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A New Model of Plaintiffs' Class Action Attorneys

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A New Model of Plaintiffs' Class Action Attorneys

Morris Ratner*

I.	INTRODUCTION	758
II.	THE CONVENTIONAL UNDERSTANDING OF THE PLAINTIFFS' CLASS ACTION ATTORNEY	762
III.	WHY THE CONVENTIONAL UNDERSTANDING FAILS AND THE NEW MODEL THAT REPLACES IT	773
	A. <i>The Plaintiffs' Class Action Bar Is Highly Stratified; the Leading Firms Are Relatively Large</i>	773
	B. <i>Law Firm Organizational Complexity Creates Incentives Other Than Maximization of Law Firm Profit</i>	780
	1. Firm Ownership May Not Track Case Management Authority	784
	2. A Lawyer's Perceived Self-Interest Is Shaped by Law Firm Practices	786
	a. <i>Equity Allocation Schemes</i>	786
	b. <i>Compensation and Promotion Schemes for Non-Equity Attorneys</i>	787
	c. <i>Case Financing</i>	790
	d. <i>Resource Allocation Mechanisms</i>	791
	e. <i>Degree of Firm Attachment</i>	793
	f. <i>Law Firm Structure, the Conventional Understanding of Plaintiffs' Class Counsel, and a New Model</i>	793
	C. <i>Plaintiffs' Class Action Attorneys Invest Time in Cases for Complex Reasons Beyond Just Expected Fees</i>	796
	1. Fees Are Difficult to Predict	796
	2. Factors Alien to the Conventional Account May Dictate Case Investment	801

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IV. WHY THE NEW MODEL IS IMPORTANT	813
A. <i>The New Model Is More Descriptively Accurate</i>	813
B. <i>The New Model's Complexity Underscores the Need for Better Empirical Research on the Actual Agency Problems that Exist in Class Action Litigation</i>	814
C. <i>The New Model's Complexity Enables Us to Identify the Best Tools for Reducing Agency Costs</i>	817
1. The New Model's Complexity May Enable Tailoring of Incentive-Based Reforms	820
a. <i>Firm Structure Reveals New Levers to Align Class Counsel's and Class Members' Interests</i>	820
b. <i>Why Tailored Incentives May Fail</i>	822
2. Complexity Counsels in Favor of Rehabilitating the Trial Court Judge to Minimize Agency Costs	824

I. INTRODUCTION

The class action mechanism is designed to harness the plaintiffs' class action attorney's self-interest, typically framed as the desire to maximize fees, to further the equitable goals of Rule 23 (e.g., enabling litigation that would not be economically viable absent certification).¹ In a series of influential articles over the past several decades, Professor John C. Coffee, Jr. identified a problem

1. See *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 617 (1997) ("The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor." (quoting *Mace v. Van Ru Credit Corp.*, 109 F.3d 338, 344 (7th Cir. 1997))); John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working*, 42 MD. L. REV. 215, 220 (1983) [hereinafter Coffee, *Rescuing the Private Attorney General*] ("In theory, the private attorney general is induced by the profit motive to seek out cases that otherwise might go undetected."); William B. Rubenstein, *On What a "Private Attorney General" Is—And Why It Matters*, 57 VAND. L. REV. 2129, 2136–37 (2004) [hereinafter Rubenstein, *On What a "Private Attorney General" Is*] (describing the emergence of a fee-driven concept of the private attorney general).

with this design.² Professor Coffee used agency cost theory³ to

2. See John C. Coffee, Jr., *Accountability and Competition in Securities Class Actions: Why "Exit" Works Better Than "Voice"*, 30 CARDOZO L. REV. 407, 408 (2009) [hereinafter Coffee, *Accountability and Competition*] ("[T]his benefit [of class action litigation] comes at the cost of creating principal agent problems that remain intractable despite repeated efforts by Congress and the courts to curb highly visible abuses."); John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Torts Class Action*, 95 COLUM. L. REV. 1343, 1349 (1995) [hereinafter Coffee, *Class Wars*] ("Although agency costs are inevitably high in all class actions, the mass tort class action is uniquely vulnerable to the danger of collusion, and thus needs special safeguards."); John C. Coffee, Jr., *Litigation Governance: Taking Accountability Seriously*, 110 COLUM. L. REV. 288, 296 (2010) [hereinafter Coffee, *Litigation Governance*] ("In particular, this Essay will focus on the concept of 'agency costs' and the tradeoffs between exit and voice as tools by which to regulate the behavior of agents in aggregate litigation."); John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877, 882–83 (1987) [hereinafter, Coffee, *Entrepreneurial Litigation*] ("High agency costs characterize class action litigation and permit opportunistic behavior by attorneys. As a result, it is more accurate to describe the plaintiff's attorney as an independent entrepreneur than an agent of the client."); Coffee, *Rescuing the Private Attorney General*, *supra* note 1, at 229 ("Put simply, the hallmark of the private attorney general is that as a practical matter he is unconstrained by the dictates or interests of a specific client."); John C. Coffee, Jr., *Rethinking the Class Action: A Policy Primer on Reform*, 62 IND. L. J. 625, 628 (1987) [hereinafter Coffee, *Rethinking the Class Action*] ("It is no secret that substantial conflicts of interest can arise in class action litigation between attorney and client."); 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, 671–72 (1986) [hereinafter Coffee, *Understanding the Plaintiff's Attorney*] ("[C]onflicts . . . arise between the interests of these attorneys and their clients in class and derivative actions . . ."); John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 LAW & CONTEMP. PROBS. 5, 11–12 (1985) [hereinafter Coffee, *The Unfaithful Champion*] ("[W]e are at the stage where the real need is not for more, inherently ambiguous empirical data, but instead for a clear model by which to predict how changes in legal rules enhance or reduce the ability of private enforcement to reduce agency costs.").

3. Agency theory is concerned with problems that arise in agency relationships when the principal and agent have different risk-preferences and goals, and it is difficult or costly for the principal to monitor the agent. See generally Kathleen M. Eisenhardt, *Agency Theory: An Assessment and Review*, 14 ACAD. OF MGMT. REV. 57, 58–59 (1989) (discussing agency theory and its applicability in a variety of contexts). See also Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 12

demonstrate that class members' inability or unwillingness to monitor class counsel gives the plaintiffs' attorney license to pursue his own interests without effective restraint. That, then, begged important subsidiary questions: what does class counsel want, and how does he achieve it? The answers to these questions inform our understanding of the nature of agency costs in class litigation and of how we should manage such costs. Professor Coffee provided one answer, by way of illustration, imagining class counsel as a solo practitioner or small law firm, cohesive in its desire to maximize law firm profit and capable of pursuing that one overriding interest by pegging case investment to expected fees.⁴ This understanding of the plaintiffs' class action attorney gained currency in the 1980s and became conventional;⁵ however, there is little consensus regarding

(1991) (noting that agency theory stems from the work of, among others, Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960), and Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976) [hereinafter *Theory of the Firm*]). "Agency costs" are the sum of monitoring expenditures by the principal, bonding expenditures by the agent, and the loss in welfare experienced by the principal due to the "divergence between the agent's decisions and those decisions which would maximize the welfare of the principal." *Id.* at 308.

4. See e.g., Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 2, at 712 ("In effect, such attorneys may restrict their investment of time and money in any individual case just as intelligent speculators may adopt self-imposed trading rules that limit their investment in any one stock.")

5. See *In re Gen. Motors Corp. Pick-Up Truck Fuel Tank Prod. Liab. Litig.*, 55 F.3d 768, 801-03 (3d Cir. 1995) (reversing the trial court's order certifying a settlement class; finding representation to be inadequate; and noting that "[s]ome commentators blame the system of compensating class action lawyers in a manner that fails to confront fully the differences between class action litigation and classical bipolar litigation for creating incentives that diverge markedly and predictably from their clients' interests") (citing as the leading critic on this issue, Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 2, at 671-72); *Gen. Motors Corp. v. Bloyed*, 916 S.W.2d 949, 953-54 (Tex. 1996) (finding that the class notice inadequately disclosed fee provisions of the proposed class settlement; noting the growing concern expressed regarding conflicts between class lawyers and their clients; and citing, among others, Coffee, *Rethinking the Class Action*, *supra* note 2, at 628-29, who listed "several factors that have contributed to entrepreneurial class action litigation, including the relatively low cost of filing dubious class action suits, the large amounts defendants are willing to pay in settling these suits, and the incentive for class counsel to invest little time and effort in protecting absent class members"); Macey & Miller, *supra* note 3, at 7-8

the solution to the agency cost problem the conventional understanding defines.⁶

This paper introduces a new perspective to the literature, namely that the conventional account of the plaintiffs' class action attorney that was developed in Professor Coffee's early work nearly a quarter of a century ago reflects a different practice regime than today's. It thus does not correctly identify class counsel's characteristics, interests, or capabilities. Specifically, there is no one entrepreneurial lawyer at the heart of class litigation. Instead, there are varieties of lawyers and law firms working on different types of cases, each combination of which produces a distinct array of incentives. Moreover, class counsel invest time in cases for complex reasons other than the effect on expected fees, which are exceedingly difficult to predict. The goal of this Article is to add depth and complexity to our understanding of plaintiffs' class counsel to enable a clearer assessment of and more tailored responses to principal-agent problems in class actions.

Part II of this Article outlines the conventional understanding of the plaintiffs' class action lawyer. Part III explores how variations in law firm size and internal architecture⁷ affect individual attorney incentives, and thus provide a new basis for modeling plaintiffs' class counsel. Specifically, Part III identifies the organizational features of firms that are most likely to fit the conventional account of fee-maximizing class counsel, and it juxtaposes that list of features against a new model of plaintiffs' class counsel. This new model describes the internal structure of the dominant plaintiffs' firms today and explains their relative lack of cohesion in pursuit of law firm profit. Part III also calls into question the emphasis that has

(describing how attorneys in these cases act "largely according to their own self interest").

6. See *infra* notes 31–34 (identifying, by way of example, disparate solutions to the agency cost problem Professor Coffee framed).

7. "Organizational architecture" includes key features of firm design, including, among others, "the assignment of decision-making authority, the reward system, and the performance-evaluation system." JAMES A. BRICKLEY, CLIFFORD W. SMITH & JEROLD L. ZIMMERMAN, *MANAGERIAL ECONOMICS AND ORGANIZATIONAL ARCHITECTURE* VI, 5 (5th ed. 2009) (examining the variation in law firm size and attorney incentives). See also *infra* note 68 (explaining organizational architecture's importance as a reference point in organizational theory and organizational economics).

been placed on expected fees as the driver of attorney case-investment decisions. Part IV explores the implications of this inquiry: a more complete account of class counsel reveals new opportunities for empirical research, identifies new levers with which to possibly better align class counsel's and class members' (actual) interests, and provides new impetus in support of direct regulation of class action outcomes at the time courts evaluate proposed settlements.

II. THE CONVENTIONAL UNDERSTANDING OF THE PLAINTIFFS' CLASS ACTION ATTORNEY

There is a popular perception of plaintiffs' class action lawyers that is not rooted in a particular model, and is, instead, an intuition: they are greedy.⁸ Anecdotal reports of bad settlements receive a great deal of attention and are referenced as proof of class counsel's essential character flaw.⁹ But without a model to define

8. See Editorial, *Going After Wal-Mart*, INVESTOR'S BUSINESS DAILY, April 1, 2011, at A12 ("If there was ever such a thing as junk justice, the suit against Wal-Mart now in the Supreme Court is exhibit A. By claiming that evidence is no longer needed to prove discrimination, what's proven is the greed of lawyers."); Peter Bronson, *Don Corleone Would Tip His Fedora to the Fen-Phen Class Action Lawyers*, CINCINNATI ENQUIRER, June 22, 2008, at 3D ("Yes, it happens all the time . . . Greedy class-action lawyers shake down corporations, often on flimsy evidence."); Susan Milligan, *Senate Battles Put Democratic Pair on the Spot*, BOSTON GLOBE, July 8, 2004, at A1 (noting, in regard to the then-proposed Class Action Fairness Act (CAFA) (eventually enacted as Pub. L. No. 109-2, 119 Stat. 4 (2005) (codified in various sections of Title 28 of the United States Code)), that backers of the bill asserted it would restrain "greedy lawyers who make millions suing businesses on what they view as questionable grounds").

9. One of the most notorious settlements involved claims against Bank of Boston Corporation, relating to its alleged practices of posting interest to escrow accounts. Those claims were settled in an Alabama state court in such a way as to generate an \$8 million fee for class counsel, while leaving some class members actually owing money (to pay the fee award). See *Kamilewicz v. Bank of Boston Corp.*, 100 F.3d 1348, 1349–50 (7th Cir. 1996) (Easterbrook, C.J., dissenting) (describing the settlement terms and arguing for rehearing en banc). See also Jennifer Brooks, *Consumers Caught in Drive to Rein in Class Action Lawsuits*, GANNETT NEWS SERVICE, Feb. 16, 2005, available at Factiva, Doc. No. GNS0000020050218e12g00001 (discussing arguments floated in favor of the Class Action Fairness Act; listing a number of settlements that appeared to pay

the parameters of class counsel's greed, the problem has no boundaries; nor does the solution. That is, we have no way of knowing whether the problem is structural (and, if so, its contours and remedy), or, alternatively, whether the occasional bad egg is at fault (and, if so, how to identify and restrain bad eggs). This Article addresses this popular intuition about class counsel only indirectly. My primary subject is what I have alternatively termed the "conventional understanding" or "conventional account" of the plaintiffs' class action attorney, one which presents a more systematic and, thus, more damning critique of the class action plaintiffs' bar.

In a series of articles, Professor Coffee provided an authoritative account of the plaintiffs' class action attorney,¹⁰ one grounded in agency cost theory.¹¹ There are two related aspects of this account. First, in the broadest possible terms, Professor Coffee's contribution was to recognize that principal-agent problems may be particularly acute in class actions because class members have little

large fees while leaving class members with little or nothing of value; and specifically discussing the Bank of Boston settlement); Sherman Joyce, *Class Action Clients Often Fleeced by Greedy and Unscrupulous Lawyers*, KNIGHT RIDDER/TRIBUNE, May 5, 1998 (discussing the Bank of Boston and other unfair class action settlements); David Wessel, *Class Action Lawyers*, WALL ST. J., Mar. 24, 2005, at A2 (discussing the Bank of Boston settlement).

10. See *supra* note 2 (identifying representative articles by Professor Coffee).

11. Professor Coffee's attraction to the agency lens is not surprising; as an expert in corporate law, where principal-agent problems are deemed central, he was nicely positioned to see the parallels between class counsel and corporate officers, as agents, and class members and shareholders, as principals. See AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE, "Analysis and Recommendations," pt. VII ch. 1 Intro. Note, 14 (2008) ("a central concept in modern institutional economics is that of 'agency cost'"); BRENT A. OLSON, PUBLICLY TRADED CORPORATIONS: GOVERNANCE & REGULATION § 2:3 (3d ed. 2011) (noting that "the current structure of laws governing publicly held corporations establishes the respective roles of shareholders, directors, and officers so as to balance these twin objectives of flexibility and accountability. In defining these respective roles, corporate law seeks to minimize the 'agency costs' resulting from the separation of ownership and control"); Charles Silver, *Class Actions—Representative Proceedings*, in 5 ENCYCLOPEDIA OF L. & ECON. 194, 199 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000) ("[I]t is useful to think of classes as litigation groups in which ownership and control of assets are in different hands In this respect, classes resemble stock companies . . . in which investors play relatively passive roles." (citations omitted)).

incentive or ability to restrain their agent, class counsel, who is thus able to pursue his own interests, even at the expense of the class members' interests.¹² What are those interests, and how do they diverge? The answer to that subset of questions is particularly important, both to measure and manage agency costs. This brings us to the second aspect of Professor Coffee's account, which this Article seeks to update and revise. In his early writings, Professor Coffee illustrated how agency costs manifest in class litigation by relying upon three core clusters of simplifying assumptions.

First, class counsel is either a sole practitioner ("the plaintiff's attorney," singular),¹³ or a cohesive group, such as a small firm,¹⁴ without internal structural complexity, such that the interests of the attorneys and the firm are indistinguishable.

Second, behaving as a rational decision-maker who acts "according to the same utility-maximizing criteria as do other businessmen,"¹⁵ the entrepreneurial plaintiffs' attorney's paramount interest is the pursuit of his own profit, which is, as noted, indistinguishable from his firm's profit. Even if class counsel seeks to maximize profits, it is not immediately obvious why his interests

12. See Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 2, at 685 (noting that a "serious" principal-agent problem is "likely" in class actions "where the number of clients is large and the individual injuries [are] small").

13. See, e.g., Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 2, at 676 (describing the plaintiff's attorney as an individual entrepreneur); Coffee, *The Unfaithful Champion*, *supra* note 2, at 12 (repeatedly referring to the plaintiff's attorney as a singular individual).

14. Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 2, at 706 n.102 (noting the small size of plaintiffs' firms but omitting consideration of firm structure's effects on attorney incentives).

15. Coffee, *The Unfaithful Champion*, *supra* note 2, at 12 ("The claim that we should view the plaintiff's attorney as a risk-taking entrepreneur will seem offensive to some and must be explained in greater detail It assumes neither that we should tolerate substantial conflicts of interest between the attorney and the class he represents, nor that all attorneys will act in a purely self-interested fashion. Rather, the only assumption underlying this perspective is that economic incentives will have a marginal impact upon the behavior of private enforcers and that therefore the law should seek to fashion the incentives that it holds out so as to align better the interests of the plaintiff's attorney with those of his clients."). Professor Coffee has also described the plaintiff's attorney as a "utility-maximizing entrepreneur who manages a portfolio of actions and thus makes litigation decisions in an individual case based upon their overall impact on the portfolio." Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 2, at 677.

would not be aligned with those of the class; typically class counsel is paid a percentage of the class's return, so for every new dollar the class makes, class counsel should continue to make his percentage and hence to push for that next dollar. But, Professor Coffee explained, class counsel and the class have asymmetric litigation stakes: class counsel bears the expenses of litigation, yet it turns out that his fee is a declining percentage of the fund, such that he always has more at stake, and more to lose, than do class members.¹⁶ For these reasons, class counsel is willing to invest less in the litigation than the clients would want¹⁷ and, moreover, is tempted to settle prematurely and sub-optimally.¹⁸

Third, class counsel not only has the opportunity, but also has the capacity to pursue his own interests, so defined.¹⁹ That is, he can ably modulate his case-investment and settlement decisions to maximize his law firm profit. To do that on a marginal basis, he must have a meaningfully definite estimate of the relationships among additional investment (e.g., additional hours spent litigating), the effect of that investment on case value (the likely outcome by litigation or settlement, and the resulting fee), and his opportunity costs (e.g., what he would earn by investing the same additional increment of time in another matter). In sum, what I refer to in this Article as the conventional understanding of class counsel imagines him as small, cohesively interested in firm profit, and capable of pursuing that overriding interest at the expense of the class.

Those three clusters of assumptions give content to the agency cost problem Professor Coffee identified. Professor Coffee graphically illustrated the manner in

16. Coffee, *Accountability and Competition*, *supra* note 2, at 413–14.

17. Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 2, at 685 (“[L]itigation must be viewed as a continuing investment decision, and plaintiff’s attorneys have reason to be more hesitant to invest in an action than do their clients.”).

18. Coffee, *Accountability and Competition*, *supra* note 2, at 412–13 (“*Absent client control, the plaintiff’s attorney will predictably deviate from the clients’ preferences to pursue the attorney’s own interests* In the simplest and most extreme case, the plaintiff’s attorney might exchange a cheap (or below-market) settlement for a lucrative (and above-market) attorney’s fee” (emphasis in original)); Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 2, at 687–90 (“[P]laintiff’s attorneys have an incentive to settle prematurely and cheaply when they are compensated on the traditional percentage of the recovery basis.”).

