

# *AUCTIONING CLASS COUNSEL IN SECURITIES LITIGATION*

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## INTRODUCTION

Private class action and shareholder derivative suits serve an important role in deterring securities fraud against innocent stockholders.<sup>1</sup> Unfortunately, however, the current mechanisms for choosing the firm that will serve in the lucrative position as counsel for the plaintiff class have failed to prevent opportunistic firms from manipulating these legal actions to the detriment of shareholders and firm alike. This paper assesses current models for securities fraud class action litigation and concludes that auctions of the right to serve as class counsel are the most effective means of promoting shareholder interests. Auction proposals are not without problems, therefore, this paper further examines critiques of proposed and actual auction processes and concludes that courts should adopt the claims auction approach with safeguards that protect shareholders from underbidding the value of the claim.

The thesis of the paper is to determine whether the Private Securities Litigation Reform Act's ("PSLRA")<sup>2</sup> existing mechanisms create sufficient safeguards against the conduct of entrepreneurial attorney conduct or whether auctions are a more effective manner to address this problem. The paper will evaluate the status quo, whether the enacting of the PSLRA has made a significant difference, and the auction system.

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<sup>1</sup> Julia C. Kou, *Closing the Loophole in the Private Securities Litigation Reform Act of 1995*, 73 N.Y.U. L. REV. 253, 255 (1998).

<sup>2</sup> *See id.*

## I. A BRIEF OVERVIEW OF THE HISTORY AND EVOLUTION OF CLASS ACTION SECURITIES LITIGATION

### A. OVERVIEW

In theory, securities fraud litigation suits act as a mechanism by which shareholders can monitor managerial conduct.<sup>3</sup> However, this laudable purpose becomes somewhat tarnished in light of the current environment of securities litigation. Many securities fraud litigation suits are so-called “strike suits” which are discovered by entrepreneurial attorneys who are less concerned with compensating defrauded stockholders than they are with lining their own pockets.<sup>4</sup> “Private lawyers, seeking private gain, have become self-employed guardians of the public interest, searching for causes of action and pursuing them to recovery.”<sup>5</sup> These class actions suits are big business. Between January 1991 and May 1999 there were approximately 733 federal class action securities cases filed in which the average fee award was approximately 30.12 percent of the settlement amount.<sup>6</sup> The total amount of settlements during this period as a result of those actions was \$6.1 billion, with approximately \$1.837 billion being paid to class counsel.<sup>7</sup> Many commentators argue that such fee awards are not consistent with market standards.

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<sup>3</sup> Randall S. Thomas & Robert G. Hansen, *Auctioning Class Action and Derivative Suits: A Rejoinder*, 87 Nw. U.L. REV. 423, 27 (1993).

<sup>4</sup> *See Kou, supra* note 1 at 254 (Defines strike suits as suits that are initiated by an attorney “without reasonable grounds to believe [the case] has merit, or having initiated an action reasonably believing it was meritorious, maintains the action even after discovery makes clear the action lacks merit.”).

<sup>5</sup> Alon Klement, *Who Should Guard the Guardians? A New Approach for Monitoring Class Action Lawyers*, 21 REV. LITIG. 25, 26 (2002)(The author argues that lawyers who have committed themselves to detecting wrongdoing have significantly contributed to the deterrence of securities fraud by using private resources. Thus, these attorneys play a positive and pivotal role).

<sup>6</sup> Joseph A. Grundfest, *Attorneys’ Fees in Class Action Securities Fraud Litigation: A Proposal for Addressing a Problem That Has No Perfect Solution*, June 1, 2001 (Testimony before the 3d Cir. Task Force on Selection of Class Counsel).

<sup>7</sup> *See id.*

This process is most effectively demonstrated by a paradigm example.<sup>8</sup> In the stereotypical securities fraud strike suit prior to the enactment of the Private Securities Litigation Reform Act, an attorney or a firm devotes some time in researching potential securities fraud cases. Noting a significant price drop in a stock, the attorney locates shareholders of the corporation's stock and approaches them regarding a possible securities fraud action. The shareholders are usually individuals who, while owning some of the corporation's stock, do not face devastating losses. Even though these individual shareholders bear little financial risk themselves, they agree to participate in the hope of receiving a settlement. Thus, the attorney has located his or her "key to the courthouse door" with little worry that the plaintiffs will monitor, evaluate, or question his or her methods.

