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PANEL DISCUSSION

THE PRIVATE SECURITIES LAW REFORM ACT: IS IT WORKING?[1]

Hon. Edward R. Becker, Hon. Milton I. Shadur, Jill E. Fisch, Gregory P. Joseph, Melvyn I. Weiss, and Daniel J. Capra

PROF. CAPRA:[2] My name is Daniel Capra and I have the honor of occupying the Philip Reed Chair in Civil Justice and Law Reform. This Chair is named in honor of Philip Reed, a distinguished alumnus of the Law School. The goal of the Chair is to present public fora such as this, discussions and exchanges of ideas on important questions of civil law reform and ethical lawyering.

We are here today to present a panel discussion on some of the issues that have arisen under the Private Securities Law Reform Act, or PSLRA.[3] This Act was adopted in 1995 with the intent to reform the way that securities class actions had been brought and prosecuted by plaintiffs' class action lawyers.

Congress thought at that time, whether right or wrong, that the typical securities class action was one in which the stock went down, plaintiffs' class action lawyers found some unsuspecting shareholders to serve as lead plaintiffs, rushed to the courthouse to get named lead counsel, ran the action without consulting the lead plaintiffs—or anybody in the class—because they were not really involved, and then obtained a quick settlement for a gargantuan fee. That was the nightmare scenario of a lawyer-driven class action.

Congress wanted to change that model to one of what would be called a client-driven class action. The thought was that in securities class actions—as opposed to maybe other class actions, like mass torts—it would be possible to find a lead plaintiff with enough money at stake, enough sophistication, enough resources, so that that lead plaintiff would control the choice and performance of counsel, rather than the other way around, where the lawyer was controlling everything. That is the model of a client-driven class action. It is also

1. These were the panelists' remarks at The Philip D. Reed Chair Panel Discussion at Fordham University School of Law on February 5, 2002.

2. Philip D. Reed Professor of Law, Fordham University School of Law.

3. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.).

known—and probably will be referred to sometimes tonight—as the empowered plaintiff model.

The way the statute effectuates this empowered plaintiff model is to gauge the lead plaintiff's status basically by the amount of economic loss. The plaintiff with the largest economic loss is presumed to be the "most adequate lead plaintiff," so long as that plaintiff otherwise satisfies the requirements of Rule 23, specifically typicality and adequacy. So there is that presumption based on economic loss.

The PSLRA further provides that "the most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class,"[4] and that select-and-retain function will be discussed in detail tonight.

This PSLRA model of client-driven class actions has been tested in a number of securities cases, but never on a grander stage than in the *Cendant* litigation.[5] *Cendant* involved a merger of two major consumer services companies. The books of one of them had been "cooked," I guess that would be the way to put it, for a number of years, and after the merger Cendant made public announcements that previous financial statements had to be revised due to serious mistakes. Of course, the stock dropped precipitously. Shareholders lost about $20 billion in value. Many class actions were brought against Cendant and its accounting firm—that has some recent resonance as well, of course—and they were consolidated in New Jersey.

The district judge appointed a group of three institutional investors, headed by the California Pension Fund, also called CalPERS, as lead plaintiff on the basis of that group having the largest economic loss. CalPERS had already selected two law firms to prosecute the class action, negotiated a fee with those two law firms, and asked the trial judge, Judge Walls, to approve the selection of counsel and to approve the fee. But instead of appointing those firms and establishing that fee agreement as controlling, the court decided to hold an auction to determine who should prosecute the action as lead counsel.

The concept of an auction would be that the qualified law firm that gave the lowest fee would be awarded the action, with the wrinkle in that case being that counsel chosen by CalPERS would have a right of first refusal; they could match the lowest bid. And that is what happened; the CalPERS counsel, those two firms, matched the lowest bid.

The parties ended up reaching a settlement in the amount of $3.2 billion. Class counsel, pursuant to the fee percentage awarded in the

4. 15 U.S.C. § 78u-4(a)(3)(B)(v) (2000).

5. *In re* Cendant Corp. Litig., 109 F. Supp. 2d 235 (D.N.J. 2000), *aff'd in part, rev'd in part* 264 F.3d 201 (3d Cir. 2001), *remanded to* 243 F. Supp. 2d 166 (D.N.J. 2003).

auction, sought a fee of $262 million. This was $76 million more than they had actually negotiated with CalPERS.

In the Third Circuit, and we'll talk about it—the reason I'm bringing this up is that it is kind of the framework of the discussion tonight—both the settlement and the attorney fee were challenged. The court held that the district court had not erred in finding the settlement to be reasonable, but the court reversed the award of attorney fees by way of auction, holding that under the PSLRA, under the circumstances presented, an auction was not permitted.[6] The case has now been remanded to determine a reasonable fee award, the court instructing that the originally negotiated fee agreement carried a presumption of reasonableness and should be enforced unless it was a clearly excessive fee.[7]

My reading of that opinion—and Judge Becker, who wrote it, can perhaps say more about this—is that the inference is that it was a clearly excessive fee, that $187 million was probably way out of whack in terms of excessiveness. But that is only an inference.

Cendant presents a dramatic example of how the PSLRA operates, and the issues arising in *Cendant* present the framework for our discussion tonight. It certainly raises questions about how the PSLRA and its selection-of-counsel provisions will operate in the future in cases like, for example, the forthcoming Enron litigation.

To discuss the issues of appointment of counsel under the PSLRA, I am truly honored to have this panel, the best panel that I have certainly ever had the luck to concoct. I would like to introduce the panelists.

Chief Judge Edward Becker is Chief Judge of the Court of Appeals for the Third Circuit. Judge Becker wrote the panel opinion in *Cendant*, and that is now really the major work on the meaning and application of the PSLRA. He is known for his creative, groundbreaking, comprehensive, and heavily footnoted opinions—although I must say, regarding the predicted estimate of footnotes in *Cendant*, that we were expecting over 100 and were severely disappointed when it came it in at under 100.

JUDGE BECKER: It just cost you money. You bet on it.

PROF. CAPRA: A recent tribute to Chief Judge Becker appeared in the *Pennsylvania Law Review* honoring his thirty years of service on the federal bench. After comparing Judge Becker to Holmes and Cardozo,[8] quite aptly, the tribute noted that he "has long been at the

6. *Cendant*, 264 F.3d at 277-86.

7. On remand, the district court approved $55 million plus interest in attorney's fees as reasonable. *See Cendant*, 243 F. Supp. 2d at 174.

8. Stephen B. Burbank, *Making Progress the Old-Fashioned Way*, 149 U. Pa. L.

forefront in developing sensible ways for addressing a variety of issues that lie at the heart of handling modern complex litigation."[9]

He is a member of the Executive Committee of the United States Judicial Conference, and earlier this year he appointed a Third Circuit Task Force on the Appointment of Counsel in Class Actions.[10] That Task Force has issued a major report on the topics we are discussing today. It will be published in the *Temple Law Review*,[11] and I was honored to be Reporter to that Task Force.

Our next panelist is Judge Milton Shadur, a Senior District Judge for the Northern District of Illinois. In the *Cendant* opinion, Judge Shadur is referred to—correctly, I believe—as "a jurist of extraordinary distinction."[12] Judge Shadur has been on the bench since 1980 and has issued more than 7,300 written opinions. He maintains a full civil and criminal calendar and sits by invitation with several Courts of Appeals around the country each year. He is the Chair of the Judicial Conference Advisory Committee on the Rules of Evidence, on which I am honored to serve as Reporter. He is the author of two important opinions holding that the PSLRA permits a court to conduct an auction process in securities class actions. He is also now a scholar because he is publishing a piece in the *Temple Law Review*.[13]

Mel Weiss is a Senior Partner at Milberg Weiss Bershad Hynes & Lerach LLP, the leading plaintiffs' class action firm in the country, without question. He is a leading practitioner in the fields of securities, insurance, environmental, antitrust, and consumer litigation, often representing plaintiffs in class actions. He has been appointed to leadership positions in numerous complex litigations. Most recently, he was one of the chief negotiators and lead counsel for claimants—German Holocaust victims—in the Swiss Bank litigation involving Holocaust confiscations. Mel was a most valued member of the Third Circuit Task Force on Selection of Counsel in Class Actions.

Jill Fisch, my colleague, is currently the Sloan Visiting Professor of Law at Georgetown University Law Center, but, more importantly, Professor of Law at Fordham University School of Law. She has been

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Rev. 1231, 1231-32 (2001).