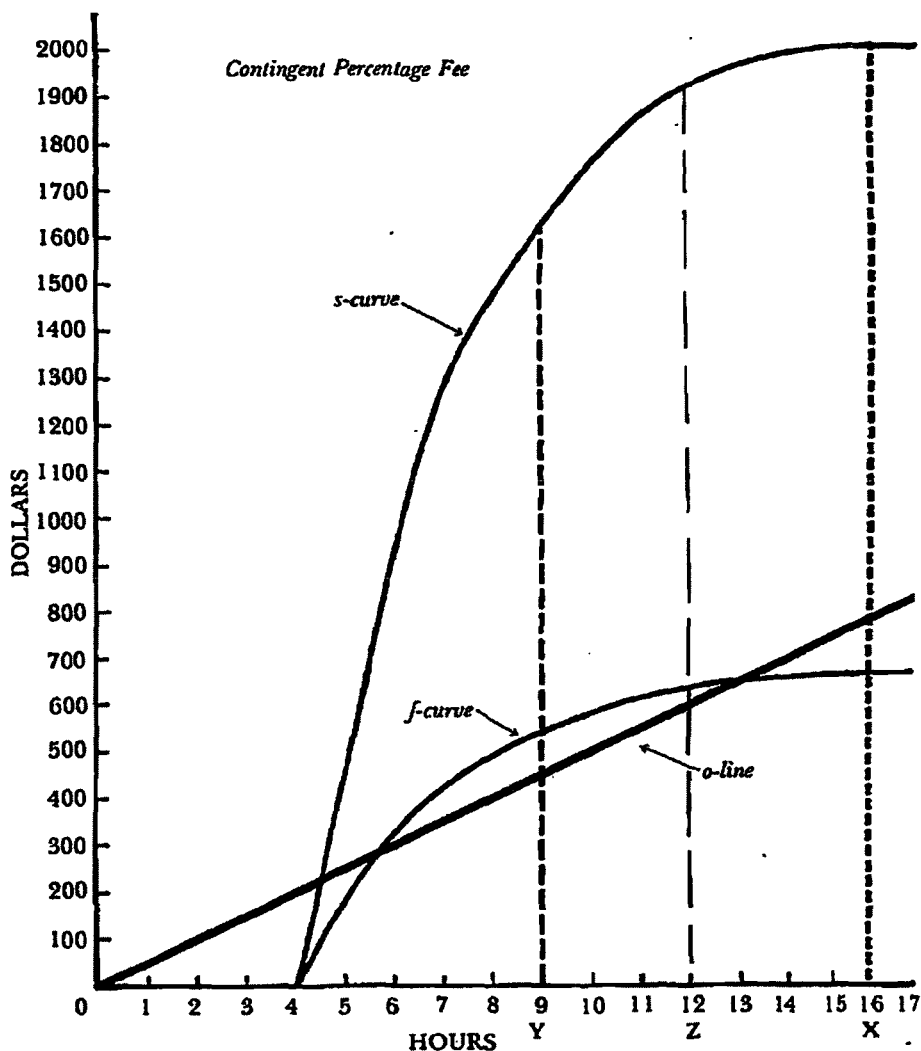
19. *Id.*

which agency costs may manifest in class litigation, using additional assumptions borrowed from a 1978 article by Kevin Clermont and John Currivan,²⁰ as set forth in Figure A.²¹

20. Kevin M. Clermont & John D. Currivan, *Improving on the Contingent Fee*, 63 CORNELL L. REV. 529, 537-46 (1978). This classic article is not specific to class actions; it addresses contingency fees in general. Its illustration of divergent interests takes on particular importance in the class setting, given the monitoring problems in class litigation that Professor Coffee highlighted. See *supra* note 2 (describing Professor Coffee's long work on the monitoring problem).

21. Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 2, at 689. Coffee has used the same chart on more than one occasion to illustrate attorney marginal investment and settlement decisions. See Coffee, *The Unfaithful Champion*, *supra* note 2, at 42 (using the same chart).

FIGURE A



In Figure A, the “s-curve” represents the settlement amount, on the assumption that settlement is assured and increases in size as a direct function of the attorney’s time, “until a point is reached where further efforts produce little or no return.”²² Assuming that the plaintiffs’ attorney will be compensated on a percentage basis, the “f-curve” represents the expected attorney’s fee, which is a

22. Coffee, *Understanding the Plaintiff’s Attorney*, *supra* note 2, at 688.

predictable function of the settlement's size.²³ The "o-line" represents the attorney's opportunity costs, which are assumed to increase at a constant rate over the period of case investment in proportion to the aggregate time invested by class counsel.²⁴ The client's interest is in a settlement at point X, which is the point of greatest distance between the settlement and fee curves; at that point, the clients' net recovery—the difference between the settlement and the fee—is maximized, which occurs, in Figure A, at that particular number of hours where the tangents to the s-curve and the f-curve become parallel.²⁵ Whereas, it is in the attorney's interest to settle much earlier at point Y, which is the point of greatest distance between the fee curve and the line representing attorney opportunity costs, after which point the o-line rises more rapidly than the f-curve, so the lawyer's opportunity cost (i.e., the amount he would earn investing the additional hour on another matter) exceeds the corresponding fee increase.²⁶ The attorney's expected return is maximized at a much earlier point in the litigation investment continuum than is the client's.²⁷ Given Professor Coffee's vision of class counsel as a profit-maximizing economic actor, who is distinctly unconstrained by a capable or interested client, class counsel will predictably invest too little (only up to point Y) in class

23. *Id.*

24. *Id.* It is assumed that the plaintiffs' attorney "has no idle time and each hour he devotes to the plaintiff's case he would otherwise have devoted to matters handled at his certain hourly wage—i.e., time that the lawyer allocates to the plaintiff's case causes him to forgo earning his certain hourly wage." Clermont & Currihan, *supra* note 20, at 538. See also Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 2, at 688 (describing the assumption that each hour spent on the case is a forgone opportunity for other involvement). Plaintiffs' counsel's "interests suggest that he should continue to devote hours to this case only as long as each additional hour increases his fee by at least as much as his opportunity cost. When the hourly increase in his fee drops below his opportunity cost, he would do better to settle and then to shift his efforts to other matters." Clermont & Currihan, *supra* note 20, at 545.

25. Clermont & Currihan, *supra* note 20, at 543.

26. *Id.* at 545–46.

27. Point Z—the point of greatest distance between the attorney's opportunity costs and the settlement amount—represents the socially optimal settlement point, assuming that only the client and the lawyer have an interest in the action, because any further marginal investment of costs will be greater than the marginal increase in settlement size at that point. Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 2, at 688–90.

action litigation.²⁸

Professor Coffee's writings are, of course, more nuanced than this short summary of decades of his work product suggests. But the basic understanding of class counsel described in his writings, and distilled above, has remained one of his most consistent themes.

A few commentators have raised doubts about the conventional understanding of class counsel, adding new features,²⁹ or questioning its significance.³⁰ But in general, the account is

28. It can be argued that Professor Coffee never intended Figure A to be taken literally. It is, the argument goes, designed merely as a visual aid, to enable "us to see how the interests of client and attorney diverge." Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 2, at 688. But for Figure A to map anything, it has to at least represent quantities that can be sufficiently ascertained to be placed in relation to each other, and to meaningfully guide attorney decision-making. There are two main types of principal-agent problems in class litigation, a typology of which may be useful at this juncture: Professor Coffee's illustration of agency costs in Figure A, above, describes one common principal-agent problem, which I label "shirking," where class counsel invests less time in class litigation than class members would prefer, and settles prematurely. Although Figure A does not map it, Professor Coffee's more general description of agency costs in class litigation also encompasses another problem, where class counsel, regardless of the amount of time invested in a case, "sells out" the class during settlement discussions, by for example trading class member settlement benefits in exchange for attorneys' fees. The two types of principal-agent problems overlap; "shirking" is arguably a particular instance of the broader "sell-out" phenomenon. The presentation in Part III, below, of a new model of plaintiffs' class action attorneys that acknowledges the effects of intra-firm structure on individual attorney incentives is equally relevant to both shirking in particular and to the "sell out" problem writ large, to the extent some lawyers, within some firm structures, are driven by incentives other than maximizing fees. However, the discussion, below, of the difficulty class counsel has pegging case investment to expected fees pertains specifically to shirking.

29. See Rubenstein, *On What a "Private Attorney General" Is*, *supra* note 1, at 2137 (supplementing the conventional account of the entrepreneurial lawyer by devising a new taxonomy of types of "private attorneys general," organized around the extent of publicness or privateness involved, rather than around the sole axis of attorney incentives); Charles M. Yablon, *A Dangerous Supplement?: Longshot Claims and Private Securities Litigation*, 94 NW. U. L. REV. 567, 589-93 (2000) (suggesting that Coffee's account may be insufficient to explain the large percentage of low-dollar settlements).

30. See Myriam Gilles & Gary B. Friedman, *Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers*, 155 U. PA. L. REV. 103, 104-06 (2006) (arguing that class counsel, in the limited context of negative value suits, should be forgiven for pursuing his own interest in fees at the

unchallenged. Professor Coffee is repeatedly cited in support of schemes to restrain class counsel by, among other things: manipulating the selection, payment, and/or monitoring of class counsel;³¹ inserting more adversarialism into or otherwise enhancing the effectiveness of the settlement-approval process;³² facilitating

expense of payments to class members, on the ground that deterrence, not compensation, is the primary goal of such suits).

31. See Alon Harel & Alex Stein, *Auctioning for Loyalty: Selection and Monitoring of Class Counsel*, 22 YALE L. & POL'Y REV. 69, 71–72 (2004) (proposing as a solution to the agency cost problem in class actions a compulsory auction mechanism for appointing counsel and for awarding fees, designed to reduce both shirking and collusion); Bruce L. Hay, *The Theory of Fee Regulation in Class Action Settlements*, 46 AM. U. L. REV. 1429, 1432 (1997) (examining judicial regulation of class counsel's fees as a means of addressing acute principal–agent issues in class action litigation); Alon Klement, *Who Should Guard the Guardians? A New Approach for Monitoring Class Action Lawyers*, 21 REV. LITIG. 25, 61–80 (2002) (recommending the use of independent private monitors to select, supervise, and pay class counsel, subject to court approval; the monitor would be appointed pursuant to an auction and would be paid a percentage of the total class recovery); Macey & Miller, *supra* note 3, at 6 (“We draw on the economic theory of agency costs to suggest that the special problems of entrepreneurial litigation could be substantially overcome if the legal system were to allow some form of auction for plaintiffs’ claims, under which attorneys (and others) could bid for the right to bring the litigation and gain the benefits, if any, that flow from success. A pure form of auction would simply sell the plaintiffs’ claim outright to the winning bidder, with the proceeds to be distributed immediately to the class or corporation.”); Elliot J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2053, 2105–09 (1995) (proposing reforms that eventually inspired the Private Securities Litigation Reform Act (Pub. L. No. 104-67, 109 Stat. 737 (codified in various sections of Chapters 15 and 18 of the United States Code)), including the creation of “a procedural environment that facilitates service by institutional investors as lead plaintiffs,” such as a presumption that the named plaintiff or group of plaintiffs with the largest financial stake in the outcome, and thus the greatest incentive to monitor class counsel, is adequate to represent the class).

32. See J. Brendan Day, Comment, *My Lawyer Went to Court and All I Got Was This Lousy Coupon! The Class Action Fairness Act's Inadequate Provision for Judicial Scrutiny over Proposed Coupon Settlements*, 38 SETON HALL L. REV. 1085, 1121–26 (2008) (suggesting a rebuttable presumption against all coupon settlements as one solution to the agency problem); William B. Rubenstein, *The Fairness Hearing: Adversarial and Regulatory Approaches*, 53 UCLA L. REV. 1435, 1438–39 (2006) [hereinafter Rubenstein, *The Fairness Hearing*] (proposing, among other fixes to the principal–agent problem in class actions, use of a court-

class member participation,³³ and increasing the scope of potential liability for plaintiffs' lawyers.³⁴ Three things are particularly noteworthy about these proposals. First, many of the proposed solutions that have actually been adopted involve market- or incentive-based efforts to, ex ante, align the perceived interests of class counsel and class members. Second, these reforms are perceived either as having had mixed results (e.g., auctions),³⁵ or as having failed to solve the agency cost problem in class action litigation (e.g., moving from a lodestar³⁶ approach to calculating

appointed "devil's advocate" during settlement evaluation to argue against approval of the settlement).

33. See Edward Brunet, *Class Action Objectors: Extortionist Free Riders or Fairness Guarantors*, 2003 U. CHI. LEGAL F. 403, 407 (considering expanded participation by settlement objectors as one remedy for the monitoring problems that plague class actions); Christopher R. Leslie, *The Significance of Silence: Collective Action Problems and Class Action Settlements*, 59 FLA. L. REV. 71, 125-33 (2007) (suggesting both increased communication between the trial court and the class and elimination of the presumption that the absence of objections from class members necessarily implies support for proposed settlements).

34. See, e.g., Susan P. Koniak & George M. Cohen, *Under Cloak of Settlement*, 82 VA. L. REV. 1051, 1056-57 (1996) (proposing civil and criminal penalties for class counsel who act contrary to the interests of the class during settlement negotiations).

35. See Edward R. Becker, C.J., *The Third Circuit Task Force Report on Selection of Class Counsel*, 74 TEMP. L. REV. 689, 696, 740 (2001) [hereinafter Becker, *Third Circuit Task Force*] (noting that the "goal of all the procedures surrounding the appointment of class counsel and the setting of fees is to establish appropriate structures and monitoring mechanisms to substitute for the ordinary attorney-client relationship and to assure performance of the fiduciary responsibilities owed by both the lawyer and the lead plaintiff to the class" and expressing skepticism about auctions because the "class recovery generally can be maximized more effectively by using the traditional methods of appointing counsel: private ordering where that is possible, court selection on the basis of quality of counsel if private ordering is not workable, and court control over the fee award in all cases"); Jill E. Fisch, *Aggregation, Auctions and Other Developments in the Selection of Lead Counsel Under the PSLRA*, 64 LAW & CONTEMP. PROBS. 53, 96 (2001) (criticizing the use of auctions in securities class actions).

36. Under the "lodestar" formula for calculating attorney's fees, fee awards are primarily the product of the number of hours reasonably expended in an action and the attorney's billing rate, adjusted if appropriate by a multiplier to account for risk and quality of work. See Becker, *Third Circuit Task Force*, *supra* note 35, at 706 ("The lodestar method requires a calculation of the hours spent in conducting the litigation, multiplied by an appropriate hourly rate, and adjusted, if appropriate,

attorney's fees to a percentage of fund methodology,³⁷ or promoting the appointment of institutional investors as lead plaintiffs in securities class actions).³⁸ Third, though the class action mechanism

by a multiplier factor for quality and risk.”); Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 2, at 675 n.16 (explaining key decisions adopting the lodestar formula as specified in the MANUAL FOR COMPLEX LITIGATION). The percentage of fund method for calculating attorney's fees gives the attorney “a portion of the fund that his efforts have ‘salvaged,’” by multiplying the fund created by the attorney's efforts by a percentage, the benchmark for which usually declines as the size of the fund increases, and which some jurisdictions still cross check against lodestar to assess reasonableness. *Id.* at 678–79 n.26. See also Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees in Class Action Settlements: An Empirical Study*, 1 J. EMPIRICAL LEGAL STUD. 27, 49 (2004) [hereinafter Eisenberg & Miller, *Attorney Fees*] (noting that fees awarded in common fund cases are now often calculated using the percentage of fund methodology).

37. See Coffee, *Litigation Governance*, *supra* note 2, at 292 (asserting that principal-agent problems in the class setting “remain intractable despite repeated efforts by Congress and the courts to curb highly visible abuses”); Coffee, *The Unfaithful Champion*, *supra* note 2, at 48 (finding the percentage of fund methodology “less imperfect” than the lodestar approach at aligning the interests of class counsel and class members); Samuel Issacharoff & Richard A. Nagareda, *Class Settlements Under Attack*, 156 U. PA. L. REV. 1649, 1699 (2008) (“One widely shared insight in the literature is that even fee-calculation methods that reward class counsel for additional increments of settlement value obtained for the class—as does the dominant method, which casts the fee award in terms of a percentage of the common fund recovered for the class—still do not perfectly align the incentives of class counsel with those of class members.”).

38. See Stephen J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA*, 106 COLUM. L. REV. 1489, 1489–90 (2006) [hereinafter Choi & Thompson, *Securities Litigation and Its Lawyers*] (finding “substantial continuity in the plaintiffs’ bar in securities class actions; the legislation did not dislodge the dominant plaintiff law firms nor did it encourage substantial new entrants”); James D. Cox, Randall S. Thomas & Dana Kiku, *Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587, 1636 (2006) (finding that lead plaintiffs who are institutional investors do add value, but perhaps they add less value to securities litigation than was expected by the architects of the PSLRA's lead plaintiff provision and appear less often than had been hoped: “Our real concern about institutions is that they do not seem to be able to increase dollar recoveries at the same pace as Provable Losses. This is disappointing and facially inconsistent with institutional lead plaintiffs’ beliefs that they can double or triple recoveries overall.”). Cf. James D. Cox, Randall S. Thomas & Lynn Bai, *There Are Plaintiffs and . . . There Are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements*, 61 VAND. L. REV. 355, 385 (2008) (“The lead plaintiff provision sought to attract institutions and others who have a significant stake in

continues to generate anxiety, as evidenced by the richness of the reform literature it inspires, there is no consensus on how best to further reduce agency costs. Acknowledging the complexity that the conventional understanding of class counsel obscures provides new insight and direction.

III. WHY THE CONVENTIONAL UNDERSTANDING FAILS AND THE NEW MODEL THAT REPLACES IT

The conventional understanding of plaintiffs' class counsel assumes the existence of a uni-dimensional plaintiffs' attorney: a small firm, without internal complexity, that cohesively and capably seeks to maximize law firm profit. However, the leading class action firms today are relatively large. The trend to large-firm dominance of the class action bar is well-known to modern observers, though the effect of firm size on the incentives of individual class action attorneys, discussed below, has not been fully appreciated. Large firms possess internal structural complexity that creates diverse incentives other than law firm profit. And they make case-investment decisions by reference to complex factors not considered in the conventional account. Acknowledging this complexity creates opportunities to construct a new model of plaintiffs' class action attorneys, and thus to more precisely map and address agency costs.

A. *The Plaintiffs' Class Action Bar Is Highly Stratified; the Leading Firms Are Relatively Large*

The small firm has historically been characterized by fewer than ten attorneys.³⁹ Such firms are more likely to adopt forms of

the litigation to become the suit's plaintiff. Our findings not only reflect that nearly eighteen percent of securities class actions settlements in suits initiated after the PSLRA are prosecuted by institutional plaintiffs of the type desired by Congress, but also, more importantly, that they add substantial value to the outcome.").

39. Geoffrey C. Hazard, Jr. & Ted Schneyer, *Regulatory Controls on Large Law Firms: A Comparative Perspective*, 44 ARIZ. L. REV. 593, 596 (2002) ("While the vast majority of American lawyers continued to practice as solos or in very small firms until the 1950s, the traditional pattern held even greater sway abroad. Until quite recently, firms with more than a handful of lawyers remained

organization that tend to enhance cohesion. When Professor Coffee first popularized the use of agency cost theory in the class setting, he described a landscape dotted with small plaintiffs' firms, which he predicted would remain static, in terms of size, due to various constraints.⁴⁰ But larger firms have in fact come to dominate the plaintiffs' class action bar.⁴¹ For example, a few large plaintiffs' firms are present in most securities class action lawsuits.⁴² Many of the largest plaintiffs' firms in this field are also the busiest:⁴³ Robbins Geller Rudman & Dowd (formerly known as Coughlin, Stoia, Gellar, Rudman & Robbins), with 180 attorneys in eight offices nationwide,⁴⁴ served as lead or co-lead counsel on an estimated 30% of all securities class action settlements in 2009–

uncommon in England and virtually non-existent on the Continent and in Latin America, India, and Japan. The large law firm is an American invention and export.”); *id.* at 597 (identifying ten as a number below which a firm should be considered “small,” based on the likelihood that firms with more than ten attorneys are more likely to adopt “bureaucratic” internal structures); Richard H. Sander & E. Douglass Williams, *A Little Theorizing About the Big Law Firm: Galanter, Palay, and the Economics of Growth*, 17 LAW & SOC. INQUIRY 391, 391 (1992) (“A century ago, no law firm outside of New York City had as many as 7 attorneys.”).

40. Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 2, at 706–11.

41. See Herbert M. Kritzer, *From Litigators of Ordinary Cases to Litigators of Extraordinary Cases: Stratification of the Plaintiffs' Bar in the Twenty-First Century*, 51 DEPAUL L. REV. 219, 230–32 (2001) (describing how larger firms tend to handle the larger class action cases and identifying leading firms based on reputation, firm size, and the size of the cases the firms tackle). The leading plaintiffs' firms today are generally larger than they were two decades ago, even if they are still smaller than the large mega-firms that have, in the same period, dominated corporate defense practice. See Brian Cheffins, John Armour & Bernard Black, *Delaware Corporate Litigation and the Fragmentation of the Plaintiffs' Bar*, 2012 COLUM. BUS. L. REV. 427, 456 (2012) [hereinafter Cheffins, Armour & Black, *Delaware Corporate Litigation*] (explaining that plaintiffs' firms are smaller than large corporate defense firms).