Alleging that the defendants have made "material misrepresentations" that induced the plaintiffs to purchase stock, the attorney races to court and files a lawsuit. Defendants allege that the statements they made were accurate and they reasonably believed they would meet their growth projections based on the information they possessed at the time. It is far from clear that the plaintiffs could win this case, however, in light of the costs that a lengthy trial would impose upon the corporation, the corporation opts to settle. Thus, after some discovery, the attorneys on both sides agree to settle the case, with the attorneys for the plaintiffs receiving 25-30%, which is considered the standard benchmark rate, of the total settlement value. Both sides have a substantial interest in gaining the court's approval of the settlement, thus there is no serious possibility that the settlement award will be challenged by either attorney. Nor will the plaintiffs in the case be in a position to question the settlement, because they are likely to be fairly removed from the litigation and the negotiations.

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<sup>8</sup> This example is loosely based on the facts of *In re Warner Communications Securities Litig*, 618 F. Supp 735 (1985).

In this situation, plaintiffs are solicited by the attorney,<sup>9</sup> and only “serve as the attorney’s ‘key to the courthouse door’ and little else.”<sup>10</sup> The way in which securities fraud class action suits are maintained created an environment where self-interested behavior on the part of attorneys flourished, often at the expense of the best interests of the clients the lawyers are purportedly representing.<sup>11</sup> Reality is a “dim reflection” of the model in which the ethical duty of an attorney to promote his or her clients’ best interests to the furthest extent permissible.<sup>12</sup> Under the current system the attorney, not the plaintiff, controls every important aspect and decision made in the case.<sup>13</sup>

Plaintiffs’ attorneys typically do not rely on named plaintiffs for vital testimony, do not bargain with named plaintiffs over the fees they will be paid, and do not require named plaintiffs’ approval of the terms on which they propose to settle class actions. The conflicts of interest inherent in class actions have led critics to claim that class action attorneys are more interested in maximizing their fee when settling a case than in attaining a fair award for class members.<sup>14</sup>

The Private Securities Litigation Act (“PSLRA”) was designed and enacted to prevent such entrepreneurial strike suits against corporations.<sup>15</sup> The PSLRA’s lead plaintiff provision requires the shareholder with the most financial stake in the litigation to serve as lead plaintiff.<sup>16</sup> The rationale for this is that a plaintiff who truly has a significant financial stake will more assertively and effectively monitor the conduct of the attorneys and will more strenuously object to an inappropriate settlement agreement.

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<sup>9</sup> Note that direct client solicitation violates most states’ rules of professional conduct governing the behavior of lawyers.

<sup>10</sup> Thomas & Hansen, *supra* note 2, at 459.

<sup>11</sup> *See id.*

<sup>12</sup> *See id.* at 433-34.

<sup>13</sup> *See id.* at 434.

<sup>14</sup> *See* Kendra S. Langlois, *Putting the Plaintiff Class’ Needs in the Lead: Reforming Class Action Litigation by Extending the Lead Plaintiff Provision of the Private Securities Litigation Reform Act*, 44 WM. and MARY L. REV. 855, 856-57 (2002).

<sup>15</sup> Pub. L. No. 104-67, 109 Stat. 737 (codified at 15 U.S.C. 77z-1 to 78u-5 (1994 & Supp.; 1996)).

<sup>16</sup> *See id.*

## B. COMPENSATION—A DESCRIPTION OF THE STATUS QUO

There are two generally accepted methods of attorney compensation in class actions, as well as in normal (i.e., single plaintiff) litigation. These include the lodestar method and the percentage-of-recovery method. Each method has its various strengths and weaknesses and creates “incentives” problems. Incentives problems are defined as situations where the agent (in this case the attorney) has incentive to act in a manner that is beneficial to the agent, but not in the best interest of the principal (in this case the plaintiff class).

The lodestar method requires the judge to take a reasonable number of hours expended by the plaintiffs’ attorneys and multiply it by a reasonable rate.<sup>17</sup> This approach was first seen in the 1973 case *Lindy Brothers Builders, Inc. of Philadelphia v. American Radiator & Standard Sanitary Corp.*<sup>18</sup> The hourly rate may vary according to the attorney’s experience, reputation, practice, and qualifications or by the nature of the services provided.<sup>19</sup> The Fifth Circuit in *Johnson v Georgia Highway Express, Inc.* adapted a twelve-factor scale which it uses to evaluate reasonable attorneys’ fees.<sup>20</sup>

Although on paper the lodestar calculation method appears to offer a meaningful way in which to set attorneys’ fees it has been soundly criticized. The factors themselves are at least partially redundant and provide “no analytical framework for their application.”<sup>21</sup> Whether the factors are to be weighed equally, or if the relative weight of each factor should vary according

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<sup>17</sup> *Court Awarded Attorney Fees Report of the Third Circuit Task Force*, 108 F.R.D. 237 (1985)

<sup>18</sup> 487 F.2d 161 (3d Cir. 1973).

