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RETHINKING THE APPROVAL OF CLASS COUNSEL’S FEES IN ONTARIO CLASS ACTIONS

Benjamin Alarie

Effective market mechanisms are hard to detect in the class action context ... opportunism reigns.

Anyone who reads even a few fee award cases will quickly form the impression that the judges shoot from the hip. They indulge in casual speculation about the reasonableness of hours and the value of lawyers’ time ... They offer paper-thin rationales for decisions on which, in a different mood or moment, they would have gone the other way.

A. INTRODUCTION

Class action legislation is a relatively new phenomenon in several Canadian provinces. The state of the law, particularly in Ontario, is at a pivotal stage. We have a sufficient number of decided cases to draw some conclusions about how well the Class Proceedings Act, 1992 as it is currently being interpreted and applied is meeting its goals, but not so many decided cases that a settled approach has emerged to its application in the courts. In this article, I analyze a sample of twenty-seven reported Ontario class action decisions, focusing in particular on what the courts have done with respect to the approval of class counsel fees. I find that courts have by and large tended to use an enhanced “lodestar method” for compensating class counsel, whereby class counsel’s base fee

1 Benjamin Alarie, Assistant Professor, Faculty of Law, University of Toronto; Senior Fellow, Taxation Law and Policy Research Institute, Monash University.
3 Charles Silver, “Unloading the Lodestar: Toward a New Few Fee Award Procedure” (1992) 70 Tex. L. Rev. 865 at 950 [Silver, “Unloading the Lodestar”].
is adjusted with a multiplier to reflect the riskiness of the litigation. In the twenty-seven class actions I analyze, the average fee award per case is approximately $3 million, representing approximately 15 percent of the average settlement. The average multiplier is about 2.5. Under the current provisions of the CPA I argue that, given the incentives facing class counsel, a percentage contingency fee would be superior to the lodestar method, could more easily be monitored for abuses by judges, and would increase access to justice for potential claimants with independently non-viable claims.

B. CLASS COUNSEL FEES IN CLASS ACTIONS IN ONTARIO

As a procedural innovation of the English Court of Chancery,\(^5\) class actions\(^6\) were originally used (much as they are today) as a device to extend the court’s reach to govern the affairs of absent individuals — that is, those who were not immediately before the court and hence not within its obvious jurisdictional ambit.\(^7\) The rules of practice in Ontario since at least the nineteenth century have permitted class actions,\(^8\) though the early guidance provided by the rules facilitating such actions was sparse. For example, Rule 75 of the Ontario Rules of Practice, first introduced

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\(^6\) I will use the terms “class actions,” “representative actions,” “class proceedings,” and “representative proceedings” interchangeably throughout the article.

\(^7\) Lord Macnaughton remarked in a 1901 speech at the House of Lords that historically the representative action was “a simple rule resting merely upon convenience.” See *Duke of Bedford v. Ellis*, [1901] A.C. 1 at 10 (H.L.).

\(^8\) For a lengthy discussion of the history of the class action, see John A. Kazanjian, “Class Actions in Canada” (1973) 11 Osgoode Hall L.J. 397; and Stephen C. Yeazell, *From Medieval Group Litigation to the Modern Class Action* (New Haven: Yale University Press, 1987). Kazanjian explains that representative proceedings can be traced back to at least the practices of the Courts of Chancery in England in the seventeenth century. The Supreme Court of Canada in *General Motors of Canada Ltd. v. Naken*, [1983] 1 S.C.R. 72 [Naken], outlined briefly the history of class actions in Anglo-Canadian law, explaining that procedural rules facilitating representative actions in Ontario (and several other provinces) were based on Order XVI, Rule 9 of the Supreme Court of the United Kingdom. More specifically, in 1881, Rule 98 of the Court of Chancery in Ontario was introduced to facilitate class actions.
in 1913 and consisting of a single sentence of thirty words, remained unchanged and relatively unused for several decades following its introduction. As a simple rule that was drafted in simple terms, there was originally no manifest expression of the specific benefits expected to be realized by Rule 75. It was not until the Ontario Law Reform Commission took a close and insightful look at class actions in the early 1980s that it became part of the conventional wisdom that class proceedings are beneficial specifically because they can promote (1) judicial economy, (2) access to justice (that is, compensation), and (3) behaviour modification (that is, deterrence).

Following the lead of the United States amendment of Rule 23 of the Federal Rules of Civil Procedure in 1966, a move which had dramatically expanded the reach of class proceedings south of the border, the early equitable rules allowing representative proceedings have now yielded to detailed legislation in several Canadian provinces. Quebec acted first in 1978, followed by Ontario in 1992 with the passage of the CPA, and by British Columbia in 1995 with legislation of the same name (and much the same content). Alberta, Manitoba, Saskatchewan, and Newfoundland and Labrador have now also enacted similar legislation enabling class actions.

Ontario’s CPA essentially adopted the draft legislation recommended in the 1990 Report of the Attorney General’s Advisory Committee on Class

9 Rule 75 read: “Where there are numerous persons having the same interest, one or more may sue or be sued or may be authorized by the court to defend on behalf of, or for the benefit of, all.” See Naken, ibid.

10 These three ends were identified and described at length in the report of the Ontario Law Reform Commission (OLRC) on class actions: Ontario Law Reform Commission, Report on Class Actions (Toronto: Ministry of the Attorney General, 1982). These ends were approved by the Supreme Court of Canada in Hollick v. Toronto (City), [2001] 3 S.C.R. 158, 2001 SCC 68 at para. 15. It might be questioned whether class actions are truly consistent with a limited notion of judicial economy to the extent that class proceedings also promote access to justice, since while non-viable claims may be made viable and therefore be brought as class proceedings, they also constitute an additional demand on scarce judicial resources that would not be made if class proceedings were not permitted.

11 See Kenneth W. Dam, “Class Actions: Efficiency, Compensation, Deterrence, and Conflict of Interest” (1975) J. Legal Stud. 47 at 47.


The Ontario legislation was motivated in part by the Supreme Court of Canada’s 1983 decision in *General Motors of Canada Inc. v. Naken*. In *Naken*, the Supreme Court held that the simplicity and brevity of Rule 75 rendered it “totally inadequate” to support the “practical problems of all sorts” associated with complex and uncertain class proceedings. The Ontario CPA was intended to provide in response an informed (if necessarily imperfect) solution to these practical problems.

How has Ontario’s CPA done at providing an informed response to the many practical problems posed by representative proceedings? Unsurprisingly, perfection is elusive. The CPA has not been able to finally solve the issues identified by the Supreme Court of Canada in *Naken*, though it no doubt represents an improvement over the threadbare Rule 75. Domestic and international experience with class actions demonstrates that numerous difficult issues persist in the day-to-day cut and thrust of class proceedings, even as class actions have grown in prevalence and importance spurred on by the detailed legislative schemes aimed at making them more manageable and administrable. The remaining difficult issues cannot be easily or tidily reconciled, as is evidenced in part by the extensive academic literature on the subject.

One of the thorniest practical problems arising in the context of class actions surrounds the compensation of class counsel. In a typical

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15 Michael G. Cochrane *et al.*, *Report of the Attorney General’s Advisory Committee on Class Action Reform* (Toronto: Ontario Ministry of the Attorney General, 1990). The Advisory Committee was formed by then-Attorney General Ian Scott, who had announced at Queen’s Park in June 1989 the government’s intention to enhance access to class actions in Ontario.

16 *Naken*, above note 8.

17 The appeal itself concerned an action which had been purportedly brought on behalf of 4,602 purchasers of 1971 or 1972 Firenas who at the date of writ had not yet disposed of their vehicles. Estey J., for a unanimous Court, held that a more extensive regulation of class actions would be needed to effectively surmount the practical issues. The Court spent much of the judgment discussing the detailed schemes employed by jurisdictions such as Quebec, the State of California, and the Federal Courts in the United States to deal with the many practical problems inherent in representative proceedings.

18 For an excellent introduction to the many conflicts of interest involved in a class action, and a bibliography of the voluminous academic literature the issues have spawned to 1998, see Charles Silver, “Class Actions — Representative Proceedings” in *Encyclopedia of Law and Economics* (Cheltenham, UK: Edward Elgar, 1999) at 194–240 [Silver, “Class Actions — Representative Proceedings”].

