"Go Pick A Client" - And Other Tales of Woe Resulting from the Selection of Class Counsel by Court-Ordered Competitive Bidding

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INTRODUCTION

The Board of Pensioners of the City of Philadelphia smelled a rat. After investing more than $3 million in Network Associates Inc., the company’s stock suddenly plummeted from $67 to $13 per share.¹ The Board carefully selected an experienced law firm it had used successfully to prosecute securities-fraud claims in the past, and directed its lawyers to investigate Network Associates.² This investigation confirmed the Board’s suspicions of impropriety; the rat it smelled was a scheme by the officers and directors to commit accounting fraud and insider trading.³ With a successful record of prosecuting securities class actions, and as one of the nation’s largest institutional investors, the Board stepped forward to protect itself and similarly situated investors by filing a securities class-action suit against Network Associates.⁴ Because the Board was the investor before the court with the largest financial interest at stake, the court—following the express language of the Private

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¹ In re Network Assocs., Inc. Sec. Litig., 76 F. Supp. 2d 1017, 1019, 1030 (N.D. Cal. 1999).
² See id. at 1030–31 (discussing the Board’s retention of the Barrack, Rodos & Bacine law firm).
³ See id. at 1030.
⁴ See id.
Securities Litigation Reform Act of 1995 ("PSLRA")—quickly appointed it to serve as the "lead plaintiff." Consequently, the Board was responsible for selecting and retaining counsel, and generally overseeing the prosecution of the suit.

Then something strange happened. The court informed the Board that it could stay and prosecute the suit, but its lawyers might have to go. The court severed the existing attorney-client relationship and informed the Board that if it wished to prosecute this litigation it would have to "re-open its consideration of counsel; promptly publicize a request for written proposals from counsel; evaluate the proposals; and interview counsel as appropriate . . . ." Unhappy with the prospect of a shotgun-marriage with strangers, the Board balked, and wrote a letter to the judge explaining why it was withdrawing as lead plaintiff:

"The board is not equipped to engage in the process envisioned by the court, nor do we believe such a process is required to accomplish what the board understands [as] the court's purpose: to obtain the highest quality representation at the most effective price . . . . Moreover, because the selection process called for in the order includes the subjective evaluations of counsel unknown to us, while at the same time includes some objective criteria, we are concerned, as a public entity, that a disgruntled applicant could make unfounded allegations that they were treated unfairly, and thus require the board to expend additional resources defending itself against such allegations." 

When another institutional investor stepped forward to assume the lead-plaintiff role and also refused to comply with the
court-ordered bidding procedure, it too was removed as lead plaintiff.\textsuperscript{11} Having driven out the two largest institutional investors, the judge was forced to select an individual investor with losses of approximately $24,000 to serve as lead plaintiff in this potentially billion-dollar litigation.\textsuperscript{12} Thus, the court-ordered bidding process drove away the two investors with millions of dollars in losses and installed an investor with less than $24,000 at stake to oversee the lawsuit.

This result is not what Congress intended. It drafted the PSLRA to encourage the participation of large, sophisticated investors in securities class actions.\textsuperscript{13} But because a few courts persist in using bidding systems to select lead counsel—and because the Third Circuit recently created a task force to evaluate the propriety of such bidding—an analysis of competitive bidding under the PSLRA is relevant, timely, and instructive.\textsuperscript{14}

This Article evaluates the use of a competitive-bidding, auction-style selection method for appointing lead counsel in securities class actions.\textsuperscript{15} Part I examines competitive bidding as a means to select lead counsel through a summary of the case that spawned the practice and is generally cited as authority for its use. Part II analyzes the PSLRA provisions governing the selection of lead plaintiff and lead counsel. Part III addresses the Reform Act's legislative history and considers why courts have rejected bidding in light of the PSLRA's objectives. Further, Part III discusses additional reasons why courts should continue to reject

\begin{enumerate}
\item See id.
\item See id.; see also Network Assocs., 76 F. Supp. 2d at 1019 (noting that eventual lead plaintiff Robert Vatuone's losses were approximately $23,500); Milberg Weiss Bershad Hynes & Lerach, \textit{Damages Analysis for Network Associates, Inc.} (Dec. 1999) (on file with author) (estimating the value of the case at approximately $1.6 billion).
\item See Press Release, Third Circuit Court of Appeals (Jan. 30, 2001).
\item The auctioning of class counsel should not be confused with auctioning the claims of plaintiffs, as suggested by some scholars. See generally Jonathon R. Macey & Geoffrey P. Miller, \textit{Auction Class Action and Derivative Suits: A Rejoinder}, 87 Nw. U. L. REV. 458 (1993).
\end{enumerate}
competitive bidding. Part IV questions the marginal results that have arisen in cases where competitive bidding has been used. This Article concludes that competitive bidding for the selection of lead counsel is neither beneficial to the class members nor warranted under the PSLRA.

I. COMPETITIVE BIDDING—JUDGE WALKER'S ORACLE DECISION

Before the PSLRA's enactment in 1995, some judges, attorneys, and scholars believed reform was needed in the federal securities laws.16 Five years earlier, espousing his belief that the current method of attorney-fee calculation and selection of counsel failed to provide sufficient monitoring of the lawyers representing the class, Judge Vaughn Walker "call[ed] for future courts to rely on new methods of determining attorney compensation in common fund securities litigation" by adopting a novel idea: competitive bidding for the selection of lead counsel.17 Judge Walker's aptly titled Oracle18 decision defied the practice of determining fees at the end of the litigation—and arguably Ninth Circuit precedent19—instead selecting lead counsel by ordering all interested firms to submit price bids for the position.20 In the five-year interim

18. Id.
19. See In re Northern Dist. Cal. Dalkon Shield IUD Prods. Liab. Litig., 693 F.2d 847, 851 (9th Cir. 1982) ("[T]he right of litigants to choose their own counsel is a right not lightly to be brushed aside .... This court is hesitant to force unwanted counsel upon plaintiffs on the assumption that appointed counsel will be adequate."); accord In re Mandell, 69 F.2d 830, 831 (2d Cir. 1934). The Mandell court specifically states that:

[W]e regard it as inimical to good administration to fasten an attorney on the [client] against his will .... [N]o reason appears why the [client] should not have been allowed to nominate another attorney satisfactory both to himself and to the court. In depriving him of his privilege we think there was an abuse of discretion.

Id.

20. See Oracle, 131 F.R.D. at 691. Lead counsel is charged with prosecuting the litigation on behalf of the members of the class. See, e.g., 15 U.S.C. § 78u-
between *Oracle* and the PSLRA, no published decision followed Judge Walker's competitive-bidding system. But since the passage of the PSLRA in 1995, a few courts have experimented with this alternative-selection scheme.\(^{21}\)

A careful understanding of what Judge Walker saw as the objectives of competitive bidding provides an insightful background helpful in understanding the impetus behind securities reform that resulted in the PSLRA's lead-plaintiff provisions. That is, competitive bidding is an alternative reform measure that was considered, but not adopted, by the Act’s drafters. Understanding why Judge Walker thought competitive market forces would improve the lead-counsel selection process helps explain why Congress adopted a different market-based approach.

Judge Walker reasoned that the competitive-bidding process "most closely approximates the way class members themselves would make these decisions and should result in selection of the most appropriately qualified counsel at the best available price."\(^{22}\) His primary rationale for this new system was that no single client had a large enough interest to monitor the lawyers: "Since it is in the nature of class actions that no single class member has a significant enough stake in the outcome to justify oversight of the litigation, it is inconceivable that any 'shopping around' among these law firms to arrange the best terms available will take place."\(^{23}\) In a prescient observation, Judge Walker noted that large, sophisticated investors "such as insurance companies and product

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22. See *Oracle*, 131 F.R.D. at 690.

23. *Id.* at 693.
liability defendants [do] engage in some price shopping for lawyers,” but none were involved in Oracle. According to Walker’s view, market forces would keep fees down and expedite the litigation:

In the matter of attorney fees, the benefits of competitive bidding include, among other things, a fee determined prior to litigation and an increased ability on the part of counsel, the parties and the court during litigation to forecast one (perhaps the most) important variable for purposes of strategy, settlement and the like. Successful plaintiffs’ securities lawyers are able to evaluate the value of a case accurately and bring about its prompt resolution.

Thus, because at the time Oracle was decided plaintiffs typically did not have a significant stake in the outcome of the case, Judge Walker believed market forces were necessary to ensure a reasonable fee structure and the prompt resolution of the case.

Judge Walker then requested that any interested law firm submit an application listing its qualifications and fee schedule. Of the twenty-nine firms who sought lead-counsel status, only four bid. Judge Walker reviewed the four bids—although he expressly abandoned any examination of the firms’ quality because he deemed it “impossible to distinguish among them in terms of their background, experience and legal abilities”—and selected one based on it “trump[ing]” the only other bid that conformed to the “competitive market.” In deciding which bids replicated a competitive market, the court decided that the bid should be one where plaintiff lawyers “obtain a smaller fraction of the total recovery the larger the recovery is, and a greater fraction of the total recovery the longer they must wait to be paid.”

24. Id. An inference can thus be drawn that had sophisticated investors been involved—as the PSLRA intends—competitive bidding would have been unnecessary.
25. Id. at 695.
26. See id. at 697.
28. See id. at 547.
29. Id. at 546 (citation omitted).
Walker selected as lead counsel the firm with the lowest bid because he felt that bid best reflected the competitive market.

With *Oracle* as a backdrop, the objectives of competitive bidding appear relatively simple: to replicate a market process in selecting counsel to get the best representation for the best price. But at least five courts rejected this bidding system prior to the PSLRA’s enactment.\(^{30}\) And although since then the overwhelming majority of courts have not adopted competitive bidding, four district courts have experimented with the auction system.\(^{31}\) Thus, despite the passage of an alternative reform measure, competitive bidding continues in post-PSLRA securities actions. Before considering whether competitive bidding is beneficial to the class,\(^{32}\) it must first be determined whether bidding is consistent with the text and legislative history of the PSLRA.\(^{33}\)

II. THE PSLRA'S LEAD-PLAINTIFF AND COUNSEL SELECTION PROVISIONS

"As long as the statutory scheme is coherent and consistent, there is generally no need for a court to inquire beyond the plain

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  \item \textbf{32.} See infra Part III.F.
  \item \textbf{33.} Note also that differences in auction theory are beyond the scope of this inquiry. The focus here is whether bidding is permitted under the PSLRA, regardless of its alleged merits in application.
\end{itemize}
language of the statute." The Act’s plain language governing lead-plaintiff and lead-counsel selection indicates that the plaintiff with the largest loss is the presumptive lead plaintiff, who in turn, selects and retains class counsel subject only to court approval:

(B) Appointment of lead plaintiff . . . .

(iii) Rebuttable presumption —

(I) In general—Subject to subclause (II), for purposes of subclause (i), the court shall adopt a presumption that the most adequate plaintiff in any private action arising under this title is the person or group of persons that —

(aa) has either filed a complaint or made a motion in response to a notice under subparagraph (A)(i);

(bb) in the determination of the court, has the largest financial interest in the relief sought by the class; and

(cc) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure . . . .

(v) Selection of lead counsel—The most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class. Through the use of “shall,” under subsection (a)(3)(B)(v), the statute provides that the plaintiff with largest financial interest—the presumptively most-adequate plaintiff—maintains sole discretion to select class counsel, with the court maintaining veto power. The majority of cases decided after the PSLRA support this interpretation. For example, in In re Cendant Corp.