9. Richard L. Marcus, *The Agenda-Setter for Complex Litigation*, 149 U. Pa. L. Rev. 1257, 1257 (2001).

10. Judge Becker is the recent recipient of the 20th annual Devitt Distinguished Service to Justice Award, which honors "an Article III judge of national stature." American Judicature Society, Devitt Award, http://www.ajs.org/ajs/awards/Devitt%20Award/ajs_awards_devitt.asp (last visited Apr. 22, 2003) (on file with the Fordham Law Review).

11. *See Third Circuit Task Force Report on Selection of Class Counsel*, 74 Temple L.Rev. 689 (2001) [hereinafter *Task Force Report*].

12. *In re* Cendant Corp. Litig., 264 F.3d 201, 274 (3d Cir. 2001).

13. *See* Milton I. Shadur, *Task Force Report: "Against the Manifest Weight of the Evidence,"* 74 Temple L.Rev. 799 (2001).

at Fordham since 1989 and teaches primarily in the areas of corporate and securities law. She has a truly remarkable—and I envy it every day—record of scholarship, which includes work on corporate law, securities regulation, and federal courts. She has published in the *Harvard Law Review, Columbia Law Review,* and *Cornell Law Review*, among other places. Her article on lead counsel auctions in *Law and Contemporary Problems*[14] was cited shamelessly multiple times in the Third Circuit Task Force Report—indeed, it formed the basic premise of that report. Her most recent article on lead counsel auctions will be published in the April 2002 volume of the *Columbia Law Review*.[15]

Greg Joseph heads Gregory P. Joseph Law Offices and is a Fellow of the American College of Trial Lawyers. Last year he was listed as one of the top ten litigators in America, a designation truly deserved. He is a former Chair of the 60,000-member Litigation Section of the American Bar Association, served on the Advisory Committee on the Federal Rules of Evidence, and is the author of several books, including books on civil RICO, modern visual evidence, and sanctions in the federal courts. Greg served as Co-Chair of the Third Circuit Task Force on the Selection of Class Counsel—so you see where we are going here—and he was formerly Chair of the Litigation Department at New York's Fried, Frank, Harris, Shriver & Jacobson.

The format today is to have opening statements by the panelists and then a free-flowing exchange, followed by questions from the audience. We open with Judge Becker to take us through some of the most interesting issues raised by the PSLRA that he tackled in *Cendant*.

JUDGE BECKER: Professor Capra has presented a great challenge, though one that I hope that I will be able to meet, talking with as great celerity as Professor Capra. I am a fast-talking Philly guy, so let's see if I can do it.

I am delighted to be here. I have long been impressed with Fordham as an institution. The adjective that I have always thought best characterizes Fordham is "class." As my comments suggest, Fordham has got a lot going for it, but for me its number one attraction is the presence on its faculty of a man whom I consider one of the American legal academy's true superstars, Dan Capra.

If I were looking for adjectives to describe Dan Capra, I would use brilliant, incredibly productive, indefatigable, personable, decent, and just a wonderful human being. I know this because I know his

14. *See* Jill E. Fisch, *Class Action Reform,* Qui Tam, *and the Role of the Plaintiff,* 60 Law & Contemp. Probs. 167 (1997).

15. *See* Jill E. Fisch, *Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction,* 102 Colum. L. Rev. 650 (2002).

teaching, I have taught with him at ALI/ABA programs, I have read his scholarship, and I know his work as a Reporter for the Advisory Committee on the Rules of Evidence and his work as Reporter for the Task Force on Selection of Class Counsel, which I appointed a little over a year ago. Dan did the report, and he turned out a very important and very useful report in a year's time. You can read it not only in your materials, soon in *FRD*, but also in the *Temple Law Review* where Judge Shadur will "take it to the cleaners," as he will this afternoon.

Now, to the topic, "The Private Securities Law Reform Act: Is It Working?" Well, we are only dealing with a portion of the topic. The Private Securities Litigation Reform Act covers a host of subjects. It is in many respects largely a pleading statute; it also has safe harbor provisions. It has a whole bunch of provisions, but we are focusing here today on whether it is working in terms of selection of lead plaintiff, and ultimately the selection of lead counsel.

My *Cendant* opinion you can find in 264 F.3d. It is a 125-page opinion. It covers a lot of ground. It also contains some recommendations to Congress, something that I as a judge have always felt it appropriate to do. I have been doing it for many, many years, and sometimes the Congress thinks I am right and changes the laws. In my view, there are facets of the Private Securities Litigation Reform Act that really need to be looked at because it has not worked out in a number of respects in the way in which Congress thought it would work out.

Now, that said, while I have played a role by creating the Task Force, have in mind that I am also a judge. We have all heard of the Iron Age. We are now in the "Enron Age," and there is going to be a lot of litigation, including some that may show up in the Third Circuit, so I've got to be pretty careful what I say, because there are a ton of issues—a ton of issues raised by the Task Force Report, a ton of issues raised by this general subject—and many may be coming before the Third Circuit, and so I will be circumspect in my remarks, which I will use more to identify issues or questions than to give answers. But I will discuss some of the things I have done in *Cendant*, and I will make a few remarks about the Task Force Report.

The first big issue, the one that Professor Capra raised, is the selection of lead plaintiff. There is a rebuttable presumption in one of the sub-sub-sections of 21(d) of the Act that "the court shall adopt a presumption that the most adequate plaintiff in any private action arising under this chapter is the person or group of persons"—that itself raises a question you can already see in terms of aggregation, as to whether the lead plaintiff is one person, one fund, a group of funds, how many, what's the limit—"that ... in the determination of the

court, has the largest financial interest in the relief sought by the class."[16]

Congress originally thought that institutions in this new client-driven, as opposed to lawyer-driven, regime that it was creating would be the lead plaintiffs, but it really has not turned out that way. The only institutions that have agreed to be lead plaintiffs are public pension funds and a few union-related institutions. By and large, the mutual funds was the group that I think Congress had in mind—because they've got more stock than anybody in any of these corporations that go sour—but the mutual funds won't touch it. Doing a cost/benefit analysis, they think that it just ain't worth it for them to get involved. So the mutual funds have not come forth as lead plaintiffs. The private pension funds have not.

But the public pension funds have stepped up. Though that, in and of itself, has raised a question because public pension funds are in many cases controlled by politicians, and politicians get campaign contributions. The question arises then as to whether the lead plaintiff, a huge public pension fund, will select lead counsel on the basis of political contributions made by law firms to the public officers who control the pension funds and who, therefore, have a lot of say in selecting who counsel is.

Now, I identified this as a problem in my *Cendant* opinion. I suggested that Congress do something about it. The Task Force has addressed it and has said that there ought to be disclosure of any contributions. There are others who think that the Ethical Rules require more than disclosure. I am simply identifying problems here.

I will not talk long about the question of aggregation. I just read you the language, which says that Congress seemed to have contemplated aggregation. In *Cendant* I rejected the notion that the statute precludes a group of unrelated individuals from serving as lead plaintiff. But the question arises as to whether a group is too large. Are you aggregating a group that is too large so that you become the largest and you become the lead plaintiff?

There are professional responsibility issues. The SEC filed a brief with us in *Cendant,* which said "groups with more than five members are too large to work with effectively." I simply state that this is an issue, it is a problem, and Congress is going to have to work it out one of these days.

Another issue that I see is that Congress did not foresee that large institutional investor lead plaintiffs would, perforce, retain a substantial investment in the defendant corporation. If they are big enough to be the lead plaintiff, they are not going to dump all their stock when something goes down; they are going to hold on to their

16. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I) (2000).

stock. The little guys, the little investors, who are the bulk of the class members, they are not going to hold on to their stock.

What this means is that a corporation that retains a substantial interest in the defendant corporation arguably cannot represent a class in a lawsuit because this lead plaintiff will likely be conflicted between trying to get the maximum recovery for the class and trying to protect its ongoing investment in the corporation—that is, for example, by settling cheaply or by securing corporate governance changes in lieu of cash, which will make the corporation healthier down the road. I simply identify this as another problem.

The Private Securities Litigation Reform Act, is it working? Well, there are problems.

The selection of lead counsel—and this really gets to the heart of the great controversy, in my view—as I expressed in *Cendant*, is dependent, at least in part, on the ability of lead plaintiff to negotiate the best deal with lead counsel. That is something that is not always considered. But the selection of lead counsel is the big-ticket item in this new regime.

The empowered plaintiff—that is, in this client-driven vs. lawyer-driven regime, as Professor Capra describes it—Congress has said that this empowered plaintiff is the one who gets to select lead counsel, and the notion is that the sophisticated plaintiff with the largest stake will negotiate the best deal, and not only will be able to negotiate the best deal, but also will be able to monitor counsel. This is a concept that I think is just coming into play. I pointed out to the drafters at a rules conference Judge Shadur and I were at in Chicago that this is one of the things that needs to be thought about.