19 For a sustained treatment, see Silver, “Class Actions — Representative Proceedings,” *ibid.* at 211–15.
lawyer-client relationship, the client undertakes to compensate the lawyer for legal services provided, typically (though not always) on the basis of time spent by the lawyer in providing the services. However, due to the nature of the cases and frequently small claims involved, in class actions class counsel frequently agree to contingent payment — that is, class counsel undertakes to front the costs of litigation on behalf of the representative plaintiff and the class in exchange for a claim to payment upon settlement or a successful outcome in the courts. Despite the *prima facie* similarity with the conventional lawyer-client relationship, however, class counsel are necessarily more entrepreneurial than are lawyers generally, and exercise a significantly greater degree of control over the litigation.

This, of course, raises the central problem with representative proceedings: there is no party with the incentive (financial or otherwise) and the ability (expertise and information) to ensure that class counsel looks out for the best interests of all the class members. At root, the issue is one familiar to economists; it is a typical principal-agent problem, albeit a particularly acute one. The plaintiff class (the principal) relies on class counsel (the agent) to faithfully pursue the action on the class's behalf. However, the interests of class counsel are likely to be only partially coincident with the interests of the class, since class counsel will at best receive part of the value of the settlement, will have incentives to shirk, and will generally not see fit to maximize the net benefits (that is, costs less settlement or judgment) for the plaintiff class. Representative plaintiffs frequently have little incentive to monitor class counsel because of a collective action problem: most of the benefits of monitoring would accrue to class members who did not bear the costs or hassles of it, while all the costs and hassles would be borne by the representative plaintiff. Even if representative plaintiffs could solve this collective action problem and had appropriate financial incentives to monitor, they would be unlikely to have the ability to do so well. Representative plaintiffs are rarely legally trained, have limited ability to observe the effort and quality of decision-making of class counsel, and are apt to have little insight into how class counsel's performance would compare with comparable services available from other possible class counsel. For obvious reasons, absent class members (that is, those not directly involved as representa-

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20 It is frequently the case that class members have varying interests, so that looking out for the “best interests of all the class members” is not even possible. For example, present claimants typically have interests that clash with future claimants. See John C. Coffee Jr., “Class Wars: The Dilemma of the Mass Tort Class Action” (1995) 95 Colum. L. Rev. 1343 at 1351 [Coffee, “Class Wars”].
tive plaintiffs) with current claims and, *a fortiori*, future claimants, are even less well positioned to monitor class counsel.

There is broad agreement that the principal-agent problem at the core of class actions is not well addressed by current fee arrangements. The enhanced lodestar method,\(^{21}\) which is frequently used in Ontario, bases compensation on time expended and hourly billing rates, with a premium awarded, usually in the form of a multiple of the base fee, for successful outcomes. Problematically, while the enhanced lodestar method does reward results, in determining the appropriate level of compensation it focuses on a crude proxy for effective representation: the time invested by class counsel. As a consequence, all else the same, class counsel are inclined to spend too much time on cases.\(^{22}\) Additionally, the method encourages settlements that mutually benefit class counsel and defendants — the parties carrying out settlement negotiations — at the expense of representative plaintiffs and other class members who do not have seats at the negotiating table.\(^{23}\)

The primary goal of this article is to analyze the difficult choices regarding class counsel compensation being faced by Ontario courts in class proceedings. To this end, the article proceeds as follows. Section C describes the statutory framework of the relevant provisions of the *CPA* and outlines how judges have approached the task of assessing and approving class counsel fees in Ontario class actions over the past ten years. In the process, summary statistics of a sample of twenty-seven Ontario cases in which class counsel fees have been approved are reported and analyzed. Section D identifies a number of pitfalls and considerations judges should focus on in deciding whether to approve a given fee agreement under the current provisions of the *CPA*. Section E seeks to present a normative starting point for future legislative changes by outlining the theoretical ideal solution to the central agency problem at the core of

\(^{21}\) For a more detailed description of the lodestar method and its defects, see Section C, below.

\(^{22}\) See Silver, “Unloading the Lodestar,” above note 3 at 867.

class proceedings. A number of constraints, some more serious than others, which preclude the attainment of the first-best solution are identified and discussed. Section E continues by assessing the merits of various proposals for better resolutions to the agency problem at the centre of class actions, with a view to more effectively advancing the three goals of (1) judicial economy, (2) access to justice (that is, compensation), and (3) behavioural modification (that is, deterrence) that constitute the ontological foundation of class actions in Ontario. Section F concludes.

C. DESCRIPTION OF THE CURRENT APPROACH TO CLASS COUNSEL FEES IN ONTARIO

There are two common approaches to the compensation of class counsel. The first of these is the lodestar method, pursuant to which class counsel is entitled to payment for a reasonable number of hours at a reasonable rate per hour (this rate is typically the lawyer’s standard rate for work billed on an hourly basis), subject in some cases to potential enhancement or premium through the application of a multiplier reflecting a number of factors, including the risk taken on by class counsel in pursuing the case. At least one commentator has likened the approach taken by judges under the lodestar method to that of a public utility commission charged with regulating prices with a view to allowing a utility an appropriate return on investment. This comparison is apt, since in both cases a fictional result is reached. In the utility case, a natural monopoly prevents competition. In the class action context, it is collective action and transaction costs that are the barriers.

The second of the common approaches to the compensation of class counsel is the percentage method, whereby class counsel is entitled

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24 For a general discussion of the lodestar method in the United States context, see Johnson v. Georgia Highway Express, Inc., 488 F.2d 714 at 717–19 (5th Cir. 1974) [Johnson]; Longden v. Sunderman, 979 F.2d 1095 at 1099 (5th Cir. 1992).

25 In many American jurisdictions there must be evidence presented to substantiate the reasonableness of the number of hours claimed. See, for example, Bode v. United States, 919 F.2d 1044 at 1047–49 (5th Cir. 1990).

26 Coffee, “Understanding the Plaintiff’s Attorney,” above note 23 at 691.

27 The Eleventh Circuit mandates the use of the percentage method. Other circuits permit the use of the percentage method, but do not require its use. See, for example, In re General Motors Corp. Pickup Truck Fuel Tank Prods. Liab. Litig., 55 F.3d 768 at 820–22 (3d Cir. 1995); Brown v. Phillips Petroleum Co., 838 F.2d 451 at 454 (10th Cir. 1988); Six (6) Mexican Workers v. Arizona Citrus
to a fixed percentage of the value of the settlement or damages award, sometimes subject (as in, for example, subsection 33(8) of the CPA) to an overriding requirement of reasonability. The percentage method can be criticized on the basis that it provides the same proportional reward regardless of the effort and investment made by class counsel into the case, which gives rise to incentives to take on too many cases, to settle cases early, and to settle for amounts that are too low. On the other hand, the percentage method does not give class counsel an incentive to unnecesarily invest time and effort into an action, and more or less automatically rewards class counsel directly for each extra dollar recovered in settlement. Nevertheless, if class counsel attempt to maximize the return to each working hour, it is probable that under a percentage method a point is reached early on in each action that the marginal working hour is better spent finding new actions to bring rather than investing in actions which have already been commenced. The intuition behind this result is that it is privately more advantageous in terms of time and resources invested for class counsel to secure the agreement of a new defendant to pay the first $X of a settlement than it is to have an existing defendant agree to pay an additional $X (for example, $2X in total) in settlement. In other words, one might reasonably expect the marginal resistance of defendants to increase as proposed settlement sizes increase.

The current Ontario approach to class counsel fees is established by sections 32 and 33 of the CPA. Although the CPA describes explicitly

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*Growers*, 904 F.2d 1301 at 1311 (9th Cir. 1990); *Bebchick v. Washington Metro. Area Transit Comm’n.*, 805 F.2d 396 at 407 (D.C. Cir. 1986); *In re Continental Illinois Sec. Litig.*, 96 F.2d 566 at 572 (7th Cir. 1992).


29 See, for example, Silver, “Class Actions — Representative Proceedings,” above note 18 at 213.

30 This would, of course, depend on the availability of non-frivolous cases to be brought.

31 This assumes that the percentage method would result in the same percentage recovery in already commenced actions versus new actions.