Chief Judge Becker of the Third Circuit wrote that the district court’s “decision to hold an auction to select counsel was inconsistent with the Reform Act, which is designed to infuse lead plaintiffs with the responsibility (and motivation) to drive a hard bargain with prospective lead counsel and to give deference to their stewardship.”\textsuperscript{37} Similarly, in \textit{In re Microstrategy Inc. Securities Litigation},\textsuperscript{38} the court refused to read into the statute any requirement that approval of class counsel should depend on a fee agreement:

And, while plaintiff’s selection of lead counsel is ‘subject to the approval of the court,’ approval should not be based on whether plaintiff’s chosen counsel promises to charge a cheaper fee than anyone else. . . . [A] district court should approve plaintiff’s choice of lead counsel based solely on that counsel’s competence, experience, and resources, saving the question of fees until the conclusion of the litigation.\textsuperscript{39}

Likewise, Judge Rakoff in \textit{In re Razorfish, Inc. Securities Litigation},\textsuperscript{40} held that competitive bidding is not “remotely consistent with the Reform Act . . . . By no reasonable reading of this [statutory] language can the Court’s right to disapprove lead plaintiff’s choice of counsel be transmogrified into a right to arrange a shotgun marriage between strangers.”\textsuperscript{41} Finally, Judge Wilken in \textit{Steiner v. Aurora Foods}\textsuperscript{42} also found bidding to be inconsistent with the text of the PSLRA:

While competitive bidding has been adopted by some district courts as a means to select lead counsel, the majority of courts have not adopted such an approach. Furthermore, competitive

\begin{itemize}
\item \textsuperscript{36} \textit{In re Cendant Corp. Litig.}, 2001 U.S. App. LEXIS 19214 (3d Cir. Aug. 28, 2001).
\item \textsuperscript{37} \textit{Id.} at *12.
\item \textsuperscript{38} \textit{In re Microstrategy Inc. Sec. Litig.}, 110 F. Supp. 2d 427, 437-38 (E.D. Va. 2000).
\item \textsuperscript{39} \textit{Id.} (emphasis added).
\item \textsuperscript{40} \textit{In re Razorfish, Inc. Sec. Litig.}, 143 F. Supp. 2d 304 (S.D.N.Y. 2001).
\item \textsuperscript{41} \textit{Id.} at 310.
\end{itemize}
biding appears to be contrary to the plain language of the PSLRA, which states that the plaintiff chosen as lead plaintiff “shall, subject to the approval of the court, select and retain counsel to represent the class.”43

Despite this “plain-meaning” interpretation, a few courts have undertaken a more active role in “approving” class counsel. Citing to the Conference Report to the PSLRA,44 a handful of judges have held that the court may take control over selecting lead counsel because, in their view, the “lead plaintiff does not come inextricably tied to its counsel.”45 Some judges have even read the word “shall” out of the statute altogether.46 But scholars have questioned this interpretation:

One problem with this conclusion is that it is inconsistent with the language of the PSLRA. The statutory text clearly vests the lead plaintiff, not the court, with authority to select lead counsel. Although the court can exercise veto power over the lead plaintiff’s selection, the statute provides no basis for the court to override the plaintiff’s selection and to impose its choice of counsel or to presume that it exercise complete discretion with respect to such selection.47

44. See H.R. Conf. Rep. No. 104-369, at 35 (1995), reprinted in 1995 U.S.C.C.A.N. 730, 734 (“The Conference Committee does not intend to disturb the court’s discretion under existing law to approve or disapprove the lead plaintiff’s choice of counsel when necessary to protect the interests of the plaintiff class.”).
46. See In re Bank One S’holders Class Actions, 96 F. Supp. 2d 780, 784 (N.D. Ill. 2000) (“It should be remembered that although Subsection (a)(3)(B)(v) provides that the most adequate plaintiffs may ‘select and retain counsel to represent the class’ that opportunity is expressly made ‘subject to the approval of the court.’”) (emphasis added).
The statutory text expressly vests the selection of counsel with the lead plaintiff. The legislative history further confirms that the PSLRA’s goal was to empower investors—not courts—to select counsel.

III. THE LEGISLATIVE HISTORY OF THE LEAD PLAINTIFF AND LEAD COUNSEL PROVISIONS OF THE PSLRA

On December 22, 1995, over President Clinton’s veto, Congress passed the PSLRA to modify the rules governing securities class action litigation.48 But the issue of securities reform had been raised in Congress and the courts before then. As already discussed, Judge Walker began experimenting with court-imposed competitive bidding for the selection of lead counsel in securities class actions as early as 1990.49 Thus, years before the PSLRA reached critical mass, there were legislative and judicial discussions of competitive bidding.

A. Discussions of Competitive Bidding Prior to the PSLRA

Securities and Exchange Commission (“SEC”) Chairman Arthur Levitt testified before Congress in 1994 about class-action reform proposals, and noted Judge Walker’s handling of the Oracle litigation as an example of how courts were attempting their own reform.50 He cautioned, however, that price should not be the sole determining factor: “the Commission recognizes that the best fee arrangement is not necessarily the lowest fee arrangement and that the quality of class counsel should be an important factor as well.”51 One month later, procedural scholar and Harvard Law School professor Arthur Miller testified before Congress about

49. See supra Part I.
51. Id.
competitive bidding, and warned against a system that would elevate price over quality of representation, and of the dangers of "pre-set" fee agreements:

At your last hearing, SEC Chairman Levitt described Judge Walker's use of competitive bidding in the Oracle case . . . . My own view is that competitive price bidding among counsel at the outset represents a significant loss of control by the court acting on behalf of the class. That system locks the class into paying a set percentage (or a set sliding scale) of the recovery no matter how the attorney performs. More importantly, competitive bidding also has the potential to foster a "race to the bottom" through which competing counsel cut fee and cost estimates to the "barebones" with a view toward obtaining the appointment rather than serving the class. Once counsel obtains control of the case, there might then be a strong incentive to do as little as possible to maximize profits. It also distracts the court from looking at the qualitative differences among the applicants, which frankness requires me to say can be considerable.

Thus, as Congress discussed and considered reforms of the federal securities laws during 1994 and 1995, it considered competitive bidding.

Five months later, turning again to academia, Congress shifted from discussing problems to finding solutions by drafting the PSLRA—and the PSLRA's academic underpinnings made clear that monitoring of class counsel by sophisticated investors was the preferred method for reform. The Senate Report, prepared as part of the legislative history of the PSLRA, specifically states that a Yale Law Journal article by Elliott Weiss and John Beckerman "provided the basis for the 'most adequate plaintiff' provision."

This statement was in a footnote attached to a sentence noting that


the then-existing system often worked to prevent sophisticated investors from selecting counsel. The Weiss and Beckerman thesis was that large, sophisticated investors "with the largest stakes in class actions are better situated than plaintiff's attorneys or courts to protect class members' interests," and thus should be the presumptive lead plaintiff. As is evident from the statute, Congress concurred with the authors' view and provided that the plaintiff with the largest loss be the presumptive lead plaintiff. Accordingly, the lead-plaintiff provisions adopted by Congress were taken directly from Weiss and Beckerman's article, which thus serves as a de facto proclamation of legislative intent. A review of that article is especially illuminating in analyzing whether competitive bidding is appropriate under the PSLRA.

B. Weiss and Beckerman's "Let the Money Do the Monitoring"

In drafting the lead-plaintiff and counsel provisions, Congress relied on Weiss and Beckerman's 1995 Yale Law Journal article, Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions. That article begins by stating that its proposed lead-plaintiff provisions "would allow market forces, not courts, to play a dominant role in determining who served as plaintiff's lead counsel in class actions [and] how lead counsel would be compensated." Thus, an inference can be drawn that the PSLRA sought to limit the court's involvement in selecting lead counsel. But more than an inference is provided.
The authors specifically distinguish their proposal—later adopted by Congress—from Judge Walker's bidding system by noting that their "market-based proposal has clear advantages over" Judge Walker's *Oracle* decision. They add that "[a]uctions will do little to eliminate [unfounded] suits, and because of informational problems, are unlikely to provide class members with adequate compensation when their claims are meritorious." To resolve any potential ambiguity, they also explain that their approach "would differ from that of Judge Walker in *Oracle Securities Litigation* . . . ."

In a passage that speaks directly to Judge Walker's concerns in *Oracle*, the article discusses the need for the lead plaintiff to have a substantial stake in the litigation: "Most critiques of class actions assume that substantial agency costs are unavoidable because no class member has a stake in the litigation large enough to justify monitoring the attorneys who represent the class. This assumption underlies . . . Judge Walker's decision to auction off the lead counsel position in *Oracle*." The authors add that, "[i]t would seem to follow that, had [Judge Walker] believed the class included a knowledgeable investor with a suitably large stake in the litigation, the court's preference would have been to involve that class member in the negotiation [of who would act as class counsel]." Thus, the lead plaintiff would be the person, group of persons, or entity that would select counsel: "The change we propose also will place institutional investors in a position to negotiate fee arrangements with plaintiffs' lawyers before class actions are initiated . . . . [I]t may well be that [these fee arrangements] will differ substantially from the fee structures courts currently employ."

The authors also explain that their system would lead to fewer baseless suits because the sophisticated investors "could then negotiate fee arrangements with their attorneys that took account

60. *Id.* at 2107, n.257.
61. *Id.* at 2107.
62. *Id.* at 2107 n.256 (emphasis added).
63. *Id.* at 2088.
64. *Id.* at 2088 n.190.
65. *Id.* at 2107 (emphasis added).
of that possibility.\textsuperscript{66} Further, fee arrangements would be made by clients, not courts: "The relevant attorneys' fee could be covered, as they are now, by the fee arrangements institutions make with lawyers they select to represent the class."\textsuperscript{67} These fee arrangements would be fair to the class because the interests of large, sophisticated investors "parallel the interests of the plaintiff class much more closely than do the interests of plaintiffs' attorneys or district judges, the parties now responsible for protecting the class."\textsuperscript{68} And the changes "relating to the selection of lead counsel"—later adopted—would "make it much easier for institutional investors to serve as class representatives...[and] to serve as effective litigation monitors."\textsuperscript{69}

These passages indicate that the authors who provided the basis for the lead-plaintiff provisions considered competitive bidding as proposed by Judge Walker, but chose their own method, which "has clear advantages over" bidding.\textsuperscript{70} The PSLRA's legislative history further supports the conclusion that competitive bidding for lead counsel is contrary to Act's intent.

\textbf{C. The PSLRA's Committee Reports and the Congressional Record}

When the Supreme Court examines legislative history it recognizes that "the authoritative source for finding the Legislature's intent lies in the committee reports on the bill..."\textsuperscript{71} Accordingly, "[b]ecause the conference report represents the final statement of terms agreed to by both houses, next to the statute itself it is the most persuasive evidence of congressional intent."\textsuperscript{72} The Senate Report's discussion of selection of lead plaintiff and counsel—and the Conference Report's incorporation of identical language\textsuperscript{73}—contain numerous references to the empowerment of

\begin{itemize}
  \item[66.] \textit{Id.} at 2123.
  \item[67.] \textit{Id.} at 2124.
  \item[68.] \textit{Id.} at 2121 (emphasis added).
  \item[69.] \textit{Id.} at 2126.
  \item[70.] \textit{Id.} at 2107.
  \item[71.] Garcia v. United States, 469 U.S. 70, 76 (1984).
  \item[72.] Demby v. Schweiker, 671 F.2d 507, 510 (D.C. Cir. 1981).
  \item[73.] The Senate Report was ultimately replaced with the Joint Explanatory
investors through the PSLRA. The Senate Report makes the Act's intentions clear: "Specifically, [the PSLRA] intends: ... to empower investors so that they not their lawyers exercise primary control over private securities litigation ....""74 Likewise, the Conference Report states that Congress intended for the lead plaintiff, not the court, to select counsel: "These provisions are intended to increase the likelihood that parties with significant holdings in issuers ... will participate in the litigation and exercise control over the selection and actions of plaintiffs counsel.""75 Significantly, Congress alluded to the precise issue of who would select lead counsel by reiterating that "'[t]he Committee permits the lead plaintiff to choose the class counsel. This provision is intended to permit the lead plaintiff to choose counsel ....""76 The Committee also added that it did "'not intend to disturb the court's discretion under existing law to approve or disapprove the lead plaintiff's choice of counsel when necessary to protect the interests of the plaintiff class.'""77 This language indicates that the lead plaintiff should control the process of selecting and retaining counsel, subject to the court's discretion to veto that selection only when necessary to protect the interests of the class. Indeed, the Conference Report seemingly resolves the issue of who selects class counsel: "this lead plaintiff provision solves the dilemma of who will serve as class counsel. Subject to court approval, the most adequate plaintiff retains class counsel.""78

The Congressional Record also proves insightful in interpreting what Congress intended to accomplish with the lead-plaintiff provisions. Shortly before the Act became law, Senator


78. Id.
Christopher Dodd, a drafter and sponsor of the PSLRA, emphasized that the Conference Report should convey investor control by giving investors authority to select class counsel: "[T]he conference report empowers investors so that they . . . have the greater control over the class action cases by allowing plaintiffs with the greatest claim to be named plaintiff and allowing that plaintiff to select their counsel."79 He later summarized what the lead plaintiff provisions were designed to do in stating that "[w]hat it does is strengthen the hand of investors tremendously by giving them the right to choose the attorneys . . . and giving them the right to determine what the attorney's fees would be. That is what we are trying to do here."80

Thus, Judge Walker's idea of court-ordered competitive bidding to select the least expensive counsel, while well-intentioned, was considered and rejected by the drafters of the PSLRA's lead-plaintiff provisions, and is contradicted by the legislative history of the Reform Act.

D. Competitive Bidding Collides With the Express Language and Underlying Goals of the PSLRA

1. The Cendant & MicroStrategy Decisions

Many post-PSLRA cases have rejected competitive bidding for lead counsel as inconsistent with the Act's statutory language and objectives. The two most detailed analyses of this issue have come from the Third Circuit's Cendant81 decision and the Eastern District of Virginia's MicroStrategy decision.82 Both decisions explain in great detail why competitive bidding is inconsistent with the PSLRA's statutory mandates.

In *Cendant*, Chief Judge Becker concluded that the trial court’s “decision to hold an auction to select lead counsel was inconsistent with the Reform Act, which is designed to infuse lead plaintiffs with the responsibility (and motivation) to drive a hard bargain with prospective lead counsel and to give deference to their stewardship.” While the court stopped short of outlawing auctions in every situation, it held that “lead counsel auctions are generally (and the auction in this case was) inconsistent with the statutory scheme embodied in the reform act.” Chief Judge Becker emphasized that when appointing a lead plaintiff, judicial intervention via auction misconstrues the context in which the appointment is to occur:

We stress, however, that the question at this stage is not whether the court would ‘approve’ that movant’s choice of counsel or the terms of its retainer agreement or whether another movant may have chosen better lawyers or negotiated a better fee agreement; rather the question is whether the choices made by the movant with the largest losses are so deficient that it will not fairly and adequately represent the interests of the class, thus disqualifying it from serving as lead plaintiff at all.