42. See Coffee, *Accountability and Competition*, *supra* note 2, at 442 (noting that “[a]s a practical matter today, three plaintiffs' firms dominate the securities class action industry: Bernstein, Litowitz, Berger & Grossmann; Coughlin, Stoia, Gellar, Rudman & Robbins; and Grant & Eisenhofer,” which currently employ 56, 180, and 60 attorneys, respectively, according to the firms' web sites, last visited June 19, 2011).

43. The rest of this analysis of firm size matches present firm size with securities class action settlement data from 2009–2010, unless otherwise noted.

44. ROBBINS GELLER RUDMAN & DOWD LLP, <http://www.rgrdlaw.com> (last visited June 19, 2011).

2010;⁴⁵ Bernstein Litowitz Berger & Grossman, with 56 attorneys,⁴⁶ served as lead or co-lead counsel in 10% of all securities class action settlements in 2009–2010;⁴⁷ and Topaz Kessler Meltzer & Check (formerly Barroway Topaz Kessler Meltzer & Check), with 110 attorneys,⁴⁸ Milberg, with 76 attorneys,⁴⁹ and Labaton Sucharow, with 62 attorneys,⁵⁰ were each named as lead or co-lead counsel in 7% of securities class action settlements in the same two-year time period.⁵¹

This phenomenon has persisted since the Private Securities Litigation Reform Act (PSLRA) was enacted in 1995.⁵² Before splitting in mid-2004 into Milberg Weiss Bershad & Schulman (now Milberg) and Lerach Coughlin Stoia & Robbins (now Robbins Geller Rudman & Dowd), the large Milberg Weiss Bershad Hynes & Lerach had served as lead or co-lead plaintiff counsel in approximately 50% of all securities class action settlements since the passage of the PLSRA.⁵³ After that split, the two successor firms

45. ELLEN M. RYAN & LAURA E. SIMMONS, CORNERSTONE RESEARCH, SECURITIES CLASS ACTION SETTLEMENTS: 2010 REVIEW AND ANALYSIS 14 (2011) [hereinafter SCAS 2010 Review], available at http://www.cornerstone.com/files/News/029b31a7-ff84-4000-b1ff-d177014ced27/Presentation/NewsAttachment/fd13e1e4-5564-4d46-86a3-882f232147a9/Cornerstone_Research_Settlements_2010_Analysis.pdf. These figures reflect a firm's percentage (as either counsel or lead counsel) of all security class action settlements.

46. BLB&G, <http://www.blbglaw.com/attorneys/index> (last visited June 19, 2011).

47. SCAS 2010 Review, *supra* note 45, at 14.

48. KESSLER TOPAZ MELTZER & CHECK, LLP, http://ktmc.com/about_attorneys.php (last visited June 19, 2011).

49. MILBERG LLP, <http://milberg.com> (last visited June 19, 2011).

50. LABATON SUCHAROW, <http://www.labaton.com> (last visited June 19, 2011).

51. SCAS 2010 Review, *supra* note 45, at 14.

52. See Choi & Thompson, *Securities Litigation and Its Lawyers*, *supra* note 38, at 1514 (referring to data sets confirming that the largest firms dominate class action suits post-PSLRA); Coffee, *Litigation Governance*, *supra* note 2, at 323–24 (discussing studies showing the persistence of market concentration in the securities plaintiffs' class action bar following enactment of the PSLRA).

53. LAURA E. SIMMONS & ELLEN M. RYAN, CORNERSTONE RESEARCH, SECURITIES CLASS ACTION SETTLEMENTS: 2006 REVIEW AND ANALYSIS 16 (2006) [hereinafter SCAS 2006 Review], available at http://www.cornerstone.com/files/Publication/d13a9e1f-b320-4884-9f25-13542dd2bed8/Presentation/PublicationAttachment/a3a3d386-3e02-4f66-904d-14e30a134e80/Cornerstone_Research_Settlements_2006.pdf.

continued their predecessor's dominance, and through 2006 they together accounted for over half of all securities class action settlements each year.⁵⁴ After the indictment of Milberg Weiss in mid-2006, its market share declined from 23% in 2006, to 7% in 2009–2010.⁵⁵ Over the same period, the other plaintiffs' firms commanding the highest market shares remained relatively constant; their percentages of all settled cases and comparative rankings have fluctuated, but the same large firms continue to dominate the securities class action field.⁵⁶

While similar data regarding plaintiffs' firms in other practice areas are more elusive, the information that is available suggests that the leading plaintiffs' class action firms are large. Only one firm on the Legal 500's 2011 ranking of five leading plaintiffs' labor and employment firms has fewer than 10 attorneys, and, on average, the firms on this list have approximately 27 lawyers.⁵⁷ For example, Lieff Cabraser, which handles employment litigation, among other

54. *Id.*

55. See James McDonald, *Milberg's Monopoly: Restoring Honesty and Competition to the Plaintiff's Bar*, 58 DUKE L.J. 507, 532–33 (2008) (stating that as of 2006, Milberg commanded 23% of all settled cases). See also ELLEN M. RYAN & LAURA E. SIMONS, CORNERSTONE RESEARCH, SECURITIES CLASS ACTION SETTLEMENTS: 2010 REVIEW AND ANALYSIS 14 fig. 13 (2010), available at http://www.cornerstone.com/files/News/029b31a7-ff84-4000-b1ff-d177014ced27/Presentation/NewsAttachment/fd13e1e4-5564-4d46-86a3-882f232147a9/Cornerstone_Research_Settlements_2010_Analysis.pdf (citing to the 7% market share of settlements in 2009–2010).

56. Compare SCAS 2006 Review, *supra* note 53, at 16, with SCAS Review 2010, *supra* note 45, at 14 (reporting the same large firms in both reviews).

57. See THE LEGAL 500, <http://www.legal500.com/c/united-states/litigation/mass-tort-and-class-action-plaintiff-representation-labor-and-employment> (last visited June 19, 2011) (listing five leading plaintiff firms: Altshuler Berzon (21 attorneys); Goldstein, Demchak, Baller, Borgen & Dardarian (15 attorneys); Lieff Cabraser Heimann & Bernstein, LLP (60 attorneys); Outten & Golden LLP (32 attorneys); Rudy, Exelrod, Zieff & Lowe, LLP (5 attorneys) (firm size data compiled from firm websites, last visited June 19, 2011)). The Legal 500 lists represent practices gaining nationwide recognition, and thus, while the lists do not indicate the market share of each firm, we treat them as representative of the leading firms in these practice areas.

categories of litigation, was founded in 1972, and has grown steadily over time to 60 lawyers in three offices.⁵⁸

The dominance of large plaintiffs' firms is also evident in the antitrust class action context. Again looking to the Legal 500's 2011 list of the top eight leading plaintiffs' firms in this field, we see large firms with a national presence—the firms on this list range from 15 attorneys to just over 200.⁵⁹ A few of these firms have experienced significant growth over the past decade: Boies, Schiller & Flexner LLP, for example, grew from approximately 100 attorneys in 2001 to 202 attorneys at present,⁶⁰ and Susman Godfrey LLP increased from approximately 50 attorneys in 2001 to around 90 today.⁶¹ Both firms handle a wide array of cases in addition to antitrust litigation.

There is yet another way to demonstrate the supremacy of larger firms in class litigation: randomly selecting nearly any case-management order appointing plaintiffs' attorneys and firms to leadership positions in high-profile MDL litigation⁶² matters reveals that, when presented with a choice, judges gravitate toward

58. Compare Kritzer, *supra* note 41, at 232 (“Lief Cabraser . . . with 45 attorneys based in San Francisco”), with LIEFF CABRASER, <http://www.lieffcabraser.com/> (last visited February 29, 2012) (providing more recent firm data).

59. See THE LEGAL 500, <http://www.legal500.com/c/united-states/litigation/mass-tort-and-class-action-plaintiff-representation-antitrust> (last visited June 19 2011) (listing eight leading plaintiff firms: Berger & Montague, P.C. (69 attorneys); Cohen Milstein Sellers and Toll LLP (60 attorneys); Hausfeld LLP (19 attorneys); Boies, Schiller & Flexner LLP (over 200 attorneys in 11 offices nationwide); Heins Mills & Olson PLC (12 attorneys); Labaton Sucharow LLP (more than 60 attorneys); Susman Godfrey LLP (90 attorneys in 5 offices nationwide); Zelle Hoffman Voelbel & Mason LLP (71 attorneys nationwide) (firm size data from firm websites, last visited June 19, 2011)). This list includes firms that self-identify as litigation firms due to their defense work, in particular Susman Godfrey, Boies, Schiller & Flexner, and Zelle Hoffman Voelbel & Mason.

60. Only a fraction of the Boies, Schiller & Flexner attorneys regularly prosecute plaintiffs' class actions.

61. Compare Kritzer, *supra* note 41, at 232 (“Boies, Schiller & Flexner . . . with one hundred lawyer[s] . . . in ten cities, and Susman Godfrey with more than fifty lawyers....”), with BOIES, SCHILLER & FLEXNER LLP, <http://www.bsflp.com/lawyers> (last visited June 19, 2011) (listing current firm size data) and Susman Godfrey LLP, <http://www.susmangodfrey.com/> (last visited June 19, 2011) (same). Both firms self-identify as litigation firms, rather than as plaintiffs' class action firms.

62. “MDL litigation” refers to cases transferred and coordinated by the Judicial Panel on Multidistrict Litigation pursuant to 28 U.S.C. § 1407.

established, big plaintiffs' firms. For example, in *In re Oil Spill by the Oil Rig "Deepwater Horizon" in the Gulf of Mexico, on April 20, 2010*, MDL-2179, Judge Carl Barbier appointed a fifteen-member steering committee, and a four-member executive committee (with two persons overlapping with the steering committee), for a total of seventeen lawyers, out of 121 applicants.⁶³ Most of the appointed lawyers are from relatively large firms, and all of the executive committee members hail from larger firms.⁶⁴ The BP litigation has produced class action settlements which are currently under review by the trial court.⁶⁵

63. Case Mgmt. Order No. 8 at 1–2, *In re Oil Spill by the Oil Rig "Deepwater Horizon" in the Gulf of Mex.*, on Apr. 20, 2010, 747 F. Supp. 2d 704 (E.D. La. 2010) [hereinafter *In re Oil Spill*], available at <http://www.mslitigationreview.com/uploads/file/MDL%20Steering%20committee%20order.pdf>.

64. The fifteen lawyers initially selected by Judge Barbier to serve on the PSC are Brian H. Barr of Levin, Papantonio, Thomas, Mitchell, Rafferty & Proctor, P.A. (approximately 38 attorneys); Jeffrey A. Breit of Breit, Drescher, Imprevento & Walker (6 attorneys); Elizabeth J. Cabraser of Lieff, Cabraser, Heimann & Bernstein, LLP (60 attorneys); Philip F. Cossich Jr. of Cossich, Sumich, Parsiola & Taylor (9 attorneys); Robert T. Cunningham of Cunningham Bounds LLC (17 attorneys); Alphonso Michael Espy (associated with Morgan & Morgan, with over 100 attorneys); Calvin C. Fayard Jr. of Fayard & Honeycutt, A.P.C. (3 attorneys); Ervin A. Gonzalez of Colson, Hicks, Eidson (14 attorneys); Robin L. Greenwald of Weitz & Luxenberg, P.C. (72 attorneys); Rhon E. Jones of Beasley, Allen, Crow, Methvin, Portis & Miles, P.C. (more than 60 attorneys); Matthew E. Lundy of Lundy, Lundy, Soileau & South, LLP (8 attorneys); Michael C. Palmintier of deGravelles, Palmintier, Holhaus & Fruge; Paul M. Sterbcow of Lewis, Kullman, Sterbcow & Abramson (4 attorneys); Scott Summy of Baron & Budd, PC (more than 60 attorneys); and Mikal C. Watts of Watts, Guerra, Craft, LLP (about 20 attorneys). In addition, four lawyers were appointed to the Plaintiffs' Executive Committee: James Parkerson Roy of Domengeaux Wright Roy & Edwards (11 attorneys); Stephen J. Herman of Herman, Herman, Katz & Cotlar, LLP (19 attorneys); Brian Barr of Levin, Papantonio, Thomas, Mitchell, Eschner; and Scott Summy of Baron & Budd, PC (39 attorneys). *Id.* at 1–2. All firm data in this paragraph is from firm web sites, where available, which were last visited July 17, 2011.

65. See Preliminary Approval Order [Economic] at 19, 29, 33, *In re Oil Spill by the Oil Rig "Deepwater Horizon" in the Gulf of Mex.*, on Apr. 20, 2010 (E.D. La. May 2, 2012) (provisionally certifying Economic and Property Damages Settlement Class; preliminarily approving of the proposed settlement; and appointing the counsel previously appointed as Liaison Counsel and appointed to serve on the Plaintiffs' Steering Committee as settlement class counsel), available at [http://www.laed.uscourts.gov/OilSpill/Orders/05022012Order\(EconomicSettlement\).pdf](http://www.laed.uscourts.gov/OilSpill/Orders/05022012Order(EconomicSettlement).pdf) (last visited July 25, 2012); Preliminary Approval Order [Medical] at

The foregoing data reflect the stratification of the class action plaintiffs' bar by showing that the largest firms dominate. Though it is hard, especially at the margins, to characterize each firm that prosecutes class actions as a particular "type" of law firm, crude categorizations, with some descriptive value, are in circulation. These categorizations turn in large part on law firm size and dominant litigation strategy. The largest class action firms predominate. They tend to get appointed to leadership positions in the most significant cases, and, as demonstrated below, are more likely to possess relatively greater internal complexity.

Smaller firms that routinely participate in class litigation are generally of three types:

- First, there are small firms with big aspirations, often started by lawyers who exit larger partnerships. They tend to follow the larger firms' business models, growing in size and internal complexity over time, and pursuing leadership roles in larger cases, often by joining forces with other plaintiffs' firms, in ad hoc firms that function as would a very large, internally complex plaintiffs' firm (though with even less cohesion).
- Then, there are small firms with small aspirations: they lack internal complexity, rarely get appointed to leadership positions in large cases, tend to file "copycat" complaints⁶⁶

15–16, 18, 22–23, *In re Oil Spill by the Oil Rig "Deepwater Horizon" in the Gulf of Mex.*, on Apr. 20, 2010 (E.D. La. May 2, 2012) (provisionally certifying Medical Benefits Settlement Class; preliminarily approving the Medical Benefits Class Action Settlement; and appointing as settlement class counsel attorneys previously appointed to serve as Liaison Counsel and as members of the Plaintiffs' Steering Committee), available at [http://www.laed.uscourts.gov/OilSpill/Orders/05022012Order\(MedicalSettlement\).pdf](http://www.laed.uscourts.gov/OilSpill/Orders/05022012Order(MedicalSettlement).pdf) (last visited July 25, 2012).

66. "Copycat" cases are actions "alleging the same injuries on behalf of the same class of plaintiffs" often in multiple (state court) jurisdictions, a form of jurisdictional gamesmanship CAFA was designed in part to address. See *Tanoh v. Dow Chem. Co.*, 561 F.3d 945, 954 (9th Cir. 2009) (addressing Dow's argument that Plaintiffs should not be allowed to 'game' jurisdiction statutes by filing copycat cases). Copycat cases may be filed for reasons other than jurisdictional advantage; for example, they are often filed by law firms seeking to free-ride off of other firms' pre-filing investigations of new cases, and, also, may be used

(which they have no intention of prosecuting through trial), rarely have a case in their case portfolio that is capable of funding firm operations individually, and, of necessity, are more likely to be driven at any given moment and to the extent practicable by hoped-for attorneys' fees.

- Finally, there are “outsider” firms, including, for example, professional objectors, often solo practitioners, who intervene in class litigation at specific points, often just to hold up larger firms for a share of the fee, by threatening to delay finality, and thus payment.

These last two categories of small firms are commonly described within the plaintiffs' class action bar, colloquially, as “bottom feeders.” Of course, few if any lawyers or firms would so self-identify; they are best identified by the pattern of their behaviors over time. There is a bridge between law firm size and the business models or practices that tend to be pursued by lawyers within firms: law firm internal structure, discussed below. While small firms (with internal structures that support the conventional account of class counsel) exist, they are not the focus of this Article. Instead, this Article primarily explores the characteristics of the largest, most significant firms that dominate various practice areas, and are thus more representative of today's practice regime.

B. Law Firm Organizational Complexity Creates Incentives Other Than Maximization of Law Firm Profit

The conventional understanding of class counsel as possessing a singleness of purpose in pursuit of maximizing law firm profit abstracts out from the picture of the plaintiffs' attorney the organizational architecture of the firm in which he practices and the diverse incentives firm complexity produces. That is why Professor Coffee and other commentators can alternate—often without explanation—between referring to class counsel as “the plaintiff's

strategically to create support within administratively aggregated proceedings for firms vying for leadership positions.

attorney” or as a small firm: they see the law firm itself as irrelevant, a black box that transforms inputs (attorney labor) into outputs (firm revenue).⁶⁷ While organizational theorists, economists, and other commentators have, in general and for some time, challenged models of the firm incorporating black box assumptions,⁶⁸ and while legal

67. See BRICKLEY ET AL., *supra* note 7, at 6 (“Traditional economic analysis generally characterizes the firm simply as a ‘black box’ that transforms inputs (labor, capital, and raw materials) into outputs. Little consideration normally has been given to the internal architecture of the firm.”); Jensen & Meckling, *Theory of the Firm*, *supra* note 3, at 306–07 (“While the literature of economics is replete with references to the ‘theory of the firm,’ the material generally subsumed under that heading is not a theory of the firm but actually a theory of markets in which firms are important actors. The firm is a ‘black box’ operated so as to meet the relevant marginal conditions with respect to inputs and outputs, thereby maximizing profits”); Timothy F. Malloy, *Regulating by Incentives: Myths, Models, and Micromarkets*, 80 TEX. L. REV. 531, 532–33 (2002) [hereinafter Malloy, *Regulating by Incentives*] (“Although no single, authoritative description of the black-box model exists, most formulations include three major components. First, the model assumes that the organization is a monolithic entity that essentially makes decisions as a natural individual would. Thus, the collective nature of the firm and its internal features are largely ignored. Second, the model assumes that the unitary firm makes decisions rationally Third, the traditional formulation of the black-box model assumes that the firm has one dominant goal: maximizing profits.” (citations omitted)).

68. Organizational theory and organizational economics explore internal firm characteristics to explain organizational form and behavior. See, e.g., Michael C. Jensen, *Organization Theory and Methodology*, 58 ACCT. REV. 319, 325 (1983) (describing the emergence of the field of organizational theory, with its emphasis on key organizational characteristics “which can explain why various organizations function as they do,” including “the performance measurement and evaluation system . . . , the reward and punishment system,” and “the system for partitioning and assigning decision rights among participants in the organization”). See also Sarah Kaplan & Rebecca Henderson, *Inertia and Incentives: Bridging Organizational Economics and Organizational Theory*, 16 ORGANIZATIONAL SCI. 509, 509 (2005) (“Organizational theorists have long acknowledged the importance of the formal and informal incentives facing a firm’s employees, stressing that the political economy of a firm plays a major role in shaping organizational life and firm behavior. Yet the detailed study of incentive systems has traditionally been left in the hands of (organizational) economists, with most organizational theorists focusing their attention on critical problems in culture, network structure, framing and so on—in essence, the social context in which economics and incentive systems are embedded.” (citations omitted)). The organizational theory literature has influenced legal commentary on firms generally. See Malloy, *Regulating by Incentives*, *supra* note 67, at 534 (“In some areas, the legal literature has begun to relax the black-box assumptions. For

commentators have moved past black box assumptions specifically with regard to large corporate law firms,⁶⁹ these same assumptions have enjoyed uncritical acceptance in class action scholarship.

example, writers using principal/agent theory and other concepts of organizational theory have breached the walls of the blackbox in the fields of corporate crime and securities regulation. Yet in other areas, the black-box remains essentially intact.” (citation omitted)); Timothy F. Malloy, *Regulation, Compliance and the Firm*, 76 TEMP. L. REV. 451, 457–58 (2003) (describing firm “routines”—which refers to “a wide range of formal and informal regular patterns of behavior that coordinate the activities of the firm members,” including “communication routines,” as well as “standard operating procedures that control production activities, budgeting and resource allocation procedures”—as driving firm behavior with regard to regulatory compliance).