32 This could result from a number of factors, not least of which would be the costs associated with financial distress (for example, insolvency proceedings), needing to raise capital by bank borrowing or on capital markets, etc. This would also be expected in “reverse auction” situations, discussed below.

33 *CPA*, above note 4. Sections 32 and 33 of the CPA provide:

32 (1) An agreement respecting fees and disbursements between a solicitor and a representative party shall be in writing and shall,
(a) state the terms under which fees and disbursements shall be paid;
(b) give an estimate of the expected fee, whether contingent on success in the class proceeding or not; and
(c) state the method by which payment is to be made, whether by lump sum, salary or otherwise.

(2) An agreement respecting fees and disbursements between a solicitor and a representative party is not enforceable unless approved by the court, on the motion of the solicitor.

(3) Amounts owing under an enforceable agreement are a first charge on any settlement funds or monetary award.

(4) If an agreement is not approved by the court, the court may,

(a) determine the amount owing to the solicitor in respect of fees and disbursements;
(b) direct a reference under the rules of court to determine the amount owing; or
(c) direct that the amount owing be determined in any other manner.

(5) A motion under subsection (4) shall be heard by a judge who has,

(a) given judgment on common issues in favour of some or all class members; or
(b) approved a settlement that benefits any class member.

(6) Where the judge referred to in subsection (5) is unavailable for any reason, the regional senior judge shall assign another judge of the court for the purpose.

(7) On the motion of a solicitor who has entered into an agreement under subsection (4), the court,

(a) shall determine the amount of the solicitor’s base fee;
(b) may apply a multiplier to the base fee that results in fair and reasonable compensation to the solicitor for the risk incurred in undertaking and continuing the proceeding under an agreement for payment only in the event of success; and
(c) shall determine the amount of disbursements to which the solicitor is entitled, including interest calculated on the disbursements incurred, as totalled at the end of each six-month period following the date of the agreement.
only an enhanced lodestar method (though it does not refer to it by this name), the CPA has been interpreted to implicitly authorize also the use of the percentage method.\textsuperscript{34} Thus, in theory and in practice, the CPA framework as it stands now is receptive to both an enhanced lodestar method and the percentage method of compensating class counsel.

Section 32 of the CPA provides, \textit{inter alia}, that agreements regarding fees will only be enforceable if approved by the court. It is necessary but not sufficient for approval that fee agreements:

(i) be in writing;
(ii) state the terms under which fees and disbursements shall be paid;
(iii) give an estimate of the expected fee, specifying whether it is contingent on success in the class proceeding or not; and
(iv) state the method by which payment is to be made, whether by lump sum or otherwise.

If an agreement regarding fees is not approved by the court under subsection 32(2), then pursuant to subsection 32(4) the court may substitute at its discretion what it regards as appropriate remuneration. This remedial discretion to substitute whatever fee the court regards as appropriate is a powerful one. It is frequently used. Nevertheless, the CPA itself provides little guidance on how courts should determine an appropriate fee.

Subsection 33(1) of the CPA explicitly approves of contingency fee arrangements between class counsel and representative plaintiffs, overcoming legal constraints which would otherwise preclude the use of contingent fee arrangements.\textsuperscript{35} Subsection 33(4) provides for the use of an enhanced lodestar method for determining appropriate fees for class counsel, whereby on a motion by class counsel the court may apply a “multiplier”\textsuperscript{36} to class counsel’s “base fee.”\textsuperscript{37} Any motion under subsection 33(4)

\begin{flushright}
5 Subsection (1) states that it applies notwithstanding both the Solicitors Act and An Act Respecting Champerty.
6 According to subsection (), the term “multiplier” means “a multiple to be applied to a base fee.”
7 According to subsection 33(3), the term “base fee” refers to “the result of multiplying the total number of hours worked by an hourly rate.” Subsection 33(8) requires the “base fee” to be “reasonable.”
\end{flushright}
is typically heard by a judge who has given judgment on common issues in favour of class members or approved a settlement benefiting any class member. Upon a motion by counsel, the court is obliged to determine counsel’s base fee, consider applying a multiplier resulting in fair and reasonable compensation to the lawyer for the risk incurred where payment is contingent upon success, and determine appropriate disbursements.

Given that contingency fees have been allowed by Ontario courts on both the lodestar and the percentage approaches and that many retainer agreements between class counsel and representative plaintiffs provide for fees determined on a percentage basis, it is perhaps surprising that Ontario judges frequently exercise their discretion under subsection 32(4) and proceed to follow the approach provided for in section 33 of the CPA (that is, determine the base fee and then apply a multiplier). Accordingly, it is worthwhile outlining how courts have approached the two-step process of determining the appropriate base fee and the appropriate multiplier in each case.

There are many factors that courts have concluded should be taken into consideration in deciding on the base fee. In an early case brought under the CPA, Sharpe J. in Windisman v. Toronto College Park Ltd. found that the factors that typically go into determining appropriate fees in the provision of legal services generally should also be applied in the context of determining the base fee under the CPA. Sharpe J. (as he then was) outlined the relevant, “usual factors” as:

(a) the time expended by the solicitor;
(b) the legal complexity of the matters to be dealt with;
(c) the degree of responsibility assumed by the solicitor;
(d) the monetary value of the matters in issue;
(e) the importance of the matter to the client;
(f) the degree of skill and competence demonstrated by the solicitor;
(g) the results achieved;
(h) the ability of the client to pay; and

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38 Subsection 33(5). Where the judge referred to in subsection 33(5) is unavailable, another judge of the court will be assigned.
39 Subsection 33(7)(a).
40 Subsection 33(7)(b). The court may also consider the manner in which counsel conducted the proceeding in determining the multiplier to be applied: subsection 33(9).
41 Subsection 33(7)(c).
(i) the client’s expectation as to the amount of the fee.\textsuperscript{43}

These “usual factors” originated in the 1985 decision of the Ontario Court of Appeal in \textit{Cohen v. Kealey & Blaney}.\textsuperscript{44} This list of factors clearly gives considerable discretion to judges to determine the appropriate base fee. There is no guidance provided about how to assign relative weights to the various factors, nor is there any methodology provided about how to assess independently each of the various criteria. Nevertheless, this list may be as precise as can be expected, given the wide variety of legal services provided and the array of circumstances that might give rise to reasonable claims to reduce or increase rates charged. In this regard, it is noteworthy that in considering the application of the lodestar method in the American context, similar factors have been identified as relevant in arriving at an appropriate base fee.\textsuperscript{45} And despite the vague guidance provided and the long list of factors, the determination of the appropriate

\textsuperscript{43} \textit{Ibid.} at para. 8.

\textsuperscript{44} \textit{Cohen v. Kealey & Blaney} (1985), 26 C.P.C. (2d) 211 (Ont. C.A.). In delivering judgment for the court, Robins J.A. stated: “The Taxing Officer properly listed the considerations normally applicable to the taxation of a solicitor’s account, namely, the time expended by the solicitor, the legal complexity of the matters to be dealt with, the degree of responsibility assumed by the solicitor, the monetary value of the matters in issue, the importance of the matter to the client, the degree of skill and competence demonstrated by the solicitor, the results achieved, the ability of the client to pay and the client’s expectation as to the amount of the fee.”

\textsuperscript{45} For example, twelve such factors were identified by the 5th Circuit in \textit{Johnson}, above note 24 at 717–19:

(1) The time and labor required.
(2) The novelty and difficulty of the questions.
(3) The skill requisite to perform the legal service properly.
(4) The preclusion of other employment by the attorney due to acceptance of the case.
(5) The customary fee.
(6) Whether the fee is fixed or contingent.
(7) Time limitations imposed by the client or the circumstances.
(8) The amount involved and the results obtained.
(9) The experience, reputation, and ability of the attorneys.
(10) The “undesirability” of the case.
(11) The nature and length of the professional relationship with the client.
(12) Awards in similar cases.