Indeed, the court later observed that a judge’s decision to hold an auction gives too little credence to the presumptive lead plaintiff’s choice of counsel:

[T]he question is not whether another movant might do a better job of protecting the interests of the class than the presumptive lead plaintiff; instead, the question is whether anyone can prove that the presumptive lead plaintiff will not done a ‘fair and adequate’ job. We do not suggest that this is a low standard, but merely stress that the inquiry is not a relative one.

In rejecting competitive bidding, the court noted that to read

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84. *Id.* at *122 n.45. The court allowed for the possibility of the court selecting class counsel only where the lead plaintiff had “repeatedly undertaken a flawed process of selecting and retaining lead counsel.” *Id.* at *171.
85. *Id.* at *137-*38.
86. *Id.* at *145 (emphasis added).
the PSLRA as allowing for auctions would mean that "the statute in effect confers upon the court the right to 'select and retain' counsel and limits the lead plaintiff to deciding whether to acquiesce in those choices, thus eliminating any discretion on the part of the lead plaintiff." Such a result, the court held, "is inconsistent with the statutory text [of the PSLRA]." Chief Judge Becker thus recognized that the PSLRA severely limits the role of the court in selecting class counsel:

[W]e think that the Reform Act evidences a strong presumption in favor of approving a properly-selected [sic] lead plaintiff's decisions as to counsel selection and counsel retention . . . . [T]he question is not whether the court believes that the lead plaintiff could have gotten a better deal. Such a standard would eviscerate the Reform Act's underlying assumption that, at least in the typical case, a properly-selected [sic] lead plaintiff is likely to do as good a job or better than the court at the tasks. Because of this, we think that the court's inquiry is appropriately limited to whether the lead plaintiff's selection and agreement with counsel are reasonable on their own terms.

Simply put, a court cannot impose an auction because it "prefers a process of counsel selection or retention that it, rather than the lead plaintiff, controls, nor is it enough that the court thinks that an auction is an inherently superior mechanism for determining a reasonable fee." Instead, "under the PSLRA, courts should afford a presumption of reasonableness to any fee request submitted pursuant to a retainer agreement," and that "presumption may only be rebutted by a prima facie showing that the (properly submitted) retained agreement is clearly excessive." Accordingly, the Third Circuit in Cendant concluded that the district court "abused its discretion by conducting an auction because its decision to do so was founded upon an erroneous understanding of the legal standards undergirding the propriety of

87. Id. at *168.
88. Id.
89. Id. at *169 (emphasis added).
90. Id. at *172-*73.
91. Id. at *188, *191 (emphasis added).
conducting an auction under the PSLRA."

The court in Microstrategy similarly rejected a putative lead-plaintiff's suggestion to adopt competitive bidding as inconsistent with the text of the PSLRA:

The final candidate was the so-called "Bidding Group,"... [which proffered an] imaginative, if unauthorized proposal to abandon the statutory lead plaintiff selection procedure and adopt instead a competitive bidding process. In so doing, the group argued, legal fees would be set competitively and hence they would be lower than fees would be otherwise. The short answer to this argument is that it finds no warrant in the statute. The PSLRA plainly states that a district court's duty is to appoint a lead plaintiff based on the relevant statutory criteria, while it is the lead plaintiff's duty to "select and retain counsel to represent the class." And, while plaintiff's selection of lead counsel is "subject to the approval of the court," approval should not be based on whether plaintiff's chosen counsel promises to charge a cheaper fee than anyone else. The ultimate fee structure is within a district court's discretion throughout the litigation, because, at the conclusion of the litigation, a district court has a statutory obligation to ensure that the ultimate award of attorney's fees is reasonable. Instead, a district court should approve plaintiff's choice of lead counsel based solely on that counsel's competence, experience, and resources, saving the question of fees until the conclusion of the litigation."

This reasoning blends the PSLRA's statutory text with its legislative history. The text states that the person or group of persons appointed lead plaintiff "shall" select counsel, and the legislative history indicates that judicial discretion in approving the selection of counsel should be guided by "existing law"—examining competence, experience, and resources—and withhold approval only "when necessary to protect the interests of the plaintiff class." As shown below, existing case law does not support

92. Id. at *180.
The “approval of the court” referenced in the PSLRA’s lead-plaintiff provisions reiterates the court’s existing discretion to ensure that the “adequacy” prong of Rule 23 is satisfied. That is, the most-adequate-plaintiff provision—which specifies the factors the court should examine to determine if the presumptive adequacy of the plaintiff the largest financial interest has been rebutted—and the selection-of-counsel provision—which allows the lead plaintiff to select counsel subject to court approval—are simply the codification of existing Rule 23 case law. Indeed, Weiss and Beckerman urged courts to interpret adequacy requirements to coincide with their “most adequate” plaintiff analysis. The Third Circuit has defined the adequacy prong in essentially the same terms as the court in Microstrategy: “Adequate representation depends on two factors: (a) the lead plaintiff’s attorney must be qualified, experienced, and generally able to conduct the proposed litigation, and (b) the lead plaintiff must not have interests antagonistic to those of the class.” Further, that the court should exercise discretion only when necessary is also consistent with existing Rule 23 case law, which has generally held that “[i]n the

95. See Fed. R. Civ. P. 23 (“One or more members of a class may sue or be sued as representative parties on behalf of all only if . . . the representative parties will fairly and adequately protect the interests of the class.”) (emphasis added).


98. See Weiss & Beckerman, supra note 16, at 2105 (“[A] court should interpret Rule 23’s requirements that a named plaintiff be able to represent the class ‘adequately’ to mean that it should select as lead plaintiff the named plaintiff capable of ‘most adequately’ representing class members’ interests.”).

absence of proof to the contrary, courts [should] presume that class
counsel is competent and sufficiently experienced to prosecute
vigorously the action on behalf of the class.”

In Microstrategy, Judge Ellis recognized that existing law gave
courts discretion to veto the most-adequate-plaintiff's selection of
counsel based on “counsel's competence, experience, and
resources,” but not simply because another lawyer “promises to
charge a cheaper fee than anyone else.” Thus, the “approval
referred in the statute’s subject-to-the-approval-of-the-court
language should be based on the factors that existing case law have
relied upon. The SEC, whose opinions are entitled to deference in
the area of securities law,” recently addressed this issue in an
amicus curiae brief to the Third Circuit, where it concluded that
bidding “may not have been appropriate.” In discussing the lead-
plaintiff's selection of counsel the Commission noted that court
approval was historically based on a Rule 23(a)(4) analysis:

(1) competence—experience and expertise—to conduct a class
action in the relevant area of law; (2) capacity, in terms of
financial resources, diligence and personal motivation, to
pursue the class action to a satisfactory conclusion; (3) freedom
from disabling conflict of interest; and (4) an appropriate
number of counsel, so as not to cause delay, disorganization, or
increased costs.

The SEC's position is that court approval of class counsel
should be based on selecting the highest caliber of counsel for the
class, not the cheapest fee. Similarly, the Second Circuit has noted
that “an essential concomitant of adequate representation is that
the party's attorney be qualified, experienced and generally able to

100. Hewlett v. Premier Salons Int'l, Inc., 185 F.R.D. 211, 218 (D. Md. 1997);
2000).
103. See Brief of the Securities and Exchange Commission as Amicus Curiae
in Support of Appellants on the Issue Specified at 23, In re Cendant Corp. Sec.
Litig., Nos. 00-2769, 00-3653 (3d Cir. Dec. 22, 2000) [hereinafter SEC Brief].
104. Id. at 18 (citing cases).
conduct the proposed litigation."¹⁰⁵ The willingness to work for the lowest fee has never been a criterion used by courts to ensure vigorous and competent class representation.

A detailed adequacy analysis under Rule 23 was not intended under the PSLRA.¹⁰⁶ Indeed, the SEC has recognized that Congress intended the PSLRA's financial-interest prong to act as a proxy of adequacy—i.e., the "most adequate plaintiff"—with Rule 23 acting in a subservient role:

[T]he Reform Act and its legislative history reflect Congress' [s] understanding of current law with regard to challenges of adequacy of representation. The Act's standards for such challenges must be viewed in the context of the lead plaintiff provisions as a whole and of the Act's purposes. The Reform Act specifies that the "most adequate plaintiff" is the plaintiff or movant that "has the largest financial interest in the relief sought by the class" and otherwise satisfies the requirements of Rule 23. The largest financial interest requirement was itself designed to ensure more effective representation of investors in securities fraud class actions.¹⁰⁷

3. Competitive Bidding May Violate the Model Rules of Professional Responsibility

The SEC's third historical factor—freedom from a conflict of interest—may be violated by the use of competitive bidding. The Third Circuit created a task force to evaluate whether competitive bidding was appropriate in securities class actions, in part, because Chief Judge Becker recognized that "many respected judges and lawyers have opined that the bidding process is flawed in concept and practice, and that it presents professional responsibility problems."¹⁰⁸

Some scholars suggest that a bidding system like the one used in Oracle violates the Model Rules of Professional Conduct's restrictions pertaining to fees, conflicts of interest, and prohibited transactions.\textsuperscript{109} Specifically, some have suggested that "preset fees and... limit[s] on reimbursable expenses[] threaten to limit the lawyer's ability to represent the plaintiff class fully and faithfully."\textsuperscript{110} One court commented that a bidding system with capped expenses raises "a serious question as to the ethical propriety of an agreement by counsel to bear the client's actual out-of-pocket expenses without a right of reimbursement."\textsuperscript{111} In fact, professional-responsibility scholar Stephen Gillers\textsuperscript{112} has submitted an ethics opinion in which he states that a fee agreement with capped expenses is not permitted under either the Model Rules of Professional Conduct or the Model Code of Professional Responsibility.\textsuperscript{113}

Another reason competitive bidding raises professional-responsibility concerns is "because of the uncertainty about how a court should determine the best interests of the class, . . . because of the inflexibility of the scheme . . . [and because] the Rule [1.7] seems not to allow an expense cap."\textsuperscript{114} Further, once a bid has been accepted by the court, a crippling conflict of interest "could arise in the event of an early settlement . . . between a lawyer's representation [of the class] and other business or personal interests of the attorney" as result of the \textit{ex ante} bid structure.\textsuperscript{115}

\textsuperscript{109} See Steven A. Burns, Setting Class Action Attorneys' Fees: Reform Efforts Raise Ethical Concerns, 6 GEO. J. LEGAL ETHICS 1161, 1178–79 (1993) (noting that competitive bidding violates Rules 1.5, 1.7, and 1.8 of the Model Rules of Professional Conduct).
\textsuperscript{110} Id. at 1179.
\textsuperscript{111} In re Amino Acid Lysine Antitrust Litig., 918 F. Supp. 1190, 1200 (N.D. Ill. 1996).
\textsuperscript{113} See Opinion by Professor Stephen Gillers of New York University Law School on a Proposed Contingent Fee Arrangement in the In re American Continental Corp./Lincoln Savings & Loan Sec. Litig., at 1–2 (June 26, 1990) (on file with author).
\textsuperscript{114} Burns, supra note 109, at 1179–80.
\textsuperscript{115} Id. at 1184.
Finally, a competitive-bidding system may be regarded as a “prohibited transaction” under the Model Rules because it would “produce a fee structure that would strain the attorney’s ability to deal with unexpected [financial] circumstances, thus potentially compromising the representation of the client to a degree not permitted by [the] Rules.”

Accordingly, the “existing law” Congress intended to guide courts in approving lead-counsel selection is not only devoid of criteria that allow for competitive bidding, but illustrates that it may actually conflict with lawyers’ professional responsibilities.

E. Competitive Bidding Is Inconsistent With Rule 23

Rule 23 of the Federal Rules of Civil Procedure does not encompass competitive bidding for the selection of lead counsel in securities class actions. In discussing adequacy under Rule 23, courts simultaneously examine both Rule 23(a)(4)—relating to adequacy of representation—and Rule 23(d)(1), which has been interpreted to give the court power to appoint lead counsel based on a finding that class counsel is inadequate under Rule 23(a)(4). Indeed, Judge Walker relied on Rule 23(d) in Oracle as authority for his appointment of class counsel. Rule 23(d)(1) has been interpreted to allow a court to impose its own choice of counsel, however, “only in ‘extraordinary situations.’” These extraordinary situations deal with caliber of counsel, rather than cost: “the overriding interest of the Court in designating lead counsel in an action...is the vigorous protection of the rights of the plaintiff shareholders. This requires representation of the

116. Id. at 1188.
117. See Fed. R. Civ. P. 23(d)(1) (“In the conduct of actions to which this rule [23] applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument.”).
120. Alpert, 163 F.R.D. at 423 (citing 2 Herbert B. Newberg & Alba Conte, Newberg on Class Actions § 9.35 (3d ed. 1992)).
Such a holding is inconsistent with competitive bidding, which seeks to appoint counsel not based on whether counsel is of the "highest caliber," but rather whether they will conduct the litigation at the cheapest price. Competitive bidding differs in objective from Rule 23 because it necessarily results in only one winning law firm, whereas Rule 23's adequacy requirements have never been interpreted to mean that only one plaintiff or law firm can be adequate in a particular case. As securities-law scholar and Columbia Law School professor John Coffee has pointed out, "[y]ou can choose an inadequate lawyer, but I don't think you can say that a lawyer is inadequate just because some other lawyer beat them by a nickel on the auction . . . ."122

Competitive bidding may also conflict with Rule 23(e) if a settlement is ultimately achieved. Rule 23(e) requires that the court ensure a settlement is reasonable before approving it.122 Where a ceiling is put on fees at the start of the litigation—even if that ceiling is merely a percentage of net recovery—the fee structure "may be inconsistent with Rule 23, because the basic premise of Rule 23 is that the fee has to be reasonable . . . ."124 Presumably, the requirement of Rule 23(e)—and the PSLRA125—that the court ensure a reasonable fee is a two-way street; that is under Supreme Court precedent, a disproportionately small attorney fee would provide the class with "an unfair advantage" at the expense of class counsel.126 Bidding puts a limit on fees, thereby preventing the court from allowing counsel "to restructure its percentage bid in comparable hindsight terms to get a bigger

share of the recovery,\textsuperscript{127} even if an after-the-fact review
determines that class counsel deserve more compensation based on
the facts of the case—as is presently allowed for.\textsuperscript{128} An \textit{ex ante} fee
determination is an amorphous concept because “percentage’ is a
relational concept. Percentage of what? Fifty percent is neither a
lot nor a little, until one knows what the underlying whole is. Half
of one cookie isn’t much. Half a full cookie jar may well be a
lot.”\textsuperscript{129} How then, can a court adopting bidding ensure that fees are
reasonable as required by Rule 23(e)? It cannot. Flexibility is
paramount in determining attorney fees, and courts have long
recognized that the “ultimate responsibility for determining the
fairness to the class of settlement decisions which compromise class
interests” is not “entrust[ed] to the representative parties,” but
solely to the court under Rule 23(e).\textsuperscript{130} By allowing one party to set
fees before an award is known, flexibility under Rule 23(e) is lost.

