DePaul Law Review

Volume 47
Issue 2 *Winter 1998: Symposium - Contingency Fee Financing of Litigation in America*

Article 7

Contingent Fees and Class Actions

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CONTINGENT FEES AND CLASS ACTIONS

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In its pure form, the contingent fee is a pre-filing contractual agreement setting the attorney's fee as a percentage of the recovery. Expenses are advanced by the attorney to be reimbursed from the recovery. If no recovery is obtained, the attorney receives no fee and usually absorbs the out-of-pocket litigation expenses. Contingent fee agreements can be viewed as a form of non-recourse, secured financing agreement; as a commission arrangement; or as a partnership or joint venture in which the client contributes the claim and the lawyer contributes the expertise and effort necessary to realize the claim.[1] As Professor Samuel Gross observes, the two salient characteristics of the contingent fee are "no win no pay" and proportionality to the outcome.[2] While contingent fees are rightly considered the hallmark of plaintiffs' personal injury litigation (and are also found in other types of cases brought by individuals and small businesses),[3] they are also indispensable in class action litigation. Contingent fees are the nearly universal form of compensation for class counsel.[4] Indeed, in most

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1. In my view, contingent fees are not, from either the attorney's or the client's perspective, a contract for litigation-cost insurance, as the Supreme Court erroneously reasoned in City of Burlington v. Dague, 505 U.S. 557, 561, 567 (1992) (striking down a multiplier for contingent fees in statutory fee-shifting cases).

2. Samuel R. Gross, *We Could Pass a Law . . . What Might Happen if Contingent Legal Fees Were Banned*, 47 DePaul L. Rev. 321, 321 (1998).

3. *Id.*

4. I refer here to plaintiff classes. "Pure" contingent fees are inapplicable to most defense counsel, including counsel for defendant classes, because defendants do not stand to recover a sum of money (unless they have a counterclaim, which is not usual in class litigation). A version of the contingent fee is sometimes used by corporate defendants, in which the attorney shares in the benefit of a better-than-expected result. For defendant classes, however, hourly fees are probably more typical. For example, in securities litigation over initial public offerings a plaintiff class sometimes sues a defendant class consisting of the syndicate of underwriters, naming the lead underwriters as representative defendants. In these cases the members of the defendant class have a pre-existing contractual agreement which authorizes the lead underwriters to defend the action and to hire counsel for the class, who are paid by the hour as is customary for securities defense counsel.

class action litigation no other form of compensation would be practical.

Here we must define terms. The type of fee awarded to class counsel does not fit the description of the contingent fee as seen in individual personal injury cases. The fee is not set by a pre-filing contract. Indeed, it would be impossible for the class to contract with its attorney before the suit is filed because the class does not come into existence, and its members cannot be bound, until the class is certified by the court, usually well into the lawsuit.[5] Instead, entrepreneurial lawyers bring the case and the class into being on the prospect of an eventual fee based on a large aggregate recovery. Even after certification, class counsel's fee is determined not by contract but by the court, following a fairness hearing at the conclusion of the case.

Moreover, the fee is not necessarily, and perhaps not even usually, calculated as a percentage of the recovery. Class action fee awards fall into two categories. In cases where the class obtains a monetary recovery, the "common fund" doctrine invokes the equitable principle of unjust enrichment to permit the class representative to recover from the fund the cost, including attorneys' fees, of creating it.[6] In common fund cases, it is the client class that pays the fee, creating a close parallel to individual contingent fee litigation. Where the lawsuit does not result in a common fund, federal courts are not permitted to shift litigation costs to the defendants.[7] Attorneys' fees in such cases must depend on the existence of a statute authorizing fee shifting.[8] In these cases, the fee award is assessed against the defendant. In both types of cases, the court must award a "reasonable" fee. In statutory fee-shifting cases and until recently in common fund cases, most courts have used some version of the "lodestar" approach.[9] The starting point under this approach is the number of hours actually and reasonably worked multiplied by the reasonable hourly rate. This

5. FED. R. CIV. P. 23; Hansberry v. Lee, 311 U.S. 32, 45-46 (1940).

6. *See* Boeing Co. v. Van Gemert, 444 U.S. 472, 481-82 (1980).

7. *See* Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 269 (1975). The decision, however, does not bind state courts. *See* Serrano v. Priest, 569 P.2d 1303, 1315 (Cal. 1977) (authorizing attorneys' fee award to plaintiffs' attorneys who litigate successfully to protect state constitutional rights).