The court stated that the factors were consistent with those recommended by the American Bar Association in Ethical Consideration 2-18, Disciplinary Rule 2-106, of its \textit{Code of Professional Responsibility}. 
base fee does not appear to have been a particularly significant challenge in the context of class action litigation in Ontario. 6

Although determining the appropriate base fee does not appear to have been overly challenging for Ontario courts in most class action cases, identifying the appropriate multiplier has been more difficult. At the Ontario Court of Appeal in Gagne v. Silcorp Ltd., Goudge J.A. remarked that, “the selection of the precise multiplier is an art, not a science.” 7 This is undoubtedly true, given the range of factors relevant to appropriately rewarding risk-taking by class counsel and for assessing the quality of the results achieved for the class members. 8 However, the fact that selecting a multiplier is more of an art than a science does not mean that there is nothing to be learned from analyzing what courts have done in selecting multipliers and approving fees of class counsel. If anything, it strengthens the case for looking for guidance both from theory and from current practice.

The following table summarizes twenty-seven Ontario class actions in which fees have been approved, beginning in 1996. 9 One of the decisions is of the Court of Appeal. 50 Notably, ten of the decisions are by Justice Warren K. Winkler and seven by Justice Peter Cumming. More recently, it appears that Justice Maurice Cullity has been particularly active in presiding over class actions, though he was responsible for just one of the twenty-seven cases reported in the following table. 51

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46 A number of reasons might be given, but probably the most compelling is that there is a market for legal services which can be referred to in determining rough benchmarks for pricing.


48 Interestingly, to the extent that the multiplier determination takes into account factors also considered in determining the base fee, there will be a tendency to over-emphasize certain factors. I thank my colleague Andrew Green for pointing this out.

49 This is not a random sample; it is an unscientific list of cases reported on Quicklaw in which fees approval is addressed.

50 Gagne, above note 47.

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<tr>
<th>Case</th>
<th>Citation</th>
<th>Approved Fees</th>
<th>Multiplier</th>
<th>Settlement</th>
<th>Fees as a Proportion of Settlement Value</th>
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<td>(1996), 30 O.R. (3d) 304</td>
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<td>[2001] O.J. No. 4073</td>
<td>$6,500,000</td>
<td>3.44</td>
<td>$260,000,000</td>
<td>2.50%</td>
</tr>
<tr>
<td>Alfresh Beverages v. Archer Daniels</td>
<td>[2001] O.J. No. 6028</td>
<td>$900,000</td>
<td>3.00</td>
<td>$6,112,000</td>
<td>14.73%</td>
</tr>
<tr>
<td>Sutherland v. Boots Pharmaceutical PLC</td>
<td>[2002] O.J. No. 1361</td>
<td>$616,822</td>
<td>1.97</td>
<td>$2,250,000</td>
<td>27.41%</td>
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<tr>
<td>Mondor v. Fisherman</td>
<td>[2002] O.J. No. 1855</td>
<td>$6,100,000</td>
<td>N/A</td>
<td>$85,000,000</td>
<td>7.18%</td>
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<tr>
<td>Fraser v. Falconbridge Ltd.</td>
<td>[2002] O.J. No. 2383</td>
<td>$750,000</td>
<td>1.40</td>
<td>$5,700,000</td>
<td>13.16%</td>
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<tr>
<td>Penton v. Parker Canada Holding Co.</td>
<td>[2003] O.J. No. 2253</td>
<td>$189,396</td>
<td>1.65</td>
<td>$757,582</td>
<td>25.00%</td>
</tr>
<tr>
<td>Burlton v. Royal Trust Corp. of Canada</td>
<td>[2003] O.J. No. 2168</td>
<td>$3,441,900</td>
<td>2.39</td>
<td>$33,876,000</td>
<td>10.16%</td>
</tr>
<tr>
<td>Gariepy v. Shell Oil Co.</td>
<td>[2003] O.J. No. 2490</td>
<td>$3,175,690</td>
<td>1.75</td>
<td>$30,500,000</td>
<td>10.41%</td>
</tr>
<tr>
<td>Bona Foods Ltd. v. Ajinomoto U.S.A., Inc.</td>
<td>[2004] O.J. No. 908</td>
<td>$1,000,000</td>
<td>2.90</td>
<td>$4,000,000</td>
<td>25.00%</td>
</tr>
<tr>
<td>McArthur v. Canada Post Corp.</td>
<td>[2004] O.J. No. 1406</td>
<td>$260,000</td>
<td>1.18</td>
<td>$1,500,000</td>
<td>17.33%</td>
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<tr>
<td>Hislop v. Canada (Attorney General)</td>
<td>[2004] O.J. No. 1867</td>
<td>$14,723,290</td>
<td>4.80</td>
<td>$81,000,000</td>
<td>18.18%</td>
</tr>
<tr>
<td>Wilson v. Servier Canada Inc.</td>
<td>[2005] O.J. No. 1039</td>
<td>$10,000,000</td>
<td>1.83</td>
<td>$40,000,000</td>
<td>25.00%</td>
</tr>
<tr>
<td>Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.</td>
<td>[2005] O.J. No. 1117</td>
<td>$15,000,000</td>
<td>2.78</td>
<td>$100,000,000</td>
<td>15.00%</td>
</tr>
<tr>
<td>Kerr v. Danier Leather Inc.</td>
<td>(2005), 76 O.R. (3d) 60</td>
<td>$2,200,000</td>
<td>1.83</td>
<td>$14,100,000</td>
<td>15.60%</td>
</tr>
<tr>
<td>Nantais v. Easyhome Ltd.</td>
<td>[2005] O.J. No. 5805</td>
<td>$750,000</td>
<td>3.40</td>
<td>$7,813,000</td>
<td>9.60%</td>
</tr>
<tr>
<td>Toevs v. Yorkton</td>
<td>[2006] O.J. No. 538</td>
<td>$650,000</td>
<td>&lt; 1.00</td>
<td>$2,600,000</td>
<td>25.00%</td>
</tr>
</tbody>
</table>
The summary statistics which can be gleaned from these twenty-seven class actions are revealing. The average approved fee for class counsel in the twenty-seven class actions was $3.06 million, with a median of $900,000. An average significantly above the median indicates the presence of some fee awards on the high side which increase the average disproportionately, which is confirmed by the fee awards of $20 million in Parsons v. Canadian Red Cross Society,52 $14.7 million in Hislop v. Canada,53 and $15 million in Vitapharm v. F. Hoffman-La Roche Ltd.54

The average approved multiplier in the twenty-seven cases was 2.48, with a median of 2.74. The fact that the average multiplier is lower than the median suggests that the distribution is skewed towards the lower end — that is, towards 1.00. The average multiplier suggests that judges (at least implicitly) regard the weighted average probability of success for each hour spent by class counsel on each class action to be approximately 40 percent. The true implicit weighted average probability of success is likely somewhat higher once factors such as the time value of money, work to be done post-approval that will not be separately compensated, and some (possible) allowance for risk are taken into account. It is not at all obvious how to estimate the magnitude of these other factors, though a rough estimate might be that the weighted average probability of recovering fees for each hour worked is probably closer to 50 percent. It would be an interesting empirical exercise to see whether this implicit estimation of risk is consonant with the experience of seasoned class counsel; apart from directly asking class counsel firms, there is no obvious source regarding the number of hours spent on failed suits.

As a percentage of the value of the settlement or award, class counsel fees averaged 14.85 percent, with a median of 14.73 percent.

<table>
<thead>
<tr>
<th></th>
<th>Approved Fees</th>
<th>Multiplier</th>
<th>Settlement</th>
<th>Fees/Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>$129,150</td>
<td>&lt; 1.00</td>
<td>$757,582</td>
<td>2.50%</td>
</tr>
<tr>
<td>25 percentile</td>
<td>$585,000</td>
<td>1.81</td>
<td>$2,250,000</td>
<td>10.00%</td>
</tr>
<tr>
<td>Median</td>
<td>$900,000</td>
<td>2.74</td>
<td>$7,813,000</td>
<td>14.73%</td>
</tr>
<tr>
<td>75 percentile</td>
<td>$3,441,900</td>
<td>3.00</td>
<td>$33,876,000</td>
<td>23.51%</td>
</tr>
<tr>
<td>High</td>
<td>$20,000,000</td>
<td>4.80</td>
<td>$785,000,000</td>
<td>28.85%</td>
</tr>
<tr>
<td>Average</td>
<td>$3,062,196</td>
<td>2.48</td>
<td>$49,833,389</td>
<td>14.85%</td>
</tr>
</tbody>
</table>

The correlation between approved fees and the value of the settlement is positive, and relatively high at +0.74. This indicates that as the value of the settlement increases, the value of the fees awarded to class counsel also increases quite reliably. The correlation between the value of the settlement and the percentage of the settlement accruing to class counsel in these twenty-seven cases is -0.22. This indicates that although approved class counsel fees do increase with the value of the settlement, they do not increase in proportion with the level of increase in the settlement amount. For example, if class counsel in two cases settled for $10 million and $20 million, respectively, we would expect to see class counsel in the second case receive a higher fee award than class counsel in the first case, but not twice as high. Curiously, too, the correlation between the multiplier used and the settlement is +0.31. This suggests that courts are more willing to award higher multiples when class counsel secures larger absolute settlements. It should be noted that percentage awards that vary inversely with settlement size exacerbate the structural problems which discourage lawyers from maximizing claim values, since the declining percentage take replicates the effect of a steeply progressive marginal tax rate on additional settlement funds. Finally, the correlation between the multiplier used and the percentage of the settlement awarded as fees is –0.235, which indicates some apparent cross-checking of enhanced lodestar awards with a percentage method.