In the ordinary course, under the lawyer-driven model, the classic example was that there was a lawyer in Philadelphia who had an uncle who had shares in every major corporation in the United States. Whenever there was something in *The Wall Street Journal*, right away he jumped in and he represented the class. Well, that was the paradigm, and maybe exaggerated, of the lawyer-driven model.

But then, in a case like that, there is no monitoring—the client isn't monitoring counsel. But presumably, if you have a huge state pension fund, the notion is that it will drive a hard bargain and that it will monitor the activity of counsel. So monitoring is another area we've got to think about.

In any case, the big-ticket item, to use that phrase again, is whether or not the Private Securities Litigation Reform Act permits auctions. I concluded in the *Cendant* case that, except in certain circumstances where the lead plaintiff isn't really doing its job or can't do the job, auctions are inconsistent with the Act. Judge Shadur has a different view.

But have in mind in terms of auctions that there are other areas where lead counsel are selected—antitrust cases, consumer cases—

which are not constrained by the Private Securities Litigation Reform Act, and the question of whether auctions are permissible is very much a live issue there.

The best example right here in New York City is the auction house cases, where there is an antitrust action against Sotheby's and Christie's. There was an antitrust violation. Judge Kaplan of the Southern District of New York selected lead counsel via an auction.[17]

But in any case, there is an issue as to whether it works. The Task Force, in seventeen pages, goes into the pros and cons—I know Judge Shadur is going to talk a little about it, and I am not going to talk about it here—but it goes into the pros and cons of a private ordering versus auction which is supposed to mimic the market.

I was impressed enough, I will say candidly, with the results—indeed, it was Judge Shadur's success in the *Lysine* case,[18] where a Philadelphia firm, which I know is one of the finest plaintiffs' securities and antitrust firms in the country, Harold Kohn's firm, was the low bidder. Nobody could say they weren't going to do a great job. And they did a great job, and apparently saved the class a lot of money.

But there were also a lot of criticisms against the auction method, and you can read 100 pages of them, as to problems of the auction method in the Task Force Report. I said, "My God, what does a newly minted—one of you is appointed to the U.S. District Court in the Southern District of New York, and your third day on the job, on the wheel, you get a class action. What do you do? You've got to select class counsel. So do you do it by auction or do you do it by the conventional private ordering method?"

I thought the Task Force would come up with a report that would aid in analyzing the situation. I thought the Task Force, led by Greg Joseph and Steve Saltzburg, and with Dan Capra as Reporter, did a brilliant job of exposing the pros and cons.

And, although the Task Force Report is viewed as largely negative to auctions, I would point out that the Task Force is careful to state that "[d]espite its reservations, the Task Force is not prepared at this early stage to conclude that a court should never have the discretion to conduct an auction,"[19] that there may be certain limited situations where it is justified. And it said: "The Task Force was persuaded by the testimony of many witnesses who urged that courts be encouraged to innovate and find creative solutions to these important issues."[20]

And, among other things, the Task Force believed that auctions would be a good laboratory for coming up with evidence to solve the

17. *See In re* Auction Houses Antitrust Litig., 197 F.R.D. 71 (S.D.N.Y. 2000).
18. *See In re* Amino Acid Lysine Antitrust Litig., 918 F. Supp. 1190 (N.D. Ill. 1996).
19. *Task Force Report*, *supra* note 11, at 740.
20. *Id.* at 740 n.177.

most difficult, if not intractable, problem, and really the deep underlying problem in this whole arena, the question of fees, because that is the real issue.

Put differently the real issue is: Do you have an auction which fixes the fee ex ante ("we agree to do it for X percent"), or the traditional private-ordering method in which the fee is decided ex post by the judge? But there again, in 78u-4(a)(6), Congress has provided in the Private Securities Litigation Reform Act that the court shall see to it that fees shall not exceed a reasonable amount.

So there is ultimately an ex post role for the court, which influenced me in *Cendant* to say, "Well, even though you've got the presumptive lead plaintiff"—and in that case it was felt that the lead plaintiff was properly selected—"the auction didn't necessarily work there because the auction price was much higher than the negotiated price." So the notion doesn't always work.

At all events, I held that if the fee that is negotiated between lead plaintiff and lead counsel is clearly excessive, then the court can review it—and, indeed, even go so far as to apply a lodestar cross-check.

One final disclaimer. The Task Force Report is not Third Circuit law. It is not binding on any panel of our court. It was independent. It was not part of our judicial business. I did that as the presiding judge in connection with our Judicial Conference, which is to improve the administration of justice, and I thought that it did.

But the short of it is—and I am going to stop talking, because these folks here really are in the trenches and they know more about it than I—I hope that what I have done is to tell you that there are some issues we've got to grapple with, some problems we've got to deal with, and, I think, some legislation that needs to be enacted.

JUDGE SHADUR: Well, it is obvious that Judge Becker's long opinion in *Cendant*—it was 125 pages in slip; I think they reduced it to something like 85 in Federal 3rd—certainly serves as a starting point for any kind of discussion in these areas. I think that the West key numbers and the table of contents are longer than most opinions.

But lest you think that that is a magnum opus for Judge Becker, I remember one issue of *Federal Supplement*, when he was a very distinguished district judge, that contained opinions that he had written in the Japanese electronics cases,[21] which ended up in the Supreme Court as *Matsushita*.[22] And if I remember right, it was about

21. In an eight month period, Judge Becker issued 495 pages of opinion in four *Matsushita* decisions published in volumes 505 and 513 of *Federal Supplement*. *See* Zenith Radio Corp. v. Matsushita Elec. Indus. Co., 513 F. Supp. 1100-1338 (E.D. Pa. 1981); 505 F. Supp. 1125-90, 1190-1313, 1313-80 (E.D. Pa. 1980).

22. Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574 (1986).

500 pages of his opinions. We used to refer to that advance sheet of *Federal Supplement* as "Federal Becker" instead of "Federal Supplement."

But to return to the business at hand, I was told that because I can't rely on Tennyson's "my strength is as the strength of ten because my heart is pure," I am entitled to get four times as much time as any of these people, because I am the only one who I think sees some very good sense in the use of bidding as part of the selection process, including in the Private Securities Law Reform Act, which I'll refer to as "the Reform Act," although I think that's a euphemism.

The reason that I say that—and by the way, "auction" is a very bad name for this. It seems to be prevalent all down the line, but it is really bad. The reason is that it suggests price only. That is what auctions typically are. When we deal with competitive bidding in this situation, it is not price only. We want to make sure that whatever firm ends up representing the class is going to be a high-quality firm, good credentials, experienced, and that is a precondition to anybody being selected in that way.

I wanted to talk about the potential use of competitive bidding as part of this process for determining "the most adequate plaintiff," as the Reform Act requires.

Let me begin with one initial premise on which Judge Becker and I certainly share common ground. In *Cendant* he quoted with approval this proposition that I had set out in my opinion in the *Bank One Shareholders* litigation. And it is important to listen to this:

> Suppose for instance a plaintiff in such a presumptive status has agreed that its own lawyers, if acting as class counsel, are to receive one-third of any class recovery. Suppose further that another highly reputable law firm that has appeared of record for another putative plaintiff or plaintiffs, having demonstrated excellent credentials in earlier securities class action litigation and being clearly capable of handling the complexities of the current lawsuit, is willing to handle the case for half of that percentage fee—or to provide even a greater contrast, is willing to work for that lesser percentage and also to impose a cap on the firm's total fee payment. In that circumstance the presumptive lead plaintiff could certainly bind *itself* contractually to pay one-third of *its* share of the class recovery to its own lawyer, but any court would be remiss if it were to foist that one-third contingency arrangement on all of the other class members who had not themselves chosen that law firm to be their advocate.[23]

At that point we part company, I know, as a matter of statutory construction. In my view, the example that I posed meshes with the

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23. *In re* Cendant Corp. Litig., 264 F.3d 201, 274-75 (3d Cir. 2001) (quoting *In re* Bank One S'holders Class Actions, 96 F. Supp. 2d 780, 784 (N.D. Ill. 2000) (second emphasis added).

provision of the Reform Act that permits the presumption—and remember, it is a presumption, not a conclusive one—that the shareholder group with the most financial stake is in fact the most adequate plaintiff, to be rebutted, among other things, "upon proof by a member of the purported plaintiff class that the presumptively most adequate plaintiff... will not fairly and adequately protect the interests of the class."[24] That, of course, is a provision that essentially mirrors the adequacy prong of Rule 23 that applies to all putative class actions, whether securities or otherwise.