Finally, in a striking indication that the authority to order
competitive bidding in securities class actions is \textit{not} within the
discretion afforded courts under Rule 23, the Advisory Committee
on Civil Rules, which is charged with evaluating federal rules
changes, specifically rejected such an approach: “Discussion of the
Rule 23 aspects of the securities litigation bills included a comment
on the practice adopted by some judges of soliciting bids by
competing firms to become class counsel. This procedure was said
to \textit{add an undesirable layer of complexity to getting class actions
initiated.}”\textsuperscript{131} More recently, the Standing Committee of the Rules
of Practice and Procedure released proposed amendments to Rule
23—which discuss competitive bidding in the committee notes—

\textsuperscript{127.} Order at 10, \textit{In re} Comdisco Sec. Litig., No. 01-C-2110 (N.D. Ill. June 25,
2001).

\textsuperscript{128.} \textit{See, e.g., In re} Pacific Enters. Sec. Litig., 47 F.3d 373, 379 (9th Cir. 1995)
(approving an increase in attorney fee percentage from the benchmark of 25% to
33% based on complexity, risk, and non-monetary benefits).

\textsuperscript{129.} \textit{In re} Superior Beverage/Glass Container Consol. Pretrial, 133 F.R.D.
119, 125 (N.D. Ill. 1990) (emphasis in original).

omitted).

\textsuperscript{131.} Advisory Committee on Civil Rules, Meeting Minutes, Feb. 16–17, 1995
(emphasis added).
and proposed-Rule 23(h) (regarding appointment of class counsel) specifically notes that competitive bidding is not allowed under the PSLRA. The Supreme Court has noted that in interpreting the Federal Rules of Civil Procedure, the meaning given by the Advisory Committee is to be given great weight. If the drafters of both the lead-plaintiff provisions and the Federal Rules considered and rejected competitive bidding in securities class actions, from whence does the authority to institute competitive bidding arise? It does not exist.

1. Beyond Cendant & Microstrategy

As shown below, many courts have expressly rejected competitive bidding as inconsistent with the text and purposes of the PSLRA; other courts, however, reject it without mention, failing to discuss their rejection of a party’s proposal that it be undertaken. While only one circuit court has squarely addressed the issue, many district courts have weighed-in on the issue and rejected competitive bidding as well.

In a recent case, Judge Rakoff in In re Razorfish Securities Litigation, rejected the suggestion of competitive bidding in no uncertain terms: “[Competitive bidding] is not, in this Court’s view,

132. See Text of Proposed Changes to Federal Rule of Civil Procedure 23, Committee Note par. (1)(a) (noting that PSLRA provisions “contain specific directives about selection of a lead plaintiff and the retention of counsel. This subdivision does not purport to supersede those provisions, or any similar provisions of other legislation.”).
133. See Mississippi Publ’g Corp. v. Murphree, 326 U.S. 438, 444 (1946).
134. Many of the courts offered the prospect of engaging in bidding proposals simply ignore it in their orders. See, e.g., Sutton v. MarchFirst, Inc., 00-C-6676 (N.D. Ill. Feb. 7, 2001) (minute order provides for counsel to submit fee agreement to court, but implicitly rejected earlier suggestion of defendants to adopt competitive bidding by not doing so); In re AT&T Corp. Sec. Litig., Civ. No. 00-5364 (D.N.J. Jan. 29, 2001) (appointing the New Hampshire Group as lead plaintiff over defendant’s suggestion of competitive bidding); Rosenberg v. Nationsbanc Montgomery Sec. Inc., No. C-98-20956 (N.D. Cal. Dec. 11, 1998) (appointing lead counsel without resorting to bidding despite the request in prior pleadings of one group of plaintiffs to auction off lead counsel position).
remotely consistent with the Reform Act . . . ." The court added that under a bidding system “the presumptive lead counsel is the cheapest lawyer, who then is more or less forced upon the largely irrelevant lead plaintiff.” The court recognized Congress’s intent to empower, not trivialize, the role of lead plaintiff:

[U]nder the auction approach, [the lead plaintiff] is an irrelevancy . . . . By no reasonable reading of this [statutory] language can the Court’s right to disapprove lead plaintiff’s choice of counsel be transmogrified into a right to arrange a shot-gun marriage between strangers . . . . Under the approach mandated by the Reform Act . . . the primary focus must always be, not on the selection of counsel, but on the selection of lead plaintiff.

In a similarly-thorough analysis worth repeating in full, Judge Wilken in Steiner v. Aurora Foods Inc., articulated her belief that competitive bidding for lead counsel cannot be reconciled with the PSLRA:

While competitive bidding has been adopted by some district courts as a means to select lead counsel, the majority of courts have not adopted such an approach. Furthermore, competitive bidding appears to be contrary to the plain language of the PSLRA, which states that the plaintiff chosen as lead plaintiff “shall, subject to the approval of the court, select and retain counsel to represent the class.” The PSLRA gives the court authority both to approve counsel selected by the lead plaintiff, and ultimately to determine the amount of fees awarded to such counsel. This oversight is sufficient to ensure that the interests of the class are protected, without depriving the lead plaintiff of its right to the counsel of its choice. Therefore, the Court declines to adopt a competitive bidding process for the determination of lead counsel in this case.

136. Id. at 310.
137. Id.
138. Id. at 310–11 (citation omitted).
140. Id. at *16–*17 (emphasis added) (citations omitted).
This lengthy discussion further supports the view that competitive bidding is antithetical to the plain language of the PSLRA, which was designed to include sufficient oversight to ensure that shareholder classes are protected.

_Aurora Foods_ also raises a new twist in the competitive-bidding spectrum. Rather than forcing bidding on a lead plaintiff, another plaintiff seeking appointment argued that the presumptive lead plaintiff was inadequate for failing to use competitive bidding to select counsel.\(^1\) The court wisely rejected such an argument: "Espinosa's arguments that the Court should adopt a competitive bidding approach to the selection of lead counsel, and that the presumption that the Aurora Lead Plaintiff Group is the most adequate Plaintiff is overcome by its failure to seek competitive bidding are unavailing."\(^2\) Relying on her belief that the PSLRA does not allow for competitive bidding, Judge Wilken "conclude[d] that the Aurora Lead Plaintiff Group's failure to seek competitive bidding does not indicate that it will inadequately represent the interests of the class."\(^3\) This slightly different approach to endorsing bidding was recently adopted by Judge Walker, although not at the prompting of any of the other potential lead plaintiffs.\(^4\) In _In re Copper Mountain Networks Securities Litigation_, he held that because the presumptively most adequate plaintiff negotiated a fee agreement that ranged from 20% to 30% of the total recovery—a percentage that he determined was not "competitive" because of its "extravagance"—that "the presumption invoked by the [group with the largest financial interest] is... rebutted" and the presumptive lead plaintiff was inadequate as a matter of law by virtue of its fee agreement.\(^5\) If followed to its logical conclusion Judge Walker's holding that a fee agreement could render a plaintiff inadequate under Rule 23 would mean that every class action adopting the Ninth Circuit's benchmark of 25% would have had an inadequate

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141. *Id.* at *16.
142. *Id.*
143. *Id.* at *17.
144. See _In re Copper Mountain Networks Sec. Litig._, 201 F.R.D. 475 (N.D. Cal. 2001), _rev'd_, 306 F.3d 726 (9th Cir. 2002).
145. *Id.* at 489.
class representative and would thus be neither binding nor satisfy due process.\textsuperscript{146} This cannot be so.

At least nine other federal district courts presented with the opportunity to adopt competitive bidding after the PSLRA have rejected the option.\textsuperscript{147} Even state courts have joined the growing chorus of bidding foes. Finding that bidding may deter counsel's diligence, the Delaware Chancery Court in \textit{Seinfeld v. Coker},\textsuperscript{148} recognized that an auction system "may not lead to a fully motivated class counsel, especially if the auction process has caused counsel to discount aggressively their bid," and that negotiated fee arrangements "may provide a superior \textit{ex ante} approach to creating the proper incentives."\textsuperscript{149}

Finally, although not directly related to securities law, competitive bidding in other areas have been struck down as unconstitutional. In \textit{State v. Smith},\textsuperscript{150} the Arizona Supreme Court held that a statute requiring competitive bidding for the representation of indigent criminal defendants violated "the right of a defendant to due process and right to counsel as guaranteed by

\textsuperscript{146} Crawford v. Honig, 37 F.3d 485, 487 (9th Cir. 1994) (stating that class members who are not parties to suit are bound by judgment—and due process is satisfied—only if absent members' interests are adequately protected by representative class members).


\textsuperscript{149} Id. at *27 n.36.

Central to this decision was the belief that bidding, when applied to legal representation, "is the least desirable and can result in inadequate representation by counsel." Like an indigent criminal defendant who has little choice in selecting his lawyer, the absent class members deserve to have their interests protected by counsel whose fees will not potentially render their representation inadequate because the court has catered solely to the lowest fee.

Blind adherence to the promotion of competitive bidding in securities class actions can lead to absurd results that are antithetical to the goals of the PSLRA. For example, in once recent case, Judge Walker instituted a competitive-bidding system and selected lead counsel based on the bids, but could not find a plaintiff willing to prosecute the suit with the "winning" counsel. The lead plaintiff determined to be most-adequate based on financial loss wanted to continue as lead plaintiff with his own lawyers, but refused to work with counsel that had opposed him earlier in the litigation. Frustrated that his auction had not yielded the result he had hoped it would, Judge Walker jettisoned the lead plaintiff and—unbelievably—told the "winning" lead counsel that they should go out and pick a new client to act as lead plaintiff. The court seemingly recognized that the case must have a plaintiff to go forward, but appointed lead counsel without one: "At some point or other, there is going to clearly have to be a class representative . . . you can identify and bring forward who has the kinds of qualities and experiences and ability to discharge the supervisory responsibilities that the Reform Act spoke about . . . ." Thus, in Quintus the court disregarded the PSLRA's emphasis on empowering the lead plaintiff—thereby abandoning the case to the lawyers—and appointed a law firm to lead a case.

151. Id. at 1381.
152. Id. at 1383.
154. See id. at 16.
156. Quintus Transcript, supra note 153, at 22.
without a client. This, clearly, is not what Congress had in mind when it sought to reform lawyer-driven litigation. Indeed, "under the approach mandated by the Reform Act... the primary focus must always be, not on the selection of counsel, but on the selection of lead plaintiff." Under the auspices of protecting the class, the court in Quintus effectively repealed the PSLRA by abandoning the statutory framework intended to protect defrauded investors.

E. Competitive Bidding Is Inconsistent With the Objectives of the PSLRA

There are many arguments as to why competitive bidding is an inappropriate method for selecting lead counsel in securities class actions. This analysis confines the discussion to the relationship between competitive bidding and the PSLRA. Relevant issues include: whether auctions deter sophisticated investors' participation; whether bidding unduly prolongs the lead-plaintiff selection process; whether the PSLRA's stay on discovery prevents informed bidding; academic review of the propriety of competitive bidding; why defendants advocate bidding; and cost-versus-quality trade-offs.