69. See MARC GALANTER & THOMAS PALAY, *TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM*, 3, 9–10 (1991) [hereinafter GALANTER & PALAY, *TOURNAMENT OF LAWYERS*] (attributing the growth of large corporate law firms to the fundamental structure of the law firm “that crystallizes around the exchange between senior and junior lawyers” structured by the “promotion-to-partner tournament”); Robert L. Nelson, *PARTNERS WITH POWER: THE SOCIAL TRANSFORMATION OF THE LARGE LAW FIRM* 38 (1988) (“My argument is that a fundamental shift in the market for corporate legal services has resulted from the expanding functions of law in the affairs of major corporate actors . . . thus creating new tensions in the traditional law firm structure. The resulting ‘new structure’ of firms is marked by the emergence of a distinctive managerial elite and increasing disparities in the status and income of partners,” as well as “a new managerial ideology”); Edward A. Bernstein, *Structural Conflicts of Interest: How a Law Firm’s Compensation System Affects Its Ability to Serve Clients*, 2003 U. ILL. L. REV. 1261, 1261 (2003) (considering the relationship between income allocation schemes and the possibility that a corporate attorney’s advice will be tainted by self-interest, in possible violation of Model Rule of Professional Conduct 1.7); Ronald J. Gilson & Robert H. Mnookin, *Sharing Among the Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits*, 37 STAN. L. REV. 313, 320 (1985) (“In turn, recognition of the central importance of the method of income division in a law firm suggests a number of hypotheses concerning other important aspects of firm organization, including hiring and partnership selection policies. Our principal concern is thus to use a different theoretical framework to study an important social phenomenon—the large firm.”); Larry E. Ribstein, *Ethical Rules, Agency Costs, and Law Firm Structure*, 84 VA. L. REV. 1707, 1707 (1998) (considering effect of ethics rules on firm structure); S. S. Samuelson, *The Organizational Structure of Law Firms: Lessons from Management Theory*, 51 OHIO ST. L.J. 645, 645–46 (1990) (“Management theory and the impact of structure on organizational problems are foreign topics to most lawyers. Moreover, scholars have offered little practical guidance. Although management theory is rich in literature on

Internal firm structure shapes decision-making in ways the conventional account of class counsel does not address.⁷⁰ Lawyers serving as class counsel have interests that diverge from the interests of the class members. But to appreciate that divergence we must go beyond the simplifying assumptions animating the conventional understanding of the entrepreneurial lawyer. To identify the incentives potentially affecting attorney behavior in a given class action, it is not enough to know that the attorney works in a for-profit law firm. We also want to know precisely who within the firm will manage the litigation, how he is compensated and promoted, the extent to which he directly bears the risk of funding the litigation, his level of firm attachment, and his ability to direct firm resources to the litigation. We need to know, in short, both how a firm is organized, and how the attorney managing a particular case is situated within the firm's architecture. Such information does not allow us to precisely predict an attorney's case-management decisions; but consideration of these factors does test the reasonableness of the black box assumption of cohesion, which in turn tells us something about whether efforts to regulate attorney behavior premised on that core assumption are likely to be successful.

Larger firms tend to have complex internal structures. Such complexity undermines cohesion in two primary ways: by creating a wedge between firm ownership and control of case-investment decisions⁷¹ and by creating incentives for case managers other than maximization of firm profit.⁷² To understand agency costs in class

generic organizational structures, academic researchers have largely neglected the application of this literature to the internal organization of law firms.”).

70. The rest of this discussion assumes that class counsel is essentially self-seeking, to squarely meet the conventional account of class counsel on its own terms (i.e., without contradicting the conventional understanding that fiduciary models of class counsel are descriptively inaccurate).

71. See Jensen & Meckling, *Theory of the Firm*, *supra* note 3, at 308 (arguing that agency conflicts can distort a firm's investment decisions if ownership and control interests do not reside in one person). The situation is in fact even more complicated, because many cases are prosecuted by consortiums of law firms functioning in effect as ad hoc firms, where cohesion is arguably even more elusive. The effect on attorney incentives of inter-firm coordination and collective action is a separate topic not explored herein.

72. The opportunity of individuals within a firm to pursue their own distinct interests is an agency issue. See George M. Cohen, *When Law and Economics Met*

actions, we must first understand what class counsel really wants, and how he achieves it.

1. Firm Ownership May Not Track Case Management Authority

Most law firms are partnerships, in which ownership is measured in percentage points.⁷³ Each equity partner's annual income is a product of his equity stake (percentage) and the firm's profit. The spread of equity by percentage point, rather than by case, creates a wedge between the interests of the firm and the particular

Professional Responsibility, 67 FORDHAM L. REV. 273, 284 (1999) ("Agency problems may be compounded by the fact that clients, their lawyers, and third parties may all have agency problems within themselves The paradigmatic agency problem 'within the lawyer' is the law firm in which the lawyer practices. Lawyers are agents of their firms as well as of their client, and difficulty of monitoring poses problems in the lawyer-firm relationship similar to those in the lawyer-client relationship."). Recognition of this issue traces, in part, to Jensen and Meckling's work conceptualizing the firm as a "nexus for a set of contracting relationships among individuals." Jensen & Meckling, *Theory of the Firm*, *supra* note 3, at 310 ("Contractual relations are the essence of the firm, not only with employees but with suppliers, customers, creditors, etc. The problem of agency costs and monitoring exists for all these contracts"). Jensen and Meckling's analysis, which is not focused on law firms in particular, undoubtedly inspired law-firm-specific analyses. See, e.g., Gilson & Mnookin, *supra* note 69, at 333 ("The potential for each participant in the organization to maximize his self-interest at the expense of that of the other participants . . . can greatly reduce or even eliminate the potential for gain from organization. An agency theory of organization focuses on how organizations maximize the gains from cooperation by adopting structures which reduce the potential for participants to pursue their individual, rather than their collective, self-interest.").

73. See Christel Walther, *LLC and Lawyers: A Good Combination?*, 50 LOY. L. REV. 359, 366-67 (2004) (defining partnerships, limited partnerships, limited liability partnerships, and limited liability companies, and noting: "The partnership is the default format for all associations of two or more persons who carry on a business or profession for profit as co-owners. For the creation of a partnership, a written agreement and filings are generally not required, but there can be agreements, for example, on how the profits shall be shared or who shall manage the partnership. If there are no agreements on profit-sharing or management powers, all partners share profits and losses equally and render decisions together . . . [An LLP] shields the partners from liability for the professional conduct of their fellow partners in most of the states. Some newer LLP statutes go even further and provide a shield against personal liability for partnership obligations much the same as for shareholders in a corporation").

attorneys working on any one litigation matter; the outcome of any case that an equity partner manages may have only a negligible and indirect impact on his income.

This decoupling of ownership and control can occur even in smaller firms. Assume we have a three-lawyer firm with two equity partners, A and B, with equity stakes of 80 percent and 20 percent, respectively. C is a senior non-equity attorney. Each attorney manages one-third of the firm's case portfolio and makes case-management decisions on his own cases. Assume, further, that one of the cases, managed by B, is expected to bring in revenue of \$10 million (in attorney's fees and cost reimbursement) before the end of the accounting year. A, B, and C know the firm's total annual expenses and are aware of the fee expected in B's big case. Assume the annual expenses of the firm are projected to be \$4 million, including C's salary, firm overhead and case investments (hard costs). Assume the firm distributes 50 percent of firm profits each year and has no outstanding credit line. For the current year, A expects an income of \$2.4 million (\$3 million multiplied by .80), and B expects an income of \$600,000, even if no other case produces revenue. In this hypothetical, one case funds the entire firm's operations and produces income for the equity partners, allowing the attorneys to focus on their other cases without regard to meeting the firm's bottom line or, depending on their personal preferences, their own perceived needs for direct income. The hypothetical is designed to avoid placing financial pressure on the case managers; but it reflects the reality that a fraction of any class action law firm's case portfolio at any given time may satisfy the revenue needs for the firm, creating spaces where individual attorneys managing other cases feel no direct or immediate link between the short-term outcome in any case and their own financial well-being. Also, the example highlights that, within law firms, case control may not track firm ownership. A, with 80 percent equity, has the greatest stake in any fee, but, in our hypothetical, has only a one-third chance of actually making case-management decisions.

2. A Lawyer's Perceived Self-Interest Is Shaped by Law Firm Practices⁷⁴

The assumption of cohesion (the uniform pursuit of the single or predominating goal of maximizing law firm profit) is most credible if class counsel are either solo-practitioners (so the lawyer's interest and the firm's interest are co-extensive) or are embedded in firms that are organized to maximize each attorney's sense that his standing in the firm—with regard to equity, compensation, promotion, ability to direct firm resources to his cases, or expected longevity with the firm—is directly tied to the expected value of his mix of cases, individually, and relative to the net expected value of the cases managed by other attorneys in the firm. To the extent a self-interested attorney sees his interests as resting on factors other than firm profit, the assumption of cohesion is not credible.

a. *Equity Allocation Schemes*

Equity is typically fixed for some contractually established period of time as set forth in a partnership agreement. Usually, the agreement specifies the procedure for revising equity spreads, e.g., by unanimous consent, or majority or supermajority vote, either by the partnership or by a committee to which equity allocation decision-making is delegated. Two primary models of law firm partner equity allocation have been described in the literature: the merit system, based on some measure of contribution to firm income, and the seniority or "lockstep" system, based primarily on longevity in the partnership.⁷⁵ Many law firms, in general, and plaintiffs' firms, in particular, allocate equity based on both merit and seniority.

Equity allocation schemes that rest on factors other than each partner's relative contribution to law firm profit are inconsistent with the black box assumption of cohesion. Senior partners with a substantial and protected equity stake may not perceive their income

74. Except where additional citations are provided, I base my comments regarding structural characteristics of plaintiffs' class action firms on my direct observations of such firms while practicing and working closely with many of the leading plaintiffs' firms, nationally.

75. See, e.g., Bernstein, *supra* note 69, at 1262 (defining the two primary models of income allocation in large law firms).

as being tied to the performance of the individual cases they happen to manage. Where partner equity is fluid, self-seeking lawyers may make case-investment and settlement decisions designed to game the partnership equity allocation process, rather than to maximize law firm profit. For example, if equity calculations rest on revenues and losses, an equity partner angling for a greater stake may have a disincentive to record disappointing outcomes in any particular year, leading him to continue to litigate less promising cases that, from the perspective of the firm, do not warrant continued investment. Similarly, a partner who believes his equity allocation each year rests on his perceived “value” to the firm may believe his value is a function of factors other than the annual revenues his cases generate, including his ability to generate new business, handle oral argument, or conduct trials. He may thus make case-investment decisions designed to emphasize these tasks to demonstrate his worth and jockey for a larger equity position. The conventional account of class counsel leaves no room for this kind of self-seeking.

b. *Compensation and Promotion Schemes
for Non-Equity Attorneys*

The leading plaintiffs’ firms have a mix of equity and non-equity lawyers. “Non-equity” attorneys do not own a percentage of the firm. They are employees, from junior associates to relatively senior and seasoned litigators, who happen not to have (and may not want) an equity stake. While equity partners may be nominally associated with or may at least loosely supervise every case, cases may in fact be managed by non-equity lawyers. Non-equity attorneys are typically compensated with a mix of a base salary and bonuses. The market for labor among plaintiffs’ firms is fluid; lateral movement among firms is common. Senior lawyers capable of running cases are valuable resources. Attorneys often negotiate individualized compensation packages, which may vary by non-equity attorney within a single firm.

The compensation and promotion of non-equity attorneys has been the subject of extensive commentary and analysis in the context of large corporate law firms. For example, Galanter and Palay identified the “tournament-to-partnership” as the engine of growth for large corporate defense firms in the latter half of the twentieth

century.⁷⁶ While some aspects of the tournament undoubtedly exist in many of the larger plaintiffs' class action firms, it is rarely as systematic or predictable as the tournament conducted by the big corporate firms studied by Galanter and Palay. For purposes of this Article, a theory of the growth of the plaintiffs' class action firm is not needed; instead, it is sufficient to note that whatever compensation or promotion system is used creates incentives for non-equity partners to game the system, rather than to maximize firm profit. The more the system of compensation or promotion considers factors other than contribution to firm net revenues as a result of case-management decisions by non-equity attorneys, the more it creates a wedge between the interests of the individual attorney and the firm, undermining the assumption of cohesion.

Guaranteed compensation unaffected by each non-equity attorney's contribution to law firm profit, combined with either an elongated track to partnership or a closed partnership with no room for advancement, creates the greatest divergence between the perceived self-interest of such attorneys and the firm's interest in maximizing law firm profit. Case managers whose income and position in the firm are relatively detached from firm profit would presumably have less motivation to deviate from client or other interests. Layering a bonus component into the attorney's

76. GALANTER & PALAY, TOURNAMENT OF LAWYERS, *supra* note 69, at 102 ("Firms can conduct the tournament in various ways, so long as in the end they promote a fixed percentage of associates and they offer a total compensation package competitive in the market for associates. Some firms may eliminate associates at given intervals (say, yearly); others may make decisions more randomly; while still others, at least in theory, might wait until the end of the tournament to notify the losers. The precise rules are dependent upon the incentives the firm wants to maintain, the structure of its compensation package, and firm culture Growth occurs because, at the end of the tournament, the firm must replace not only the losing associates who depart, but also all those who win and are promoted."). The tournament-to-partnership explanation of law firm growth has critics. See George Rutherglen & Kevin A. Kordana, *A Farewell to Tournaments? The Need for an Alternative Explanation of Law Firm Structure and Growth*, 84 VA. L. REV. 1695, 1704 (1998) ("In order to come to a more satisfactory understanding of intra-firm structure, we need to turn to an analysis of inter-firm competition for top associates."); David B. Wilkins & G. Mitu Gulati, *Reconceiving the Tournament of Lawyers: Tracking, Seeding, and Information Control in the Internal Labor Markets of Elite Law Firms*, 84 VA. L. REV. 1581, 1586-89 (1998) (offering a revised version of the tournament, as a metaphor).

compensation package only partially aligns the attorney's and firm's interests. For example, non-equity attorney bonuses may be structured with an upside for revenue, but little or no downside for losses. Similarly, where bonus programs are linked to the revenues from the cases handled by an individual attorney, rather than to overall firm revenue, that attorney's incentive is to invest sufficiently in his own cases to maximize the fees they produce, without considering the relative value of cases within the firm's portfolio.

Promotion opportunities also only partly close the gap in interests between owners and non-owners. Promotion within the firm often depends on factors other than just the revenue produced by the cases on which a particular attorney works. As is the case with equity partners, non-equity attorneys may see their value to the firm as connected to their ability to demonstrate competence at specific tasks, which could conceivably prompt them to focus on those tasks when litigating (rather than on expected fees, as the conventional account assumes). Partnership elevation may depend, too, on relationships within the firm, causing non-equity lawyers to focus on the cases they handle with or for partners whose votes are considered key (again, without regard to the effect on law firm profit). Similarly, promotion may encourage attorneys to continue litigating cases that should be voluntarily dismissed after they present no reasonable opportunity for success, because those attorneys do not want blemishes on their records before promotion decisions are made (an option the conventional account does not consider when mapping the divergence of interests between class counsel and the class members).

Finally, the track to partnership—especially in larger firms—may be so elongated that non-equity attorneys do not see their immediate case-management decisions in particular cases as having a direct effect on their prospects, in the long term, to be elevated to partner. Or there may be, at least as to some senior attorneys, no reliable track to partnership because the attorneys are never promised an equity stake. These attorneys may have less of an incentive to consider the firm's profit when making case-management decisions, absent other mechanisms to tie their interests to the firm's, such as a compensation system that effectively links their salary to the firm's performance or to the outcome of the cases on which they work.

c. Case Financing

The conventional understanding is that the plaintiffs' class action attorney making case-management decisions is identical to his firm in terms of his perceptions of the rewards and risks associated with litigation. Solo practitioners who self-fund their cases directly experience the risk their case-management decisions impose on their law firms. In multi-attorney firms, that experience of risk can be maintained by, for example, requiring individual partners to fund their own case costs, sharing only firm overhead with other law firm partners, to achieve economies of scale⁷⁷ with respect to firm operational expenses. But most leading firms finance litigation in such a way as to distance or insulate individual case managers from the experience of risk. Some attorneys who make case-management decisions do not contribute at all to the financing of litigation. These non-equity attorneys may experience an upside for successful case outcomes, for example, as a result of the compensation or promotion scheme applicable to them, but they rarely, if ever, directly experience risk associated with the firm's investments in litigation. Equity partners typically bear responsibility for case costs in proportion to equity stake, rather than in proportion to liability inflicted upon the firm as a result of each partner's relative contribution to the firm's liability for case costs. Just as with the discussion of equity, above, this creates a wedge between the interests of the persons making case-investment decisions and the interests of the firm as a whole. The attorneys with the lowest potential liability (and corresponding equity stake) may have the greatest incentive to undertake risk, all other things being equal, because they are bearing relatively less risk than their partners. The conventional understanding is that attorneys making case-investment decisions are relatively risk-averse; but, in fact, depending on the

77. Ronald J. Daniels, *The Law Firm as an Efficient Community*, 37 MCGILL L.J. 801, 810 (1992) ("Economies of scale arise when the fixed costs required to produce a single unit of output can be reduced by increasing the output of the good, thereby spreading these costs among a greater number of goods produced. In the case of legal services, economies of scale can result from the cost savings that can be generated by spreading the costs of certain fixed inputs, like libraries, accounting, time-recording, data collection, and word processing facilities, over a greater number of lawyers.").

firm's internal structure and the case manager's place within it, the opposite may be true.

d. Resource Allocation Mechanisms

There are several types of resources within a firm to be allocated, including: (1) attorney time, (2) paralegal time, (3) case costs (e.g., expert fees, travel expenses), and (4) overhead (e.g., secretaries, file room staff). Firms easily monitor expenses in categories 1–3, because relevant records are often maintained electronically, and thus can be generated easily.⁷⁸ Category 4 (overhead) expenses are not typically tracked by case.

A firm that is most cohesive in its pursuit of the goal of maximizing law firm profit would allocate resources, to the extent possible, based on regularly adjusted assessments of relative case value, however defined, so that the “best” cases receive a greater share of firm resources. In practice, however, many firms use some variant of the “squeaky wheel” approach to allocating resources,

78. See MANUAL FOR COMPLEX LITIGATION (FOURTH) § 14.213 (2004) (explaining the importance of accurate time records in calculating fees based on the lodestar and requiring counsel to maintain contemporaneous records showing “name of the attorney, the time spent on each discrete activity, and the nature of the work performed” and suggesting that any such records be maintained in an electronic format); *id.* at § 22.62 (recommending that when selecting lead counsel or members of a steering committee, judges set forth their expectations regarding number of attorneys to be assigned to particular tasks, the use of paralegals and associates, and recordkeeping and time and expense reporting). Though the percentage of the fund method is the preferred method for determining fees in class actions, courts often use counsels' lodestar as a cross-check. See also *In re AT&T Corp.*, 455 F.3d 160, 164 (3d Cir. 2006) (noting that the percentage method is generally favored in common fund cases, while the lodestar method is used to check the reasonableness of the percentage fee award); *In re Qwest Commc'ns Int'l, Inc. Sec. Litig.*, 625 F. Supp. 2d 1143, 1149 (D. Colo. 2009) (utilizing the lodestar cross-check as one of the factors used in determining the reasonableness of the percentage award); *Loudermilk Servs., Inc. v. Marathon Petroleum Co.*, 623 F. Supp. 2d 713, 717 (S.D. W. Va. 2009) (employing a so-called “hybrid” approach to the determination of attorneys' fees, applying the percentage of the fund method and using the lodestar figure as a cross-check); *In re Enron Corp. Sec., Derivative & “ERISA” Litig.*, 586 F. Supp. 2d 732, 766–67 (S.D. Tex. 2008) (applying the percentage of the fund methodology to a securities class action under the PSLRA when approving an award of 9.25% of the fund, using the lodestar method as a cross-check).

which makes resource allocation, to the extent there is a gatekeeper at all, a function of some combination of attorney seniority and desperation.⁷⁹ Most firms do not have an effective gatekeeper ex ante analyzing the flow of resources within the firm; instead, case staffing decisions are often made haphazardly with attorneys managing cases negotiating with each other on an ad hoc basis. That is not surprising. The larger the firm, the more polycentric the case-management structure (with individual or small groups of attorneys running their own cases, and having relatively exclusive knowledge of the elements of case value) and the less likely it is that any one individual within the firm can mediate resource allocation disputes by reference to the “value” (i.e., the likely contribution to firm profit) of each case.