As you have heard from Judge Becker, he finds such an ex ante effort to evaluate fee proposals to be generally at odds with the Reform Act. Instead, to serve as a kind of means to ensure what we are all looking for—and that is the maximization of benefit to the class out of any recovery, a common fund that is obtained usually through settlement or trial—the *Cendant* panel looked to the ex post obligation of the court, which says: "Total attorneys' fees and expenses awarded by the court to counsel for the plaintiff class shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class."[25]

That, of course, is very much the same as the common law as it has developed under Rule 23 in all kinds of class actions, and that is viewed as providing adequate protection of the class.

It struck me in thinking about this problem for today's panel that posing a realistic scenario would help to sharpen the case for an up-front look at the level of fees, rather than simply relying entirely on that ex post standard. Assume a major securities class action—not as big as Enron—with the typical array of lawsuits by prospective lead plaintiffs whenever any kind of stock has fallen out of bed with the release of bad news and the contention is that the company should have gone public with the information earlier. Assume also that examination of the several cases and the people who are interested in it, after the publication of notice that the Securities Act requires, shows one major pension fund or a group of related employee benefit funds has by some margin the largest amount at stake. That fund or those funds have retained Mel Weiss's firm under a formula that calls for fees amounting to 10% of the first $20 million recovered, 20% of the next $20 million, and 30% of everything over that. That kind of increase-in-percentage arrangement has been urged, I know, by Mel's firm as important to create the maximum incentive for maximum effort and maximum recovery. For the minute I am going to skip my disagreement with the need for that kind of approach in terms of ethical aspects of the profession, but I am going to accept it.

24. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(II) (2000).
25. Id. § 78u-4(a)(6).

Now segue to the end of the case. Mel's firm does a terrific job and ends up with a $100 million settlement for the class. Under the formula, 10% of the first $20 million is $2 million, 20% of the next $20 million is $4 million, and 30% of the next $60 million is $18 million, so you end up with a total fee of $24 million on the $100 million: 24%.

If you look at the cases, that is within the range of so-called "norms" that have been approved in a great many class actions. So what we have had here under the Securities Act is a major shareholder, a major stakeholder, who retained a very highly reputable, highly experienced, high-quality law firm. And under *Cendant*, unless such a consideration as a comparison with what I think is the much-discredited lodestar calculation shows that fee to be seriously problematic, that is the end of the matter.

But should it be? My suggestion is not at all. Although the use of competitive bidding up-front has been limited to only about 15 cases, believe it or not, up to this point experience suggests that such so-called "norms" as a 24% cost to the class represent a lot of money out of the pocket of the class that a healthy degree of competition would put back into the pockets of the clients rather than the lawyers.

In two of the three cases that I have handled with the use of bidding as one component—and I emphasize one component—of the determination of who is going to be the class representatives—one of those cases was under the Securities Act, as Ed Becker has reflected; the other one was in an antitrust action, the *Lysine* case—but in each instance, the successful bid proved to be only 6 percent of the common fund recovery, and each of those involved a settlement in the $50 million range.

In the third case, which is a still-pending securities class action—I can't comment on it for that reason, because I don't know the result—but I do know that the successful bidder representing the presumptive lead plaintiff came in with a 7.5% bid.

Vaughn Walker of San Francisco is the one who had first done this, and he has done it, I think, in more cases than anybody else—I know he has—and he has obtained quite similar results.

In my two cases, what that meant was that close to $10 million went into the pockets of the class members in excess of the amount that would have been the case under the so-called "norms." Whether under the Reform Act requirements of no more than a reasonable percentage to be awarded to counsel, or under the case law that has developed under Rule 23, the court's role is satisfied in cards and spades.

My own court of appeals—you know, I come from where they like to think of themselves as "the land of free competition," because all of you know the economists who view cost/benefit as the answer to everything. Those of us on the district court, I think, differ, but we must do as our seniors tell us. They haven't had a chance to talk

about this in the Reform Act context. I know the Ninth Circuit has pending a mandamus action against Judge Walker that Mel Weiss's firm has brought, stemming from his rejection of a putative class representative that was represented by the firm,[26] so I'm making no comment obviously on the merits of that.

But as maybe could have been anticipated from the land of law and economics from which I emanate, here is what the Seventh Circuit said in its *Synthroid* class action.[27] That happened to be one that was RICO and antitrust and some supplemental jurisdiction state law claims, but what they say I think is equally relevant here in the securities field:

> We have held repeatedly that, when deciding on appropriate fee levels in common-fund cases, courts must do their best to award counsel the market price for legal services, in light of the risk of nonpayment and the normal rate of compensation in the market at the time.
>
> . . .
>
> . . . On remand the district court must estimate the terms of the contract that private plaintiffs would have negotiated with their lawyers, had bargaining occurred at the outset of the case (that is, when the risk of loss still existed). The best time to determine this rate is the beginning of the case, not the end (when hindsight alters the perception of the suit's riskiness, and sunk costs make it impossible for the lawyers to walk away if the fee is too low). This is what happens in actual markets. Individual clients and their lawyers *never* wait until after recovery is secured to contract for fees. They strike their bargains before work begins. Ethically lawyers must do this, but the same thing happens in markets for other professional services with different (or no) ethical codes. Many district judges have begun to follow the private model by setting fee schedules at the outset of class litigation—sometimes by auction [—what are you going to do?—], sometimes by negotiation, sometimes for a percentage of recovery, sometimes for a lodestar hourly rate and a multiplier for risk bearing. . . . Timing is more important than the choice between negotiation and auction, or between percentage and hourly rates, for all of these systems have their shortcomings.[28]

Now lest you think that I am really plumping for the idea of bidding at all costs, that's really not so. Let me emphasize another point of basic agreement between what you've heard from Judge Becker and what you hear from me, although we do draw different conclusions as to the utility of competitive bidding.

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26. *See In re* Cavanaugh, 306 F.3d 726, 739 (9th Cir. 2002).
27. *See In re* Synthroid Mktg. Litig., 264 F.3d 712 (7th Cir. 2001).
28. *Id.* at 718-19.

Suppose the presumptive lead plaintiff really tested the market in terms of fees—for example, by inviting a "beauty contest" among interested law firms, or by conducting the kind of private equivalent of competitive bidding to select a really high-quality, experienced law firm prepared to handle the case at the least costly fee arrangement. At that point I don't think there is any need for judicial involvement in the identity of counsel, and I cheerfully relinquish that role.

But you see the problem is that the real world doesn't function that way. That is very expensive. It is time-consuming. Putative class representatives do not have any assurance that they are going to end up as lead counsel. There is not a lot of incentive for them to invest their time and money to beat the bushes in that way. Instead what happens is they file suit using the firm they have had a relationship with in other matters, or a firm recommended by their usual counsel. And what that does, then, is not to provide the kind of assurance that I think the court is entitled to when it talks about ordering how the matter gets resolved.

I am going to defer talking about a number of the other items because I think I've overused my welcome in any event, despite my allocation that Dan was good enough to give me.

MR. WEISS: I would like to approach this from the standpoint of real-life problems for the lawyer. To me, the issues really are how lawyers in the class action context can properly evaluate the risks ahead and their staying power, and how much it will likely cost in time, effort and expense to maximize the recoveries for the clients, on an ex ante basis versus ex post.

I have represented clients, both private and in class actions, throughout my career. When a private client walks in, they tell me a story, a story in which they have a personal involvement. For example, they have dealt personally with the prospective defendant in a business transaction, or they bought securities in a private placement, and they can give me a relatively detailed set of facts or a perspective that really is much easier to evaluate from the standpoint of likelihood of success.

In a class action, we have a totally different environment. We have people who are very remote from the wrongdoing that is being alleged in the complaint or that brings them into your office. They generally have, even in the case of sophisticated institutional investors, very little understanding of what happened that caused them the injury. And, by the way, in almost every one of these cases it's not the institutional investor that walks into the lawyer's office in the first instance; it is a relatively small investor, at least relative to the institutional investor, who typically commences the inquiry.

Now, you are the law firm that has to make a decision: Am I going to throw resources into the investigation, huge resources sometimes,

in order to come up with enough information to satisfy myself that this case should be brought? To what degree am I willing to take the risk of making that expenditure? Am I willing to build up an arsenal of expertise within my law firm to be able to do a proper investigation up-front, have forensic experts, and hire investigators?

In my firm we have 550 people. We have something like 190 full-time lawyers. The rest are support people. These people are expensive to maintain. I have to get paid adequately in order to maintain that arsenal of support and that ability to do an investigation.