8. The most important of these are the Civil Rights Attorney's Fees Awards Act of 1976, 42 U.S.C. § 1988 (1994), which authorizes the district court to award a reasonable attorney's fee to prevailing plaintiffs in civil rights litigation, and the Equal Access to Justice Act, 28 U.S.C. § 2412(b) (1994), which authorizes the award of a reasonable attorney's fee in civil actions against the United States.

9. *See* Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 538-39 n.160 (1991) (collecting cases from every federal circuit adopting lodestar methodology).

amount is the "lodestar," which may then be adjusted up or down by a "multiplier" based on factors such as the contingent nature of the recovery.[10] Recently, there has been a trend in common fund cases away from the lodestar and toward a return to the percentage-of-the-recovery method of calculating fees.[11] Meanwhile, fee awards in statutory fee-shifting cases have been tied more tightly to hourly compensation.[12]

Nevertheless, fee awards in class actions do retain the essential characteristics of contingent fees. First and most importantly, they follow the "no win no pay" principle. Class action attorneys recover fees only if the class prevails. In common fund cases, the fee is paid out of the recovery, before any distribution to the class, just as in traditional contingent fee litigation. Where a statute provides for fee shifting, the prevailing party is entitled to recover a reasonable, court-approved fee directly from the defendant. The "no win no pay" principle means that the fee arrangement in class actions, as in individual personal injury cases, provides a way for plaintiffs to finance litigation

10. In a series of cases, the Supreme Court chipped away at the number of factors that could be considered in setting the multiplier in statutory fee-shifting cases. *See, e.g.*, Blum v. Stenson, 465 U.S. 886, 899-901 (1984) (allowing no enhancement for novelty or complexity of case, or for quality of representation); Pennsylvania v. Delaware Valley Citizens' Council (I), 478 U.S. 546, 567-68 (1986) (finding enhancement for quality of representation appropriate only in exceptional cases); City of Burlington v. Dague, 505 U.S. 557, 567 (1992) (holding enhancement for contingent normally not permitted). It may be that enhancement beyond the "fully compensatory" lodestar amount is permitted only "in some cases of exceptional success." Hensley v. Eckerhart, 461 U.S. 424, 435 (1983). Most courts have not regarded this line of cases as binding in determining fee awards in common fund cases, though they have become more restrained in the size of the multipliers awarded. Correspondingly, lawyers in jurisdictions that retain the lodestar approach have been careful to document sufficient hours to justify the desired fee without the need for large multipliers.

11. *See, e.g.*, 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); Bebchick v. Washington Metro. Area Transit Comm., 805 F.2d 396, 406-07 (D.C. Cir. 1986). In the early days of class actions, fees were commonly calculated as a percentage of the recovery, apparently by analogy with contingent fees in personal injury cases. Recognizing that the percentage method created incentives to early, cheap settlements, courts embraced the hours-based lodestar method in the early 1970s. *See, e.g.*, Lindy Bros. Builders, Inc. v. American Radiator & Standard Sanitary Corp., 382 F. Supp. 999 (E.D. Pa. 1974) ("Lindy I"), *aff'd in part and vacated in part*, 540 F.2d 102 (3d Cir. 1976) ("Lindy II"). For a considerable time, this was the dominant method. In the late 1980s, the pendulum began to swing back as courts recognized that an emphasis on hours worked created an incentive to long and costly litigation for both sides. Courts desiring to lower costs and reduce delays began to see the percentage method as a way to achieve the same result earlier and cheaper. *See, e.g.*, *In re* Activision Sec. Litig., 723 F. Supp. 1373, 1375 (N.D. Cal. 1989).

12. *See supra* note 10. This development is somewhat ironic, as hourly billing came to predominate among corporate law firms only within the last thirty years or so, and there has been some movement even among these practitioners to "value," or non-hours-based, billing—and even to contingent fee arrangements.

when they lack the personal assets to do so and cannot obtain financing from more conventional sources.

Second, as a practical matter, fees are proportional to the recovery. This is certainly true in common fund cases, where the trend is toward a return to the percentage-of-the-recovery method. Even when the lodestar method is nominally used, courts commonly "check their work" by referring to the percentage of the recovery yielded by the lodestar calculation.[13] In statutory fee-shifting cases as well, larger recoveries typically result in larger fees: larger stakes justify, in economic terms, more intensive litigation efforts, and lawyers recognize that courts will look to the amount of the recovery in determining whether hours worked were "reasonable."