1. Deterring Sophisticated Investors from Participation in Class Actions

The Network Associates case discussed at the outset of this article shows that competitive bidding can deter sophisticated investors from participating in securities class actions. The SEC has also recognized this possibility:

The court's resort to an auction could discourage institutions

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157. See, e.g., H.R. CONF. REP. NO. 104-369, at 35, reprinted in 1995 U.S.C.C.A.N. 730, 734 ("[T]he Conference Committee expects that the plaintiff will choose counsel rather than, as is true today, counsel choosing the plaintiff.").
159. See supra INTRODUCTION.
from stepping forward to lead class actions. Institutions and other large investors, whose participation Congress sought to encourage, may understandably be reluctant to invest time and money in selecting counsel and negotiating advantageous fee arrangements if these actions are at risk of being overridden by the court. Even if they are not deterred from participating, they may find it difficult to work with unfamiliar counsel and thus may place a less active and effective role on behalf of the class.160

The Commission has also noted that the court should rely on investors’ judgment in approving the selection of counsel because “failing to do so could enhance counsel’s control of the litigation, which is contrary to Congress’[s] intent. It could also deprive institutional investors of a core reason for serving as lead plaintiff, only adding to the already significant disincentives for them to do so.”161

Professor Coffee, who served as legal consultant and adviser to the White House’s Office of General Counsel during the PSLRA’s consideration and passage,162 has also noted this possibility of sophisticated-investor deterrence:

> Although the PSLRA gives the court authority to veto the choice of an unqualified class, counsel, it does not confer the right to disregard the client’s choice . . . . Not only does letting the low bidder control litigation decisions maintain control in lawyers’ hands, but it may chill the willingness of . . . institutional bidders to serve as lead plaintiffs, if they are to be involuntarily wedded to counsel they did not select.163

In other words, forcing a shotgun-marriage between a sophisticated investor and an unfamiliar counsel may drive away the very type of lead plaintiff the PSLRA sought to encourage. Similarly, Professor Elliott Weiss, who co-authored the article that

160. SEC Brief, supra note 103, at 2.
161. Id. at 14–15.
provided the basis for the lead-plaintiff and counsel provisions,\(^{164}\) has noted that the competitive-bidding process is "misguided."\(^{165}\) Professor Weiss believes that such a practice will deter large investors from participating in securities actions: "[I]f courts develop a practice of second-guessing the considered decisions of sophisticated institutional investors concerning which attorneys to hire and on what terms to retain them, such institutional investors will become even more reluctant than they are now to assume the burdens of serving as lead plaintiffs."\(^{166}\) Professor Weiss recently submitted this opinion to the Third Circuit Task Force addressing the selection of class counsel:

> If it becomes clear that institutional investors' good faith efforts to select and retain counsel will frequently be subjected to judicial second guessing, it seems clear to me that fewer institutions – and in particular, far fewer of the most responsible and diligent institutions – will seek to plaintiffs in securities class actions in the future .... [J]udicially conducted auctions constitute a particularly clumsy mechanism for selecting lead counsel is [sic] securities class actions.\(^{167}\)

Once the selection of lead counsel has been given to the court rather than counsel, the relationship between an institutional investor and counsel is fundamentally altered:

> [After the auction] the working relationship with lead counsel and the supervisory role we had carved out for ourselves was subtly but irretrievably damaged. Since we were no longer in control of the agreement our authority over counsel was undermined. Lead counsel was the court's choice ... [and] "ownership" of the case had been ceded to the court.\(^{168}\)


\(^{165}\) Declaration of Elliott J. Weiss ¶ 27, In re Cendant Corp. Sec. Litig., No. 1664 (D.N.J. May, 2000) [hereinafter Weiss Declaration].

\(^{166}\) Id. ¶ 27(a).

\(^{167}\) Elliott J. Weiss, Written Statement Before the Third Circuit Task Force on Selection of Class Counsel, at 3 (Mar. 8, 2001).

\(^{168}\) Lona Goodman, Testimony on Behalf of the City of New York, Third Circuit Task Force on Selection of Counsel, at 5 (June 1, 2001) [hereinafter
Deterring institutional investors is not just an abstract possibility. Several of the nation's largest institutions have emphasized that they will not participate in securities class actions if competitive bidding is used. For example, the General Counsel to the Florida State Board of Administration recently explained that the Florida Board would never agree to a competitive bidding regime:

We would not think of bidding out... assignments to the low-price bidder. Legal services are not a commodity... The FSBA believes that auctioning class counsel is wholly inconsistent with both the express letter and spirit of the PSLRA... [W]e would not care to work with counsel other than that of our own choosing, if that other counsel had prevailed in an auction process on criteria heavily reliant on price, slighting our own experience and judgment in identifying and working with highly qualified law firms many times before and negotiating a fee.\textsuperscript{169}

Even assuming an institutional investor is willing to go along with a competitive-bidding system, the structure of that system may also drive away institutional investors. For example, in In re Quintus Securities Litigation,\textsuperscript{170} the court chided the lead plaintiff for requesting an increasing-percentage fee agreement.\textsuperscript{171} Ironically, one of the commentators relied upon by the court for support in that case\textsuperscript{172} represents one of the nation's largest pension funds and insists on an increasing-percentage fee: "To date we have always opted for an increasing percentage fee arrangement. I believe that structure tends to align the interests of lead counsel with the class and simplifies supervision of counsel as the case progresses."\textsuperscript{173} Thus, even if an institution participates in an

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\textsuperscript{169} Horace Chow II, General Counsel, Florida State Board of Administration, Remarks Before Third Circuit Task Force on Selection of Class Counsel, at 3–5 (June 1, 2001).
\textsuperscript{170} In re Quintus Sec. Litig., 148 F. Supp.2d 967 (N.D. Cal. 2001).
\textsuperscript{171} Id. at 986–87.
\textsuperscript{172} See id. at 974 (citing Keith L. Johnson & Douglas M. Hagerman, The Elephant in Securities Class Actions: Lessons Learned About Legal Fees, 9 CORP. LEGAL ADVISOR 8 (2001)).
\textsuperscript{173} Written Statement of Keith Johnson, Chief Legal Counsel, State of
auction and has lawyers it disagrees with forced upon it, that institution may be further held hostage by a fee structure that it also disagrees with.

Some argue that large, sophisticated investors have not come forward in the volume the PSLRA drafters had hoped, and, accordingly, the courts may step in to protect the class members by selecting lead counsel. This argument misses the point. The PSLRA is still in its infancy and sophisticated investors are coming forward in greater numbers. In late-1997 Professor Weiss suggested that it would be another “five years or more before we have enough data to reach more than very tentative conclusions as to how the lead plaintiff provisions have affected the conduct of securities class actions.” That time has only just arrived. Competitive bidding does not further the PSLRA’s objective that sophisticated investors come forward to take control of cases and ensure vigorous class representation. To step in now and potentially force the retreat of sophisticated investors just as their participation begins to increase would effectively nullify Congress’s intentions in drafting the PSLRA.

2. Bidding is Inconsistent With the PSLRA’s Strict Time Constraints

One of the PSLRA’s goals was to expedite the lead-plaintiff and counsel selection process. The Act provides that the court should consider motions for lead plaintiff—who in turn is to select

Wisconsin Investment Board, to Third Circuit Task Force on Selection of Counsel, at 5 (May 5, 2001) [hereinafter Written Statement of Keith Johnson].

174. See, e.g., Hearings Before Subcomm. on Sec. of the Senate Comm. on Banking, Housing and Urban Affairs, 105th Cong. (July 24, 1997); Joint Written Testimony of Joseph A. Grundfest & Michael A. Perino, Ten Things We Know and Ten Things We Don't Know About the Private Securities Litigation Reform Act of 1995 (noting that, as of mid-1997, institutional investors were not coming forward in the volume that had been hoped for).

175. See supra notes 47, 54–56 and accompanying text.


177. See supra notes 47, 54–56 and accompanying text.
lead counsel—"not later than 90 days after which notice is published. . . ." Adding another procedural level to the process to allow for competitive bidding will only further delay the process. The Advisory Committee on the Federal Rules of Civil Procedure recognized this unattractive effect when it considered the appropriateness of competitive bidding under the discretion given courts by Rule 23, concluding that such a procedure "add[ed] an undesirable layer of complexity of getting class actions initiated." This delay is not what Congress intended: "The PSLRA imposes strict time requirements . . . The obvious intent of these provisions is to ensure that the lead plaintiff is appointed at the earliest possible time, and to expedite the lead plaintiff process." The *Microstrategy* court discussed Congress's intent that the lead-plaintiff selection process—including selection of counsel—be performed quickly, and that lead-plaintiff time-period limitations were "a significant element of the statute, and reflect[] Congress's sensible intent that the lead plaintiff be appointed as early in the litigation as possible." As demonstrated by *Network Associates*, the final selection of lead plaintiff may be dependent upon the approval of lead counsel. Adding a bidding procedure into the mix likely forces courts to take much longer than the statutorily required ninety days to select lead plaintiff and counsel. In *Oracle* the court added ten weeks to lead-counsel selection process to allow for evaluation and submission of bids; in *Network Associates* it took more than eight months; in *Wenderhold v. Cylink* it took almost eleven

179. Advisory Committee on Civil Rules, Meeting Minutes (Feb. 16–17, 1995) (emphasis added).
182. See *supra* INTRODUCTION.
183. See *In re Oracle Sec. Litig.*, 136 F.R.D. 639, 641 n.4 (N.D. Cal. 1991) (noting that three weeks were allocated for bid calculation and seven weeks to consider those bids).
184. Compare *In re Network Assocs., Inc. Sec. Litig.*, 76 F. Supp. 2d 1017, 1019 (N.D. Cal. 1999) (noting that the first complaint was filed on April 7, 1999), with *In re Network Assocs., Inc. Sec. Litig.*, 1999 U.S. Dist. LEXIS 21484, at *3–*4
months from when the first complaint was filed until bidding was completed; and in *In re California Micro Devices Securities Litigation*, it took over a year to find lead counsel through an unsuccessful bidding process which was eventually abandoned as unsuccessful, with the court letting the lead plaintiff “choose class counsel and proceed with the litigation as it s[aw] fit.” These cases span a ten-year period from 1990 to 1999. In *Oracle*, Judge Walker assumed that with experience, the time it takes to select lead plaintiff and counsel under an auction system would “considerably shorten . . . .” But ten years later the process, if anything, is taking longer. Thus, the gantlet that is competitive bidding has proven itself not only contrary to the express provisions of the PSLRA, but also inconsistent with its intent to expedite the process for selecting lead plaintiff and counsel in securities class actions.

3. **Inadequate Informational Base for Bidding or Accepting Bids**

Lead-counsel auctions have been defended, in part, because they allow a court to conclusively set the fee amount at the beginning of the litigation. The benefits of this argument, although superficially appealing, are doubtful. The PSLRA imposes a strict stay on discovery until after the court has decided a motion to dismiss. A lead-counsel auction places both plaintiff’s counsel and the court in the unenviable position of determining the value of the case before discovery can reveal the full facts, and before motion practice reveals the full extent of the issues. Thus,

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185. *See Wenderhold v. Cylink Corp.*, 188 F.R.D. 577, 582 n.3, 587 (N.D. Cal. 1999) (noting that the first notice of the complaint was published on November 6, 1998, and that bids were due to the court by September 30, 1999).

186. *See In re California Micro Devices Sec. Litig.*, 168 F.R.D. 257, 259, 276 (N.D. Cal. 1996) (noting that the litigation had been going on for over one year, and that the auction had failed and thus lead plaintiff could simply choose its own counsel).


both the bidders and the court are severely constrained in their knowledge of the likelihood, total dollar amount, or scope of the potential recovery. This deficiency means that some bidders will make unknowingly unrealistic bids; this process yields what's known as the "winner's curse"—a mis-estimation of market value. This problem is particularly acute when a court adopts a bidding system where class counsel gets paid only when the class obtains a minimum settlement amount:

In short, the problem with the Court's bidding formula is that it virtually ensures that no settlement is possible below the [bidder's estimated value of the case]. Moreover, at least when a large number of bidders are attracted, it becomes predictable that one or more bidders will be either overly optimistic or will behave as rational risk preferrer, bidding well above the consensus of the action's worth. In other contexts this would be only the bidder's problem, but... the bidder who [mis-estimates its] bid[...] will predictably harm the class.... As a result, the classic "winner's curse" is borne at least as much by the class as class counsel.\textsuperscript{190}

Indeed, class counsel auctions cast lawyers and the court in roles not suited to adequate representation:

The amount of fee awarded in a class action should not be based on a "gamble" at the beginning of the case. A class action is not a lottery with the prize going to the counsel who "guesses" right before all the facts are in. Auctions cast lawyers as entrepreneurs and gamblers—not professionals governed by a code of professional responsibility and a fiduciary duty.\textsuperscript{191}

Other scholars have similarly found that an auction systems fails to adequately serve the class's interest because of the lack of meaningful information available at the start of the litigation:


\textsuperscript{191} Goodman Testimony, \textit{supra} note 168, at 10.
preparation of informed and well-reasoned bids. . . . The price for switching from \textit{ex post} to \textit{ex ante} fee determinations would therefore appear to be less informed decision-making, resulting in the submission of bids inappropriately tailored to the claim and the selection of a bid that may ultimately disserve the class' [s] interests.\textsuperscript{192}

A more balanced approach is where the court approves fees at the conclusion of the case—as required by the statute—when it can value the time and talent of the lead-counsel’s work.\textsuperscript{193} In fact, under Rule 23(e) a class action cannot be settled without “approval of the court,” and even courts using bidding have recognized that “auctions do not obviate the Court’s final review of fees pursuant to Rule 23(e).”\textsuperscript{194} Further, with the information obtained during the course of the litigation, the court will have a much better sense of the value of the case, the amount of risk involved, and the skill demonstrated by class counsel. For example, the Third Circuit Court of Appeals recently noted that a district court “abuses its discretion by not exercising” it in applying specific factors for evaluating fee awards.\textsuperscript{195} Those factors include:

the presence of absence of substantial objections by members of the class to the settlement terms and/or fees requested by counsel . . . the skill an efficiency of the attorneys involved . . . the complexity and duration of the litigation . . . the amount of time devoted to the case by plaintiffs’ counsel, and . . . the awards in similar cases.\textsuperscript{196}

Significantly, none of these factors can be considered when the fee is set at the litigation’s outset.

\begin{footnotesize}
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\item[194.] \textit{In re} Cendant Corp. Sec. Litig., 182 F.R.D. 144, 152; \textit{see also} FED. R. CIV. P. 23(e) (“A class action shall not be dismissed or compromised without the approval of the court . . . ”).
\item[196.] \textit{Id.} at *30–*31 (citing Gunter v. Ridgewood Energy Corp., 223 F.3d 190, 195 n.1 (3d Cir. 2000)).
\end{enumerate}
\end{footnotesize}
Because the court will be the final arbiter of fees at the litigation's conclusion—with the benefit of a full record and knowledge of the result—and because lead plaintiffs now generally rely on market forces in selecting from qualified counsel,\textsuperscript{197} it is unnecessary to institute bidding to achieve the same result. Moreover, all interested parties have traditionally had the right to object and address the fee petition at a settlement or fairness hearing.\textsuperscript{198} This hearing is one of the few opportunities where a client—under the PSLRA, class members and lead plaintiff—is able to carefully reflect upon the performance of its lawyers by presenting to the court their position concerning any fee award. Competitive bidding would destroy this right and force the class to accept whatever fees the bidding lawyers have set out, even if an after-the-fact analysis shows the fees to be unreasonable.