And then, under the PSLRA, I have to take the risk that I am not going to get appointed lead counsel because some other firm comes forward with a proposed plaintiff, at the end of a sixty-day rat race for clients, who suffered bigger financial losses. In other words, even though my firm may have spent significant resources developing the case, if another firm comes in with a client who suffered larger losses than my clients, that firm will likely be appointed lead counsel, even though they didn't put up resources up-front to investigate and start the case. In *CellStar*, as an example, which was one of the first battles over who should be lead plaintiff and who should be lead counsel, we filed an extraordinary complaint and then had the case given to an institutional lead plaintiff who expanded the class period in order to make its loss larger. That plaintiff and its lawyer then settled that case based upon the pleadings, without any depositions at the time of the settlement, and the lawyer who got that client wound up getting all of the fee. Now, my firm spent something like a quarter-of-a-million dollars on that case up-front and got nothing back.

So, from my perspective, I see an environment where certain law firms lie in the weeds, with relatively little overhead, waiting to "cherry pick" the best cases with the lowest bid. These law firms are not willing to put in the resources up-front to protect victims in our society and are simply not prepared to take all manner of cases because they do not have the arsenal to do so.

Those lawyers who are the "cherry pickers" aren't necessarily bad lawyers—they will meet Judge Shadur's test of adequacy—but have they met the test of willingness to make the investment to truly protect the clients?

Now, take *Enron* as an example. We still don't know who is going to become the lead plaintiff and the lead counsel, and at my firm we have spent easily $1 to 2 million investigating that case. At this point, there is an institutional investor with a much larger loss, individually, than our client's largest loss. We have a client, the University of California Regents, that lost $144 million. This other one has a loss of $300 million. Leaving aside the suspicious circumstances of how that $300 million was lost, why should the court necessarily have to pick that plaintiff and its lawyers over another institutional investor that

has certainly a large enough loss to do an adequate job, or to be willing to do an adequate job, to protect its investment? After all, our client, the Regents, manage a big fund, and it hired a law firm—my firm—that was willing to take all the risk and spend the money to do the job right.

Another interesting thing about the PSLRA is that we are dealing up-front with the appointment of lead plaintiff; we are not dealing with class representative. The lead plaintiff isn't necessarily the one who is going to be held out as the class representative later in the case when the court rules on class certification, and the PSLRA does not make that a requirement.

So let's assume you have sub-classes. Take *Enron*: there are people who bought bonds and preferred stock, there are 401(k)-type purchasers, there are ordinary open-market purchasers, there are people who bought during different class periods. For example, one large proposed lead plaintiff, Florida's pension fund, bought all of its stock between mid-August and December of 2001. How do you figure out which claims within that panorama of claims are the stronger ones, and which are the weaker ones?

You are also in competition for recoveries with other claimants, such as contract holders, and secured and unsecured creditors. Connecticut has a quasi-public organization that gave Enron $220 million on December 28, 2000, in exchange for a payout over eleven years. I don't think it got its first payout. I am sure that $220 million was reported as profit on the books of Enron. But it's a contract claim. And claims like that are all over the place, in huge amounts, so there is going to be a tremendous competition for dollars.

And how do you know who is going to have the priority for those dollars, or whether those dollars are going to be adequate to pay 5% of the losses or 10% or 20%, even if you get all of the resources of those defendants?

These are huge risks, and I happen to believe that the best approach to fees is to wait until the end when the court can review how the case was handled, and what the results were. The court is ex post in the best position to evaluate all of the factors that should be evaluated that go into the fee award.

Now, Judge Becker was dealing with an interesting situation. He had *Cendant*. The lawyers had a contract with their client. By the way, I think their client was the New York City and New York State retirement funds; it wasn't CalPERS.

JUDGE BECKER: CalPERS was lead and New York City and New York State.

MR. WEISS: Oh, right, there were three of them, okay.

JUDGE BECKER: Three of them.

MR. WEISS: Right, and it was New York City, I think, that had the contract . . .

JUDGE BECKER: Correct.

MR. WEISS: . . . with the lawyers that had the cap.

In that case, as I recall the underlying facts, the lawyers were told by the court that the court wanted an auction. So the court set the rules. At the end, there was only, I think, $9 million in lodestar. It was relatively low in relation to the amount of fees awarded.

JUDGE BECKER: Eight million was on the record, but they said it would have been higher. They said it would have been $14 million, $15 million, something like that.

MR. WEISS: All right, so we'll give them $15 million, give them $20 million, whatever.

The point is, and I've been there, that lawyers do get incentivized by the fee arrangement. I remember in the *Keating* cases, Judge Bilby set out a fee scale where we got increasing percentages as the amount of recoveries went up, because I think it is pretty well known by all of us who practice that the last dollars are the toughest dollars to recover. You know, it is very easy to fold your tent at $200 million, but it is very hard sometimes to go from $200 million to $300 million. And that is where you earn your money as a lawyer. In my book, the endgame is the most important.

And I know clients, private clients, to whom I've spoken many times about this, and they want their lawyers to be on the same yardsticks as they are. They want the lawyers to have the same incentive as they have to go for the bigger dollars and not fold their tent because there is a lot of risk and not that much more reward. So they give the lawyers a bigger reward for the bigger dollars.

I measure outcomes by the net recovery, not by how much the fee percentage is.

I will never forget what Judge Jack Weinstein did in the *Franklin National Bank* case, way back in the 1970s. There were three of us vying to obtain recoveries from the defendant: the FDIC, the trustee in the bankruptcy, and the plaintiff class (which I represented). We were on the eve of trial, and the way it was supposed to work was the FDIC would put on its case first, the trustee second, and then I would. I went home on a Friday after we opened to the jury. The FDIC was supposed to start on Monday.

I get a call that night that the FDIC and the trustee settled. Judge Weinstein said: "All right, Mr. Weiss, you're up on Tuesday." I said, "Judge, this is not fair. Give me one week." He said, "I want you to settle this case for *X*." I said, "I'm not going to take *X*."

So I held out and Judge Weinstein gave me a week to prepare. The next Monday, the defendants offered me two times *X*. Judge Weinstein called me in and he said, "I'm prepared to give you a 50% fee." I said, "That's a lot of money, a big percentage." He said, "You earned it." He said, "If I gave you a third of *X*, the class would have gotten less than they will get with 50% of *2X*." And he was dead right. So I made an application for 40%. He gets on the bench and he says, "Granted. I'm not even writing an opinion. For 50%, I would have written an opinion. For 40%, I'm not."

That told me a lot. It taught me a lot about how to measure outcomes. Judge Weinstein understood it very well. You have to look at this situation at the end, look back, and then you make the fairest allocation.

To me, this front-end approach to setting counsel fees is taking too much responsibility away from the courts. The courts have an obligation and responsibility to award fair fees, which are not only fair to the class, but are also fair to the lawyers. Windfalls work both ways: the lawyer can get a windfall or the class can get a windfall. Neither should be permitted. We should try to avoid windfalls either way.

In our society, when the clients wind up with, let's say, 90% of the recovery, to me, that's a windfall for the client. Whether it is a justifiable windfall is a very difficult question.

I think that you cannot divine whether the *Cendant* lawyers would have gotten $3.2 billion with another fee arrangement. You cannot get into their hearts and souls and minds and you cannot understand what they went through in the endgame, but the fact is they got a $3.2 billion recovery for the class. They got $3.2 billion.

Percentage fees align lawyers with their clients, and replicate the market, and that is also why I like percentage approaches. As the Circuit Court said in the *Continental Illinois* case, the judge is not there to decide what the fairest and the best fee is, but what the court should do is try to replicate what happens in the marketplace.[29] I know from long experience that the most sophisticated clients do not even hesitate to enter into a 25 or a 30% agreement, no matter how big the case is. In *Pennzoil*, Joe Jamail got his full fee from Pennzoil, and given the huge recovery he obtained for his client I am confident that Pennzoil paid Joe's percentage fee with pleasure. And Vinson & Elkins, the same thing, in another major case where I think they got a $750 million fee, and I think it was like a one-third percentage fee

29. *See In re* Continental Illinois Secs. Litig., 962 F.2d 566, 572 (7th Cir. 1992).

arrangement. Clients, sophisticated clients, want to give incentives to their lawyers and do not hesitate for a minute to pay their lawyers well when they do well on a contingency basis.

PROF. FISCH: Each time I participate in one of these discussions of class action reform, I am struck by the ambivalence that we have about the class action structure in general. Listening to Dan's recap of the motivation for the Reform Act, one concern that I see—a dominant concern among Members of Congress—was frivolous litigation: meritless lawsuits, strike suits, and so forth. Many of the provisions in the Reform Act are designed to cut down on frivolous litigation.

