the hourly based methodologies was simple, but highly undesirable—too many lawyers would participate, requiring overstaffing, bureaucracy, undue monitoring of each others' work, and infighting. Typically, all counsel seek compensation for all hours worked.

Over-lawyering will be less likely to happen under a properly managed percentage arrangement. Under a percentage arrangement, the fee "pie" is not unlimited: it is strictly defined. Latecomers face a substantial risk that they will not be compensated at all for tardy and unnecessary efforts. Bureaucracy and duplication are not rewarded by a compensation system that is not based on hours logged.

However, a percentage fee arrangement requires strong management of resources. While such management will presumably do away with armies of lawyers, it makes much more difficult the task of selecting the "manager." The Third Cir-
cuit would have competitors for representation present their proposals to another lawyer, who would make recommendations to the court on financial and representational matters.

When a case can be handled by one firm or a cooperating group of lawyers, the court (and not an appointed lawyer) should decide which "entity" will represent the class. The question of adequacy of counsel is reserved to the court under Federal Rule of Civil Procedure 23(a)(4), and presents issues with which courts are fully familiar. Representation battles, unseemly as they become, are best presented on the record and to the court.

In cases requiring representation by multiple firms,\textsuperscript{122} the attorneys should attempt to agree on division of responsibility and fees. If the firms are brought together before filing the complaint, this can be expected. When the firms cannot agree, the court must intervene; maybe surprisingly, many of the hourly based problems re-emerge.

There are a variety of means of dividing fees among lawyers: prearranged percentages, \textit{pro rata} allocations based on hours, or percentages after deduction of hours.\textsuperscript{123} Payment of percentages of the total award without regard to hours will encourage firms to attempt to shift as much work to the others as possible, and will result in disagreement over who is responsible for a given task. Methods that factor in hours will lead to as many questions concerning churning, padding, and reasonableness as hourly based methodologies.\textsuperscript{124} Given the analysis above, when firms cannot agree, it is probably best for the court to allocate and delineate responsibility as clearly as possible with compensation based on percentages.\textsuperscript{125}

The decision maker also will be faced with the difficult task of establishing and applying criteria for evaluating com-

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\textsuperscript{122} For whatever reason: sheer size, risk of loss conflicts, sub-classes, or geographic factors.
\textsuperscript{123} In the \textit{Agent Orange} litigation, counsel arrived at a formula (later abandoned) in which 50\% of the total fee was divided in equal shares to the participants, 30\% was divided based on hours expended, and 20\% was divided based on quality and risk multipliers as approved by a vote of counsel. \textit{In re Agent Orange Prod. Liab. Litig.}, 818 F.2d 216, 218 (2d Cir. 1987).
\textsuperscript{124} It should be observed, however, that plaintiffs' counsel will have a strong self-interest in policing unnecessary hours or churning, given the overall limitation on the fee. Such an interest is weaker under hourly based arrangements, for extra hours Gore no one's ox but the class'.
\textsuperscript{125} It is advisable for counsel to submit any unusual allocation of fee and expense recoveries to the court. \textit{Agent Orange}, 818 F.2d 216 (2d Cir. 1987) (fees based in part on amounts advanced for expenses).
\end{flushleft}
peting proposals from various firms. This task may involve selecting one firm as manager of the litigation, or a group of firms as the lawyers for the class. Fee arrangements should be one, but not the only, factor considered. The class must be represented by qualified counsel. The firm should demonstrate a willingness and ability to devote the time and attention the case deserves. Firm size and capital (assuming the firm will be required to advance costs or if the case is expected to be protracted) must be considered. Prior experience, results, and effectiveness are other factors to which the court should give consideration as well.\(^\text{126}\)

IV. CONCLUSION

The purpose of this Article has been to explore the problems that have been identified with hourly based methodologies. Contingent fee arrangements should result in lower fees and larger recoveries. They will also reduce the cost to the parties and the court system, promoting certainty in, and good management of, hard cases. It serves as a lesson that sometimes the best solutions are found in the common law.

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\(^{126}\) One method of selecting class lawyers is that the court should select the "qualified" firm or group of firms that will undertake the case for the lowest fee. Another method would be to select the proposal that the court believes will offer the best "net" return (recovery less fees and costs) to the class. The firm that can maximize the recovery may also charge the highest fee. The Third Circuit seemed to adopt this latter approach, by seeking recommendations concerning both economics and effectiveness of the representation. *Third Circuit Report*, 108 F.R.D. at 256.