In terms of comparative experience, it turns out that the fees awarded in Ontario class actions have been relatively modest. In the United States, fee awards in class actions average 21.9 percent of the amount recovered, as compared with approximately 15 percent in Ontario. This suggests that Ontario judges under the lodestar method have been approximately two-thirds as generous as their American counterparts in rewarding entrepreneurial lawyering. Other American results, such as a negative correlation between percentage of settlement awarded as fees and the size of the settlement, are consistent with the Ontario experience reported in Section E.  

55 This point will be taken up in Section E.  
This may, in part, account for the relatively low rate of class actions brought in Ontario as compared with the United States. The reluctance to reward entrepreneurial lawyering in Ontario may account for the observation of Marc J. Somerville and Francois Baril that, “[m]any Canadian class actions are in fact spin-offs of ongoing American litigation.” As spin-offs of American litigation, these cases are presumably much less risky than other potential class actions. If it is true that predominantly less risky class actions are being brought, this may suggest that lawyers are not confident that they will be rewarded sufficiently if they take on riskier cases. This may lead to a catch-22 in which class counsel do not take on particularly risky cases out of a belief that fees awarded will not sufficiently compensate for the risks run. If judges see less risky cases more frequently and grow acclimated to awarding low levels of fees, it may be more difficult to secure a higher multiplier or greater percentage of the recovery in a truly very risky class action. The conservatism of Ontario judges in assessing fees of class counsel is surprising given that the same two general gauges (amount of work done by class counsel, and the fees as a percentage of the settlement or award) are used by both American and Ontario courts in determining the reasonableness of fees. It is arguable that much of the downward bias in fees is due to the application of the lodestar method combined with the inevitable influence of hindsight bias, though it is difficult to explain why Ontario judges would be more susceptible to hindsight bias than American judges.

See Eisenberg & Miller, above note 56 at 28–29.
Marc J. Somerville & Francois Baril, “These Plaintiffs Have No Class: A Defendant's Perspective to Defeating or Avoiding Certification” (County of Carelton Law Association, paper presented at a conference on 2–3 November 2001, Château Montebello, Quebec).

In discussing the American approach to assessing the reasonableness of a proposed fee award, Bruce Hay makes the following observation, which is more or less consistent with the approach of Ontario courts: “Courts use two basic methods to test the ‘reasonableness’ of a proposed fee award to class counsel for negotiating a class settlement. The first is to examine the counsel’s fee in relation to the amount of work he did (the time he spent) on the case. Courts disallow proposed fees that, in their view, give the counsel an excessive return on their investment in the case. The second method is to examine the counsel’s fee in relation to the class’s recovery in the settlement. Courts disallow proposed fees that, in their view, give counsel an excessive distributive share of the total amount paid by the defendant to settle the case.” Bruce L. Hay, “Asymmetric Rewards: Why Class Actions (May) Settle for Too Little” (1997) 48 Hastings L.J. 479 at 489.

On the hindsight bias generally, see Baruch Fischhoff, “Hindsight/Foresight: The Effect of Outcome Knowledge on Judgment under Uncertainty” (1975)
It bears mentioning in concluding this discussion of actual practice of judges in awarding fees in Ontario class actions over the past ten years that the fears frequently expressed in the past and even the recent past regarding the likely chilling effect of adverse costs awards in favour of defendants against representative plaintiffs have not been fully borne out. In *Joanisse v. Barker*, Cullity J. addressed the issue of costs awards against representative plaintiffs, mentioning that for incentive reasons, there should in many cases not be adverse costs awards against representative plaintiffs. Nevertheless, Cullity J. suggested that whether there should be a costs award in favour of a successful defendant is to be determined under subsection 31(1) of the *CPA*, which in turn requires consideration of subsection 131(1) of the *Courts of Justice Act*, and whether the “class proceeding was a test case, raised a novel point of law or involved a matter of public interest.” In addition, Cullity J. in a later decision has remarked,


62 According to the Ontario Law Reform Commission in its *Report on Class Actions*, above note 10 at 663, “the matter of costs will not merely affect the efficacy of class actions, but in fact will determine whether this procedure will be utilized at all … It is… the view of the commission that, if the expanded class-action procedure is to be utilized at all, the present costs rules cannot continue to apply. Accordingly, we recommend that actions brought under the proposed class actions Act should not be governed by the costs rules that govern individual actions brought in the Supreme Court of Ontario and the county and district courts.” See also the *Report of the Attorney General’s Advisory Committee on Class Action Reform*, above note 15 at 13, where it was recommended that, “assistance through a ‘Costs Assistance Fund’ should be provided to absent plaintiffs with disbursements, the costs of experts and such expenses as notice to the class. In addition, the Fund should stand ready to indemnify a plaintiff for the defendant’s costs if the action is unsuccessful.”

63 See, for example, Watson, above note 28 at 274–77.


65 Compelling economic analysis suggests that this is almost certainly the appropriate approach. Donald N. Dewees, J.R.S. Prichard, & Michael J. Trebilcock, “An Economic Analysis of Cost and Fee Rules for Class Actions” (1981) 10 J. Legal Stud. 155 at 182, where the authors report that, “in order to encourage significant amounts of class litigation it is necessary to protect the class representative against the cost of his lawyer’s fees if the suit fails and against all other downside risks.”


Other considerations that have been regarded as relevant are the objectives of the C.P.A., including, in particular, that of access to justice where individual proceedings would be prohibitively uneconomic or inefficient ... I did not find that the goal of access to justice would justify certification of the proceedings. This does not exclude, as a legitimate costs consideration, the possible “chilling effect” on access to justice in other cases of a costs order against a plaintiff who did not succeed in obtaining an order for certification that was probably essential to the initiation of any proceeding to obtain even the declaratory and injunctive relief that the plaintiff sought ... To the extent that awards of costs may act as a deterrent to proceedings brought to achieve this objective they will tend to defeat two of the objectives of the legislation.68

This reasoning is persuasive. From an incentive perspective, costs awards against representative plaintiffs should not be made unless it is clear that the suit was brought frivolously or vexatiously.69 Additional developments in this direction would be salutary.

D. SHORT-TERM RECOMMENDATIONS: APPLYING SECTIONS 32 AND 33 OF THE CPA

There is little reason to expect that judicial oversight will be effective in curtailing fee-related misconduct.70 Judges generally lack the full complement of information which would be required to make a sound decision as to whether a particular fee should be approved. Nevertheless, the current CPA demands that judges approve all settlements and fee agreements. Probably one of the best short-term recommendations for judges considering the approval of fees under the current CPA is for judges to regard the retainer agreements entered into by class counsel as presumptively valid, unless there is reason to believe that the retainer agreement does not provide for reasonable compensation for class counsel. These agreements typically provide for the percentage method of compensation. Courts should be somewhat reluctant to conclude that retainer

68 Ibid. at para. 10.
69 This is the approach taken in British Columbia. See Watson, above note 8 at 7.
agreements are not reasonable *ex post*, largely because the benefit of hindsight will tend to make success seem more likely that it actually was at the outset.\textsuperscript{71} If in fact a retainer agreement yields a fee that is unreasonably high or low, it is only then that judges should apply the enhanced lodestar method. In this event, judges should closely examine the time spent by class counsel over the lifespan of the litigation, paying particular attention to the amount of time spent as the settlement approached. If many of the hours spent by class counsel were back-loaded, this suggests that they should be given a relatively low multiplier, since they would have been relatively low-risk for class counsel.