When Judge Becker said, "Well, there is this concern that institutional investors might still be invested in the company, they might have a conflict of interest, they might not fully reflect the interests of the in-and-out plaintiffs," maybe some Members of Congress thought, "Well gee, having such institutional investors act as lead plaintiffs may be a good idea because that makes litigation more consistent with societal interests. If litigation decisions are made by investors that are representing the market as a whole, instead of the day traders or whatever, maybe we'll wind up with a better benchmark of socially productive litigation."

I guess what I am saying is that there are a lot of people who think there is too much litigation, there should be ways of cutting down, and that going for the maximum recovery and the maximum number of cases filed isn't necessarily a good idea.

But I said we are ambivalent about this. On the other hand, we rely on the class action mechanism, on private attorneys general, to deter wrongdoing and to compensate victims—victims of securities fraud in this case, but also victims of mass torts, victims of consumer fraud and antitrust violations, and all different kinds of wrongdoing. We rely very heavily as a society on private litigation, and we do not put the same kind of resources into government investigation and government enforcement that we would need to dedicate if we did not have an effective class action mechanism.

Well, for class actions to be successful at compensating victims and deterring misconduct, we've got to have the right incentives for class members, and particularly for class counsel, because class counsel is behind the class action mechanism, right? That is no surprise. That is no great flaw in the system. That is the way the system is designed to operate. If we structure a system in a way that deters lawyers from filing cases or awards lawyers the minimum amount necessary to get a lawyer to take on a case, we may not maximize our compensation and deterrence objectives.

So how do we balance between these two visions? How do we deal with these two competing goals in the class action structure?

I think what is interesting about the Reform Act is that Congress is not trying to make all of these value judgments. Congress is saying: "Okay, here is an area in which we've got the possibility of private plaintiffs and empowered lead plaintiffs, let us strengthen the market structure so that perhaps it can deal with some of these issues."

Obviously it is going to take some time, and it is going to take a certain degree of restraint by the courts. If the courts get too heavily involved in deciding what appropriate lead plaintiff qualifications are, many lead plaintiffs are not going to get in the game—they do not want to compete. The cost/benefit analysis may not make sense anyway for some lead plaintiffs—such as mutual funds—but you can bet it does not make sense if an investor cannot be assured of being appointed lead plaintiff when it has the largest stake. Institutions in particular will be unwilling to face a lot of collateral litigation on issues such as: are they really bona fide lead plaintiffs, how did they acquire the stock, and do they fairly represent the interests of the other investors? Similarly, institutional investors will legitimately be concerned about the prospect of burdensome discovery of the lead plaintiff, the lead plaintiff's holdings, the lead plaintiff's transactions, and the lead plaintiff's potential conflicts of interest. Will the lead plaintiff face accusations of "pay to play," which, so far as I have seen and so far as my research has uncovered, have thus far proven completely unfounded? These problems will dissuade institutional investors before they ever have the chance of getting involved.

Then, assuming we overcome that hurdle and they do get involved, what kind of say are they going to have in selecting lead counsel? I have talked to institutional investors who say, "Look, if I am going to design a 'beauty contest,' if I am going to set standards, if I am going to evaluate a bunch of different potential lawyers, I want to know that at the end of the day I am going to be the lead plaintiff and I am going to make the selection decision. It is no good to me to be involved in the case if I've got some lawyer foisted upon me with whom I am not familiar and whose style is not compatible with mine. That is not what I want to do. I would not have that relationship in anything other than the class action context. Why should I go out of my way to look for that sort of thing?"

So I think the message or the concern that I would raise for courts is that we do not really know how well the lead plaintiff provision is going to work, but we need to allow it a certain amount of flexibility until it finds its course, until institutional investors figure out what they need to do and how to operate effectively within the constraints, before we go back to Congress and say, "Here's some fine tuning," or before the courts get scared and say, "This is something with which we really are not comfortable, and we need to take control."

Progress reports to date on institutional lead plaintiffs are pretty good. Sure, institutional investors are not involved in a majority of

securities fraud cases, but the number is growing. There are probably a couple of dozen public pension funds that have been involved in securities fraud cases. I did an eyeball analysis of the securities fraud filings in 2001, and institutional investors either sought lead plaintiff status or were appointed lead plaintiff in over ten percent of those cases.

And if you look at the types of cases, it is not really surprising that the number is not higher. A very large number of the filings are cases involving a relatively small amount of money, cases in which there is no competition for the lead plaintiff position, cases that are resolved either as a result of, or shortly after, a motion to dismiss. I am not surprised that an institutional investor would not show up in every single case. That is not an indication that the lead-plaintiff provision is not working or that institutions are unwilling to get involved.

In the cases where institutions are involved, as I said, they are designing procedures; they are trying to come up with standards for the attorney selection process and standards for fee agreements. Institutions are experimenting with different types of fee arrangements, things that the courts have not invented on their own. Institutions are developing fee structures designed to create the different structures that try to take into account the various incentives that Mel Weiss talked about, that take into account the deterrence objectives of securities litigation as well, the desirability of sometimes proceeding against the more difficult defendants, the individual defendants in some cases, for which the case may be harder to bring, not just going for the company and the amount of the insurance coverage. So those sort of experiments, I think, are going to bear fruit if we give them a little bit of time to develop.

The biggest problem that I see under the statute right now is uncertainty—uncertainty about what the lead plaintiff role is, what the courts are going to accept, and so forth. We have talked about the lead plaintiff's role in selecting counsel today, but we have left a host of issues on the table without even discussing them.

What is the lead plaintiff's role in settlement? If the lead plaintiff opposes a settlement that counsel comes forward with, at some point in the case, should that objection be given any weight? Should the court defer to that objection?

Traditionally, in standard class actions, the class representatives are figureheads.[30] They do not really have an active role in terms of litigation strategy once the case has been filed. Courts have held that the objections of a class representative to an appeal decision or a settlement decision are not entitled to any substantial weight. So will institutional lead plaintiffs, will empowered lead plaintiffs, have more

30. *See, e.g.*, Fisch, *supra* note 14, at 172-74 (describing the limited role of the class representative in standard class actions).

substantial power to affect litigation decisions, or does their role stop at the point when they select counsel?

What about this much-touted monitoring function of the lead plaintiff? What happens if the lead plaintiff says at some point during the case, "I am not happy with the job the lawyers are doing. They are spending too little time or they're doing things that I think are wasteful from the class's perspective?" Will there be any judicial willingness to back up that sort of a concern? And, if not, can we really expect institutional investors—or any lead plaintiff—to monitor effectively?

So I think there is a lot of potential for experimentation, for innovation. I think that looking, at least under the PSLRA, at other mechanisms for solving the class action problem, is likely to interfere with that natural development. Obviously, securities lawsuits are not the only types of class actions. There may be room for experimentation in other areas. I have suggested that the empowered lead plaintiff model might be very effectively extended to areas beyond securities litigation, such as derivative litigation.[31]

But the empowered lead plaintiff model is not going to be the answer in every case. It is not going to be the answer in consumer fraud; it is not going to be the answer in mass torts. So this does not mean that our search for how to solve the problems of class actions is at an end. It is, I think, just a beginning, and a promising beginning at that.

MR. JOSEPH: It is always a pleasure to begin speaking after the time that Dan had hoped to begin a panel discussion.

I was taken by Judge Shadur's comments about Judge Becker's opinion, which I thought were quite delicate. He noted that the volume of the opinion was reduced from 125 pages in the slip opinion to eighty-five pages in F.3d. I think, regrettably from his perspective, none of the text was lost in that reduction.

I am going to talk about two aspects of what has been broached so far: one is the auction and the second is the most-adequate-plaintiff model.

Now, the Third Circuit Task Force did not say "never" to auctions. I mean, you really cannot say never about much of anything. I am reminded of the scene, both in *Butch Cassidy* and in *The Fugitive*, when there are occasions when one would jump into a flood of water 150 feet below one, but one does not do it frequently.

My comments are not going to be directed to Judge Shadur, to Judge Kaplan, to Judge Walker—we have had superb jurists that address these issues. But there are systemic issues in setting lawyer fees up-front to bear in mind.

31. *See* Fisch, *supra* note 15, at 724-25.

The first is that the judge has to have a basis for deciding how to set a fee structure, and that basis is going to come from ex parte communications—which will bear on the merits—from one side of the case, from the plaintiffs' perspective. That is something that makes defendants quite unsettled. Corporations already consider themselves targets when they are sued in class actions, and they are quite unsettled at the prospect that their side of the story is not being heard.

Not only does the judge hear about the merits, the judge then sets incentives based upon an understanding of the merits. Again, I am not concerned that that is going to have any impact on Judge Shadur when a motion to dismiss is brought before him. There may be other judges about whom other clients would have concerns.