Further, while judges adopting bidding systems have noted that "a court's expertise is rarely at its most formidable in the evaluation of counsel fees,"\textsuperscript{199} this observation begs the question whether the court's expertise is any better at evaluating bids which may differ dramatically in sophistication and complexity, before any of the case's facts are available.

Judges are neither economists, statisticians, nor fortune-tellers; their jobs are difficult enough without forcing these additional roles upon them: "appraising the qualities of bids requires sophistication; . . . [bids] vary, and selections require tradeoffs that in turn demand value-laden evaluations. . . . Judges are not surrogate clients, . . . rather, . . . judges have a host of difficult regulatory choices to make. No mechanism exists that reduces the task to a simple equation . . . ."\textsuperscript{200} Indeed, Professor Miller recently

\textsuperscript{197} The SEC has indicated that market forces have had an effect on lead plaintiff's selection of counsel. \textit{See} U.S. Securities and Exchange Commission, Office of the General Counsel, Report to the President and the Congress on the First Year of Practice Under the Private Securities Litigation Reform Act of 1995, at 63, n.231 (Apr. 1997).

\textsuperscript{198} \textit{See}, e.g., \textit{In re} Prudential Ins. Co. of Am. Sales Prac. Litig. Agent Actions, 148 F.3d 283, 329–30 (3d Cir. 1998).

\textsuperscript{199} \textit{Cendant Corp. Sec. Litig.}, 182 F.R.D. at 150.

\textsuperscript{200} Judith Resnik et al., \textit{Aggregation and Individual Justice: Individuals Within the Aggregate: Relationships, Representation, and Fees}, 71 N.Y.U. L. REV.
made this same point to the Third Circuit Task Force: "One must ask whether one of the system's most precious and limited resources—judicial time—is better expended in running competitive bidding regimes or devoted to other, more judicial, matters." The Supreme Court has long cautioned that a judge's role should be limited to judging, rather than trying to resolve issues they are ill-equipped to handle: "Judges, after all, are human. They, no less than others in our society, have a natural tendency to believe that their individual solutions to often intractable problems are better and more workable than those of the persons who are actually charged with" making those decisions.

In Oracle, the court eschewed quality as a meaningful factor and reduced the task of fee assessment to the simple equation of the cheapest fee, yet provided no insight as to why price alone dictates a reasonable fee that is not "too good" to be true. Scholars have commented on the judicial dogma associated with divining the correct bid by noting that "courts have assumed too glibly that they know which bid is best." Even Judge Walker has noted that "judges are poorly suited to determine reasonable fees . . . . Judges who believe that they have any special expertise on this subject are simply fooling themselves (but probably no one else)." One must wonder if judges who employ bidding systems are also "simply fooling" themselves into believing that they can determine what constitutes a reasonable bid. In approving the winning bid in Oracle, Judge Walker justified it, in part, on the ground that the fee "was not out of line with that produced by

296, 389 (1996); Cf. In re Bank One S'holders Class Actions, 96 F. Supp. 2d. 780, 785 (N.D. Ill. 2000) (noting that the court is called upon to act as "surrogate client" for the class).

201. Written Statement of Professor Arthur R. Miller, Bruce Bromley Professor of Law, Harvard Law School, Submitted to the Third Circuit Task Force on the Selection of Class Counsel, at 22 (June 1, 2001) [hereinafter Written Statement of Professor Arthur R. Miller].


other fee regimes." Because the fee structure was "consistent with amounts courts have found appropriate," Judge Walker held that the fee was consistent with existing Ninth Circuit standards of reasonable compensation. If the lengthy process that is competitive bidding yields fees that are the same as traditional regimes of fee calculation, then why bother with it?

4. Academic Review of Competitive Bidding

It appears that every academic who has submitted an affidavit to a court considering bidding has rejected mandatory court-ordered bidding for the selection of lead counsel. For example, Stanford Law School professor—and former SEC Commissioner—Joseph Grundfest has observed that "a court mandated bidding process appears, on its face, to be inconsistent with the statutory language [of the PSLRA] which suggests that lead counsel is to be selected by the lead plaintiff, not by the court, and then subject to judicial review." Grundfest has also stated that such a system "is fundamentally at odds with Congressional intent and with the clear language of the [PSLRA]."

Fordham Law School professor Jill Fisch, who has written extensively in the area of securities class actions, notes that, "[a]lthough the auction procedure has some theoretical appeal, the

207. Id. at 547-48.
208. Some of those academics, however, have observed that, despite their inconsistency with the PSLRA, auctions are one method of ameliorating agency concerns in class actions where there is evidence that the lead plaintiff will fail to closely monitor class counsel. See Declaration of Joseph Grundfest Regarding Procedures Employed in the Selection of Lead Plaintiff and Lead Counsel Pursuant to the Private Securities Litigation Reform Act of 1995 ¶ 4, Aronson v. McKesson HBOC, Inc., No. C-99-20743-RMW (N.D. Cal. Oct. 7, 1999).
209. Id. ¶ 27.
210. Id. ¶ 34.
difficulties in designing and implementing an appropriate auction make it an inappropriate tool for selecting and compensating lead counsel. An auction does not simulate the market process for selection of counsel.”212 Likewise, Professor Weiss recently noted in the Cendant case that competitive bidding did not lead to the best fee arrangement for the class, and that “the Court’s decision [to] select[] the ‘lowest qualified bid’ [in Cendant]... illustrates some of the perils of a judicially mandated and controlled auction process.”213

Harvard Law School’s Lucian A. Bebchuk, Professor of Law, Economics, and Finance, has also rejected bidding, because “competitive bidding would be inconsistent with the PSLRA’s goal of strengthening the role of lead plaintiff in two ways—first, because it would diminish the role of chosen lead plaintiffs, and, second, because it would discourage potentially valuable lead plaintiffs from coming forward to serve in that capacity.”214

Finally, Professor Coffee, who has specifically acknowledged that he “do[es] not believe the PSLRA contemplates the use of auction procedures,”215 rejects an auction which forces counsel upon a client:

In my judgment, this [“subject to the approval of the court”] language has a two-edged significance: the court can veto any counsel it considers unqualified, but it cannot mandate the choice of counsel... The legislative history to the PSLRA clearly indicates a desire to increase client control, and minimize lawyer control, of securities class actions. In that light, although the court can veto [lead plaintiff’s choice], any attempt to impose an attorney on an unwilling institutional client would amount to a forced “shotgun marriage” that the PSLRA simply does not authorize or contemplate.216

213. Weiss Declaration, supra note 165, ¶ 27(e).
216. Id. ¶ 18(F).
This consistent condemnation of mandatory competitive bidding by academics weighs heavily against forcing it on lead plaintiffs. One must wonder why courts continue to employ it. One suggestion is docket management: "The real driving force behind [some court's] affinity for the class counsel auction... appears to be a more self-interested effort to reduce the amount of judicial time it takes to monitor and administer large class action cases...." Docket-clearing measures, while beneficial to the court, are of doubtful benefit to the class. Perhaps the SEC recognized this sentiment best, when it wrote: "It is not sufficient justification for a court-ordered auction, that the court merely prefers a process that it, rather than the lead plaintiff, controls, or assumes that an auction is inherently superior to a negotiated agreement."

G. Why Defendants Suggest Competitive Bidding

Defendants occasionally suggest competitive bidding for the selection of plaintiff's lead counsel. But are they so altruistic as to seek the highest quality representation for the class that is bent on holding them liable for potentially billions of dollars in

219. SEC Brief, supra note 103, at 23.
220. The overwhelming majority of courts addressing this issue have held that defendants lack standing to object or be heard on a lead plaintiff's motion for approval of counsel. See, e.g., Gluck v. Cellstar Corp., 976 F. Supp. 542, 550 (N.D. Tex. 1997) ("The statute is clear, only potential plaintiffs may be heard regarding the appointment of a Lead Plaintiff."); Greebel v. FTP Software, Inc., 939 F. Supp. 57, 60 (D. Mass. 1996) ("[T]he issue is one over which only potential plaintiffs may be heard."); Takeda v. Turbdyne Techs., Inc., 67 F. Supp. 2d 1129, 1138 (C.D. Cal. 1999) ("[D]efendants lack standing to object to the adequacy or typicality of the proposed lead plaintiffs at this preliminary stage of the litigation.").
221. See, e.g., In re AT&T Corp. Sec. Litig., Civ. No. 00-5364 (D.N.J. Jan. 29, 2001) (appointing the New Hampshire Group as lead plaintiff over defendant's suggestion of competitive bidding).
damage? Not likely. Judge Hillman in Ballan v. Upjohn\textsuperscript{222} noted that defense counsel queries into opposing counsel's adequacy should be taken "with a grain of salt. Unless the practice of law has changed dramatically since I was in practice, I never knew a defense lawyer who wasn't always delighted if opposing counsel was inexperienced, incompetent and perhaps less than adequate to the task."\textsuperscript{223} The Seventh Circuit has also recognized the dangers of giving defendants a voice in the selection of plaintiffs counsel—to do so is like "permitting a fox... to take charge of the chicken house," and manifests nothing more than defendants' desire to "not be successfully sued by anyone."\textsuperscript{224} It is more likely true that defendants and their lawyers are not altruistic, but rather seek a less experienced, less competent, or financially constrained adversary to do battle with. A competitive-bidding system assumes that logical class members believe minimizing fees will maximize their overall success in the litigation. The same logic should be equally ascribed to defendants to understand why competitive bidding fails to benefit the class:

\[\text{One can safely assume that in most cases a rational defendant, if forced to choose [counsel for plaintiffs], would take its chances on whichever law firm submitted the lowest bid (on the theory that the best plaintiffs' lawyers logically would expect to command some premium for their superior abilities). If a defendant instinctively is likely to prefer to litigate against the lower bidding plaintiffs' law firms, what does that say about the wisdom of equating low auction bids with the best interests of class members?}\textsuperscript{225}\]

Indeed, Professor Coffee recently commented that defendants would obviously be in favor of a system which has limited controls on the quality of bidding lawyers and simultaneously constrains the winners financially: "defense counsel would find nothing more attractive to it than an auction which awarded the control of a class

\begin{footnotesize}
\begin{enumerate}
\item Id. at 487.
\item Eggleston v. Chicago Journeyman Plumbers' Local Union, 657 F.2d 890, 895 (7th Cir. 1981).
\item Written Statement of Professor Arthur R. Miller, supra note 201, at 27.
\end{enumerate}
\end{footnotesize}
action to the lowest bidder in a selection process that had relatively little controls on . . . quality . . . . That is the field day for defense counsel using that kind of auction technique.\textsuperscript{226}

By focusing primarily on lead-counsel’s fee, the bidding process perverts the valuation of lawyering skills. It is unfair to afford defendants an opportunity to select the highest caliber of counsel regardless of fees, yet deny class-action plaintiffs facing the PSLRA’s heightened pleading requirements that same chance: [D]efendants in class-action litigation do not select their counsel solely on price. They have a myriad of considerations of which price is but one factor. Judging from the quality and cost of class-action defense counsel, price is not even a particularly important factor and is far outweighed by . . . quality.\textsuperscript{227}

By attempting to “protect” the class by denying them the ability to enter into ‘expensive’ contracts for legal services,” courts ignore that “such paternalism . . . permit[s] the defendants to purchase more costly legal services than can the plaintiffs, thereby eroding the deterrent potential of private law enforcement.”\textsuperscript{228} Put simply, the class should be allowed the same right to choose the best, rather than the cheapest, counsel.