Less senior attorneys, as well as staff, often feel caught in the middle of firm power struggles. Ironically, though, they often independently determine who gets their time. In many instances, it is the low-level associate or the staff member who decides how to allocate his time, based on such factors as his feelings about competing senior attorneys or particular cases.

Precise resource management calibrated to the expected return on cases is exceedingly rare. This is partly because—as discussed below—case value is often indeterminate. Even where value can be estimated, knowledge of it is often not in the hands of the persons making resource allocation decisions within the firm. Moreover, that value itself is often dependent upon these very staffing decisions, if it is assumed that greater investment in a case correlates with better outcomes.⁸⁰

79. Some firms have gatekeepers responsible for allocating resources within the firm, who can be either an attorney or a senior staff member. Other firms simply require the attorneys competing for firm resources to negotiate with each other over scarce resources.

80. Some commentators assume that greater investment predictably produces better outcomes. See, e.g., David Rosenberg, *Mass Tort Class Actions: What Defendants Have and Plaintiffs Don't*, 37 HARV. J. ON LEGIS. 393, 401 (2000) (“In general, the unequal investment incentive for defendants and plaintiffs in mass tort cases translates into a much greater chance that the defendant, who aggregates all classable claims automatically, will prevail on the common questions over the plaintiffs’ attorney who acquires fewer than all claims.”); Coffee, *Understanding the Plaintiff’s Attorney*, *supra* note 2, at 689 (demonstrating, to a point, the additional return generated by greater investment). But value sometimes rests as much on the lucky find—such as a helpful former employee of a defendant with

e. Degree of Firm Attachment

Firm attachment or identification is one way of characterizing the extent to which a lawyer internalizes the interests of the firm as his own. That attachment may be a product of a number of intangibles, including a law firm's culture and work environment, the extent to which a lawyer likes or seeks the approval of his colleagues, and the degree to which the firm, internally, disseminates a clear and consistent formulation of the firm's interests. Even within the two-dimensional world of the conventional account of class counsel—which assumes that the firm's interest is maximizing profit and that information regarding it is meaningfully shared internally—firm attachment can be significantly influenced by one particular factor: an individual attorney's expectation of continued employment with the firm. The more fluid a firm's roster of attorneys, the more likely it is that attorneys will calculate utility in ways that diverge from the firm's interest in maximizing profit. Attorneys who feel detached from the firm are more likely to make case-management decisions to enhance their personal interests, including: (1) reputation, (2) standing in the plaintiffs' bar or within a particular jurisdiction or practice area, and (3) contacts with organizations that can provide access to clients and future cases.

f. Law Firm Structure, the Conventional Understanding of Plaintiffs' Class Counsel, and a New Model

The foregoing analysis enables the identification of elements of plaintiffs' law firm architecture relevant to (and implicit in) the conventional understanding of plaintiffs' class action attorneys and the juxtaposition of that understanding against a new model of plaintiffs' class counsel addressing the current characteristics of the leading class action firms. The conventional account, when

inside knowledge who is willing to testify truthfully, or a particular document that is discovered—as it does on the resources devoted to the case. Moreover, there is, at some point in every case, a decreasing marginal utility of investment of attorney time and resources, because cases are ready for trial after a finite amount of investment, and because not every task performed to prepare a case is equally important to the outcome.

characterizing the plaintiffs' class action attorney's interests, looks only at firm size and assumes that all plaintiffs' class action attorneys are solo practitioners or small firms without internal structural complexity of any significance. However, implicit in the conventional understanding of plaintiffs' class counsel as cohesive in pursuit of the one overriding goal of maximizing law firm profit are the internal firm structural characteristics presented below. The existence of firms with internal structures consistent with the conventional understanding of plaintiffs' class action attorneys suggests that accounting for law firm internal architecture does not undermine the conventional account's usefulness with regard to every lawyer or firm. Where the conventional understanding of class counsel fails is with regard to the leading class action firms, which are more likely to possess characteristics identified in the new model and summarized in the chart below. The conventional account does not correctly map the way the most significant attorneys' and firms' interests diverge from the interests of the class members they represent; and the conventional understanding of class counsel is thus unreliable as a foundation for reform. As discussed in Part IV, below, accounting for law firm internal architecture confronts that problem.

The Conventional Understanding and the New Model of Plaintiffs' Class Counsel

	The Conventional Understanding	The New Model
Firm Size	Small (one to five attorneys)	Relatively larger (more than five attorneys)
Equity Concentration	All case managers are equity partners.	Relatively fewer case managers are equity partners.

Equity Allocation Schemes	Equity is regularly adjusted to reflect net expected fees anticipated in each partner's cases.	Equity allocation is infrequently modified and rests on factors other than expected fees, including, among other things: (a) seniority, (b) historical performance, and (c) wins but not losses, etc.
Non-equity Compensation/Promotion Schemes	Non-equity attorney pay is tied to contribution to firm profit; eligibility for elevation to partnership turns on contribution to firm profit.	Non-equity attorney pay does not depend on contribution to firm profit; partnership eligibility turns on factors other than contribution to firm profit, such as demeanor, special skill sets, or relationships with existing partners.
Financing	Attorneys making case-management decisions front their own case costs.	Attorney contributions to financing of firm operations and case costs are not fully dependent on the risks and costs each attorney imposes on the firm.
Resource Allocation	Marginal case-investment decisions turn on regularly updated assessments of the net expected fees in each case.	Resource allocation decisions rest on factors other than the relative value (in terms of expected fees) of each case, including, among other things, partner seniority.
Attorneys' Firm Attachment/Loyalty	Firm attachment is high, in that attorneys expect to remain with the firm.	Firm attachment is low, in that attorneys expect to leave the firm.

These law firm structural models or archetypes are not presented to suggest that one can more reliably determine whether suspicion of class counsel is warranted in any given case merely by accounting for internal firm architecture. Instead, the models show that the situation on the ground is more complicated and less predictable than much of the academic literature suggests. Law firm internal structure creates diverse incentives other than maximization of law firm profit.

C. *Plaintiffs' Class Action Attorneys Invest Time in Cases for Complex Reasons Beyond Just Expected Fees*

The conventional understanding of class counsel predicts that he will be disloyal at a particular point in time—namely, when his next dollar of investment will not be adequately compensated by the fee he will recover for that dollar. This characterization of class counsel's disloyalty therefore relies on the idea that class counsel can predict his fees with some certainty. This is unrealistic because fees are often difficult to estimate. In addition, class counsel makes case-investment decisions for complex reasons unrelated to expected fees. The existence of asymmetric interests is of little significance if the potentially disloyal agent cannot know when the asymmetry exists and effectively act on it.

1. Fees Are Difficult to Predict

The conventional understanding is that the value of a case to class counsel is the expected fee.⁸¹ In Figure A, above, the f-curve—class counsel's expected fee—is a constant function of the settlement's size, which is itself just a function of class counsel's investment of resources. Commentators more typically discuss class counsel's expected fee as a function of the expected outcome for the class (by trial or settlement) and the formula for calculating

81. See Coffee, *Understanding the Plaintiff's Attorney*, *supra* note 2, at 686 (“The key point is that the litigation stakes are asymmetric, with the defendant focusing on the judgment or settlement and the plaintiff's attorney focusing on the fee, which is typically a declining percentage of the recovery.”).

attorney's fees (e.g., percentage of the fund).⁸² In fact, expected fees are far more indefinite and involve additional contingencies merely implied by the conventional account, including: class certification, appointment of the plaintiffs' attorney as class counsel, success on the merits or by settlement, and the court's award of a particular fee upon application by class counsel under Fed. R. Civ. P. 23(h). The following paragraphs examine each of these variables, highlighting the sources of their indeterminacy. However the formula for expected fees is stated, it is too imprecise to carry the weight it has been given in the conventional account of how plaintiffs' attorneys litigate and settle class actions.

Fees are typically a percentage of a case's total settlement value, but quantification of actual damages is often more of an art than a science. Except for the simplest of cases, the actual damages involved in a lawsuit may depend on factors that are not susceptible to precise calculation. Some components of injury may be difficult to quantify, or unknown at the time of suit, either because all injuries have not yet manifested or because the injuries, even if they have manifested, can only be roughly estimated, producing a range of possible values.

Class certification—another element of the expected fee calculus—is often determined only after substantial case investment, leaving plaintiffs' counsel in a position of uncertainty regarding both the fact and scope of class certification (e.g., certification as to all claims, or only as to particular issues or subclasses, etc.).⁸³ Class

82. See, e.g., Janet Cooper Alexander, *Contingent Fees and Class Actions*, 47 DEPAUL L. REV. 347, 348–50 (1998) (identifying as determinants of class counsel's expected fees in a class case both the amount of the class recovery and the method by which any fee is calculated). Cf. Bruce Hay & David Rosenberg, *"Sweetheart" and "Blackmail" Settlements in Class Actions: Reality and Remedy*, 75 NOTRE DAME L. REV. 1377, 1394–97 (2000) (characterizing the "expected fee" as the "average" fee award in "similar" cases).

83. See *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2551 (2011) (noting the "rigorous analysis" that a trial court must undertake when resolving a class certification motion will "frequently" entail "some overlap with the merits of the plaintiff's underlying claim"); *In re Initial Pub. Offering Sec. Litig.*, 471 F.3d 24, 39 (2d Cir. 2006) (noting that amendments to Rule 23 in 2003 precluding "conditional" certification orders and delaying the expected timing on class certification determinations support the need for "a more extensive inquiry into whether Rule 23 requirements are met than was previously appropriate," including

certification is granted if plaintiffs demonstrate, on a proper record, that all of the prerequisites of Rule 23 are satisfied, including 23(a) and at least one sub-section of Rule 23(b).⁸⁴ The exact scope of the class certified and the identity and number of class counsel dictate the size of the case and the degree to which a plaintiffs' attorney controls it and can thus seek a fee for whatever benefit he confers on the class. Class certification is often only one of several aggregation devices potentially applicable to a given category of litigation, including both contractual and administrative aggregation in state and federal courts.⁸⁵ The more fragmented the litigation, the more jurisdictions that may provide the vehicle for a litigated judgment or settlement, and the more difficult it is to estimate either the likelihood of certification or of a particular firm being appointed as class counsel. The probability that a particular attorney seeking appointment as class counsel will achieve a desired level of aggregation in his chosen forum may depend on factors that change, too, over time, including evidence developed in pre-certification discovery, the schedule in competing cases, and the outcome of administrative aggregation efforts.

Estimates of the probability of success on the merits are similarly mostly guesswork. Expected outcomes on the merits are dependent upon procedural developments, including the outcome of disputes regarding jurisdiction, the pleadings, discovery, and summary judgment. These developments may not be foreseeable. For example, a race discrimination class action lawsuit against Texaco settled in 1996 for what was then a record amount—\$176 million—after the plaintiffs obtained an audio-recording in which top company executives admitted to destroying documents responsive to discovery requests and used racial slurs to refer to the

findings regarding satisfaction of the elements of Rule 23 that happen to overlap with the merits).

84. See *Shady Grove Orthopedic Assoc., P.A. v. Allstate Ins. Co.*, 130 S. Ct. 1431, 1437 (2010) (“By its terms this creates a categorical rule entitling a plaintiff whose suit meets the specified criteria [of Rule 23] to pursue his claim as a class action.”).

85. Judith Resnik, Dennis E. Curtis & Deborah R. Hensler, *Individuals Within the Aggregate: Relationships, Representation, and Fees*, 71 N.Y.U. L. REV. 296, 329 (1996).

class action plaintiffs.⁸⁶ Similarly, in Holocaust-era class action litigation against several Swiss banks, described more fully below, the value of the litigation was dramatically enhanced after a night-watchman rescued documents from the shredder that were arguably related to the plaintiffs' claims.⁸⁷ It is impossible to quantify and, at the same time, difficult to overstate how the evidence of the defendant's document destruction added to the value of the litigation. Expected outcomes hinge, too, on post-trial developments, long after the most significant case investments are made, including appeals.⁸⁸

The likely fee associated with any hoped-for outcome is even more indeterminate than the expected outcome at trial.⁸⁹ Fees are subject to court approval⁹⁰ and cannot be predicted based only on the value of the benefit class counsel's efforts confer upon the class.⁹¹ Fees are commonly calculated as a percentage of the common fund, though the precise percentage can vary dramatically, depending on

86. *Roberts v. Texaco, Inc.*, 979 F. Supp. 185, 189–90 (S.D.N.Y. 1997). See also André Douglas Pond Cummings, *Pushing Weight*, 33 T. MARSHALL L. REV. 95, 111–12 (2007) (describing the events of the *Texaco* case).

87. See *In re Holocaust Victim Assets Litig.*, 319 F. Supp. 2d 301, 316 (E.D.N.Y. 2004) (describing incident).

88. See, e.g., *Exxon Shipping Co. v. Baker*, 554 U.S. 471, 512–15 (2008) (finding a punitive damages award resulting from a class action jury trial to be excessive after nearly fifteen years of appeals from the 1994 jury verdict); *Avery v. State Farm Mut. Auto. Ins. Co.*, 835 N.E.2d 801, 855 (Ill. 2005) (decertifying plaintiff class and reversing trial court judgment after approximately five years of appeals from the 1999 class action jury verdict and trial court judgment).

89. MDL judges can reduce some of the ex ante uncertainty in that setting by issuing case management orders providing for compensation to counsel for doing common benefit work. See, e.g., MANUAL FOR COMPLEX LITIGATION, *supra* note 78, at App. A (reproducing Pretrial Order No. 127, the Amended Case Management Order, from *In re San Juan Dupont Plaza Hotel Fire Litig.*, 768 F. Supp. 912 (D.P.R. 1991), and stating, in regards to fees for attorneys doing MDL work: "Once any settlement approved by the Court is finalized, a percentage amount (to be determined later but probably less than ten percent (10%)) of the gross settlement amount will be ordered deposited into a special account and will be used to pay PSC [Plaintiffs' Steering Committee] members a fee for their services as well as to reimburse the PSC for authorized expenditures").

90. FED. R. CIV. P. 23(h).

91. See MANUAL FOR COMPLEX LITIGATION, *supra* note 78, § 14.121 (describing the variation in percentage awards and noting emerging judicial resistance to the use of "benchmark" percentages); Becker, *Third Circuit Task Force*, *supra* note 35, at 705–07 (recommending that courts avoid rigid adherence to percentage benchmarks).

the size of the fund, the type of case, the judge's views of fees generally and of the particular plaintiffs' counsel involved in the case, and the response of class members to the notice of the anticipated fee application. The range of fees awarded in big fund cases, from the low single digit percentages to over one-third,⁹² makes fee-driven marginal investment unreliable; class counsel's best basis for achieving a substantial fee is to get the maximum common benefit for the class.⁹³

Attorneys can and do attribute a working "hunch" of a value to cases, based on prior experience with similar claims and on experience litigating in particular jurisdictions, or against specific defendants, law firms, or insurers. But these hunches—often expressed as broad possible ranges rather than as precise figures—can vary dramatically over time and, separately, among different lawyers. Until sufficient discovery is conducted, these hunches may not even be expressed in dollar figures; characterizing a case as "big" may be as precise as it gets.

92. See Brian T. Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. EMPIRICAL LEGAL STUD. 811, 832–33 (2010) [hereinafter Fitzpatrick, *An Empirical Study*] ("Not only do district courts often have discretion to choose between the lodestar method and the percentage-of-the-settlement method, but each of these methods leaves district courts with a great deal of discretion in how the method is ultimately applied," which partly explains the range of fees found in a study of cases settled in federal court in a two-year window, "from 3 percent of the settlement to 47 percent of the settlement."). See also *In re Enron Corp. Sec., Derivative & "ERISA" Litig.*, 586 F. Supp. 2d 732, 776–77 (S.D. Tex. 2008) (listing, in a chart, the percentage fee awards for post-PSLRA securities fraud class actions with settlements of \$400 million or more and finding awards ranging from 1.73% to 21.4%); *Allapattah Servs., Inc. v. Exxon Corp.*, 454 F. Supp. 2d 1185, 1210–11 (S.D. Fla. 2006) (citing the percentage attorney fees award in recent mega-fund settlements with awards ranging from 25.4% to 35.5%); WILLIAM RUBENSTEIN, ALBA CONTE, & HERBERT B. NEWBERG, *NEWBERG ON CLASS ACTIONS* § 17:25 (4th ed. 2008) ("To avoid depleting the funds available for distribution to the class, an upper limit of 50 percent of the fund may be stated as a general rule, although even larger percentages have been awarded."); Stuart J. Logan, Dr. Jack Moshman & Beverly C. Moore, Jr., *Attorney Fee Awards in Common Fund Class Actions*, 24 CLASS ACTION REP. 167 (2003) (surveying fee awards in 1,120 cases representing aggregate class recoveries of about \$41 billion in common fund cases between 1973 and 2003 and documenting variability in percentage awards).

93. MANUAL FOR COMPLEX LITIGATION, *supra* note 78, § 21.71 ("Compensating counsel for the actual benefits conferred on the class members is the basis for awarding attorney fees.").

The difficulty of estimating case value could be thought to make class counsel generally less likely to invest in cases, or at least less likely to invest in cases where fees are more uncertain, due to risk aversion. That may be especially true in smaller cases, as explained below. The point here is not that class counsel should make the “correct” level of investment in every case without regard to fees, but, instead, that marginal case-investment decisions are rarely pegged to expected fees with anything close to the level of precision necessary to say that expected fees, alone, explain such investment choices. Expected fees shape case investment in a relatively attenuated and rough fashion, at best.⁹⁴

2. Factors Alien to the Conventional Account May Dictate Case Investment

“Case value” is simply too amorphous to produce anything other than the crudest relationship between it and attorney case-investment choices. If we assume that lawyers are self-interested—cabining, for now, the diversity of interests produced by law firm structural complexity, discussed above—how do lawyers make marginal case-investment decisions (e.g., whether to invest additional time in a case or to settle)? To begin to answer that question, it is helpful to identify two general categories of class cases: large and small. Large possible recoveries dilute the meaningfulness of case value, such as it is, as a determinant of marginal case investment. Even with relatively indeterminate or low probabilities of success, very large cases present sufficient incentive to fund litigation through a final judgment, without necessitating fee-driven marginal case investments. The smaller the expected

94. As discussed in note 28, *supra*, the difficulty pegging case investment to fees is particularly relevant to one particular form of agency cost problem, i.e., shirking, where class counsel invests too little in litigation. It is not a counter to the “sell out” principal-agent problem, where, at the time of settlement discussions, in exchange for an agreement regarding a substantial fee, class counsel agrees to accept less relief for the class. The arguments regarding firm structure, discussed above, relate more squarely to the “sell out” problem that arises at the moment of settlement; to the extent a particular lawyer is less focused on maximizing law firm profit, he is less likely to trade class benefits for fees (though, as noted, may still pursue selfish interests at the expense of the class that the conventional account of class counsel does not acknowledge).

recovery, the more likely it is that lawyers, however inefficiently, will attempt to tailor investment and settlement decisions to anticipated results.

Three case examples are worth mentioning here to illustrate both valuation difficulties and the absence of a precise relationship between, on the one hand, expected fees and opportunity costs, and, on the other, marginal case-investment decisions, at least in larger class actions.⁹⁵ For each case example, it is possible to loosely reconstruct early estimates of case value using the elements implicit in the conventional account, including, as discussed above, actual damages, the likelihood of class certification, the likely outcome at trial, and the possible range of attorney's fees that could be awarded; mapping that formula for case value against the case-investment decisions actually made by class counsel demonstrates that—except at one point, in one instance, when case value was essentially reduced to zero—estimated case value did not determine counsel's marginal case investments. Further—as it turned out—the weakest case produced the best outcome (for class members and also for class counsel), turning attorney estimates of case value and likelihood of success on their heads and underscoring the imprecise nature of investment in class action litigation.

Case Example 1: In *Avery v. State Farm Mutual Automobile Insurance Company*, named plaintiffs, on behalf of a proposed nationwide class of more than four million State Farm automobile insureds, sued State Farm for breach of contract and statutory fraud because of its practice of specifying non-original equipment manufacturer (“non-OEM”) crash parts instead of OEM parts on damaged vehicles.⁹⁶ Plaintiffs alleged that non-OEM parts were—by virtue of being manufactured by reverse engineering—categorically of lower quality than what plaintiffs were promised under their allegedly uniform insurance contracts.⁹⁷

95. These cases were selected for their size, because I have direct knowledge of the case-investment decisions associated with them and because they have all been finally resolved.