In addition to the enhanced lodestar method encouraging class counsel to work harder (and, importantly, not necessarily smarter), it gives both class counsel and defendants increasing incentives to settle as the case goes on. Class counsel has an incentive to settle, but not too fast, because in all probability they will receive a multiple of the value of the time spent on the action. Likewise, defendants have an incentive to allow class counsel to build up a significant sunk investment in the case because class counsel will then become increasingly desperate to settle, and this desperation will increase the bargaining power of the defendant, which (all else the same) will result in a lower settlement. More specifically, based on the experience so far in Ontario, self-interested class counsel will become particularly driven to settle at the point where the base fee multiplied by a typical multiplier of say, 2.5, amounts to 15–25 percent of the settlement offered by a defendant. At this point, the question for class counsel will be whether they will be able to profitably hold out for a higher settlement yielding more hours that will be remunerated at 2.5:1, or whether they would be better served by investing their scarce time elsewhere. In contrast, defendants do not want to make an offer too early, because class counsel will be unlikely to accept the offer if they have not yet accumulated a sufficient reserve of time invested in the case with which to apply a multiplier. Even the highest possible multiplier, say 5, applied to a small number of hours could result in class counsel earning nowhere near 15 percent of the settlement value in an average class action. Thus, even in the absence of explicit collusion between class counsel and defendant there may be the appearance of collusion simply because of the nature of the incentives facing both class counsel

\textsuperscript{71} See above, note 61 on the hindsight bias generally. See also, Silver, “Class Actions — Representative Proceedings,” above note 18 at 229.
and defendants. Based on a median fees award of about $900,000, and a median multiplier of 2.74, and assuming an average billing rate of $400 per hour, under the enhanced lodestar method one would expect the median class action to settle at the point at which class counsel has invested around 800 hours of ordinarily billable time in a given case.

Certain judges have by now developed considerable experience with class actions (for example, in Ontario Chief Justice Warren Winkler and Justice Peter Cumming have decided collectively approximately half of the class actions in the sample and, more recently, Justice Maurice Cullity has been very active). Judicial oversight of fees in Ontario has been uneven so far, however, largely because judges do not have sufficient information regarding the true risks run by class counsel to make considered decisions on fees, and also because judges do not have sufficient incentives (or time, for that matter) to fully investigate all the factors that would be necessary in order to reach a completely informed or critical decision on fees. To the extent that judges do have access to relevant information, it is mostly provided by class counsel and defendants. One would reasonably expect that the information, even when it is complete and accurate, will be presented to the court in a way that puts class counsel and defendants in the best possible light.

In addition, since Ontario judges frequently face significant workloads, it is probably not entirely realistic to expect them to spend inordinate time on matters that have been settled pending approval, especially given the strong policy arguments in favour of encouraging settlement.

For a discussion of this and related points, see Coffee, “Understanding the Plaintiff’s Attorney,” above note 23 at 717–18.

Assessing whether this is the case would be a fruitful avenue for future work.

See Silver, “Class Actions — Representative Proceedings,” above note 8 at 216.

Indeed, in light of the incentives for class counsel and defendants alike in securing settlement approval, one can scarcely imagine any other outcome. In addition, regardless of pecuniary incentive, self-serving biases are common and would lead to the same result. On this self-serving bias, see generally Dale T. Miller & Michael Ross, “Self-Serving Biases in the Attribution of Causality: Fact or Fiction” (1975) 82(2) Psychol. Bull. 213; and Miron Zuckerman, “Attribution of Success and Failure Revisited, or: The Motivational Bias is Alive and Well in Attribution Theory” (1979) 47(2) J. Personality 245.

Consider this observation from Amoco Canada Petroleum Co. v. Propak Systems Ltd. (2000), 200 D.L.R. (4th) 667 at 677 (Alta. C.A.): “In these days of spiralling litigation costs, increasingly complex cases and scarce judicial resources, settlement is critical to the administration of justice.”
In addition to the problems associated with the enhanced lodestar method of determining class counsel fees more generally, judges should be aware of a number of other incentives class counsel and defendants have to manipulate settlements to their mutual advantage. One of these incentive-related problems is the possibility of a reverse auction, which can arise when there are parallel proceedings concerning the same defendant and issues.\(^77\)

Even if there is no reverse auction issue, another potential strategy which favours class counsel and defendants alike (at the expense of class members)\(^78\) involves arriving at a settlement that offers coupons and other non-cash settlements to class members and a substantial fee recovery, typically in cash, for class counsel.\(^79\) The economic value of coupon/in-kind relief is difficult to gauge, especially when coupons are not transferable, and the value is frequently overestimated by experts called by class counsel. Because fees are typically assessed (at least in part) on the basis of the claimed value of settlement, a fee agreement that appears to be reasonable when compared with the face value of the coupons or in-kind settlement will frequently result in class counsel fees that are out of touch with the actual value of the settlement for class members.

Another problem to be alert to is a strict set of conditions restricting class members from claiming benefits under a proposed settlement, particularly when the unclaimed portion of the settlement fund will revert to the defendants. This issue, as well as the coupon/in-kind relief problem, can be addressed by allowing class counsel to recover fees only on the basis of the settlement value actually distributed to class members.\(^80\) Under the enhanced lodestar method, this sort of contingency is more difficult to justify; however, as I will explain below, combined with the other recommendations it would constitute a significant improvement over the administration of sections 32 and 33 of the CPA.

In applying sections 32 and 33 of the CPA, judges should be more aware of the weaknesses of the enhanced lodestar method of compensating class counsel. As demonstrated in Section C, as it has been applied

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80 This was the recommendation of a RAND study of class actions. See Deborah R. Hensler et al., Class Action Dilemmas: Pursuing Public Goals for Private Gain (Santa Monica, CA: RAND Institute for Civil Justice, 1999) at 32.
in Ontario over the past ten years, the enhanced lodestar method has resulted in compensation rates that are just two-thirds as generous as the compensation of class counsel in American class actions, where the recovery rate has been on average about 21.9 percent of settlement values. While one may question whether the average American recovery rate is the appropriate benchmark, the disparity in the figures along with the much richer experience with class actions in the United States suggests that the disparity cannot reasonably be dismissed out of hand. In my view, there are two short-term recommendations that judges should consider in exercising their discretion under sections 32 and 33 of the CPA.

The first recommendation is to de-emphasize the use of the enhanced lodestar method in determining the compensation of class counsel. In most Ontario class actions, the retainer agreement between class counsel and representative plaintiffs provides for a contingency fee calculated on a percentage of the settlement or judgment. Unless a case can be mounted for regarding this agreement as unsuitable, compensation at the rate agreed to by the representative plaintiff should be the court's starting point in deciding a “fair and reasonable fee.” First and automatic resort should not be made to the base fee and multiplier method, because of the considerable incentives class counsel and defendants have for tacit collusion in allowing class counsel's base fee to rise to a level conducive to settlement, and the inefficiencies this engenders. If this recommendation is taken up, and the percentage method (if agreed to by the representative plaintiff and class counsel) is specified in the retainer agreement, there are four specific concerns judges should consider. First, the court should examine whether there is any reason to think that the compensation provided for by the retainer agreement does not represent a fair and reasonable return to class counsel given what was known ex ante about the strength of the case, the costs of making the case, and the likelihood of success. This may be a difficult determination to make, but however imperfect it is apt to be, it is necessary. Second, the court should consider whether the settlement takes the form of coupons or in-kind relief. If so, the court should discount the judgment appropriately. Third, if there is a reversionary interest of the settlement fund to the defendant, then the court should allow class counsel to recover the stated percentage only of the amount actually distributed to class members. Finally, the court should be attuned to the incentives class counsel have under the percentage method for premature settlement. If it appears that class counsel has settled too quickly for an amount lower than what one might reasonably
consider to be the value of the claims of the class members, then the enhanced lodestar method might be more appropriately used than the percentage method (assuming the percentage method is provided for in the retainer agreement).