Thus, the core contingent fee attributes of "no win no pay" and giving the lawyer a stake in the outcome are also central to class action fees. Interestingly, the core rationales advanced by advocates and opponents of contingent fees are the same as those cited for and against class actions. Both contingent fees and class actions are praised for providing access to those who would otherwise lack the economic resources to vindicate their legal claims.[14] Both are attacked as ways by which plaintiffs' lawyers appropriate for themselves too much of the recovery and take advantage of bargaining inequalities in their relationships with their clients, and as incentives for bringing too many or nonmeritorious cases. In light of these similarities, it is worth asking Professor Gross's question in this less familiar context: What would happen to class action litigation if contingent fees were abolished?

Here we need to know more about the precise wording of the hypothetical statute. If the statute barred all fee arrangements deferring payment until the conclusion of the case—a "pay as you go" rule—we can safely assume that class action litigation would be effectively wiped out.[15] The very premise of the class action device is that in its

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13. *See* Alexander, *supra* note 9, at 539-40 n.161.

14. Class actions are also said to be more efficient than multiple individual litigation. The efficiency rationale is less often heard as a justification for contingent fees, though this argument is implicit in the claim made by both supporters and opponents that contingent fees allow the lawyer to spread risk by diversifying, and encourage lawyers to screen cases for merit.

15. Having written this sentence, I am immediately uneasy with it. One need only recall the confident predictions that the Private Securities Litigation Reform Act of 1995 would wipe out securities class actions. *See, e.g.*, Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C.). In fact, securities class actions have continued to be filed and litigated at about the same rate as before the statute. JOSEPH A. GRUNDFEST & MICHAEL A. PERINO, SECURITIES LITIGATION REFORM: THE FIRST YEAR'S EXPERIENCE 3-9, 11 (John M. Olin Program in Law and Economics, Stanford Law School Working Paper No. 140, Feb. 1997) (last modified Nov. 17, 1997) <http://securities.stanford.edu/report>;

absence, no individual plaintiff would have the means or the motivation to pursue litigation. There might be a few exceptions at opposite extremes of the class action spectrum.

In securities class actions, for example, every study has shown that a large proportion of the recovery goes to a relatively few large investors; a dozen or two claimants may receive half or more of the recovery. Such claimants, usually institutional investors such as pension funds, would have both the means and the stakes needed to justify litigation on their own. If contingent fees were statutorily barred, they would be able to finance their suits by standard hourly fee arrangements. But there is no reason to believe that these litigants would be motivated to sue on behalf of a class as well. They would not thereby increase their own recovery. To the contrary, increasing the number of claims might dilute the amount they could expect to recover for their own claims. The statute would prevent the lawyers from receiving a larger fee by representing the class, unless they could persuade class members to contribute voluntarily after they were identified (but before the conclusion of the case). At most, there would be an incentive to identify other large claimants by, for example, advertising or posting on the Internet, and to encourage them to use traditional joinder methods to participate in a nonrepresentative lawsuit.[16]

At the other end of the spectrum, civil rights and other public interest cases might continue to be brought by lawyers who volunteer their time or are paid by public interest organizations. The number of these cases would be reduced, as the resources available would be diminished by the inability to recover statutory fees (although fee-shifting statutes might be invoked to allow successful plaintiffs to recover reimbursement from defendants for their legal expenses).

U.S. SECURITIES & EXCHANGE COMM. OFFICE OF GENERAL COUNSEL, REPORT TO THE PRESIDENT AND THE CONGRESS ON THE FIRST YEAR OF PRACTICE UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT (Apr. 1997).