96. 835 N.E.2d 801, 810–11 (Ill. 2005).

97. *Id.* I served as one of the Court-appointed plaintiffs' class counsel in this litigation and pursued a number of other “imitation parts” cases against other automobile insurance companies in state courts across the country, some of which settled while *Avery* was pending, but none of which provided a value benchmark

Ex ante, at the time early and major case-investment decisions were made, what was the value of the litigation? There were millions of class members, a sampling of whom appeared to have incurred losses in the range of at least a few hundred dollars, on average. Still, no one knew the exact value of the litigation, and it is unlikely that any of the attorneys who prosecuted the litigation shared a precise estimate. When *Avery* commenced, the likelihood of class certification was relatively high, given plaintiffs' theory of the case, which emphasized manifestly common questions, and favorable law on certification of similar claims in Illinois at that point in time.⁹⁸ The merits of plaintiffs' claims were untested⁹⁹ because they were, individually, negative value suits and because plaintiffs had only recently uncovered the alleged wrongdoing. The aggregate dollar value of class plaintiffs' injuries was not known at the time the litigation was commenced, at the time of certification, nor before substantial fact and expert discovery was completed. Plaintiffs' damages expert ultimately testified at trial to a broad range of possible damages for the class, from several hundred million dollars to well over one billion dollars;¹⁰⁰ the variability was the result of missing data regarding whether non-OEM parts specified by State Farm were actually installed on class members' vehicles.¹⁰¹ If plaintiffs could prove that State Farm violated the Illinois Consumer Fraud Act, there was a possibility that punitive damages would be awarded, though, again, a numerical estimate of the likelihood of success would have been misleadingly precise and without foundation; it could safely be assumed that—if awarded—

for *Avery*, given the absence of any momentum toward settlement in the *Avery* case.

98. At the time *Avery* was filed, Illinois state courts were accustomed to certifying multistate classes involving breach of contract and statutory fraud claims, applying Illinois law to the claims of all class members where the defendants were headquartered in Illinois. See, e.g., *Miner v. Gillette Co.*, 428 N.E.2d 478, 485 (Ill. 1981) (reversing trial and appellate courts' rejection of a multi-state class asserting Illinois breach of contract and statutory fraud claims).

99. The legal claims, based on contract principles as well as the Illinois state consumer fraud statute, were both well-established and relatively straightforward.

100. See *Avery*, 835 N.E.2d at 833 (indicating that damages as a result of non-OEM parts could range from \$658.5 million to over \$1.2 billion).

101. *Id.* at 833–34.

punitive damages would likely be either a fraction or a single-digit multiple of compensatory damages.¹⁰²

At any point between commencement of the litigation and the moment the jury rendered its verdict, reasonable estimates of the expected outcome at trial (“actual damages” discounted by the possibility that the class would not be certified, and that plaintiffs would not prevail on the merits), ranged from tens of millions of dollars to several billion dollars. It would have been impossible to reliably translate those possible trial outcomes into a likely fee, other than to note that, in Illinois, at the time of the trial in *Avery*, courts regularly used the percentage methodology to calculate fees in class cases and often awarded such fees as a percentage of the common fund.¹⁰³

The *Avery* litigation lasted approximately eight years, from commencement in July 1997 through the conclusion of appeals.¹⁰⁴ In that period, plaintiffs’ counsel conducted pre-certification discovery, successfully moved for class certification, paid for nationwide class notice, completed full fact and expert discovery, and conducted a trial in 1999 that lasted nearly two months, resulting in a \$1.18 billion judgment for plaintiffs.¹⁰⁵ Defendants appealed. At the intermediate appellate level, the judgment was reduced by \$130 million, but was otherwise affirmed, as was the order granting class certification.¹⁰⁶ The Supreme Court of Illinois ultimately reversed the portions of the appellate court decision that affirmed the trial court on the certification issue and on the merits.¹⁰⁷

At no procedural point in *Avery* did class counsel calibrate case investment along the lines implied by the conventional account

102. See, e.g., *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 425 (2003) (surveying typical punitive damage awards).

103. See, e.g., *Ryan v. City of Chi.*, 654 N.E.2d 483, 491–92 (Ill. 1995) (affirming the lower court’s award of a one-third fee due to counsel’s efforts, the risk assumed, and the success of the litigation).

104. See *Avery*, 835 N.E.2d at 812 (noting that plaintiffs’ original complaint was filed in July 2007).

105. *Avery v. State Farm Mut. Auto. Ins. Co.*, No. 97-L-114, 1999 WL 955543, at *1 (Ill. Cir. Ct. Oct. 8, 1999), *aff’d*, 746 N.E.2d 1242 (Ill. App. Ct. 2001), *aff’d in part, rev’d in part*, 835 N.E.2d 801 (Ill. 2005).

106. *Avery v. State Farm Mut. Auto. Ins. Co.*, 746 N.E.2d 1242, 1248, 1262 (Ill. App. Ct. 2001), *aff’d in part, rev’d in part*, 835 N.E.2d 801 (Ill. 2005).

107. *Avery*, 835 N.E.2d at 863–64.

or illustrated by Figure A above. Settlement was never presented as a serious option; there was no “s-curve.” Case value was never determinate, so the “f-curve,” to the extent it was considered, was just a number deemed capable of dwarfing all anticipated litigation investments. Similarly, contrary to the calculus suggested in Figure A above, counsel’s opportunity cost was, at no point, a meaningful determinant of counsel’s marginal case investment; the expected outcome in *Avery* was never sufficiently definite to permit particularly useful comparisons to the hypothetical next best use of counsel’s time except in the most broad-brushed way.

Instead, once the decision to proceed with the *Avery* litigation was made, the level of investment was dictated principally by the scope of the class certified by the court, the demands of trial preparation, and, post-judgment, the appellate briefing schedule. In terms of fact discovery, plaintiffs’ counsel reviewed the documents and deposed the witnesses necessary to prove each element of the class members’ claims. In terms of class notice, plaintiffs’ counsel paid for that level of notice that the court deemed to be warranted under the relevant legal standards and the facts of the case. Plaintiffs’ counsel developed the expert testimony required to support the class claims without more or less investment. The trial’s contours were shaped by the evidence, the length of time it took to present and cross-examine witnesses, and counsel’s sense of what was needed to prove plaintiffs’ claims or test the defendant’s defenses. Similarly, time invested in the (ultimately unsuccessful) defense of the class judgment on appeal was dictated by the arguments raised by State Farm and the schedules set by the appellate courts, rather than by plaintiffs’ counsel.

Case Example 2: A second case example is the original MDL proceeding, *In re: Methyl Tertiary Butyl Ether (“MTBE”) Products Liability Litigation*.¹⁰⁸ Plaintiffs—owners of residential water wells contaminated or threatened with contamination by the gasoline additive MTBE—sought certification of a multi-state plaintiff class against twenty oil companies for injunctive relief (testing and remediation).¹⁰⁹ The key hurdle was the motion for class

108. 209 F.R.D. 323 (S.D.N.Y. 2002). I served as a Court-appointed Plaintiffs’ Liaison Counsel in the MDL proceeding.

109. *Id.* at 328–29.

certification. Individually, most of the private well-owner cases were seen as negative value lawsuits because the cost of proving liability, including causation, was close to the value of the relief sought. Given the presence of individual issues and variations in state law, certification was always deemed to be a low probability event; the trial court described plaintiffs' counsel's approach to certification as "creative" when denying class certification.¹¹⁰ Still, if certification had been granted, the value of the claims for injunctive relief was substantial and could easily have reached billions of dollars. So even discounted by the possibility that class certification would be denied and that the cases would then not be economical to litigate, the MTBE litigation had a net expected value, *ex ante*, that justified the necessary investment of attorney time and costs to undertake the litigation.

Until certification was denied, case investment was dictated by factors other than those implied by the conventional understanding of class counsel. Pre-filing informal discovery, ultimately successful motion practice before the Judicial Panel on Multidistrict Litigation, and the organization of a leadership structure in the transferee district were all undertaken as a matter of course and pursuant to the schedules set by the Panel and by the trial court. Thereafter, time invested to successfully defeat defendants' motions to dismiss¹¹¹ was dictated by the scope of the briefs defendants filed, and, again, by the schedule set by the court. Plaintiffs then sought to conduct the level of discovery necessary to permit an informed consideration of class certification. The scope of pre-certification discovery was a function of: the proposed class definition (including private well-owners in four states, seeking primarily injunctive relief); the Rule 23 criteria; the class certification discovery and briefing schedule set by the court; the available evidence (which was substantial); and the court's orders on motions to compel. Expenses associated with working the case up to the certification decision, though significant, were a small fraction of the value of the relief sought. When the court denied plaintiffs' motion for class certification, the case became uneconomical to litigate. It was at that

110. *Id.* at 329.

111. *See In re MTBE Prod. Liab. Litig.*, 175 F. Supp. 2d 593, 635 (S.D.N.Y. 2001) (indicating that the defendants' motion to dismiss the strict liability, negligence, failure to warn, public nuisance, and conspiracy claims were denied).

extreme point, only, that the expected value of the litigation (i.e., zero) directly shaped case-investment decisions; after certification was denied, the private well-owner class actions were voluntarily dismissed.

Thus, as with *Avery*, in *MTBE*, the conventional account of plaintiffs' class counsel predicts or explains very little about how class counsel chose to litigate the case. More specifically, Figure A is completely inapposite; in *MTBE*, settlement was never an option, and expected fees could not be estimated with any kind of precision. As with *Avery*, *MTBE* was a high-risk investment that plaintiffs lost, one that could not be meaningfully compared to any hypothetical next best use of counsel's time, at least until the value of the litigation was reduced to zero. At all points during which the litigation was economically viable—i.e., until the court denied plaintiffs' motion for class certification—case-investment decisions were dictated, instead, by counsel's assessment of what was necessary to properly advance the claims to a successful resolution and by the case schedule established by the trial court.

Case Example 3: A final example is *In re Holocaust Victim Assets Litigation*,¹¹² a settlement administration which is just now winding down, in 2011, after a class settlement was reached, in principle, in 1998, and granted final approval in 2000.¹¹³ Beginning in mid-1996, plaintiffs—including victims and targets of Nazi persecution, and their heirs—prosecuted class actions alleging that, in knowingly retaining and concealing the assets of Holocaust victims, accepting and laundering illegally-obtained Nazi loot, and transacting in the profits of slave labor, the Swiss bank defendants collaborated with and aided the Nazi regime in violation of New

112. 105 F. Supp. 2d 139, 166 (E.D.N.Y. 2000) (granting final approval to the proposed settlement of \$1.25 billion for five settlement classes). I served as a member of the plaintiffs' steering committee responsible for prosecuting the litigation, and was ultimately appointed as one of the settlement class counsel for the plaintiff classes defined in the settlement agreement.

113. See *Holocaust Victim Asset Litig. Case*, No. CV 96-4849, available at http://www.swissbankclaims.com/Documents_New/DistributionStats2010.pdf (last visited May 24, 2011) (indicating the amount of Swiss bank settlements through 2010).

York, Swiss, and international law.¹¹⁴ Plaintiffs sought, among other relief, an accounting and disgorgement of dormant accounts and other ill-gotten gains.¹¹⁵ The cases were consolidated before Judge Edward R. Korman in the Eastern District of New York.

In nearly every respect, the Swiss litigation was more difficult (and had a lower probability of success) than either the more conventional *Avery* insurance litigation, or even the *MTBE* matter. At the time of the filing of the complaints, actual damages were not known, partly because the quantification of plaintiffs' injuries was part of the relief sought, in the form of an accounting, and partly as a result of the passage of time and destruction of records.¹¹⁶ The cases presented novel issues regarding choice of law, statutes of limitations, the applicability and effect of Swiss banking secrecy laws, and plaintiffs' entitlement to an accounting and disgorgement for—not just dormant accounts, but also—profits from the Swiss banks' alleged activities laundering looted assets and transacting in profits from slave labor.¹¹⁷ Defendants asserted multiple possible grounds for dismissal of the litigation; though motions to dismiss were briefed and argued, the court had not ruled on them by the time a settlement in principle was reached in August 1998.¹¹⁸ If claims survived motions to dismiss, it was not at all clear that the court was inclined to certify multinational plaintiff classes; however, it is not

114. See Morris A. Ratner, *The Settlement of Nazi-era Litigation Through the Executive and Judicial Branches*, 20 BERKELEY J. INT'L L. 212, 212 (2002) [hereinafter Ratner, *The Settlement of Nazi-era Litigation*] (indicating the plaintiffs' determination to seek an accounting and disgorgement of perceived ill-gotten gains).

115. *In re Holocaust Victim Assets Litig.*, 105 F. Supp. 2d at 141–42.

116. It was not until the completion of an agreed-upon audit, which was folded into the settlement of the claims, and the conclusion of work by various historical commissions that it became clear that provable actual damages, at least in regards to the dormant accounts, were roughly in line with the ultimate settlement amount. See *In re Holocaust Victim Assets Litig.*, 302 F. Supp. 2d 59, 61 (E.D.N.Y. 2004) (rejecting Swiss bank objections to valuation presumptions regarding dormant accounts and describing audits and historical investigations of bank conduct during and after World War II).

117. See generally Morris A. Ratner, *Factors Impacting the Selection and Positioning of Human Rights Class Actions in United States Courts: A Practical Overview*, 58 N.Y.U. ANN. SURV. AM. L. 623 (2003) (highlighting many of the issues present in these cases).

118. *Id.* at 642–47.

possible to more specifically quantify the possibility of certification. Because actual damages were not known, it was not possible to even crudely estimate an expected outcome at trial; it was clear, though, that if key pre-trial hurdles could be successfully negotiated, including Rule 12 and 23 motion practice, whatever claims were ultimately tried would have tremendous value that would likely dwarf case costs. It is highly doubtful that any lawyer making marginal case-investment decisions had a more refined sense of the expected outcome of the litigation on the merits.

The Swiss litigation was unusual in terms of the attorneys' fees. Several of the lead plaintiffs' firms prosecuted the litigation on a pro bono basis. Those lawyers who declined to waive fees did so with the knowledge that any fees awarded would likely be less than those typically awarded in other class actions.¹¹⁹ So the net expected value to counsel making investment decisions was clearly lower in the Swiss case, ex ante, than in *Avery* and *MTBE*. That lower net expected recovery did not dictate how the case was litigated. On the one hand, it could be argued that the Swiss Holocaust-era cases were "cause litigation," and that the cases, too, had value to the participating firms that went beyond any anticipated fee, including the value that comes from working on high profile litigation. However, if case-investment decisions are meaningfully shaped by expected fees (to counsel) and by perceived opportunity costs, then one would expect to see, on balance, less effort in the Swiss litigation than in the other categories listed above by way of example. That did not happen. The Swiss case was litigated as aggressively as possible by the attorneys who had leadership roles in it, with investment decisions basically determined by the court's briefing schedules and rulings limiting discovery, rather than by counsel pegging marginal investment decisions to expected fees.

119. *In re Holocaust Victim Assets Litig.*, 270 F. Supp. 2d 313, 315 (E.D.N.Y. 2002) (noting that certain counsel had agreed to either prosecute the litigation pro bono, or to donate their fees, and refusing to award risk-multiplier on lodestar-based fee award to one of the firms seeking a fee). Lief, Cabraser, Heimann & Bernstein, LLP donated the fee awarded to it in the Swiss banks litigation to endow a clinical human rights chair at Columbia University Law School. Karen W. Arenson, *Bulletin Board; Human Rights Law at Work*, N.Y. TIMES, Oct. 9, 2002, at B8, available at <http://www.nytimes.com/2002/10/09/nyregion/bulletin-board-human-rights-law-at-work.html> (last visited Apr. 15, 2012).

Unlike *Avery* and *MTBE*, the Holocaust-era class actions against the Swiss banks resulted in a settlement. However, the conventional account of class counsel provides little insight into the timing or nature of the settlement. As a result of the combination of the efforts of counsel, the trial judge's personal involvement in settlement discussions, the political and extra-judicial movement that coincided with the litigation, and the Swiss banks' interest in achieving closure on the issue, the litigation resulted in the largest human rights class action settlement in history, at \$1.25 billion.¹²⁰ That settlement point was a consensus figure, reached with the participation of victim advocates and the judge presiding over the litigation, rather than a figure selected by plaintiffs' counsel to maximize fees.

These three examples illustrate that—in cases with relatively larger possible values, however imprecisely measured—case-investment decisions are not typically made on a marginal basis by reference to a meaningfully definite estimate of expected fees. Instead, such cases represent rough calculated bets, where aggressive case development of even novel or difficult claims can pay off handsomely for the class, and, through that common benefit, for the class counsel. In such cases, calibration of marginal case investments to expected fees is not necessary to make the litigation viable; moreover, plaintiffs' counsel quite regularly lacks the opportunity to select the end point of the investment continuum via settlement.

It is in comparatively smaller cases that class counsel's case-investment calculus is more likely to be shaped, however crudely, by counsel's rough estimate of the likely case outcome. It would not make sense to litigate a case involving only, say, \$5 million in actual damages the way plaintiffs prosecuted the *Avery*, *MTBE* and the Swiss banks litigation, each of which involved an investment of lodestar and hard costs by class counsel, collectively, well in excess of \$5 million. The expected fee in the hypothetical case involving \$5 million in actual damages would be, at most, some fraction of that

120. See JOHN AUTHERS & RICHARD WOLFFE, *THE VICTIM'S FORTUNE: INSIDE THE EPIC BATTLE OVER THE DEBTS OF THE HOLOCAUST* 350–64 (2002) (noting the involvement of all parties, including the trial judge, in reaching a settlement); Ratner, *The Settlement of Nazi-Era Litigation*, *supra* note 114, at 215–16 (describing key settlement negotiations supervised by Judge Korman).

amount. Of relatively lower value, smaller cases more clearly require counsel to at least attempt to calibrate case-investment decisions. Even as to that subset of class actions, however, law firm internal architecture may influence the case-management decisions of individual attorneys in ways that the conventional account of class counsel does not capture.

One might respond to the catalogue of “interests” other than firm profit provided in the preceding section and to the discussion of case investment and expected fees in this section by invoking the concept of natural selection in markets, whereby, over time, firms that more effectively maximize firm profit presumably edge out firms that are, for whatever reason, less profitable.¹²¹ By this logic, firms that are closer to the new model in the preceding chart—i.e., those that adopt forms of internal organization that make their constituent elements less cohesively pursue the goal of maximizing law firm profit—will eventually be overtaken by more profitable firms, and will disappear. Even if we accept the natural selection thesis in general, we need not accept it in the context of plaintiffs’ class action law firms, which operate in the absence of a competitive market. Plaintiffs’ class action law firms are different from firms that manufacture goods or services and compete with each other primarily on the basis of price. An inefficient class action plaintiffs’ law firm may never be “edged out” because there are no consumers choosing between the price of its “product” and any other more efficient firm’s product.¹²² The client of a class action plaintiffs’ law

121. See Malloy, *Regulating by Incentives*, *supra* note 67, at 587 (“Even scholars who reject the black-box conception of the firm, such as Williamson and Jensen and Meckling, use market selection to justify the assumption that firm structure moves inexorably to the most efficient state.”) (citing Michael C. Jensen & William H. Meckling, *Rights and Production Function: An Application to Labor-Managed Firms and Codetermination*, 52 J. BUS. 469, 473 (1979)); see also Sidney G. Winter, Jr., *Economic “Natural Selection” and the Theory of the Firm*, 4 YALE ECON. ESSAYS 225, 225 (1964) (describing the assertion of “survival of the fittest” arguments in response to critiques of the assumption of profit maximization by firms).

122. *But see* Cheffins, Armour & Black, *Delaware Corporate Litigation*, *supra* note 41, at 467 (“During the 2000s there was increasingly vigorous jockeying among law firms who brought securities class actions for the lead counsel role.”). It is important to distinguish competition for control of litigation from competition that is based on price of services; firms jockey for position

firm never directly experiences the inefficiency described above because the lawyer's fee is awarded by the court, typically as a percentage of the total recovery, normally at the end of the case, without any basis for comparison shopping for a cheaper deal *ex ante*.

