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Eleventh Circuit Breaks "New Ground" for Common Class Action Practice: Incentive Awards Banned by 1880s Supreme Court Precedent

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In a surprising opinion, the Eleventh Circuit politely pointed out that "The Emperor has no clothes." A common practice in class actions is for class representatives to claim and settling defendants to pay incentive awards. These are payments separate from the representative's individual recovery, recognizing the effort to serve as class representative in class actions. These awards vary from a few hundred to tens of thousands of dollars. However, they are almost always modest compared to the overall recovery to the class. These awards are often not contested, and are typically a nominal factor in settlement negotiations.

The Eleventh Circuit slammed the brakes on this long-standing and largely unquestioned practice. In *Charles T. Johnson v. NPAS Solutions, LLC*, Case No. 18-12344, September 17, 2020, the Court considered an objector's appeal of a settlement. Its opening line was prophetic:

The Class-Action settlement that underlies this appeal is just like so many others that have come before it. And in a way, that's exactly the problem. We find that, in approving the settlement here, the District Court repeated several errors that, while clear to us, have become common place in every day Class-Action practice.

The Court first considered the timing of the settlement process relating to objections and attorneys' fees, but saved its biggest punch for the second act, when it considered the $6,000 incentive payment to plaintiff, acknowledging his role in prosecuting the case on behalf of the class, when it said, "In so doing, we conclude, the Court ignored on-point Supreme Court precedent prohibiting such awards." With that introduction, the Court dove into Supreme Court precedent from the 1880's, immediately adding two cases to the mental libraries of class action practitioners by citing *Trustees v. Greenough*, 105 U.S. 527 (1882) and *Central Railroad & Banking Co. v. Pettus*, 113 U.S. 116 (1885). The Court noted that these Supreme Court decisions squarely prohibit "incentive awards" and noted that the award creates a conflict of interest between the class representative and other class members.

The Court reviewed the *Greenough* and *Pettus* decisions, noting that the seminal cases established the basic rule that attorneys' fees can be paid from a common fund. But the Court noted that the cases also established limits on the types of

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awards that attorneys — and litigants — can recover from the fund. "Because they seem to have been largely overlooked in modern class-action practice," the Court explained the cases in detail.

The *Greenough* case related to railroad bonds and required several years of litigation. The class representative had "bore the whole burden of this litigation" himself, and advanced most of the expenses. The issue at the heart of the 1882 Supreme Court case was a $2,500 payment for ten years of personal service to the class as representative, along with reimbursement of personal expenditures for railroad fares and hotel bills. (Our rough calculation of inflation from $2,500 in the 1880's equates to about $65,000 in today's dollars, which might capture a court's attention.) The Supreme Court rejected the class representatives' award of personal services and private expenses. The Court noted that the class representative was essentially a creditor like the rest of the class, and incentivizing the creditor to carry on the litigation could present "too great a temptation of parties to intermeddle in the management of valuable property or funds in which they have only the interest of creditors." The *Greenough* court upheld the award of attorneys' fees and litigation expenses, but rejected as without legal basis the award for "personal services and private expenses."

The Eleventh Circuit then discussed the *Pettus* case, which stood for the ground-breaking proposition that attorneys could recover fees out of the common fund. The *Pettus* court, however, also noted that the class representative's claim for reimbursement in the form of compensation out of the fund for his personal services and private expenses was "unsupported by reason or authority."

The Eleventh Circuit noted, "We take the rule of *Greenough*, confirmed by *Pettus*, to be fairly clear: a plaintiff suing on behalf of a class can be reimbursed for attorneys' fees and expenses incurred in carrying on the litigation, but he cannot be paid a salary or be reimbursed for his personal expenses." It then stated the unspoken: "It seems to us that the modern-day incentive award for a class representative is roughly analogous to a salary — in *Greenough's* terms, payment for 'personal services.'" And if that wasn't enough, the Court noted that modern-day incentive awards:

. . . present even more pronounced risks than the salary and expense reimbursements disapproved in *Greenough*. Incentive awards are intended not only to compensate class representatives for their time (i.e., as a salary), but also to promote litigation by providing a prize to be won (i.e., as a bounty).

The incentive award at issue in the case was found to be "part salary and part[y] bounty." (sic) The $6,000 was awarded because the class representative protected the interest of the class, spent considerable time pursuing their claims, frequently communicated with counsel, remained apprised of the matter, approved drafts before filing, and responded to discovery. According to the Eleventh Circuit, this was essentially compensation for his personal services spent by time litigating the case, which had been declared improper in *Greenough*.

The class representative argued to the contrary. He noted that the 1880's Supreme Court decisions predated the enactment of Federal Rule of Civil Procedure 23, to which the Eleventh Circuit responded: "So what," noting that Rule 23 says nothing about incentive awards. Next, the class representative — according to the Eleventh Circuit — "appeals to ubiquity"— arguing that incentive awards are routine in class actions, and that therefore 1880's Supreme Court decisions cannot possibly prohibit them.

The Court acknowledged that the awards are fairly common in class action cases. "But, so far as we can tell, that state of affairs is a product of inertia and inattention, not adherence to law. The uncomfortable fact is that 'the judiciary has created these awards out of whole cloth' and 'few courts have paused to consider the legal authority for incentive awards.'" The Court even likened incentive awards to dandelions on an un-mowed lawn, noting they are present more by inattention than by design. "Needless to say, we are not at liberty to sanction a device or practice, however widespread, that is foreclosed by Supreme Court precedent."

Given the dramatic statement made by the Eleventh Circuit, it is not surprising there was a dissent:

The majority takes a step that no other court has taken to do away with the incentive for people to bring class actions. For class actions, the class must be represented by a named plaintiff, who incurs costs serving in that role. Those costs may include time and money spent, along with all the slings and arrows that accompany present day litigation. By prohibiting named plaintiffs from receiving incentive awards, the majority opinion will have the practical effect of

requiring named plaintiffs to incur costs well beyond any benefits they receive from their role in leading the class. As a result, I expect potential plaintiffs will be less willing to take on the role of class representative in the future.

The dissent went on to cite various treatises and articles talking about the history of class representative incentive awards and noted that courts routinely scrutinize the fairness of the award to the named class representative. Dissents, however, are often written for future courts that consider the issue. That will certainly happen. The case itself will likely face appeal or reconsideration, particularly since there is a dissenting opinion. And, what other circuits do will be telling, potentially creating yet another circuit split in class action law. Will state courts follow suit? Will this truly squelch the willingness to serve of potential class representatives? Stay tuned for the next act(s).

If you have questions about this, contact your Lathrop GPM attorney.