16. This technique is already used in litigation over limited partnerships, and the "most adequate plaintiff" provisions of the Private Securities Litigation Reform Act of 1995 have given rise to a version of it, as plaintiffs' firms vie to sign up large numbers of shares (usually in the form of large numbers of small investors) in order to take advantage of the statutory presumption that the plaintiff or group of plaintiffs with the largest financial stake in the litigation should be named lead plaintiff. *See* Private Securities Litigation Reform Act of 1995, 15 U.S.C. §§ 77z-1(a)(3)(B)(iii)(I)(bb), 78u-4(a)(3)(B)(iii)(I)(bb) (1983 & Cum. Supp. 1997). Such developments might introduce more competition to the plaintiffs' bar or lead to different firms becoming dominant in the field (though it is equally likely that existing firms would continue to maintain their dominance on the basis of their expertise, as has happened under the 1995 securities litigation reforms). *See* GRUNDFEST & PERINO, *supra* note 15, at 25 (stating that the Milberg Weiss appearance rate went from 31.4% to 58.7%). It seems unlikely that they would result in a continued flow of class action litigation.

Other types of class action litigation probably would not survive. The size of individual consumer claims would not support litigation financed by individuals or groups of class members, and tort plaintiffs typically lack sufficient assets to pay as they go. Moreover, there is no practical way to assess the class for ongoing litigation costs before a recovery is achieved. Consumer and mass tort class actions, therefore, would only be brought for free, by public interest or pro bono lawyers; such cases, however, are unlikely to attract ideological lawyers.

Professor Gross suggests a number of responses to the abolition of contingent fees.[17] These seem less likely to be effective in the class action context. Cheating would be impractical, for any fee paid by the class must be approved by the judge. Insurance would not fill the gap either. Insurance against small consumer harms would be expensive, and most people probably would not purchase it. Insurance against mass torts is basically first-party health insurance. There would be even less reason to purchase litigation insurance for such claims. In any event, first-party litigation insurance would provide less universal access to courts than contingent fees presently do. Self-representation on a large scale is unlikely for small or complex claims.

The notion of a market for legal claims is also unpromising in the class context.[18] Even if legal rules were changed to permit a general market for legal claims to exist, a market for class claims probably would not emerge. The numerosity property suggests that claims buyers could not sign up all the class members individually—but due process would prevent selling the class's claim in the aggregate until a complaint was filed and a class certified. In short, it would be difficult to find someone with legal authority to sell. The same problem would

17. Gross, *supra* note 2, at 322-23.

18. Several years ago, Professors Macey and Miller proposed auctioning the class's claims to class action lawyers as a way of eliminating conflicts of interest between the class and its lawyers. Jonathan Macey & Geoffrey Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 6 (1991). In my view, this proposal would only make the conflict more stark, because at the time of the auction the class would have no information and would be unrepresented, while the bids would be deeply discounted because bidders would also lack information, as discussed in the text. Macey and Miller argue that these problems will be taken care of by competition among law firms eager to bid for the claims. This faith in the free market seems to be an example of the Nirvana fallacy (in which all markets are thought to be perfect except the one under observation); it is belied by experience. Today, large numbers of law firms do not vie to be designated lead counsel in most class actions. Indeed, when one court experimented with a competitive bidding process, plaintiffs' lawyers were conspicuously unenthusiastic about competing. *In re* Oracle Sec. Litig., 131 F.R.D. 688, 693 (N.D. Cal. 1990) ("[p]laintiffs' lawyers . . . have shown a virtual allergy to price competition"). Some firms withdrew after competitive bidding was instituted, others formed coalitions to submit only one bid. *Id.* The public comments of plaintiffs' lawyers have been negative. *Id.* at 690-97.

confront any effort to allow third parties, such as banks, to make non-recourse loans secured by the eventual recovery, or to syndicate class claims. In the current system, the lawyers for the class can obtain financing based on their expected fee. This possibility would be eliminated by the hypothetical statute.

From the class members' perspective, it is unlikely that individual recoveries would be increased under either variety of market, or claim-selling approach. The claims would be sold before discovery, when class members have little or no information to enable them to value the claims, as opposed to the present system when payment is deferred until after discovery and motion practice. Class members would not be represented by a knowledgeable attorney. The would-be class attorneys would be in a complete conflict of interest with class members on the other side of a financial transaction. The class's interests could not be adequately represented by the judge, who would lack familiarity with the facts and circumstances necessary to value the claim. Bidders, too, would have inadequate information to value the claims. Uncertainty on both sides would lead to deep discounting, to the class's disadvantage. Moreover, we have seen that despite competition, "standard" fee percentages persist in the contingent fee market and there is little competition for lead counsel status in class actions even when courts attempt to facilitate price competition. Finally, Professor Gross plausibly predicts that claims buyers would tend to be institutions that would consolidate claims and give them mass treatment rather than resolving them individually.[19] But in the tort area, we see that individual recoveries are smaller under class treatment than when claims are individually litigated, except perhaps for very low-value claims.[20]

It is hard to imagine, though, that a statute would be passed simply banning arrangements until the conclusion of the case, and precluding attorneys from collecting a fee if they are unsuccessful. "No win no pay" is not only deeply ingrained in our legal consciousness, it is also a very popular aspect of the legal system, as Professor Marc Galanter's article shows.[21] The rule would also be difficult to enforce, and does not respond specifically to the most insistent criticisms of the present system.