The second recommendation is that if, for whatever reason, the enhanced lodestar method is used, courts should pay attention to the lifecycle of a given suit. More specifically, it is unlikely that all hours over the course of a given class action should be rewarded with the same multiplier. Courts should attempt to identify “litigation landmarks” (such as certification of the class) and award different multipliers to hours at different stages of the litigation to reflect changing risks. Of course, this is inexact and apt to be difficult, but the basic insight is that there is some reason to think that pre-certification hours are more risky than serious settlement negotiation hours. If class counsel comes to expect that hours spent early on will attract a multiple, whereas hours spent later in the litigation will not attract a multiple, then there will be a significantly lessened incentive on the part of class counsel to spend considerable additional time on an “all but settled” case. To operationalize this safeguard, judges would simply have to draw on their expertise to identify key dates at which the riskiness of the suit either increased or decreased significantly and award higher or lower multiples to different blocks of time as appropriate. The most obvious abuse of the lodestar method and the lifecycle of an action relates to hours worked on the eve of settlement. Post-approval hours that are unlikely to be compensated separately, to the extent that they are taken into account at all, should not be awarded any multiplier for the same reason.

E. LONG-TERM RECOMMENDATIONS:
CRAFTING A NEW SOLUTION

1) The First-Best Solution: A Description of the Theoretical Ideal

Rational class counsel will not expend more resources than they can hope to recover from defendants. Thus, they are unlikely to incur costs exceeding 30 percent of the amount claimed from the defendant, since this is the maximum amount they can reasonably hope to recover. Under

81 This will be difficult, particularly in settlement class actions where certification and settlement approval are sought simultaneously, but getting a sense of the distribution of time spent will remain informative.
the enhanced lodestar method, and assuming an average multiplier of 2.5 or 3 and the presence of not insignificant disbursements, class counsel would be unwise to spend more than about 10 percent of the amount at stake. By contrast, defendants will rationally spend up to and perhaps more than the amount at stake. It would be surprising if this sort of systematic asymmetry in stakes of this kind did not have an effect on results of class litigation. To devise the most efficient solution possible, among other things, this persistent asymmetry of stakes between class counsel and defendants must be adequately addressed.

An optimal solution to the challenges posed by class litigation will eliminate agency costs. Agency costs are costs that are associated with keeping an agent (in this case class counsel) loyal to the principal (in this case, members of the class). Agency costs can be understood as coming in three varieties: (i) monitoring costs; (ii) bonding costs; and (iii) the costs of self-dealing which cannot be cost-effectively deterred. There is good reason to believe that market discipline is ineffective at containing agency problems in the context of class actions. For one thing, class members have little or no control over class counsel (and generally have little incentive to exercise that control, since the stakes per class member are frequently so small). Class members cannot sell their claims, absent specific statutory approval, because of long-standing prohibitions against champerty. Moreover, there is nothing like the market for corporate control, pursuant to which poorly performing class counsel can be bought out by more effective class counsel.

The search for an agency costs minimizing approach to class counsel compensation must necessarily extend beyond the enhanced lodestar method and the percentage method. Both are associated with significant agency costs, not least because they rely on external monitoring by judges to ensure that any abuses by class counsel have not been egregious which is costly and imperfect. The enhanced lodestar method is suboptimal because it results in incentives for class counsel to prolong cases and delay settlement so as to pad the bill, especially when there is a prospect

82 Defendants may spend more than the amount at stake to defend if they are attempting to establish or maintain a reputation for fiercely contesting claims. On this asymmetry of stakes, see Silver, Class Actions — Representative Proceedings,” above note 18 at 218–19.


84 On this entrenched position of class counsel, see Silver, “Class Actions — Representative Proceedings,” above note 18 at 219–20.
of receiving a multiple of the base fee as there is under the CPA (but only to a point, as explained earlier). Conditional on reaching a settlement, the lodestar method transfers money from class members to class counsel whenever the class counsel works longer, with few constraints imposed on the quality of the work done. The percentage method, on the other hand, typically gives incentives for premature settlement because compensation is more or less invariant with respect to the investment of time and effort in a case.\(^85\)

The first-best solution to the conflict between class counsel and class members with respect to fees would be to devise a system that would eliminate the need for monitoring entirely; the best system would be one in which class counsel would have an independent, self-interested incentive to maximize the net benefit of class actions. This is precisely the approach advocated by John C. Coffee Jr., who has written, “In light of the lodestar formula’s deficiencies, it is worth asking what other alternatives can be imagined. An economic answer might be to eliminate the principal-agent relationship entirely by permitting the plaintiff’s attorney to acquire all the client’s rights in the action.”\(^86\) That is, the first-best solution would be one in which judicial monitoring is not necessary because there is no class member-class counsel relationship to monitor. One straightforward way to do this would be to allow class counsel to compete with each other at auction to purchase outright the rights of class members at auction.\(^87\) If there is a sufficiently capitalized and well-informed pool of class counsel, the price at auction paid to the class members will approximate the net present value of the settlement or monetary award they could expect if they had themselves pursued the action. After having purchased the rights to pursue the class action, the successful counsel would then be the residual claimants, which would give them the incentive to ensure that they make cost-justified decisions

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86 Coffee, “Understanding the Plaintiff’s Attorney,” above note 23 at 691.

87 A recent article has taken up this possibility and described it as “highly unrealistic.” See Alon Harel & Alex Stein, “Auctioning for Loyalty: Selection and Monitoring of Class Counsel” (2004) 22 Yale Law & Policy Rev. 69 at 71.
in pursuing the action. There would be little or no reason to expect the lawyer-owner of the class action to be biased towards an early (or late) settlement, to over or under-invest in experts, or to spend inefficient amounts of time pursuing the action.

There are many practical constraints frustrating the realization of the theoretical optimum. The primary economic problem is that the amount of financial capital necessary to buy out all the members of a class would in many cases be so significant that few law firms would be capable of financing the purchase of a significant class action. Even if there were several law firms that could stretch to afford to purchase a medium-sized class action, there would still be problems of risk aversion that would be acute because class counsel are often from small firms with limited resources. There are, however, other ways that the problems associated with selling class actions could be handled. For instance, insurance companies or other financial intermediaries with deep pockets might buy the suits and thereby diversify the risks. Even if this were successful, however, diversifying the risk would replace one type of agency problem with another. The problem would persist in another form because if an insurance company or other financial intermediary had purchased the suit, then as employees the lawyers prosecuting the case would still not bear the full costs and reap the full benefits of decisions relating to the suit.

There would also be issues surrounding transaction costs and collective action problems. To put a class action on the block to be sold, an auctioneer would have to contact all the class members to determine their reservation prices which, even if it were possible, would present an essentially insurmountable collective action problem in most cases involving a large number of class members. It might be possible to introduce a scheme to essentially force class members to accept a pro rata portion of an auction of their claim (perhaps subject to opt-out), but even in this case, it would be extremely challenging to divide the auction proceeds in a way that is consistent with the size and strength of class members’ claims.

Finally, there are apt to be significant and acute information asymmetries in the market for class actions that require significant investment to overcome. For example, a representative plaintiff might have a vague

88 Nevertheless, it might be easier to find an incentive-compatible way to solve this problem in the context of an employment relationship.

sense of the extent of provable losses, but without hiring experts, going through discovery, and investing generally in additional information about the extent of compensable losses, the class action might not be very marketable. And, to the extent that there will only be an incentive for classes with relatively weak cases to sell because of the non-verifiability of the strength and hence value of a class action without significant investment on the part of would-be buyers, one might expect the market for class actions to be a typical type of lemons market. If it is true that a market for class actions would be a lemons market, then because verifying quality of class actions put up for sale would be difficult and costly (if possible at all), one would expect predominantly weak cases to be sold. This would, unfortunately, be a self-fulfilling expectation.

Thus, there are at least four sets of difficulties associated with the first-best solution of selling class actions: (i) capital market imperfections which make borrowing to finance the purchase of class actions extremely difficult; (ii) complications with risk-spreading and the consequent persistence of agency problems; (iii) collective action and hold-out problems among members of the class; and (iv) acute informational asymmetries giving rise to a market for lemons. Unless each of these difficulties can be effectively overcome (and it is reasonable to remain extremely skeptical), then it is unlikely that the sale of class action claims will constitute a feasible and administrable solution for what ails class actions for the foreseeable future.