Why do plaintiffs' law firms tolerate inefficiency? The absence of a truly competitive market allows plaintiffs' class action attorneys to be satisficing (content with making *a* profit, rather than profit maximizing). This then allows the partners to organize their firm internal architecture to achieve goals other than maximizing firm profit by, for example, constructing a reward system within the firm that benefits particular partners or elements of the partnership (e.g., a reward system that is focused on seniority, rather than on relative contribution to law firm profit, or that rewards attorneys who are loyal to the particular partners who establish firm reward routines). In addition, there are information problems associated with structuring the reward and resource allocation routines within the firm around the one dimension of relative contribution to law firm profit. For example, it may be difficult to ascertain, on a case that lasts multiple years, which of several different attorneys within the firm make case-management decisions and whose decisions contributed to the profit, if any, ultimately generated by the case. So attorneys structuring reward systems may use proxies for relative contribution to law firm profit that feel more reliable, such as an attorney's work ethic, or the skills possessed by an attorney, reference to which in the reward system creates the very distortions that are the subject of this Article.

It could be argued that lawyers would tend to flee inefficient firms for more profitable firms in pursuit of greater profits, assuming they could somehow identify them (a tough project, given the fact that most plaintiffs' firms do not publish data showing profits per partner). In fact, lawyers maintain their association with firms for any number of reasons, one of which may very well be that they appreciate or prefer a work environment that is more analogous to the new model in the chart above. This is especially true among class action plaintiffs' attorneys generally, who are a relatively

mainly through strategic moves unrelated to the price of the services they offer, such as the choice of venue. Competition for position in cases thus does not translate into an emphasis on efficiency.

independent and colorful lot, and plaintiffs' firms that specialize in complex or aggregate litigation in particular, which can, by virtue of the pursuit of very large cases, generate enormous revenues for partners who need not devote much effort to achieving the kind of efficiency that economists deem paramount in other settings.

IV. WHY THE NEW MODEL IS IMPORTANT

Complicating the conventional account of class counsel has three virtues. First, it is more descriptively accurate. Second, and relatedly, it directs our attention to the need for particular empirical work that has, to date, been largely overlooked. This empirical work will shed light on what agency problems actually infect class action litigation today. Finally, a more accurate account of plaintiffs' class counsel and the particular agency problems at work in class actions better positions us to assess the likely efficacy of reform measures, particularly the choice between direct regulation versus market or incentive-based approaches to managing agency costs.

A. The New Model Is More Descriptively Accurate

The new model of plaintiffs' class action attorneys presented in this Article is more descriptively accurate than the conventional understanding of class counsel, at least with regard to the large firms that dominate the plaintiffs' class action bar. Descriptive accuracy presents a real rather than a fictive target for both understanding and managing agency costs in class litigation. What do plaintiffs' class action attorneys want, and how do they achieve it? The answer is: it depends on, among other things, the peculiar position of each lawyer within his law firm's internal structure. As firm size and complexity increase, the likelihood is greater that any particular attorney managing cases from within that firm will face relatively dampened pressures to maximize law firm income when making case-investment and settlement decisions. At the same time, complexity creates new incentives relating to, among other things, the compensation and promotion structures within the firm. For example, a non-equity attorney from a large firm who is managing a particular case, whose income is not tied directly to the case outcome

and who does not contribute at all to case costs and thus personally experiences virtually no direct risk, but who believes, perhaps because of the way promotion decisions are made, or perhaps because he is thinking of switching firms, that his personal interests would best be served either by getting the largest win possible for the class, or, alternatively, by avoiding an outright loss during his stewardship of the case, may actually over-invest in litigation. Alternatively, his position in his firm's architecture or his inability to peg case investment to expected fees, may, quite haphazardly, prompt him to invest at a level the clients would consider optimal, e.g., point X on Figure A. This Article commences the project of mapping the plaintiffs' class counsel's actual incentives created by law firm architecture; as it advances, the project should be guided in part by further empirical research.

*B. The New Model's Complexity Underscores the Need
for Better Empirical Research on the Actual Agency
Problems that Exist in Class Action Litigation*

Empirical work measuring agency costs in class actions is limited.¹²³ Recent empirical work on class action outcomes and fees, though rich and detailed, is not designed to specifically measure agency costs, either as conventionally understood or as suggested by the new model of plaintiffs' class counsel this Article provides. For example, Professor Brian T. Fitzpatrick's excellent empirical study attempting to gather all class action settlements approved by federal judges during the period 2006–2007¹²⁴ revealed a total of 688 class settlements approved by federal courts in that window.¹²⁵ Professor Fitzpatrick found that the average and median time to settlement was approximately three years;¹²⁶ eighty-nine percent of the settlements

123. Fitzpatrick, *An Empirical Study*, *supra* note 92, at 812 (“Despite all the attention showered on class actions, and despite the excellent empirical work on class actions to date, the data that currently exists on how the class action system operates in the United States is limited.”). Professor Fitzpatrick's empirical work is among the most comprehensive in the literature. *Id.* at 812–13 (“As far as I am aware, this study is the first attempt to collect a complete set of federal class action settlements for any given year.”).

124. *Id.* at 812.

125. *Id.* at 817.

126. *Id.* at 820.

provided “cash relief,” as opposed to just in-kind relief such as coupons, injunctive relief, or declaratory relief (a telling figure, given that the stereotypical “sell out” settlement, involving coupons for the class and relatively large cash fees for class counsel, appears to be implicated in, at most, a small fraction of federal court settlements);¹²⁷ the settlements had a value of more than \$33 billion,¹²⁸ or roughly ten percent of the wealth transferred as a result of all non-class tort actions during the same period;¹²⁹ and the settlements involved an average percentage fee award of approximately fifteen percent, well below the roughly one-third contingency percentage considered standard in non-class tort cases.¹³⁰

What does this tell us about whether agency cost problems systematically and predictably plague class actions? In fairness, Professor Fitzpatrick did not ask this precise question. It is thus not surprising that we cannot tell from his data how the settlement amounts compare to actual case value or whether the lawyers invested time and costs in the cases at a level that is consistent with their clients’ best interests. Nor can we measure the extent to which law firm internal structure affects case outcomes or enables distinct kinds of principal–agent problems based on the data as it has been presented thus far. We can say, grounding our conclusions in Professor Fitzpatrick’s data, that class litigation involves substantial, long-term investments by class counsel that generate significant value to class members. But how that value compares to the value that would have been created in the absence of agency costs—either those mapped by the conventional account or by the new model—is not known.

Other recent empirical studies similarly provide only tantalizing hints about the nature and extent of agency costs in class litigation; though, again, in fairness, they were not designed to specifically measure such costs. Professors Eisenberg and Miller found that the class recovery and risk undertaken by counsel significantly shaped fee awards, while class certification for

127. *Id.* at 824.

128. *Id.* at 826.

129. *Id.* at 830.

130. *Id.* at 830–31.

settlement purposes only did not.¹³¹ Professors Eisenberg and Miller updated their empirical study in 2010, with similar results.¹³² The Eisenberg and Miller data is particularly helpful to courts seeking information about trends in class action attorneys' fee awards. As presented, the data does not permit measurement of agency costs as conventionally framed, or as suggested by the new model presented above.

To assess the true nature of agency costs in class litigation, we can, using a more complete account of class counsel, search for data that tracks the properly-defined divergence of interests between class counsel and the class. If my more complete description of the plaintiffs' attorney is correct, then it may be possible, by accounting for variations among law firms, lawyers, and cases, to obtain more refined information. Do firm size and internal complexity affect case-investment strategies? Does the relationship of an attorney with case-management authority to his firm's internal architecture affect his case-investment and settlement decisions? Do lawyers in class

131. See Eisenberg & Miller, *Attorney Fees*, *supra* note 36, at 76 ("The single most important factor determining the fee is the size of the client's recovery."); *id.* at 77 ("Risk is also usually significant: fees as a percentage of the recovery tend to be higher in high-risk cases than in other cases, and lower in low-risk cases."); *id.* ("Settlement classes were not robustly significantly associated with fee levels."); *id.* at 67 ("We could not reject the null hypothesis as to the presence of a settlement class in non-fee shifting cases. This result casts some doubt on the common perception that settlement classes are suspect because they can be vehicles for collusion between defendant and class counsel."). For this empirical study, Professors Eisenberg and Miller surveyed state and federal class actions with reported fee decisions between 1993 and 2002, inclusive, in which the fee and class recovery could be ascertained, along with additional class action data from a previous empirical study. *Id.* at 28 (identifying data used for their analysis and citing Stuart J. Logan, Jack Moshman & Beverly C. Moore, Jr., *Attorney Fee Awards in Common Fund Class Actions*, 24 CLASS ACTION REP. 169 (2003), as one of their sources for data); *id.* at 44–46 (describing data and coding conventions).

132. See Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees and Expenses in Class Action Settlements: 1993-2008*, 7 J. EMPIRICAL LEGAL STUD. 248, 250 (2010) ("We find, regardless of the methodology for calculating fees ostensibly employed by the courts, that the overwhelmingly important determinant of the fee is simply the size of the recovery obtained by the class Although the size of the class recovery dwarfs other influences, significant associations exist between the fee amount and both the fee method used and the riskiness of the case Fees were not significantly affected by the existence of a settlement class").

cases in fact have the capacity to meaningfully peg case investment to expected fees? These are all questions that can and should be asked. Professor Deborah Hensler's prior work suggests one way to gather such data: ask the lawyers who are involved in class litigation. She and her colleagues did so, profitably, in their survey of ten class cases from the mid-1990s,¹³³ though without focusing on the organization structure of the individual law firms that prosecuted such cases.¹³⁴ The outcome may not be scientific, but the case studies were revealing, partly because they did not precisely track the conventional understanding of class counsel. Professor Hensler reports that by peering "into the class action fishbowl, we found a murky picture of Rule 23(b)(3) damage class actions. In the ten class actions we studied closely, plaintiff attorneys seemed sometimes to be driven by financial incentives, sometimes by the desire to right perceived wrongs, and sometimes by both."¹³⁵ Asking more precise questions about motive would no doubt expose yet additional fault lines, including those relating to firm structure, as discussed above.

C. *The New Model's Complexity Enables Us to Identify the Best Tools for Reducing Agency Costs*

Proposals for reducing agency costs can be roughly divided into two categories: first, market-based or incentive-based reforms that are designed to better align class counsel's perceived interests with those of the class, and, second, direct regulation approaches, including, for example, the formulation of generally applicable

133. DEBORAH R. HENSLER ET AL., CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAIN 5 (2000) [hereinafter HENSLER ET AL., CLASS ACTION DILEMMAS] ("The best sources of information on class action litigation practices are the parties, lawyers, and judges involved in class action lawsuits."). Professor Hensler and her colleagues selected ten class action lawsuits for "case studies," focusing on consumer and mass tort damages class actions. *Id.* at 138–39. One major source of information for the case studies was interviews with key participants, including outside defense and corporate counsel, plaintiff class counsel, judges, special masters, and, in some of the cases, objectors. *Id.* at 142. They also studied case-specific documents. *Id.* at 143.

134. *Id.* at 79 (discussing collusion by reference to the conduct of law firms handling case portfolios, without regard to the complicating factors discussed above, including firm structure).

135. *Id.* at 401.

standards governing the conduct or resolution of class actions, which typically require the court to police class counsel's faithfulness (e.g., by more effectively identifying and rejecting settlements that appear to be collusive).

The question regarding how best to address agency costs in the class setting is reminiscent of an ongoing debate in the regulatory compliance setting between proponents of "command-and-control" or direct regulation (in which regulatory agencies establish not only standards but, also, the means by which they will be achieved, imposing penalties when the means are not adopted)¹³⁶ and proponents of market or incentive-based regulations (which, as the name implies, typically hold out the promise of increased profits or reduced costs to induce desired behavior).¹³⁷ Attempts to align the incentives of class counsel and the class members by reference to class counsel's perceived interest in maximizing his profit are analogous to incentive-based regulations. In their favor, such regulations generally require less monitoring than command-and-control regulations. Incentive-based regulations also allow for more flexibility by the regulated entity to develop its own processes for meeting announced targets.¹³⁸ "Command-and-control" regulation is loosely analogous to direct regulation by the courts of the adequacy of class settlements, such as when class settlement evaluation standards are imposed under Rule 23(e), discussed below (with the rejection of a proposed settlement amounting to a penalty for failure

136. See Richard H. Pildes & Cass R. Sunstein, *Reinventing the Regulatory State*, 62 U. CHI. L. REV. 1, 97 (1995) ("Command-and-control regulation is a dominant part of American government in such areas as environmental protection and occupational safety and health regulation. In the environmental context, command-and-control approaches usually take the form of regulatory requirements of the 'best available technology'"); see also Cass R. Sunstein, *Problems with Rules*, 83 CAL. L. REV. 953, 1017 (1995) ("Rules that specify end-states are common in modern regulation, in the form of 'command and control' regulation that says exactly what people must do and how they must do it.").

137. See Malloy, *Regulating by Incentives*, *supra* note 67, at 531–32 (explaining that market-based regulations create an opportunity to comply with specific obligations by offering the positive incentive of increased profits or reduced costs).

138. See, e.g., Daniel C. Esty, *Revitalizing Environmental Federalism*, 95 MICH. L. REV. 570, 622 (1997) ("The use of economic-incentive-based regulatory tools can further loosen the grip of federal regulators and give broad scope to private actors to determine how best to meet environmental goals.").

to comply with counsel's obligations). In its favor, this approach to regulation, in general, does not depend on incentives to be properly formulated or calibrated; the regulated entity either complies or faces the risk of a penalty.¹³⁹ To some extent, command-and-control and incentive "regulation" in the class setting overlap.¹⁴⁰ For example, a fee award could be characterized as direct regulation in a particular class action if it penalizes plaintiffs' counsel in that case for having agreed to a barely-adequate settlement; that same award, however, may also affect the incentives of other lawyers prosecuting other class actions if they monitor fee awards in class cases. Broadly framed, the policy question is: do we trust the "market" or the regulator (here, the court)?¹⁴¹ In the class setting, the answer to this question—assuming we want to emphasize one form of "regulation" of class counsel over another—depends in part on the characteristics of class action litigation and firms, highlighted in the preceding sections of this Article. The more complete account of class counsel, outlined above, provides a new basis on which to tentatively formulate specific recommendations; reform measures are most likely to succeed if they reflect and respond to current conditions and

139. See Howard Latin, *Ideal Versus Real Regulatory Efficiency: Implementation of Uniform Standards and 'Fine-Tuning' Regulatory Reforms*, 37 STAN. L. REV. 1267, 1330–31 (1985) (concluding that while command-and-control regulation may not be "efficient," more tailored approaches have not proved to be as effective).

140. See Sunstein, *Problems with Rules*, *supra* note 136, at 1017 ("The line between privately adaptable rules and commands is one of degree rather than one of kind.").

141. To help mediate this debate, Professor Malloy has developed a "resource-allocation" model that peers inside the firm to determine whether command-and-control or incentive-based regulations are more likely to encourage innovation by firms attempting to comply with environmental regulations. Malloy, *Regulating by Incentives*, *supra* note 67, at 535–36. Building on the work of organizational theorists and considering such factors as the role of employee attention as a scarce resource to be allocated within a firm, *id.* at 556–58, the subgoals (other than maximizing firm profit) communicated by the firm's formal and informal operating procedures and by routines of individuals or subdivisions within the firm, *id.* at 560–61, and the way firm structure (e.g., specialization of tasks) affects the distribution of information within a firm, *id.* at 565, Professor Malloy suggests that regulatory choice and application should be guided in part by our understanding of the internal structure of firms, *id.* at 604. I adopt this proposal in this Article, below, without, however, relying upon the specific technical language developed by Professor Malloy.

practices.

1. The New Model's Complexity May Enable Tailoring of Incentive-Based Reforms

- a. *Firm Structure Reveals New Levers to Align Class Counsel's and Class Members' Interests*

To reduce agency costs, courts and commentators have promoted reforms designed to more closely align the interests of class counsel and class members, focusing on two moments in class litigation: the appointment of class counsel (e.g., ensuring that subclasses with distinct interests are separately represented by class counsel¹⁴² or conducting auctions¹⁴³) and the award of fees to successful counsel (e.g., the methodology used to calculate fees).¹⁴⁴ The more complete account of class counsel outlined in this Article presents at least the opportunity to better tailor these incentives.

142. In *Amchem*, confronting a mass tort settlement class involving asbestos claims, the Supreme Court added its imprimatur to several years of efforts by various lower courts to better define the limits of Rule 23, by describing the (limited) relevance of settlement to the certification determination. 521 U.S. at 621 (“[I]f a fairness inquiry under Rule 23(e) controlled certification, eclipsing Rule 23(a) and (b), and permitting class designation despite the impossibility of litigation, both class counsel and court would be disarmed.”). In the process, the Court also refashioned the adequacy of representation determination under Rule 23(a)(4), to focus more squarely on class counsel’s economic interests. *Id.* at 626 (finding representation to be inadequate when presently-injured and exposure-only settlement class members were lumped together in a single class). The Court took a similar approach to assessing adequacy of representation by reference to class counsel’s perceived economic interests in *Ortiz v. Fibreboard Corp.*, another proposed asbestos settlement class. 527 U.S. 815, 855–56 (1999) (“[E]ven ostensible parity between settling nonclass plaintiffs and class members would be insufficient to overcome the failure to provide the structural protection of independent representation as for subclasses with conflicting interests,” including persons with present and future injury claims, who should have been divided into separate subclasses “with separate representation to eliminate conflicting interests of counsel.”).

143. See *supra* notes 31 and 35 (citing journal articles discussing the use of auctions in class action cases).

144. See *supra* notes 31 and 36–37 (citing journal articles discussing attorney fees in class action cases).

Three examples illustrate approaches that could be explored in reliance upon a more complete account of class counsel.

First—though, as noted, more data is needed to verify this hypothesis—it is possible that the natural instinct of many MDL judges to gravitate toward larger firms when selecting counsel for leadership positions is more than mere bias. As discussed in Section III, above, that strategy or preference may actually increase the likelihood that lawyers working on those cases will feel less pressure to make case-investment and settlement decisions driven predominantly by their interest in maximizing their law firm's profit. That preference could be converted into a presumption when courts are selecting among firms competing for appointment as class counsel.

Second, to refine the project of interest alignment and thus reduce possible agency costs, courts could appoint individual attorneys, rather than firms, and, moreover, could restrict the appointed attorneys' opportunity to delegate case-management authority within the firm. In the BP MDL, Judge Barbier did just that.¹⁴⁵ He effectively pierced the firm and required that it make internal case staffing decisions in accordance with his dictates.¹⁴⁶ A more complete account of class counsel suggests that Judge Barbier's instinct was correct. However, by disproportionately

145. See Case Mgmt. Order No. 8 at 2, *In re Oil Spill*, 747 F. Supp. 2d 704 (E.D. La. 2010), available at <http://www.ms litigation review.com/uploads/file/MDL%20Steering%20committee%20order.pdf> (“The appointment to the PSC and/or Executive Committee is of a personal nature. Accordingly, the above appointees cannot be substituted by other attorneys, including members of the appointee's law firm, to perform the PSC's exclusive functions, such as committee meetings and court appearances, except with prior approval of the Court.”).

146. See Malloy, *Regulating by Incentives*, *supra* note 67, at 536 (“[W]hat goes on inside the firm matters, and regulators should pay attention to this point in designing and implementing regulation.”); Malloy, *Regulation, Compliance and the Firm*, *supra* note 68, at 460 (“Admittedly, the notion that regulators should reach within the firm to purposefully and directly alter the management function challenges the longstanding presumption in the compliance literature against such intervention. Given, however, what we now know about the internal workings of firms and other organizations, the time has come to revisit that presumption. Research on bounded rationality, organizational inertia, and cognitive biases demonstrates that firms and the individuals within them are much less efficient and adaptive than is typically assumed.”).

appointing senior partners who presumably have greater equity stakes in their firms, he may have exacerbated the agency cost problems predicted by the conventional account of class counsel. Cabining considerations like experience and skill (factors relevant to appointment to a leadership position, but not necessarily relevant to reducing agency costs), the “best” lawyer may be one who is likely to be less identified with the firm in which he practices, and thus less focused on maximizing its fees.