Would the hypothetical statute abolish existing fee-shifting statutes? If not, civil rights class actions and other statutory fee-shifting cases

19. Gross, *supra* note 2, at 326-27.

20. *See, e.g.*, Amchem Products, Inc. v. Windsor, 117 S. Ct. 2231, 2246 (1997).

21. Marc Galanter, *Anyone Can Fall Down a Manhole: The Contingency Fee and Its Discontents*, 47 DePaul L. Rev. 457, 459 (1998).

would survive (and prosper, as securities, mass tort and personal injury lawyers flooded into the field). Proponents of class actions could attempt to secure passage of fee-shifting statutes for other categories of cases. The current legislative mood, however, does not seem hospitable to one-way pro-plaintiff fee shifting. Rather, Congress has flirted with proposals to eliminate the American Rule in favor of some form of "loser pays" in a broad range of cases, including tort cases. Two-way fee shifting, or "loser pays," would deter risk-averse individual plaintiffs of modest means (or even wealthy individuals) from pursuing expensive complex litigation against corporations. This effect would be magnified in class action litigation because it would be impracticable to assess fee awards against individual class members. Actual fee-shifting proposals, such as those proposed in early versions of the 1995 securities reform legislation, often seem directed at requiring class action attorneys, rather than the class, to pay the prevailing defendants' fees. Such measures would certainly have a deterrent effect on lawyers, but some well-financed plaintiffs' firms might very well stay in the field and flourish, particularly as "loser pays" would not apply in cases that are settled without a finding or admission of liability.

How would the statute deal with common fund cases—that is to say, what aspects of common fund class action fee awards might be banned? The most likely possibilities are to require fees to be calculated based on hours worked and to ban non-recourse fee arrangements (i.e., "client pays, win or lose").

Abolishing non-recourse fee arrangements would be unworkable in class actions. No one with substantial assets would agree to be a class representative, and lawyers could not be forced to exact fees from clients who could not pay. The only way to enforce such a rule would be to make ability to pay counsel fees a requirement for certification; if enforced, the rule would likely disable class action litigation. But "no win, no pay" is a very popular part of the legal system, at least outside corporate executive suites, and there would be no real constituency for requiring individuals to pay lawyers massive fees for litigation pursued on behalf of others when no one received any money from the lawsuit.

A more likely reform would be to ban percentage fees. The most common criticism of contingent fees is that too much of the recovery goes to the lawyers. In this view, lawyers exploit clients by forcing them into percentage fee arrangements that overcompensate the lawyers on an hourly basis. Professor Herbert Kritzer's study suggests that this criticism is misplaced and that in the average case contingent fee lawyers are not compensated more generously than lawyers doing comparable work for an hourly fee (though above-average fees in a few cases make the risk worthwhile).[22] One might expect, though, that forbidding percentage-of-the-recovery fee agreements would be a primary goal of opponents of contingent fees. The objection, in other words, would be not so much to the contingent nature of the fee as to a high-percentage commission.[23] Restricting percentage fees might seem even more attractive in class actions, where aggregate recoveries are large enough routinely to produce fees in the millions of dollars and where public opinion may regard class members' alleged injuries more skeptically than in individual tort cases.

It may seem ironic, then, that critics of securities class actions have recently sought to require fees to be calculated as a percentage of the recovery—the opposite of what one would expect in light of the debate about contingent fees. Such a requirement was included in the Private Securities Litigation Reform Act of 1995 ("PSLRA").[24] The reason for conservative and defense-side support for the percentage method appears to be that these critics desire earlier settlements with less litigation expense (and, possibly, less disclosure to plaintiffs). The supporters of percentage fees in class actions cannot be concerned that too much money goes to lawyers under percentage arrangements because they say that percentage fees will result in the same settlements occurring earlier in the litigation, and because courts adopting percentage rules in place of the lodestar have chosen percentage benchmarks comparable to the percentage historically awarded under the lodestar.[25] These fees fall in the twenty to thirty percent range in most cases, which is not too different from standard contingent fee arrangements in personal injury cases.