JUDGE SHADUR: Pardon me for interrupting. I have never, and I would never, consider an ex parte communication in connection with any of these matters. It just has not happened. I do not know where you got this, but it is just wrong.

MR. JOSEPH: All right. Let me continue about how these things are often done, which is that the bids are always submitted to the court in camera. There is nothing that the defendant can look at. And the communications that the judge considers have to take into account the merits sufficiently to permit the court to determine a likely range of results, which necessarily entails an assessment of the merits and prospective recoveries. And I accept Judge Shadur's observation that he has never considered the merits of the case. I do not know how a judge can determine how properly to incentivize counsel without taking into account the merits. And I can assure you that corporate defendants are convinced that this is exactly what is happening when these in camera matters are sent to the court and the other side is not being heard.

The entire structure of the PSLRA contemplates that when the most-adequate plaintiff is set, the defendant may not be heard. The statute is very clear that objections to a putative "most adequate plaintiff" may come only from another plaintiff, not a defendant.

So we have the judge looking at whatever the judge considers is necessary on the merits in order to set incentives for the plaintiff. Then, the judge knows what the incentives for the plaintiff are, which the judge has set, at the time the judge rules on a variety of matters that come before the court—motions to dismiss, for partial summary judgment, in limine attacks on damages evidence, and the like. The judge knows exactly how his or her ruling will financially impact plaintiff's counsel.

As I said in the beginning, I am not suggesting that this affects any of the three jurists I mentioned who have conducted auctions. It is a

significant concern, and a perception concern, on the part of defendants when this is done.

Fourth, there is a real question as to whether we have any way of ever knowing that a better recovery, net to the class, has ever been accomplished in an auction. We know that we have gotten good recoveries, very good recoveries, and even excellent recoveries, given the incentives that were provided. We do not know, because settlement value is a function in part of who counsel are, what the recoveries otherwise would have been.

I remember my friend Lester Brickman from Cardozo had a theory some years ago about tort cases: that lawyers were being overpaid, and that this was demonstrably true because any lawyer could come in and get the same recovery. It is preposterous. Who is on the other side of a case largely determines both the quality of the representation and the value of the case. A case with Edward Bennett Williams for the plaintiff, and the same case with Joe Blow for the plaintiff, has dramatically different values. So we cannot assume that the net recovery is likely to be the same where two different lawyers or firms come in with different bids. That one came up with a very, very fine result given a certain set of incentives is not an indicator of how other counsel, with other incentives, would have performed.

I also would suggest that courts are not replicating the market when they conduct auctions. When I am retained, when Mel is retained, when any lawyer is retained in security cases, you are dealing with a sophisticated client with a sophisticated general counsel. They do not just look at who happens to knock on their door. They make inquiry by talking to a whole array of sources that are not available to a judge—other general counsel, other clients, other adversaries—many other kinds of information that they have at their disposal. It is not on the basis of written submissions with information limited to that selected by the submitter.

So while the auction is an attempt to replicate the market, and I credit it as that, the fact is it is not a replication of the market. It is something that an academic may perceive as a replication of the market. It is nothing like the market that exists for legal services in New York City, or in any other major city in the United States.

We also know that if you as judge set a fee formula in an auction, all you are setting is a cap. It is extraordinarily unlikely to me that you are ever going to permit counsel to exceed that cap. They have agreed to eight percent, twelve percent—why would you give them more? But it is certainly not a floor, because we know that the court has the obligation under Rule 23 and *Cendant* to reduce it if the amount is unreasonable, as exactly the court should do.

So the Task Force conclusion was that there may be circumstances where an auction is appropriate, but they are not the norm. There are paradigmatic cases, and a number of the cases that have spawned

auctions fit the paradigm: There is clear liability—is Enron a case of clear liability?—and there is also clear collectibility, which there certainly is not in Enron. And there are a lot of qualified people that are very interested in bidding for the lead counsel role.

Now, Enron is a PSLRA case. It raises unique statutory issues, so that is a separate kind of circumstance. But it is down in the Fifth Circuit. They may not agree with Chief Judge Becker[32] that the PSLRA precludes auctions.

If you have a case, where there is clear collectibility, there is clear liability, and there are a large number of competing bids, an auction may be something to consider, and we would not preclude that. That is the auction paradigm.

Let me turn to the most-adequate-plaintiff issue because I think that the concept of an empowered plaintiff is one of those things that corporate America deserves for having created it.

This is what you get when you get the most-adequate plaintiff:

- You get a new set of lawyers that know nothing about the field of securities litigation and law—these are the general counsel at the client;
- You get a new set of clients that not only know nothing about the law, but also generally have other fiduciary duties that they must consider at the same time they assume the set of fiduciary duties associated with most-adequate-plaintiff status. This conflict explains why no private mutual fund gets into this.

Professor Fisch talks about institutions, but if you look at the names, these things all sound like institutions, but some of these institutions are very, very tiny entities. You know, they are not all CalPERS or the City of New York or the State of New York. They are often a small pension fund for a small local of a small union. You know, there are institutions and then there are institutions.

So I think that the interposition of a "most adequate plaintiff" makes it more difficult for corporate America to be able to settle these cases, which is fine with me. That is something they wanted. They wanted Eliot Weiss's article; they have Elliot Weiss's article. Elliot Weiss is now going to be arguing for Judge Walker[33] in the Ninth Circuit as to why Chief Judge Becker is wrong. And that is perfectly fine. He is the law professor who wrote a *Yale Law Journal* article that happened to come out just before the Republican revolution, and that is why we have the PSLRA.[34] If you look substantively at that statute, I think it turns out to be a blip on the

32. And now with the Ninth Circuit, *In re Cavanaugh*, 306 F.3d 726 (9th Cir. 2002).

33. Judge, United States District Court for the Northern District of California.

34. *See* Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 Yale L.J. 2053 (1995).

screen in terms of the substantive pleading changes. The only thing it has done is help protect accountants like Arthur Andersen from joint and several liability. That is the one lasting testament of the PSLRA.

PROF. CAPRA: I just have a couple of questions, and then feel free to just jump in.

If you are not holding a class counsel auction, I guess the alternative—or at least one big alternative—is what has been referred to as "private ordering." I think, for the audience perspective, we ought to say what that means.

What private ordering means is that the putative class counsel come up to the judge and say, "This is the way we have arranged to have lead counsel, and we have arranged the situation where this firm is lead counsel, this firm does this, this firm does that." Essentially, it is kind of a consortium of counsel.

One of the things that the Task Force recognizes is that there may be problems with private ordering, in that the court is presented with an arrangement of counsel, and who knows if that is the most efficient arrangement? So, for example, what might be happening is that, since everybody is fighting to be lead counsel, everybody is kind of cut in on the pie, everybody is cut in on the deal.

I have a question for the judges. Judge Becker, if you would, what do you do if you are a district judge—newly minted, as you say; or even older minted, as might be said—when somebody comes to you, firms come to you with a private ordering arrangement, and maybe you suspect it is not the most efficient arrangement? What would you do in that situation?

JUDGE BECKER: Well, you ask a lot of questions. You ask an awful lot of questions.

The problem with these cases is that district judges are overburdened and they will take the path of least resistance very often—more likely if they are new, but not necessarily—and many of them will not ask too many questions, and they say, "You talk about private ordering; this is the order that we live under," and they will go along.

But if they ask questions, then they ought to depend on the answers because, as the tenor of your question suggests, there are a lot of very disturbing things that can happen, and it is not necessarily always going to be on the up and up. And there are professional responsibility questions. The law of professional responsibility has grown and grown and grown, and properly so. There is a lively dispute as to whether the district court has a fiduciary relationship to the class. I do not think that, in the strict sense, the district court has a fiduciary relationship to the class, just as a judicial commission on the rove is not a roving commission to do good. But the district judge has

got a lot of suasion and can have a lot of clout and can point out problems. Whether or not the district judge has a fiduciary relationship in the strictest sense, the district judge has huge clout, has huge power. It has power over the selection. It has power—of course, we are talking about class actions, but a lot of this happens in MDL, where there are steering committees and liaison committees—and all of this has got to be approved by the court.

If the judge will have courage and stand up and ask a lot of right questions, the judge may say, "Uh-uh, don't do it this way; don't do it that way."

MR. WEISS: Can I make a point on this? I am drafting an article on what drives fees in complex cases. I came to it because we represented the FDIC a number of years ago in a major case against Ernst & Young down in Tennessee arising out of the Butcher Bank failures. We were under a lot of pressure from our clients to keep the fees down. It was a federal agency, and I think we incurred something like $26 million in fees and $12 million in out-of-pockets for experts and the like. At the end of the ball game, the FDIC settled all of its claims all over the country, whichever banks they were involved in, for something like $400 million. We were already at trial, and our case was the only one that had advanced beyond the pleading stage.

