Legal Opinion Letter

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INVESTORS SHOULD BENEFIT FROM COURT RULING ON ATTORNEYS' FEES

by

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"It is well established that where an attorney creates a common fund from which members of a class are compensated for a common injury, the attorneys who created the fund are entitled to 'a reasonable fee — set by the court — to be taken from the fund'." *In re Interpublic Sec. Litig.*, 2004 WL 2397190 (S.D.N.Y. Aug. 5, 2004). What is not well established — especially in securities class actions — is the definition of "reasonable." The United States District Court in the Western District of Washington at Seattle, however, in its recent opinion in *In re Infospace, Inc., Securities Litigation*, 330 F.Supp.2d 1203 (W.D. Wash. 2004), sheds some much needed light on the debate by making clear what is *not* reasonable: huge windfalls in fees for attorneys. The court's opinion allows those who suffered the injuries to receive the maximum compensation possible while still awarding attorneys for their successes.

In *Infospace*, the court, employing a reduced "lodestar" calculation and a 3.5 multiplier, reduced an attorneys' fee request of $8,456,353.94 (25% of a $34.4 million settlement fund) to $3,937,867.32 (12%). Judge Thomas S. Zilly, in departing from the U.S. Court of Appeals for the Ninth Circuit's established 25% benchmark, noted that the benchmark was "inherently" unreasonable and that even courts who used it did not explain its logic. *See Infospace*, 330 F. Supp. 2d 1203 at 1210. The court noted the simplicity of the matter, the low risks of recovery, and the minimal amount of work actually performed by plaintiffs' counsel as factors to support its decision. *See id*. The opinion criticized the discrepancy between the windfall attorneys receive and the "pittance" class members often receive. *Id* at 1211. If plaintiffs' attorneys in *Infospace* had received 25% of the settlement fund, as they requested, they would have profited 7.5 times the value the court attributed to their work while the class members would only recover 14 cents per share (0.10 percent of their loss based on the value of the share). *Id* at 1211, 1214. Judge Zilly decided such a discrepancy was unreasonable given the court's duty to the class members. Though the court stopped short of precluding the application of the 25% benchmark in securities fraud cases, it certainly provided fresh ammunition for anyone set to take aim at the often huge attorneys' fees earned by plaintiffs' counsel in securities class actions.

Judge Zilly is not alone in his criticism of the 25% benchmark. Both United States District Courts and legal academia have criticized its application, calling the benchmark arbitrary, artificial, overly simplified and shortsighted. *See In re Washington Pub. Power Supply System Sec. Litig.*, 779 F. Supp. 1056 (D. Ariz. 1991); *In re Superior Beverage/Glass Container Consol. Pretrial*, 133 F.R.D. 119 (N.D. Ill. 1990); Lisa L. Casey, *Reforming Securities Class Actions from the Bench: Judging Fiduciaries and Fiduciary Judging*, 2003 BYU L. REV. 1239 (2003), cited by the court at 1210. Casey notes that

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after reviewing "numerous reported decisions", there appears to be no basis for the reasonableness of the benchmark. *See Infospace*, 330 F. Supp. 2d 1203 at 1210.

In *Reforming Securities Class Actions from the Bench: Judging Fiduciaries and Fiduciary Judging*, Casey states that 2002 saw a record number of class action filings with increases in the dollar amounts sought. Noting the recent $200 million settlements of eight securities class actions, she goes on to quote one insurance industry insider who estimates that over 35 cases, then currently pending in the courts, would settle for over $500 million. Applying an automatic 25% benchmark would generate some $125 million in legal fees, an obvious lure.

When one considers the distribution of the settlement fund, one will see why any increase in class actions premised on reaping huge automatic attorneys' fee awards is harmful to the legal profession. It fuels further criticism (some of it misplaced) that the legal profession is in the habit of filing problematic lawsuits seeking huge fees at the expense of the public or its clients.

As noted above, the fees which judges award to attorneys for negotiating settlement funds are taken out of the fund itself. Though this practice is founded on the logical premise that the cost of the creation of the fund should be borne by all those benefiting from the fund, the result is that an increase in attorneys' fees results in a decrease in class member compensation. In fact, in some cases only the attorneys see cash, as the settlement is funded by discounts or vouchers to the class members. In *Superior Beverage/Glass Container Consol. Pretrial*, plaintiffs' counsel received a payment of approximately $11.5 million while class members received discounts on future purchases. 133 F.R.D. 119. Even when cash is paid to the plaintiffs' class, as in *Infospace*, class members get pennies on the dollar while attorneys cash million-dollar paychecks.

It is this imbalance that Judge Zilly attempts to correct. While other recent court opinions take a more dualistic approach to calculating attorneys' fees — using both lodestar and percentage methods with one cross-checking the other for reasonableness — they all focus on the value of the work done by the attorney. *See Oh v. AT&T Corporation*, 2004 WL 2956049 (D.N.J. 2004); *Godshall v. The Franklin Mint Co.*, 2004 WL 2745890 (E.D.Pa. 2004); *In re Interpublic Sec. Litig.*, 2004 WL 2397190 (S.D.N.Y. 2004). *Infospace* places the focus back on the injured class, while amply compensating class counsel. The attorneys in *Infospace* still received 3.5 times the value the court attributed to their actual work. Undeniably, attorneys deserve to be compensated for the financial risk they incur by taking on these cases without assurance of payment. In current times, however, the reality of securities class actions often does not justify the attorneys' fees being sought by counsel. As the *Infospace* court suggests, large recoveries are often more a result of large class size rather than attorney skill, the vast majority of securities class actions settle early in the litigation, and most involve typical securities violations. Furthermore, securities class actions have minimal collection risk because of the coverage corporations receive from their insurers.

The *Infospace* opinion does not preclude the award of benchmark attorneys' fees where attorneys take on actual risks, provide outstanding expertise and experience, and recover exceptional awards. The court recognizes a need to consider all the circumstances surrounding litigation. The court's opinion should be a concern only for those attorneys who negotiate quick settlements and reap huge profits for little expended effort without a concomitant benefit to the class they represent. It should be encouraging, however, for the clients and class members who will benefit from the Court's ruling by seeing more value from settlement funds created on their behalf. In *Infospace*, the Court has struck an appropriate balance of the interests between both the class members and their attorneys.

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