In any case, banning percentage fees would have less effect on class actions than on individual tort litigation, for hours-based fee rules have been in effect for most class action fee awards for the last quarter century. To be sure, the lodestar formula frequently operated as a sub rosa percentage method because of liberal use of large multipliers. But in fee-shifting cases, and to a lesser extent in common fund cases, the use of large multipliers has declined and class action lawyers have

22. Herbert M. Kritzer, *The Wages of Risk: The Returns of Contingency Fee Legal Practice*, 47 DePaul L. Rev. 267 (1998).

23. Doubtless the proscription would apply to investment bankers as well.

24. *See* 15 U.S.C. §§ 77u-1, 78u-4 (1983 & Cum. Supp. 1997).

25. *See, e.g.*, Paul, Johnson, Alston & Hunt v. Graulty, 886 F.2d 268, 273 (9th Cir. 1989) (holding that a 25% benchmark figure is proper); *In re* Activision Sec. Litig., 723 F. Supp. 1373, 1378 (N.D. Cal. 1989) (holding that the benchmark rate should be 30%, "absent extraordinary circumstances").

continued to find the field profitable. They have responded to hours-based fee formulas by documenting their hours more carefully, staffing more like corporate law firms, claiming hefty hourly rates (and obtaining some hourly-fee work to substantiate the claimed rates), and entering serious settlement discussions only after substantial hours have been logged.[26] Common fund class actions are normally filed only when the aggregated claims are large enough to justify a satisfactory attorney's fee; increased staffing by associates billed at high rates provides sufficient documentation to support the fee request. Moreover, any legislation that could actually pass might well include a provision for a contingency premium (say, a multiplier of up to two). Notwithstanding the Supreme Court's opinion in *City of Burlington v. Dague*,[27] it seems no more reasonable to ask lawyers to ignore the time value of money, opportunity costs, and the risk of nonpayment in deciding which cases to take, than to ask the same of bankers setting loan rates.

Returning to a more general perspective, perhaps the most important consideration in evaluating the effect on class actions of a ban on contingent fees is the law of unintended consequences. We have not discussed who would enact this hypothetical statute. A federal statute would probably cover only federal court suits,[28] allowing cases to proceed in state court. Legislation at the state level would probably not be universal or uniform, which should lead to increased levels of filings in states that continued to permit contingent fees.[29] Thus, an attempted ban on contingent fees might simply shift contingent fee class action litigation to courts in jurisdictions that did not adopt the ban. Something similar occurred, at least temporarily, following the enactment of the PSLRA. The Act contained a number of onerous procedural provisions, including a heightened pleading standard, a mandatory stay of discovery pending the resolution of a motion to

26. One consequence of the Ninth Circuit's adoption of the percentage approach has been a trend toward earlier settlements.

27. 505 U.S. 557 (1992).

28. An argument could certainly be made for regulation under the Commerce Clause, though it would be tougher sledding after United States v. Lopez, 514 U.S. 549 (1995). The qualifications and ethical standards of lawyers have traditionally been matters for state control, however, and Congress has not thus far attempted to regulate the attorney-client relationship or the compensation of lawyers in state-court cases, except to strike down state regulation under the Constitution. Recently, however, Congress has sometimes been surprisingly willing to legislate in areas such as tort reform that have traditionally been left to the states.

29. Such a development might give new urgency to the question of whether a state court can certify a nationwide class in a damages action.

dismiss, and restrictions on the selection of the class representative.[30] Contrary to expectations, the number of filings did not change materially, but at least initially the number of cases filed in state court increased dramatically—apparently the result of plaintiffs either fleeing the federal courts for more favorable state fora, or filing in state and federal court simultaneously to avoid the federal court discovery stay.[31] Data for 1997 suggest that the phenomenon may have been only temporary; filings in both state and federal courts appear to have returned to their pre-reform levels. The lesson appears to be that squeezing the pipeline shut may not close off the flow of cases, but may simply divert them to other courts or even have no effect at all.