About three or four months ago, there was a trial in New York County Supreme Court between the insurance companies, the excess carrier and the primary carrier that insured Ernst & Young. It was revealed in the coverage action that the amount of defense costs in the *FDIC v. Ernst & Young* case was $126 million. I was stunned. I was stunned.

When you see what goes on on the defense side of these cases, you can start understanding why we on the plaintiffs' side frequently need multiple law firms to respond effectively to the defendants' litigation tactics, and how defense strategies can drive the amount spent on the plaintiffs' side.

Now, why should the courts get involved in all of that? I mean, they can't really be cops policing all of the ways cases are litigated. Those defendants on the other side are "sophisticated." It is their money at stake and they are letting it happen. We have to react to it.

In my view, the only way you can really handle this efficiently is with a percentage approach and using the criteria, applied on an after-the-fact basis, that the circuit courts have generally established for awarding fees.

JUDGE SHADUR: Well, I have been at this business a long time, thirty years in practice before I took the vows of poverty, and I was on both sides of class actions. I am very sympathetic to a number of the things that Mel Weiss has pointed out.

But I must tell you that the product of that and another two decades on the bench has left me with less confidence than he has in the omniscience of federal judges when it comes to evaluating fees at the end of the case, because you have to have a benchmark against which you are going to be making your judgment. And if the benchmark is the result of these fictitious percentages that have grown out of the P.I. model that existed when lawyers were always getting a third because that was what they charged their clients, and then that somehow gets translated into a totally different animal, I find that very troublesome. One plus that has to be recognized as coming out of even a limited amount of experience in the use of competitive bidding is that those so-called "benchmarks" have in fact been demonstrated not to have a lot of reality in terms of need.

I did not start out subscribing to the notion of using bidding. As a matter of fact, what happened was that I had a case—in 1990, I think it was—in which I was presented with the product of what happens with the Manual on Complex Litigation, which dictates you have a lead counsel, you have a liaison counsel, you have a committee of counsel, and I had something like fourteen law firms seeking to feed at the trough. One of them was a Philadelphia law firm, highly involved in class action litigation, in which the guy had done nothing really other than to draft a complaint, which was not used, and he was putting in for his time in those days, a decade ago, at $400 an hour.

When I went carving through the thing as best I could—dealing with it in hindsight and from the outside is very difficult for anyone, omniscient or otherwise—I carved the thing down from maybe an aggregate of—this was small—we're talking about millions. The late Everett Dirksen was fond of saying that, "A billion here and a billion there, pretty soon you're talking about real money." In this case, I think the total fee requested was only about $400,000, and I cut it down to about $350,000. I dropped a footnote in the opinion that said: "You know, next time around, if I am presented with this, maybe I am going to think about what Vaughn Walker has done"—at that time he had done that in the *Oracle* litigation.[35]

You see, one of the problems with the notion of bidding is that there is not a model for bidding either. One of the big difficulties is that if you look at them, you know, you can pick flaws, and I recognize that in each one of the methods.

For example, I do not think that the judge knows enough about the case at the beginning to set up a grid in which the judge says "for the first so many million you fill in the blank, for the next so many million you fill in the blank," to the bidding lawyers. That makes it easier to compare, but it makes it infinitely more difficult for the judge to feel that there is any validity.

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35. *In re* Telesphere Int'l Secs. Litig., 753 F. Supp. 716, 721 n.12 (N.D. Ill. 1990).

My own approach to the problem has been, instead, to let the lawyers design their bids. Now, what that does—and this is the reason I hated to be sharp with my good friend, Greg Joseph—but you see what that does basically is to present a judge with a difficulty of evaluation because at that point, with lawyers having designed very different bids, the court's problem becomes one of figuring out which bid is better, and that necessarily involves making some assumptions that may create crossover points.

Law firm *A*'s bid may be better at one dollar level but worse than *B*'s at a different dollar level. Now what happens at that point is not an ex parte communication, at least in my experience, but rather one in which counsel for plaintiffs and defendants are asked, "What is your best judgment as to what the maximum recovery would be if the plaintiffs were right?" Surprisingly, sophisticated lawyers usually come out pretty close on that kind of assumption.

The difficulty that comes is in what the late Hu Will used to refer to as "the Lloyd's of London approach." And that is, "what is the probability of success?" If that process results in the evaluation of what Nathan Detroit said in *Guys and Dolls*—you know: "Nothing in life is four-to-one, most things are six-to-five and take your pick"—if that process makes it difficult for me, I would then abandon the use of the bidding process.

It is not a panacea. It is a tool, and I think it is a useful tool, and I think it is a useful tool in the private securities class action as well, because it provides information, and it is information that is not otherwise available in terms of evaluating things that at the end of the case, as was quite accurately pointed out, the court is obligated to do.

PROF. FISCH: I wonder if we are talking about two different states of the world here. I mean, Judge Shadur, you talk about a very thoughtful and careful implementation of the auction procedure, but, at the same time, you are worried about the courts that are not going to do that, and those are exactly the same courts that are going to just say, "Well, all right, 33%, that is the standard benchmark, I won't give it very much thought."

The auction does not give those judges better tools because unless they correctly identify which is the right case for the auction, unless they recognize the problems with the auction procedure, unless they design their auction carefully, whatever information they come up with will not be reliable. Similarly, it is precisely these courts that will not know what to do with the information that they obtain.

JUDGE SHADUR: Well, how many cases do you need that produce 6%, 7.5%, 10%, in order to recognize that maybe a third or 25% is not always the right answer?

PROF. FISCH: I completely agree. But you know what? A court can do that without an auction, and courts have. They do it all the time. I mean, the *Prudential Insurance* case in New Jersey, 4.8% of the recovery, in a case involving "extraordinary risk";[36] the *Goldberger* case in the Second Circuit, 4% of the recovery;[37] the *NASDAQ* antitrust case, 14% of the recovery.[38] You know, judges are doing this without using an auction.

MR. WEISS: The *Prudential* case, just to get the record straight, was a negotiated fee. I negotiated it, and I was severely underpaid.

PROF. FISCH: The courts adjusted that afterwards.

MR. WEISS: No, it was not adjusted.

PROF. FISCH: Well, they suggested that you were underpaid.

MR. WEISS: It was remanded and it was reaffirmed. It was awarded in full at the end.[39]

MR. JOSEPH: Well, let me just give you a fact scenario from a real class action. The announcement that causes a stock to go down was made on March 7. There was a press release on January 25. There was an investor conference on February 15. There was an investor conference on March 1.

The determination of the potential recovery is a function of which of those or how many of those actually give rise to liability. How far back was it that the company potentially knew the bad news? Now, if it was March 1, damages are about $600 million; if you go back to February 15, damages are potentially $2 billion; and if you go back to January 25, they are potentially $4 billion.

Now, to set the fee to the extent that anybody asks me to assume it is January 25 or February 15 or March 1, I can have my economist do a plaintiffs' model and I can tell you within 10% what the plaintiffs are going to come up with. Not that I consider that a valid analysis, but I could have that done.

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36. *In re* Prudential Ins. Co. of Am. Sales Practices Litig., 106 F. Supp. 2d 721, 735-36 (D.N.J. 2000).

37. *See* Goldberger v. Integrated Res., Inc., 209 F.3d 43, 51-53 (2d. Cir. 2000).

38. *See* In re NASDAQ Market-Makers Antitrust Litig., 187 F.R.D. 465, 485-88 (S.D.N.Y. 1998).

39. *See In re* Prudential Ins. Co. of Am. Sales Practices Litig., 962 F. Supp. 572 (D.N.J. 1997), *vacated in part by* 148 F.3d 283 (3d Cir. 1998), *remanded to* 106 F. Supp. 2d 721 (D.N.J. 2000).

But if you are setting a fee in which the amount of the recovery matters, then the issue is going to be how far back you are going to go. That is the kind of area where, if submissions are being made to explain to the court why "my bid is better than his bid, because I am willing to go back to January 25, because here are all the bad things that I can tell you happened," that is merits-oriented. It is what makes defendants very uncomfortable about this whole process.

MR. WEISS: You left out some other complicating factors. Were there partial revelations along the way?

MR. JOSEPH: That happens in every case. That is a separate issue.

MR. WEISS: That is the point. I mean—

MR. JOSEPH: It gets too complicated if you get into real life, Mel.

PROF. CAPRA: But the risk of uncertainty and how we deal with it is the basic issue. On behalf of the panelists, I would like to thank you for attending this most interesting discussion of problems arising under the PSLRA.