Competitive bidding gives defendants an unfair advantage in any prolonged litigation; to understand why this is, imagine the uproar defendants would raise if the court forced them to adopt it. One pension fund recently did:

> In my view, the plaintiff class should be put in the same stead regarding the selection of counsel as defendants . . . . One might ask, when a judge directly selects class counsel for the plaintiffs through a bidding process, shouldn’t fairness require the defendants to under go the same process? . . . [T]he plaintiff class should be afforded a level of integrity in the selection of

\textsuperscript{226} Coffee Testimony, supra note 122, at 30.
\textsuperscript{228} John C. Coffee, Jr., Rethinking the Class Action: A Policy Primer on Reform, 62 IND. L.J. 625, 636 (1987).
lead counsel similar to what the defendants enjoy. 229

To date, no court has ordered defendants to open their counsel-selection process to competitive bidding.

Lest defendants be convinced that auctions are a panacea to securities-fraud claims, they should know that this competitive advantage in prolonged litigation may hurt them in the initial pleading stages. This is because, despite the heightened pleading standards of the PSLRA—intended to weed-out more cases at the motion-to-dismiss stage—every case where a court has adopted competitive bidding has survived the motion to dismiss. It is quite possible that after having invested so much time and energy into the selection of class counsel through the use of an auction, courts are far less likely to throw that work away by dismissing the case a few weeks later.

Competitive bidding presents an even greater danger if plaintiffs' firms are less willing to accept cases—or less willing to investigate in fear of wasting time and money—for fear of losing control of the case to a competing firm that seeks to ride on the coat-tails of the investigating firm. 230 Indeed, part of the impetus behind the PSLRA was that prior to its enactment, "Courts often afford[ed] insufficient consideration to the most thoroughly researched... complaint." 231 The result then, will be less sophisticated-investor involvement, less investigation, less redress, and more fraud—a result no published decision has discussed. Less investigation of securities fraud conflicts with the Supreme Court's recognition that private enforcement of securities fraud is the "most effective weapon in the enforcement of the securities laws and are a necessary supplement to [SEC] action." 232 Any practice that discourages sophisticated investors from serving as lead plaintiff and endangers thorough investigation of fraud is

229. Written Statement of Keith Johnson, supra note 173, at 3.
230. See Three Crown Ltd. P'ship v. Caxton Corp., 817 F. Supp. 1033, 1040 n.11 (S.D.N.Y. 1993) ("Plaintiffs cannot be permitted to free ride off... [of] the complaints of other parties filing similar lawsuits... ").
antithetical to the PSLRA’s goals. Auctions do both.

The investigation of securities fraud is expensive, especially in light of the PSLRA’s heightened pleading requirements.\(^233\) Attempting to properly calculate an appropriate bid for a major securities-fraud class action adds further expense. Every cent spent on investigation and bid calculation is wasted if the investigating firm is underbid. The investigating firm must then factor that expense into its bid, whereas a competing firm—which has the benefit of the already filed complaint to work from—does not, and thus can proffer lower bids, thereby increasing its chances of being selected as lead counsel. Professor Coffee refers to this as “claim jumping,” and notes that auctions will thus “reduce[] the incentive to search [for fraud].”\(^234\) He adds, somewhat poetically, that class-counsel auctions “permit the original prospector who discovered the violation of law, maybe after much work, off there in those lonely desert hills where he found the law in violation, to suddenly have his claim jumped by the [winning] bidder.”\(^235\) Higher-quality firms will have less incentive to incur and write-off the lost time and opportunity costs necessary to prepare a bid, because they realize their efforts will not be rewarded if the non-investigating firms consistently win the auction. The costs don’t always end at the bidding preparation stage. For example, in *In re Bank One Shareholders Class Actions*, the court failed to select a winning bid at the time defendants moved to dismiss the case, and thus ordered *all nine* bidding firms to research and draft an opposition to the motion to dismiss, thereby adding an unrecoverable expense to all but one of the bidding firms.\(^236\) This process results in the “lemon” problem: high-quality firms are unwilling to incur bidding costs to enter an unwinnable auction, leaving the court to select from a motley crew of “lemon”

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234. Outline of Testimony by Professor John C. Coffee, Jr., Adolph A Berle Professor of Law, Columbia Law School, before the Third Circuit Task Force on the Selection of Class Counsel, at 7 (May 5, 2001) [hereinafter Coffee Outline].
235. Coffee Testimony, supra note 122, at 38.
SELECTION OF CLASS COUNSEL

Judge Walker seemingly recognized this fact in Oracle, where he noted that "uncertainty about compensation affects not only the litigation at hand, but also incentives in future roughly comparable cases." In fact, Judge Walker has commented on the lack of competition among some of the auctions he has held. He attributes this lack of competition to "collaboration among plaintiff firms engaged in securities class action litigation..." A less sinister rationale is more likely, however, as one former Third Circuit judge recently noted:

[T]he lower fee awards in auctioning cases seems to have caused many of the law firms that specialize in class actions to become reluctant participants, or 'gun shy,' and to choose not to participate in auctions. Many such firms have found the risk of investing a substantial amount of time and expense in investigating and developing claims is simply too great, in light of the statistical probability that they will lose in the bidding process and go uncompensated for pre-bid work. The costs associated with this process appear to be an expense these firms are not willing to sustain.

This competitive-bidding process thus yields less investigation and recovery for corporate fraud, which contradicts the very purpose of the securities laws "to protect investors and to maintain confidence in the securities markets, so that out national savings, capital formation[,] and investment may grow for the benefit of all Americans."

Does a system that deters the investigation of fraud better

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240. Id.
241. Statement by Arlin M. Adams in Response to "Questions to be Addressed by Third Circuit Task Force on Appointment of Counsel in Class Actions" (on file with author).
serve the public interest? No. Competitive bidding may not only harm class members in any particular action, but may also indirectly harm investors and undermine investor confidence by severely diminishing the incentive to thoroughly investigate securities fraud. This analysis shows competitive bidding to be "penny-wise and pound foolish." With fewer fraud actions being brought, the incentive to commit fraud will increase, as will the harm done to investors and the securities markets as a whole.

1. The Cost v. Quality Trade-Off

Another relevant consideration in examining the effects of competitive bidding is whether the reduction in fees yields a concomitant reduction in quality of representation. One scholar recently discussed this trade-off:

[Courts] incorrectly assign[] an equal probability of achieving each level of recovery regardless of the requested attorneys' fees. In other words, [courts] fail[] to take into account the dynamic interaction between the investment incentives created by attorneys' fees and the probability of certain levels of recovery. Consider the following hypothetical: Firm A seeks 15% of the first $30 million of recovery in a class action, and Firm B asks for 30% of the same amount. Based on a static analysis, Firm A would be the obvious choice of the plaintiff class because its fee would increase the class recovery by $4.5 million for the first $30 million. However, because Firm A will rationally invest only half the resources that Firm B will invest, on average Firm A will be less likely to recover the $30 million. If, for instance, Firm B's additional investment increased the chance of success from 60% to 75%, the plaintiff class would clearly prefer Firm B. Although the attorneys would take a larger share, the expected recovery is sufficiently greater to increase the net recovery for the plaintiff class. In other words, the competitive pressure on prices that the lead counsel auction creates will not always increase the plaintiffs' net recovery, as the courts have assumed.243

In simpler terms, 70% of something is substantially better than 85% of nothing.

Professor Coffee has also discussed this cost-versus-quality trade-off when he reviewed the auction in *Cendant*, reaching a similar conclusion while emphasizing the significance of the quality of representation:

Competitive bidding ignores the cost/quality tradeoff to which most clients are very sensitive. If you were facing heart surgery tomorrow, it is unlikely that you would hire the heart surgeon who submitted the lowest bid. Nor is the cheapest lawyer usually the best. Although competitive bidding is used in many contexts, it works best when the goods or services being auctioned are fungible or objectively verifiable. Litigation services are, however, more intangible. To date, courts have responded to this point by ruling that only "qualified" law firms would be permitted to bid. *This response sidesteps the critical point that there is a wide margin between "qualified" and "excellent."*

Columbia University Law School professor Samuel Issacharoff makes a similar point by observing that a bidding system may inspire unscrupulous lawyers to proffer low bids in many cases to create a cache of cheap settlements with little work involved:

As with dentistry, there may be some pain associated with delivering yourself to professionals whose chief attribute is their willingness to work you over cheaply.... If we may assume that the interests of the absent class members consist chiefly in maximizing the return for the prosecution of their claims, there is no reason to believe that the lowest percentage bidder can realize that goal. The lowest percentage bidder may simply be lawyers with lesser overhead, lesser ambition, or volume discounters.

Professor Miller, discussing Professor Issacharoff's concern over "volume discounters" under an auction system, agrees that

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244. Coffee, *supra* note 163, at B6 (emphasis added).
competitive bidding may result in meager settlements at a systemic level:

Creating incentives for ‘volume discounters’ to settle uncertain cases early and cheaply may simply substitute a large number of small windfalls for the far less infrequent large fee ‘windfall’ attributed to non-auction approaches...—the only difference being that class members are usually much better served by the skilled lawyer who is willing to take greater risks in exchange for greater rewards.246

Similarly, Professor Grundfest has emphasized that “a lead plaintiff can responsibly conclude that a law firm’s skill and expertise relative to other bidding law firms is such that the class can expect to attain a higher net recovery even if it agrees to pay a higher fee.” Beyond these well-reasoned opinions, the Supreme Court recognizes that experience and skill yield higher rates for counsel, and are not fungible goods: “We recognize, of course, that determining an appropriate ‘market rate’ for the services of a lawyer is inherently difficult. Market prices of commodities and most services are determined by supply and demand. In this traditional sense there is no such thing as a prevailing market rate for the service of lawyers...” Even Judge Walker seemingly recognized that market forces are better determined by clients than courts, when he stated that “[m]arkets know market values better than judges do.”

There is a trade-off between the odds of success and the amount of money paid for that success. In fact, at least four courts have endorsed the view that a judge breaches his fiduciary duty to the class if he appoints counsel willing to work at the low-end of the contingent spectrum.

246. Written Statement of Professor Arthur R. Miller, supra note 201, at 18.
247. See Grundfest Declaration, supra note 208, ¶ 11.
249. In re Copper Mountain Sec. Litig., 201 F.R.D. 475, 489 (N.D. Cal. 2001) (citing In re Continental Ill. Sec. Litig., 962 F.2d 566, 572 (7th Cir. 1992)), rev’d, 306 F.3d 726 (9th Cir. 2002).
The big difference is in my experience in the amount obtained [for the class] and you don’t get the highest recovery when you are paying at the low end of the scale of fee recovery in contingent actions. It seems to me that I as the protector of the class can fairly say, and honestly say, that I believe it is in the class’s best interests—of this class and future classes yet unknown—to pay this kind of money for these kind of benefits.250

It is inconsistent for judges professing to protect the interests of the absent class members to not consider the financial realities behind lower bids. Those realities dictate that the result often will be a lower chance of recovery, which further results in less redress for corporate fraud. These results reveal a major shortcoming of competitive bidding—early and cheap settlements.

IV. THE PREDICTABLE RESULTS OF COMPETITIVE BIDDING: MARGINAL RECOVERY

Even assuming the nonexistence of the PSLRA’s textual and legislative instruction that the lead plaintiff—and only the lead plaintiff—select and retain counsel, the recovery garnered by the “winning” lawyers in the few cases where bidding was employed militates against its future use. Professor Coffee has noted that, thus far, auctions don’t seem to benefit the class financially: “[E]xperience with auctions suggests . . . that there is a serious . . . problem: In practice, they reveal a marked tendency to result in early, cheap settlements well below the litigation value of the action.”251 Thus far, only six cases that have used competitive bidding have settled.252 With the exception of Wells Fargo—where

252. See In re Oracle Sec Litig., 132 F.R.D. 538, 542 (N.D. Cal. 1990); In re Wells Fargo Sec. Litig., 157 F.R.D. 467 (N.D. Cal. 1994); Cox v. Work Recovery,
the attorneys appointed had prosecuted the case for more than three years to both the Ninth Circuit\textsuperscript{253} and the Supreme Court\textsuperscript{254} (and thus had no possibility of an early settlement)\textsuperscript{255}—these cases uniformly demonstrate that competitive bidding is detrimental to the class.

For example, in Oracle, the winning bid followed a "declining percentage of the recovery" formula, which decreases the percentage of attorney fees with the increase in the recovery.\textsuperscript{256} The bid imposed a $325,000 cap on the litigation expenses chargeable to the class, and included a 20\% discount if the settlement was reached within one year.\textsuperscript{257} Predictably, the recovery in Oracle was dictated by the incentive scheme fostered by the bid structure. The case settled after one year for $25 million, at exactly the point when the expenses incurred reached $320,065.95.\textsuperscript{258} That settlement was reached almost immediately after the time for the 20\% discount had expired, and within $5,000 of the expense cap, which implies that the decision to settle was dictated by counsel's incentive to maximize its fees and reduce its exposure to expenses, rather than the best interests of the class.