Extending the "mind experiment" of imagining the abolition of contingent fees to the class action context affords a new perspective on the function and social value of contingent fees. It adds an important category of litigation that would be impossible without contingent fees. As with individual tort claims, we can (barely) imagine other financing methods for class actions, but they would be difficult to construct, might not work at all because of market failures and the difficulty of bundling claims, and would probably result in decreased access for meritorious claims. The market-oriented alternatives would entail a serious loss of process values, including the opportunity to be heard before an independent judge, represented by a loyal, competent and knowledgeable attorney with access to information and evidence relevant to the claim. Though these values may be endangered by the class action device itself because of the attenuation of client control over counsel for the class, contingent fees make access to the civil justice system possible in class actions, as they do in most claims by individuals.

Thinking about abolishing contingent fees in class actions directs attention to the separate components of this litigation institution, and illuminates the different significance and effects of those components. Doing away with "no win no pay" and instead requiring clients to "pay as you go" and "pay, win or lose" would effectively kill off most class action litigation for damages, though as Professor Gross observes, individual tort litigation could probably survive (even if by cheating).[32] On the other hand, requiring compensation to be based solely on hours worked would seriously decrease access for individual

30. *See, e.g.*, Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of U.S.C.).

31. *See* GRUNDFEST & PERINO, *supra* note 15, at ii (stating that 26% of litigation activity moved to state court in the first year after the Act was enacted).

32. Gross, *supra* note 2, at 323-24.

plaintiffs by undercompensating their lawyers, but might not significantly hamper class actions. That is to say, as Professor Kritzer has observed, "no win no pay" is critical to contingent fees' role in increasing public access to justice, while the percentage aspect is important in assuring a supply of lawyers willing to take contingent fee cases.[33] Additionally, fees in federal class action litigation are explicitly based either on statutes authorizing fee shifting or on the equitable principle of unjust enrichment. It is difficult to justify displacing either statutes specifically authorizing the award of contingent fees in particular categories of cases or equitable principles of general application. This insight suggests that the underlying principles of contingent fees are more deeply embedded in our legal fabric, and more generally accepted, than critics sometimes acknowledge.

Although class actions and personal injury cases appear to be examples of claims where some form of contingent fee provides the best available method of financing litigation, the class action context also illuminates some of the less attractive elements of the contingent fee that are associated with the potential for conflict of interests between the attorney and the client.[34] Contingent fees create incentives for lawyers to prefer settlement to trial, because a settlement assures that the attorney will receive at least some fees, while trial carries the risk of losing both out-of-pocket expenditures and the opportunity cost of the time spent on the case. This incentive becomes more powerful as cases become more complex and protracted and require more pretrial expenses. Class actions, especially mass tort cases, are the paradigm example.

The higher profitability of a high-volume practice, as shown by Professor Kritzer,[35] also provides an incentive to settle cases rather than to try them. Indeed, as Kritzer also shows, the earlier cases are resolved, the more profitable they are for contingent fee lawyers, providing a strong incentive to settle cases early, perhaps before relevant information is obtained and analyzed during discovery.[36] Taking cases

33. Kritzer, *supra* note 22.

34. Because the attorney-client relationship is an agency relationship, there is always a potential for conflict between the economic interest of the client and that of the agent. Different fee arrangements manifest that conflict in different forms. For example, hourly fee arrangements create incentives to overwork cases and to litigate inefficiently, and pro bono arrangements may lead to insufficient loyalty to the client's interests, with the client's own personal interests being subordinated to the lawyer's ideological goals. Contingent fees in class actions, however, lead to distinctive conflict of interest problems. *See, e.g.*, John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 716-20 (1986).

35. Kritzer, *supra* note 22, at 298-99.

36. *Id.* at 293-96.

to trial takes longer than settling them, and trial time is both harder work and less profitable than time invested at earlier stages. Settlement smoothes out the distribution of outcomes, making total losses less likely. This consideration may be particularly persuasive in complex litigation where substantial out-of-pocket expenses and opportunity costs are involved and where even "early" resolution may take a long time. Absent effective client control (and it *is* absent in the typical class action) these incentive structures can lead to smaller settlements.