2) A Variety of Second-Best Ideas

If the first-best approach is unlikely to be feasible, what else should be considered? There is some empirical evidence showing that class actions tend to settle for too little. The predictable result is under-compensation of the class members, and under-deterrence of undesirable conduct.

90 The seminal article on the role of informational asymmetries in markets which coined the phrase “the market for lemons” earned George Akerlof the Nobel Prize for Economics. See George A. Akerlof, “The Market for ‘Lemons’: Quality Uncertainty and the Market Mechanism” (1970) 84 Q. J. Econ. 488.

91 If sellers know they have a high quality class action but also that this is not verifiable by the market, they will prefer (in many cases) to pursue the action rather than sell, which reinforces the market’s expectations.

by potential defendants. To help combat this tendency to settle for too little, Coffee has made the following arguments: “[T]he law could make greater use of multiple damage formulas, or award substantially higher fees or prejudgment interest on such fees. More to the point, courts could employ a marginally increasing percentage of the recovery fee formula.”

Coffee thus makes two proposals. The first is to award multiple damages in successful class actions. Under a percentage fee, the damages multiplier necessary to result in class counsel effectively receiving the full settlement is determined by the inverse of the contingency percentage. For example, if class counsel expects to receive 25% percent of a settlement or judgment, then a multiplier of the settlement or judgment of 4.0 will allow class counsel to fully internalize the benefits of increasing a settlement for class members. However, such a regime may over-deter defendants, since defendants will anticipate that they will have to pay 4.0 times as much in damages as they would under a conventional damages rule. This potential over-deterrence is apt to be economically inefficient (unless the acts themselves are per se inefficient or there are other factors leading to under-deterrence).

Coffee's second proposal is to award a marginally increasing percentage of the award. The findings of Section C demonstrated that Ontario fee awards represent a declining marginal proportion of the settlement value as the settlement value increases, an empirical finding that holds also in the United States. This suggests that Ontario judges would be extremely uncomfortable with the suggestion to award an increasing marginal percentage of settlements or judgments to class counsel, even if this were feasible. If the idea is understood as one consonant with ex post judicial approval of fees, one reason to doubt its feasibility is that

93 Silver, “Class Actions — Representative Proceedings,” above note 18 at 211.
94 Coffee, Understanding the Plaintiff's Attorney,” above note 23 at 725.
96 See, for example, the Clayton Antitrust Act, 5 U.S.C. § 5d (2000).
97 Eisenberg & Miller, above note 56 at 15.
judges have no way of assessing what the benchmark settlement should be. In other words, if a court is assessing fees on a proposed settlement, how can a court tell whether the “right” settlement amount was higher or lower than the settlement actually presented? Clearly, class counsel will have a strong incentive to argue that the settlement is on the high side of what would have been possible at trial, and that therefore they should receive a relatively high percentage of the settlement as fees. And if in response to this lack of a benchmark settlement the same marginal rate structure is imposed on all settlements regardless of size, it should be pointed out that the effective marginal rate will be less than the highest marginal rate (it will be some weighted average of the marginal rates appearing in the rate structure). This would tend to dampen the incentives class counsel would have to increase settlement values. On the other hand, if this is understood as being applicable only in instances in which a progressive percentage fee structure is decided upon ex ante, circumstances may change from the time a retainer agreement is entered into that make the action either more or less lucrative. If class counsel is rewarded (or penalized) based on exogenous events, even an ex ante progressive fee structure will not appropriately award the results obtained by class counsel. Moreover, also on this ex ante interpretation, there is little reason to expect representative plaintiffs to have a clear appreciation of what a “good” settlement is likely to be versus a “bad” settlement before discovery occurs and the real merits of the case become known. This is especially the case given the lack of legal expertise most representative plaintiffs are apt to have.

The question, “when are fee agreements best approved?” is not restricted only to the imposition of a progressive percentage fee.99 Ongoing debates surround whether fees should be approved ex ante (for example, at the certification stage or even before) so that class counsel can make decisions in reliance on a set fee arrangement, or whether it is better to keep class counsel unsure of the manner in which they will be compensated until after a settlement has been negotiated and approved. In its Manual for Complex Litigation (Fourth), the Federal Judicial Center suggests that it is generally preferable to have separate negotiation of class settlement and fees.100 However, the Manual for Complex Litigation

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99 See, for example, Watson, above note 8 at 8.

Plaintiffs’ Bar: Awarding the Attorney’s Fee in Class-Action Litigation” (1994) 23 J. Legal Stud. 185 at 204; and Eisenberg & Miller, ibid. at 27.
(Fourth) is silent on the question of whether fees should be approved afterwards or before settlement. In Ontario, the practice is generally to delay the matter of class counsel compensation until class actions settle. However, this means that class counsel must devote significant economic resources to a risky venture with no reliable guidance as to the expected return. Investors in risky undertakings do not typically endure such uncertainty without demanding handsome rewards. Investors usually know exactly how returns will be divided, even if as events play out there may be no returns to divide. It is reasonable to argue that courts ought to mimic the market in this regard. As mentioned above, because of the hindsight bias, the risk of losing will naturally seem smaller after a settlement has been reached than at the outset of class counsel’s representation. This problem nearly disappears when fees are set and approved before a settlement is reached. One straightforward solution to this problem would be to take more seriously (that is, consider presumptively fair and reasonable) retainer agreements between class counsel and representative plaintiffs.

F. CONCLUSION

At their best, class actions promote (1) judicial economy, (2) access to justice (that is, compensation), and (3) behaviour modification (that is, deterrence). Judicial economy results from many claims being automatically addressed through one action. Access to justice is improved if many claims that would otherwise not be economically viable are facilitated by the sharing of fixed litigation costs among many class members. Finally, class actions can achieve behaviour modification or deterrence because potential defendants can anticipate being held to account for imposing small damages on a diffuse group. In other words, the class action can force defendants to internalize externalities that they would otherwise ignore.

The class action also features a variety of difficult practical problems, as emphasized by the Supreme Court of Canada in Naken. Among the challenges are fashioning an incentive-compatible set of incentives for class counsel, combating the lack of market oversight, and overcoming

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101 It also introduces a new problem, however — that of a snap settlement, which was discussed above as a central issue with percentage of settlement awards.
102 This idea has already been addressed in some detail in Section D, above. Of course, this should remain only a presumption, for the reasons outlined above.
103 Naken, above note 8.
the disincentives for judicial policing of settlements and fee awards. The costs associated with these challenges, if not effectively managed, can exceed the benefits of class actions on account of underdeterrence of potential defendants and undercompensation of class members.

Nevertheless, there are certain strategies that judges can employ to improve the administration of the CPA as it currently stands. The foremost of these strategies is to give pride of place to retainer agreements between class counsel and representative plaintiffs, perhaps regarding them as presumptively fair and reasonable subject to identifiable market failures. This would naturally entail de-emphasizing the enhanced lodestar method of compensating class counsel, since many retainer agreements currently provide for a contingent percentage fee. And if the enhanced lodestar method is used, attention should be paid to various litigation landmarks, to ensure that appropriate multipliers are applied at each stage of the proceedings to reflect the risk that class counsel would have been operating under at that time. This is less desirable than enforcing retainer agreements, however, because it is still subject to considerable hindsight bias. Ideally, the best approach would be to allow class actions to be bought and sold in an active market. However, as described, there are at least four significant market failures which will need to be overcome to make this a feasible and administrable alternative.

Thus, the overriding recommendation of this article is for courts to resist the temptation to automatically adjust the fee arrangements made between class counsel and representative plaintiffs. This recommendation has two main advantages. First, a focus on the original fee arrangement may result in less biased fee awards because it reduces the impact of hindsight bias, which makes a settlement that has been reached appear to have been more likely than it in fact was at the outset. Second, a presumption in favour of the original agreement should also improve upon the set of incentives facing class counsel, because the enhanced lodestar method is fraught with problems and is difficult to administer, whereas the percentage method is probably less susceptible to abuse, and the abuse may be more detectable when it does in fact occur. If the enhanced lodestar method is applied, then in determining an appropriate multiplier, courts should attend to the varying risk profile of an action throughout time, attempting to assign appropriate multipliers at each point given the information available to class counsel at each juncture.