Third, when considering the effects of fees on lawyer incentives, courts and commentators can, equipped with a more complete account of plaintiffs’ class counsel, be mindful of the ways law firm internal structure may enhance or detract from expected fees as an effective lever for aligning interests of class counsel and the class. Is a particular fee award methodology likely to induce plaintiffs’ attorneys to make the “correct” investment in a particular class action? The answer is that it depends, at least in part, on who is running the case and on his particular relationship with his firm; it also depends on the extent to which case value is capable of reasonably precise estimation at the time case-investment decisions are being made. In a large class action, where case value is indeterminate and the lawyer making case-management decisions does not perceive his own interests to appreciably turn on the fee calculation methodology, the fee lever may not have the desired effect.

b. Why Tailored Incentives May Fail

There are a number of reasons to doubt the effectiveness of tailored incentive-based efforts to better manage agency costs in class actions. First, to the extent such reforms seek to control how law firms allocate intra-firm case-management authority, they may unduly invade law firm autonomy; after all, the law firm, as a whole, presumably bears the costs of prosecuting litigation and should arguably have the opportunity to influence the case-management decisions made by individual attorneys (even if, as I argue above, that rarely happens in practice). Moreover, case staffing changes over time and is exceedingly difficult for a court to police. In short, it is not clear that any one lawyer’s incentives will or should shape all case-investment and settlement decisions in each case.

Second, complexity may provide more insight, but it does not necessarily identify a more effective lever for reducing agency costs by manipulating incentives. As noted, the factors suggesting an absence of cohesion within a firm regarding the presumed goal of maximizing firm profit do not necessarily suggest that the interests of lawyer and clients are better aligned; instead, they may simply diverge in ways the conventional account of class counsel does not contemplate. A lawyer may over-invest or under-invest in litigation, or pursue his own interests at the expense of the class, in any number of ways unrelated to maximizing law firm profit.

Third, there are costs associated with too nuanced an approach to either attorney selection or to fees, in terms of court time, as well as errors. Courts will need to evaluate much more information to select and pay counsel involved in litigation when attempting to factor into their analysis the effects of law firm structure on attorney incentives or on attorney sensitivity to fee-driven incentives, in particular. To the extent courts attempt to direct internal firm case staffing, courts may need to police the staffing of class cases, a time-consuming and possibly futile task. Courts also lack information about the way each attorney working on a case is positioned within his law firm structure, something that changes over time. For these reasons, courts are likely to make errors or likely to resist this kind of micromanaging.

Finally, reducing agency costs is just one goal of court intervention in both the selection and payment of class counsel; Fed. R. Civ. P. 23(g), addressing selection of class counsel, considers multiple factors—such as experience—which are not designed to align interests, but are, instead, designed to promote competent representation.¹⁴⁷ Rule 23(h), authorizing a court to award “reasonable” attorney’s fees in class actions,¹⁴⁸ requires courts to consider factors—including the reaction of the class, or the “skill and efficiency of the attorneys involved”—that, at best, only tangentially relate to the project of reducing agency costs by better aligning the

147. See FED. R. CIV. P. 23(g)(1)(A) (listing, among other factors to be considered when a court selects class counsel, class counsel’s “knowledge” and “experience”).

148. FED. R. CIV. P. 23(h).

interests of class counsel and the class.¹⁴⁹ Those competing goals may not be served by an undue focus on *ex ante* interest alignment.

2. Complexity Counsels in Favor of Rehabilitating the Trial Court Judge to Minimize Agency Costs

How can we best address the problem of agency costs in class litigation, such as it is? It may not be by constructing a better hypothetical plaintiffs' class action attorney, ascribing to him limited incentives, and then manipulating those incentives to ever-more-closely align his presumed interests with those of the class members. Because of the variety of incentives potentially influencing class counsel's case-investment and settlement calculus, it is easy to rely too heavily on market-based (interest alignment) approaches to reducing agency costs. Instead, though commentators have generally low opinions of the ability of judges to directly regulate class counsel and weed out bad settlements,¹⁵⁰ the trial court judge—

149. See, e.g., *Gunter v. Ridgewood Energy Corp.*, 223 F.3d 190, 195 n.1 (3d Cir. 2000) (listing factors to be considered by courts when determining a "reasonable" fee in class cases).

150. See, e.g., Coffee, *Accountability and Competition*, *supra* note 2, at 413 (noting that the need for judicial approval of class settlements has had "only marginal success at best" in reducing agency costs); see also Samuel Issacharoff, *Class Action Conflicts*, 30 U.C. DAVIS L. REV. 805, 829 (1997) ("The same problems that confront courts in the settlement context are present throughout class action litigation. No matter how virtuous the judge, the fact remains that courts are overworked, they have limited access to quality information, and they have an overwhelming incentive to clear their docket. They cannot reliably police the day-to-day interests of absent class members."); Richard Marcus, *Reviving Judicial Gatekeeping of Aggregation: Scrutinizing the Merits on Class Certification*, 79 GEO. WASH. L. REV. 324, 348–49 (providing a particularly nuanced analysis of the trial court's ability to serve a gatekeeper function generally, and noting: "The detail provided by amended Rule 23(e) does not alter the reality that judges performing this task [of reviewing proposed class settlements] are doing a job quite different from traditional adjudication Ultimately, what they must do is become regulators, sensitive both to the dynamics of litigation activity and the underlying concerns of the body of law that give rise to the claims asserted."); Rubenstein, *The Fairness Hearing*, *supra* note 32, at 1438 (arguing that the fairness hearing deserves "more, not less, attention," and noting that some commentators have "essentially given up on the judiciary's ability to provide real class action oversight; indeed the [agency cost and collateral attack] literature is

properly guided by better-articulated settlement evaluation standards and by better evidence regarding case value—may be worth rehabilitating. That is, direct regulation of class counsel, especially at the final approval hearing stage of class litigation, may have a greater role to play in the ongoing project of managing agency costs.

Courts currently assess the substantive fairness of proposed class settlements by reference to criteria that are too loose to properly weed out bad settlements, whether such settlements are caused by misaligned interests not captured by the conventional account of class counsel, or even, just by ineffective lawyering.¹⁵¹ The Second Circuit's test, articulated in *City of Detroit v. Grinnell Corp.*¹⁵² in 1974, remains good law in that jurisdiction¹⁵³ and is typical.¹⁵⁴ The “*Grinnell* factors” include: (1) the complexity, expense, and likely duration of the litigation; (2) the reaction of the class to the class settlement notice; (3) the stage of the proceeding;

largely motivated by this failure. Market-focused scholars locate monitoring outside of the judiciary and then rarely ponder what effect their proposals ought to have on the fairness hearing that will inevitably take place; it appears implicit that if the monitoring mechanism works, it does not really matter what the judge does at the end of the show, so long as she simply lowers the curtain”).

151. See Jonathan R. Macey & Geoffrey P. Miller, *Judicial Review of Class Action Settlements*, 1 J. LEGAL ANALYSIS 167, 168 (2009) (“Review of class action settlements takes the form of a list of factors uncertain in scope, ambiguous in meaning, and undefined in weight.”).

152. 495 F.2d 448 (2d Cir. 1974).

153. *Grinnell* remains good law on the issue of the settlement approval factors. The Second Circuit has retreated, however, from the position it staked out in *Grinnell* favoring the lodestar approach on fees. See *Goldberger v. Integrated Res., Inc.*, 209 F.3d 43, 49–50 (2d Cir. 2000) (embracing percentage methodology for calculating class action fees as an option).

154. See, e.g., *Sullivan v. D.B. Invs., Inc.*, 667 F.3d 273, 319 (3d Cir. 2011) (citing as the doctrinal core of the settlement approval analysis the test articulated by the Third Circuit in *Girsh v. Jepsen*, 521 F.2d 153, 156–57 (3d Cir. 1975) (directing trial courts faced with proposed class action settlements to consider, under Rule 23(e), when assessing the settlement's adequacy: “(1) The complexity, expense, and likely duration of the litigation; (2) the reaction of the class to the settlement; (3) the stage of the proceedings and the amount of discovery completed; (4) the risks of establishing liability; (5) the risks of establishing damages; (6) the risks of maintaining the class action through the trial; (7) the ability of the defendants to withstand a greater judgment; (8) the range of reasonableness of the settlement fund in light of the best possible recovery; and (9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation”).

(4) the risks of establishing liability; (5) the risks of establishing damages; (6) the risks of maintaining the class action through trial; (7) the defendant's ability to withstand a greater judgment; (8) the "range of reasonableness of the settlement fund in light of the best possible recovery"; and (9) the "range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation."¹⁵⁵ These approval criteria are too vague in both formulation and application. In formulation, the factors fail to specifically identify the recurring settlement structures that generate hostility to class aggregation. In application, the class settlement final approval criteria deployed in most Circuits rely too heavily on *ex ante* indicia of structural fairness to justify settling counsel's determination of settlement value, presuming fairness, in many jurisdictions, of class settlements "reached in arm's-length negotiations between experienced, capable counsel after meaningful discovery."¹⁵⁶

Patently unfair settlement structures can easily be identified, and either presumptively disfavored—such that a much higher showing would be needed in order to justify either preliminary or final approval—or barred. CAFA already disfavors coupon settlements, though it seeks to curb abuse using market incentives by requiring that the fee award in such settlements "shall be based on the value to class members of the coupons that are redeemed."¹⁵⁷ The Federal Judicial Center's *MANUAL FOR COMPLEX LITIGATION* lists settlement red flags, though it does not suggest that judges necessarily presume the inadequacy of settlements with these provisions.¹⁵⁸ Another recent list of inappropriate settlement

155. *City of Detroit*, 495 F.2d at 463.

156. *Wal-Mart Stores, Inc. v. Visa U.S.A. Inc.*, 396 F.3d 96, 116 (2d Cir. 2005) (quoting *MANUAL FOR COMPLEX LITIGATION* § 30.42 (3d ed. 1995)). See also *In re Warfarin Sodium Antitrust Litig.*, 391 F.3d 516, 535 (3d Cir. 2004) (reaffirming the Circuit's commitment to requiring a "presumption of fairness when reviewing a proposed settlement where: '(1) the settlement negotiations occurred at arm's length; (2) there was sufficient discovery; (3) the proponents of the settlement are experienced in similar litigation; and (4) only a small fraction of the class objected'" (quoting *In re Cendant Corp. Litig.*, 264 F.3d 201, 232 n.18 (3d Cir. 2001))).

157. 28 U.S.C. § 1712 (2006).

158. *MANUAL FOR COMPLEX LITIGATION*, *supra* note 78, § 22.923 (identifying as "things to avoid in mass tort settlement," among others: (1) treating similarly situated persons differently, (2) splitting claims of class members via

provisions comes from federal trial court Judge William Alsup, who, in his “Notice Regarding Factors to Be Evaluated for Any Proposed Class Settlement,” which he has issued in a number of pending class cases,¹⁵⁹ expresses skepticism of specific settlement structures, like overly-broad releases,¹⁶⁰ reversionary funds married to unduly difficult claims programs,¹⁶¹ or, even, agreements between the settling counsel as to class counsel’s fees.¹⁶² The point here is not that Judge Alsup’s list is perfect, but that it heads in the correct direction: obviously-unfair settlement provisions can and should be expressly identified and either barred or disfavored. Judge Alsup’s list of factors goes well beyond Rule 23(e)’s “fair, reasonable, and adequate” standard for final approval,¹⁶³ and, also, is much more specific than the multi-factor tests for settlement approval that have been articulated by various appellate courts.

Judge Alsup’s “Notice” provides useful guidance, too, on the evidentiary support that could be required in every class action case to establish the adequacy of a proposed settlement’s value. Judge Alsup suggests, specifically, that class counsel should prepare a “final expert class damage report” as part of his “due diligence” on behalf of the class, and, presumably, before settling the class

settlement, (3) disparate treatment of inventory or future-injury claims, (4) overly-strict eligibility criteria, and (5) restrictions on opt outs).

159. *See, e.g.*, *Thoms v. Officemax N. Am. Inc.*, No. C 11-02233 (N.D. Cal. June 8, 2011), *available at* <http://docs.justia.com/cases/federal/district-courts/california/candce/3:2011cv02233/241512/13> (showing an example of Judge Alsup’s application of his “Notice Regarding Factors to Be Evaluated for Any Proposed Class Settlement” to a pending case); *Xavier v. Philip Morris USA Inc.*, No. C 10-02067, (N.D. Cal. Mar. 21, 2011), *available at* <http://docs.justia.com/cases/federal/district-courts/california/candce/3:2010cv02067/227577/84> (explaining factors Judge Alsup expects counsel to consider in structuring class action settlements). All further references herein are to the version of the Notice Judge Alsup issued in *Xavier*.

160. *Xavier*, No. C. 10-02067 at 2.

161. *Id.* at 3.

162. *Id.* at 3–4.

163. FED. R. CIV. P. 23(e) was helpfully amended in 2003 to provide direction to trial courts which earlier iterations of the Rule lacked. In addition, the Committee Note to Rule 23 now provides additional useful guidance. However, even the amended Rule 23 lacks the kind of specificity that could be considered as part of the next step in guiding the exercise of trial court discretion with respect to proposed class settlements.

claims.¹⁶⁴ Recognizing the limits of the project of interest alignment as a way of ensuring fair settlements, courts could also insist upon some acceptable method of non-binding sampling (for settlement purposes), conducted by or before a competent neutral, to be developed as a rough proxy for the value of the litigation, prior to and as a basis of settlement discussions in damages class actions.¹⁶⁵ Giving more precise content to what constitutes a fair and adequate settlement, including the use of sampling or formulas to create a comparison point for settlement value, may enhance the likelihood that class action settlement values will more closely reflect case value: in every case, there would at least be a fixed start for purposes of assessing the adequacy of settlement amount, something that current practices and doctrine do not create or require.¹⁶⁶ Identification of the precise sampling procedures best able to generate reliable figures for case value is a separate topic, in and of itself, and one that has already been the subject of some inquiry.¹⁶⁷

164. *Xavier*, No. C. 10-02067 at 2.

165. MDL courts (to which related cases on file in the federal system are transferred pursuant to 28 U.S.C. § 1407) routinely use bellwether trials designed for a similar purpose. See Eldon Fallon, et al., *Bellwether Trials in Multidistrict Litigation*, 82 TUL. L. REV. 2323, 2332–42 (2008) (describing the mechanics and benefits of using the modern “informational approach” to bellwether trials, i.e., individual cases within the aggregate selected for trial because they involve representative facts, claims or defenses). However, the use of bellwether trials or of other sampling methods is not currently required to justify settlement value in aggregate litigation.

166. Settling parties who wish to deviate from case value by settlement could be required to justify any such variance. For example, sampling variability, the parties’ risk preferences, and litigation transaction costs could all justify some level of deviation from the values produced by whatever formula is ultimately employed to assess case value.

167. See, e.g., Luke McCloud & David Rosenberg, *A Solution to the Choice of Law Problem of Differing State Laws in Class Actions: Average Law*, 79 GEO. WASH. L. REV. 374, 378 (2011) (“Our principal contribution is a basic, straightforward point: the average of the differing state laws is, as a practical matter, the actual law that governs the choice a business will make. It expresses the choice that the multiple states involved expect, and presumably want, a business to make regarding whether and how safely it should engage in activities involving interstate risk.”); see also Michael J. Saks & Peter David Blanck, *Justice Improved: The Unrecognized Benefits of Aggregation and Sampling in the Trial of Mass Torts*, 44 STAN. L. REV. 815, 839 (1992) (“We already have noted one flaw in the imagery of the archetypal civil trial: The verdict appears precise and individualized, but in reality it is only a sample of one from a wider population of

The rough contours of possible sampling procedures can easily be imagined; “settlement by formula” would at most require the universal application of current best practices, rather than the invention of wholly new procedures.

In *Wal-Mart Stores, Inc. v. Dukes*, the Supreme Court, confronting an expansive Title VII gender discrimination class asserting pay and promotion claims, rejected the use of statistical sampling in lieu of additional individual proceedings to calculate the amount of any back pay owed to class members asserting pattern-or-practice claims.¹⁶⁸ The Ninth Circuit, addressing manageability and due process concerns, had suggested that the *Dukes* trial court could determine a back pay award using procedures analogous to those approved by the Ninth Circuit in *Hilao v. Estate of Marcos*,¹⁶⁹ a class action involving approximately 10,000 victims of torture and other abuse, where the court appointed a special master under Federal Rule of Evidence 706 to select a statistically valid sampling of claims for purposes of calculating aggregate damages.¹⁷⁰ The Supreme Court in *Dukes* characterized that approach as “Trial by Formula,” and rejected it as a violation of the Rules Enabling Act, 28 U.S.C. § 2072(b).¹⁷¹ Other courts, faced with similar proposals in different substantive law settings, have rejected the use of statistical sampling to prove and allocate class damages (often called “fluid recovery”) on Constitutional grounds, as a violation of defendants’ Due Process rights.¹⁷²

possible outcomes. The illusion that individualized adjudication provides a precision that aggregation lacks is nothing more than that, an illusion.”); Byron G. Stier, *Jackpot Justice: Verdict Variability and the Mass Tort Class Action*, 80 TEMP. L. REV. 1013, 1044–51 (2007) (surveying legal commentary on the use of statistical sampling in mass torts).

168. 131 S. Ct. 2541, 2545–46 (2011).

169. 103 F.3d 767, 782–87 (9th Cir. 1996).

170. *Dukes v. Wal-Mart Stores, Inc.*, 603 F.3d 571, 625–26 (9th Cir. 2010).

171. *Dukes*, 131 S. Ct. at 2561 (stating that the Rules Enabling Act, 28 U.S.C. § 2072(b), provides that federal rules of procedure cannot be used to “abridge, enlarge, or modify any substantive right”).

172. See, e.g., *McLaughlin v. Am. Tobacco Co.*, 522 F.3d 215, 231–32 (2d Cir. 2008) (rejecting use of statistical sampling and averaging to both calculate and allocate aggregate class damages as a violation of the Rules Enabling Act and of defendants’ due process rights: “When fluid recovery is used to permit the mass aggregation of claims, the right of defendants to challenge the allegations of individual plaintiffs is lost, resulting in a due process violation”).

None of these doctrinal concerns impedes “settlement by formula,” i.e., the use of statistical sampling to connect settlement and case value. Requiring specific evidence as a condition of approval of proposed class settlements neither violates the Rules Enabling Act, nor poses a threat to any party’s Constitutional rights. It does, however, squarely address one of the most troubling difficulties with regard to the evaluation of any class settlement, i.e., the relative indeterminacy of case value. The exact content of a valuation process could be tailored to the size and nature of a case or category of litigation. The only real requirement is that the valuation method be reliable. For example, settlement by formula could involve the use of court-appointed experts to sample and value claims, as the trial court did in *Hilao*,¹⁷³ or bellwether trials¹⁷⁴ of a statistically valid sampling of relevant categories of individual claims, or the adjudication of a sampling of representative claims before a neutral arbitrator. While any procedure would be subject to strategic behavior by settling parties, trial courts would at least have a target category of evidence on which to insist, the quality of which the courts could regulate.

Settlement by formula sets a benchmark for case value against which any settlement can be compared, and thus takes pressure off of ex ante structural interest-alignment or market-based approaches to ensuring fair process and outcomes. A properly conducted sampling would also address allocation issues within settlement classes, taking pressure off of courts concerned about conflicts within classes, under Rule 23(a)(4) or 23(g). Requiring this kind of procedure could also have ancillary benefits, such as reducing the effectiveness of reverse auctions¹⁷⁵ among competing groups of plaintiffs’ counsel. In addition, the requirement of specific kinds of proof of case value would enable legitimate (non-professional) objectors to more meaningfully participate in the settlement evaluation process; currently, settlement value is one of

173. See *supra* note 169 and accompanying text.

174. See *supra* note 165 and accompanying text.

175. See *Negrete v. Allianz Life Ins. Co. of N. Am.*, 523 F.3d 1091, 1099 (9th Cir. 2008) (“A reverse auction is said to occur when ‘the defendant in a series of class actions picks the most ineffectual class lawyers to negotiate a settlement with in the hope that the district court will approve a weak settlement that will preclude other claims against the defendant.’” (quoting *Reynolds v. Beneficial Nat’l Bank*, 288 F.3d 277, 282 (7th Cir. 2002))).

the hardest things for a class member to assess, or for a potential objector to criticize, because it is so difficult to ascertain, and because case value, at the moment, tends to be deemed to be whatever the settling parties say it is, after arm's-length negotiation. This notion results from the widespread use of a presumption of fairness, one which should be abandoned in favor of a more rigorous inquiry regarding the fairness of class settlements.

By giving specific, clear content to the approval criteria for class settlements, in the form of specifically-enumerated disfavored settlement terms, and by reducing uncertainty at the settlement evaluation stage regarding case value, we can better equip the trial court to facilitate class action settlements that are truly fair and adequate without placing undue emphasis on whether, in any given case, class counsel's and class members' interests may or may not have been formally aligned.