In common fund cases, where the fee is paid out of the monetary recovery as in individual personal injury cases, the lawyer's interest will be to emphasize monetary recovery rather than looking to the possibility of "enlarging the pie." This characteristic is probably more important in some types of class actions than in the traditional tort case, for in many types of class actions, nonmonetary structural reforms might serve the class's interest better and more efficiently than distributing a large number of checks for trivial amounts. There is little incentive to seek such solutions in a common fund class action. In a perfect world, this incentive structure might be cause for concern. In our world, however, one need look no further than coupon settlements and Delaware shareholder derivative suits to conclude that the risk of collusive nonmonetary settlements that benefit everyone but the class probably outweighs the potential benefit of nonmonetary solutions.

All of these considerations suggest that rather than abolishing contingent fees, it would be worthwhile to fine-tune the procedures for awarding fees in class actions to avoid some of the problems that may flow from the incentive structures contingent fees create. Such reforms might include the following ideas.

1. *Promote more effective monitoring by clients.* Where possible, class members with large stakes should be encouraged to participate. In securities cases, for example, a significant share of the recovery invariably goes to large claimants, usually institutional investors. Very large claimants could be required to opt in to be included in the class, and opt ins could be required to serve, if requested, on a plaintiffs' steering committee to oversee the conduct of the litigation. An intermediate approach is taken by the PSLRA, which already requires notice of the filing of an action and an opportunity for class members to seek to be named class representatives.[37] Courts could seek ways to

37. Securities Reform Act, 15 U.S.C. §§ 77z-1(a)(3)(A), 78u-4(a)(3)(A) (1983 & Cum. Supp. 1997).

encourage formal or informal participation by class members, including expanded use of the Internet to communicate with the class. In the mass tort area, individually retained plaintiffs' attorneys might be encouraged to play a monitoring role with respect to class counsel.

2. *Minimize opportunities for conflicts of interest to arise.* The Supreme Court's recent opinion in *Amchem v. Windsor*[38] raises difficult issues with respect to subclasses. The larger the class, the more likely it is that there will be conflicts within the class and that settlements will disadvantage some class members. As *Amchem* illustrates, such conflicts are particularly troubling in the case of future claimants,[39] but they can exist even within classes that are apparently homogeneous.[40] Subclasses may be one way of dealing with this issue, though they are cumbersome and may give rise to new conflicts. For example, what happens to the fees of lawyers who agree that the subclass they represent—for example, exposure-only plaintiffs—should receive no recovery?[41]

Within the present class-action structure, however, there are simple steps that could minimize conflicts between the class and its lawyers. These include: requiring the recovery for the class to be negotiated and approved separately from, and before, negotiation or approval of fees to prevent both collusion and the type of exploitation approved in *Evans v. Jeff D.*;[42] stating the class recovery on a per claim basis rather than an aggregate lump sum for the entire class, so that the notice of settlement will be in a more useful form for the class; and requiring the defendant to pay the class's attorney's fees directly to assure an adversary presentation throughout the fairness hearings to assist the judge in protecting the interests of the class.

3. *Tie the lawyers' compensation directly to the interests of the class.* The application, briefing and hearing on the fee request should not take place until after all claims are filed, and the judge should be required to take into account the actual benefit conferred on the class (as demonstrated by the claims made) as well as the effort and skill

38. 117 S. Ct. 2231 (1997).

39. *Id.* at 2251-52.

40. *See In re* Clearly Canadian Sec. Litig., 875 F. Supp. 1410, 1422 (N.D. Cal. 1995) (refusing to certify plaintiffs as a class because of intra-class conflicts).

41. *See* John C. Coffee, Jr., *After the High Court Decision in* 'Amchem Products Inc. v. Windsor,' *Can a Class Action Ever Be Certified Only for the Purpose of Settlement?* NAT'L L.J., July 21, 1997, at B4, B6 ("If a plaintiffs' counsel . . . settles for no cash payment, but only the right to medical monitoring, such an attorney should be entitled to an attorney fee equal to one-third of zero plus an annual paid doctor's appointment").

42. 475 U.S. 717 (1986) (approving settlements conditioned on waiver of statutory attorney's fees).

required to obtain the result, in determining an appropriate fee, which would not be limited to compensation for actual hours worked.

Narrowly-targeted measures such as these could greatly reduce the potential for attorney-client conflicts of interest inherent in class litigation. Yet they are manageable and should be achievable, indeed, some would not even require legislation. Such reforms are greatly to be preferred to broad-brush attacks on contingent fee lawyers that, if taken to their logical conclusion, could make it impossible to bring class actions.