\textsuperscript{253} In re Wells Fargo Sec. Litig., 12 F.3d 922 (9th Cir. 1993).
\textsuperscript{254} In re Wells Fargo Sec. Litig., 513 U.S. 917 (1994).
\textsuperscript{255} See Wells Fargo Sec. Litig., 157 F.R.D. at 468–77 (discussing the use of competitive bidding and noting that the Lieff Cabraser law firm had successfully appealed the case's dismissal); see also In re Wells Fargo Sec. Litig., 1991 U.S. Dist. LEXIS 20567 (N.D. Cal. Dec. 26, 1991). For the sake of completeness, it is worth noting that the total damages in Wells Fargo were estimated at $162 million. See Reply Memorandum of Points and Authorities in Support of Final Settlement Approval at 7, In re Wells Fargo Sec. Litig., No. C-91-1944 (N.D. Cal. March 29, 1995). The case settled for $13.5 million. See Paul Elias, Walker Knocks BASF Windfall in Class Action, RECORDER, Oct. 15, 1997, at 1. Thus, the case settled for approximately 8.3\% of the total damages and class counsel obtained approximately 21.5\% of the recovery. Id. (noting that the class received $10.6 million of the $13.5 million settlement).
\textsuperscript{256} Oracle Sec Litig., 132 F.R.D. at 541–42.
\textsuperscript{257} See id.
\textsuperscript{258} See In re Oracle Sec. Litig., 852 F. Supp. 1437, 1457 (N.D. Cal. 1994).
But although the *Oracle* settlement appears to have been severely influenced by the bid structure, the settlement itself was respectable.\(^{259}\) This is not a total surprise, though, as counsel ended up getting "22.5% of the total settlement fund," an amount consistent with the Ninth Circuit’s benchmark.\(^{260}\) Ironically, this 22.5% attorney award in *Oracle* is within the same range that Judge Walker deemed unreasonable as a matter of law in *Copper Mountain*.\(^ {261}\) Hence, had the plaintiff in *Oracle* come forward with the same "winning" fee structure in *Copper Mountain*, Judge Walker would have rejected him outright because any fee agreement that ranges between 20% to 30% "cannot meet the adequacy requirement the PSLRA and FRCP 23(a)(4)."\(^ {262}\)

Regardless of the relative merits of the $25 million settlement, the fact that counsel miraculously settled the case within $5,000 of the expense cap indicates a universal truth inherent to capped fee structures: plaintiffs had no incentive to further prosecute a case when they would be paying for any additional recovery in unrecoverable expenses. This limitation will always be detrimental to the class.

Another pre-PSLRA bidding case worth mentioning is *Cox v. Work Recovery Inc.*\(^ {263}\) In *Cox*, the judge conducted an auction for class counsel because he believed it was "the best arrangement for reasonable compensation of counsel," and that the process "protects against lawyer windfalls... without complicated fee litigation" after the settlement.\(^ {264}\) The court selected a firm which targeted a $10 million recovery; counsel was to receive 20% if the class recovered under that amount, and 15% if over.\(^ {265}\) That $10 million target proved chimerical. Once the case began to take

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259. *Id.* at 1459 (obtaining 24.5% of the total damages of $102 million).
260. *Id.* at 1458.
261. *See In re Copper Mountain Sec. Litig.*, 201 F.R.D. 475, 488 (N.D. Cal. 2001) (holding that because of the "extravagance" of the 20% to 30% fee proposed, the plaintiff "failed to demonstrate that it has negotiated a reasonably competitive fee arrangement."), *rev'd*, 306 F.3d 726 (9th Cir. 2002).
262. *Id.*
264. *Id.* at 4–5.
longer than expected, class counsel cut their losses and gave the class a settlement of less than $61,000, despite knowing that actual damages were in excess of $52 million. This amounts to a recovery of approximately 1/10th of 1%.

In what may be the biggest securities-fraud class action in history, the court in In re Cendant Corp. Securities Litigation conducted a particularly ill-suited bidding process. In that case, when the public pension-fund lead plaintiffs asked the court to appoint the counsel they had selected, the court refused to do so, concluding that a competitive bidding process was necessary to "to simulate the free market in the selection of counsel." Rather than protect the absent class members, however, that auction "led to a windfall for the successful bidders. The court ignored the fact that the public pension fund lead plaintiffs had already conducted a competitive bidding process in their choice of lead counsel . . . ." Within two years of the auction, the case settled and the firm with the winning bid received $262 million under the court-ordered bidding system. Under the original retainer agreement negotiated by the pension funds, the fees would have been only $186 million. Hence, "the Cendant court's well-intentioned auction cost the class $76 million."

In In re Bank One Shareholders Class Actions, the court
conducted an auction for the selection of class counsel.\textsuperscript{274} The bids varied in structure so that some bids provided a better recovery at one settlement amount, but not another; in evaluating the nine bids, the court recognized that “because of the existence and differing amounts of several cross-over points of [the] bids... it [was] necessary... to make some assumptions about the prospects of recovery for the class.”\textsuperscript{275} In making those assumptions the court concluded that “the best-informed” estimates of potential class recovery “appear[] to be in the $4.6 to $4.8 billion range.”\textsuperscript{276} The judge then selected one bid over all others because he determined that the cross-over points in the various bids “drop out of significance” because, under the bids submitted, the cross-over only made a difference at a percentage of recovery of 1.5\% or less—approximately $67.5 million.\textsuperscript{277} The judge in \textit{Bank One} determined that a recovery of only 1.5\% was “so far below anything that experience teaches” that he had no problem rejecting bids that would only help that class in the event of such a paltry recovery.\textsuperscript{278} Unfortunately for the class, experience has now taught that bidding can result in precisely the cheap settlement that the court thought impossible. The \textit{Bank One} court recently approved a preliminary settlement of approximately $45 million—less than 1\% of the estimated recovery, with attorney fees comprising $2.75 million, or approximately 6\% of the recovery.\textsuperscript{279} Thus, competitive bidding saved the class approximately $12 million in fees,\textsuperscript{280} yet cost the class potentially $4.5 billion in recovery. Once class counsel surpassed their maximum potential fee award, they had little incentive to pursue the case further. Such results are a testament

\textsuperscript{274} \textit{Id.} at 784 (noting that a bidding system was adopted and that “best informed” estimates of class recovery ranged between $4.6 to $4.8 billion).

\textsuperscript{275} \textit{Id.} at 788. Cross-over points are the points at which differing bids are better for the class depending on the stage of the litigation.

\textsuperscript{276} \textit{Id.}

\textsuperscript{277} \textit{Id.}

\textsuperscript{278} \textit{Id.}

\textsuperscript{279} \textit{See In re Bank One S'holders Class Actions, No. 00-C-880, Ex. A, at 1, 3 (N.D. Ill. Mar. 21, 2001).}

\textsuperscript{280} This figure is derived by taking the difference between 33\% of the recovery—the highest amount usually awarded in securities class actions—and the 6\% awarded.
to the impotence of competitive bidding.

Coming full-circle, the *Network Associates* case recently settled for $30 million. While this award sounds impressive, it is anything but. One of the firms associated with the original lead plaintiff—the Board of Pensioners of the City of Philadelphia—performed a damages analysis at the start of the litigation and determined that the total recoverable damages were approximately $1.6 billion. Indeed, one lead plaintiff movant by itself lost $4 million more than the entire class-wide settlement. The case settled for less than 2% of its projected value, thus saving the class approximately 25% in attorney fees at the expense of 98% of the recovery. Such meager results speak for themselves.

Competitive bidding for the selection of lead counsel in securities class actions simply does not work. Indeed, comparing the relative recoveries in *Oracle* and *Bank One*, it appears that the lower the contingent fee agreement, the lower the recovery tends to be as compared to total recoverable damages. In *Quintus*, Judge Walker relied on a recent study of securities class action settlements to evaluate potential bids. That study provides average settlement-to-investor-loss ratios for different levels of losses. Looking at all six bidding cases that have settled, and comparing those settlements to the average settlement-to-loss ratio for their respective loss levels, competitive bidding can be shown to have cost class members more than $240 million over the last ten

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284. *See Network Assocs. Sec. Litig. No. C-99-001729* (N.D. Cal. Feb. 28, 2001) (noting that the attorney fees were 7% of the recovery).
286. *See Bajaj, supra* note 285, at 24, table 7A.
Professors Weiss and Beckerman, when they drafted the lead-plaintiff provisions, correctly observed that “auctions... are unlikely to provide class members with adequate compensation when their claims are meritorious.” The real problem with competitive bidding lies in attempting to define the why it is needed: “Do courts want to adopt a fee formula that is likely to maximize the net recovery to the class? Or, do they want to adopt a formula that protects them from public criticism?”

287. See id. This figure is extremely conservative and derived from table 7A of the Bajaj study, supra note 285, and the materials referred to in the above text, and was calculated as follows: (1) the Bank One case had estimated damages of $4.6 billion, which should have resulted in a settlement of 4.25% of that amount, or $195.5 million. The actual settlement was only $45 million; thus, bidding in that case cost the class members $150.5 million; (2) the Network Associates case had estimated damages of $1.6 billion, and thus, should also have resulted in a settlement of 4.25%, or $68 million. In fact, the case settled for $30 million; thus bidding cost the class $38 million; (3) In the Cox case, the claim forms that were actually sent in showed losses of $52 million. These damages should have yielded a settlement of 7.87%, or $4.1 million. The case actually settled for $61,000, thus costing the class approximately $4 million; (4) in Cendant, because we know the difference in result from the bidding versus non-bidding fee, we have definitive evidence that bidding cost the class $76 million; (5) in Oracle, the total damages were approximately $102 million, and thus the settlement should have been around 4.25%, or $4.3 million, and thus the class ended up above average by around $21 million, which off-sets the losses of the other cases (but still appears to have been limited by the expense cap in place); and (6) in Wells Fargo (an atypical case in that bidding took place after the case had been successfully appealed to the Ninth Circuit and years after it was filed), the total damages were approximately $162 million, and thus the settlement should have been 4.25%, or $6.9 million. The case settled for $13.5 million, and thus the class benefitted more than usual by $6.6 million. Taken in concert, the entire universe of competitive-bidding settlements appears to have cost the collective class members $241 million: \([\$150.5 + \$38 + \$4 + \$76] - [\$21 + \$6.6] = \$240.9\) million. To demonstrate the conservative nature of this calculation it is worth noting that had the overall average loss-to-settlement ratio of 16.6% been used for the same figures above—as was done by Judge Walker in Quintus, see 148 F. Supp2d 967, 985—competitive bidding would appear to cost the collective class members $1,044,070,000, or more than $1 billion.


289. Coffee Outline, supra note 234, at 12.
adopting bidding regimes are more concerned with preventing a perceived windfall than with maximizing class recovery. One does not necessarily lead to the other. Rather, the real issue should not be “whether a particular fee regime will give class members a larger percentage share of the common fund recovery, but whether it will maximize the net recovery for the class.”

CONCLUSION

The theoretical benefits of competitive bidding for lead counsel in a securities class action are obvious and salutary: the best lawyers for the best price. Unfortunately, the benefits are just that— theoretical—and disappear when applied. The original rationale behind competitive bidding was that this purported market process “most closely approximates the way class members themselves would make these decisions,” but this rationale is misguided because “[a]n auction does not simulate the market process.” An auction to select class counsel “is not the way it is done in the marketplace and dangerously underplays the more important values of character, compatibility, and specific expertise, which usually guide selection of counsel.” Courts are ill-equipped to step in and attempt to create a market when a more efficient one already exists:

The insight of the PSLRA was that the best way to simulate a market process was to create one by putting a real functioning consumer [as] the lead plaintiff on one side of the negotiation...[where] there will be a real live body with a great deal of sophistication and resources on the consumer side ....[I]t is a true marketplace where the lead plaintiff may consider the very same factors that defendants use when they select counsel.... In these circumstances, the purpose of the auction to approximate a market of fees has already been

290. Written Statement of Professor Arthur R. Miller, supra note 201, at 15.
292. Fisch Affidavit, supra note 212, ¶ 46.
293. Goodman Testimony, supra note 168, at 7.
satisfied through an actual market check.  

Indeed, “there is no need to ‘simulate’ the market in cases where a properly-selected [sic] lead plaintiff conducts a good-faith counsel selection process because in such cases—at least under the theory supporting the PSLRA—the fee agreed to by the lead plaintiff is the market fee.”  

The PSLRA was enacted to combat the very issues that competitive bidding sought to remedy, and it vests the selection of counsel with the lead plaintiff, not the court. Those who drafted the PSLRA considered and rejected competitive bidding, yet left courts some discretion under Rule 23 to veto selected counsel if necessary to guarantee adequate representation. Those who drafted and edit Rule 23 expressly rejected competitive bidding as a possible means of guaranteeing adequacy of representation in securities class actions. Accordingly, there exists no legal justification for allowing competitive bidding.  

The purpose of the PSLRA’s lead-plaintiff and counsel provisions was to “strengthen the hand of investors tremendously by giving them the right to choose the attorneys, giving them the right decide what the settlement will be, if there is going to be any settlement, and giving them the right to determine what the attorney’s fees would be.” If Congress intended investors to choose counsel and determine fees, it is inconsistent with that intent to take those decisions away by instituting competitive bidding. Auctions focus on the selection of counsel, rather than the empowerment of the most-adequate plaintiff. Such a focus simply was not intended. Competitive bidding has the potential to reduce the investigation of fraud, delay the litigation, deter sophisticated investors from participating in securities class actions, and yield hasty settlements that fail to benefit the class. These results conflict with the spirit, text, and purpose of the PSLRA.

296. See supra notes 131–32, and accompanying text.
Thus, "[i]n the end, then, the benefits of lead counsel auctions seem chimerical.... Lead counsel auctions...create the impression of protecting the interests of the plaintiff class without actually doing so."\(^{298}\)

\(^{298}\) See Developments in the Law, supra note 243, at 1844–45.