<sup>19</sup> *See id.* at 168.

<sup>20</sup> 488 F.2d 714, 717-19 (5<sup>th</sup> Cir. 1974)(the twelve elements are: (1) the time and labor required; (2) the novelty and difficulty of the questions involved; (3) the skill requisite to perform the legal service properly; (4) the preclusion of other employment by the attorney due to acceptance of the case; (5) the customary fee; (6) whether the fee is fixed or contingent; (7) time limitations imposed by the client or the circumstances; (8) the amount involved and the results obtained; (9) the experience, reputation, and ability of the attorneys; (10) the “undesirability” of the case; (11) the nature and the length of the professional relationship with the client; (12) awards in similar cases).

<sup>21</sup> *See Smith Berger, Court Awarded Attorneys’ Fees: What is “Reasonable”?*, 126 U. PA. L. REV. 28, 286-87 (1977)(footnotes omitted).

to the circumstances of the particular litigation is unclear.<sup>22</sup> However, the lack of analytical weight given to each factor pales in comparison with the potential problems that the lodestar method creates in terms of attorney incentives. The most obvious problem with the lodestar method is that it offers no motivation to control hours and costs.<sup>23</sup> An Attorney can be “reasonably sure” of having most of his or her costs paid as long as the fees are less than any settlement.<sup>24</sup> These attorneys actually have an incentive to engage in “make-work” or otherwise increase their hours on a case to the extent that they believe the court will still approve the fee request.<sup>25</sup> The excessive charges which this behavior creates are obviously contrary to the interests of the class.<sup>26</sup> Inquiries by the court into the reasonableness of the fees, or any investigative attempt by the court are unlikely to yield results.<sup>27</sup> The judiciary lacks the time and the resources to engage in a truly meaningful investigation of proposed attorneys’ fees. Furthermore, inquiries into the fees could make attorneys refuse certain types of litigation.<sup>28</sup>

Secondly, the lodestar method may create an incentive for plaintiffs’ attorneys to settle on the eve of the trial for a lesser amount than what could be achieved at a trial in order to avoid the expense and time of a full-blown trial.<sup>29</sup> Plaintiffs’ attorneys have completed most of the work

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<sup>22</sup> See *id.*; see also, *Copeland v. Marshall*, 641 F.2d 880 (D.C. Cir. 1980) (en banc):

Simply to articulate those twelve factors...does not itself conjure up a reasonable dollar figure in the mind of a district court judge. A formula is necessary to translate the relevant factors into terms of dollars and cents. This is particularly true because the twelve factors overlap considerably. For example, largely subsumed under the factor “time and labor required” is an assessment of the “difficulty of the questions.” That is so because the more difficult the problem, the longer it will take to adequately resolve it.

<sup>23</sup> See *Thomas & Hansen*, *supra* note 2 at 431 (1993).

<sup>24</sup> See *id.*

<sup>25</sup> See *Kou*, *supra* note 1 at 263 (1998).

<sup>26</sup> See *id.*

<sup>27</sup> See *Thomas & Hansen*, *supra* note 2, at 431.

<sup>28</sup> See *id.* at 431-32, the author hypothesizes that:

judicial supervision could worsen the situation by making certain classes of activities especially prone to judicial review and therefore risky to undertake, from the point of view of the attorney. Consequently, there would be a tendency to avoid these activities even in cases where they would benefit the plaintiffs.

<sup>29</sup> See *Kou*, *supra* note 1, at 263.

that their fee is likely to be based upon prior to trial, therefore, they have little incentive to actually prosecute the case fully and completely.<sup>30</sup> Plaintiffs' attorneys who actually do go to trial risk losing at trial and recovering nothing. Most attorneys in this situation would obviously opt for the sure settlement amount, rather than an uncertain amount awarded by a jury, even if this is not necessarily in the best interests of the class.<sup>31</sup>

The second usual method of attorney compensation is the percentage method. Although there are different methods of calculating percentage compensation, all percentage compensation methods allocate a percentage of the plaintiff's recovery to the attorney. In contrast to the lodestar method, percentage compensation creates incentives for attorneys to control legal costs. But that same incentive structure also suffers from several problems of perverse incentives.<sup>32</sup> First, percentage compensation provides incentives to agree to premature settlements.<sup>33</sup> This is because "payments to the attorney will increase with additional effort only if that additional effort results in a higher settlement."<sup>34</sup> The attorney spending additional resources to litigate a case with the hope of increasing the settlement, will only receive a fraction of the ultimate settlement increase.<sup>35</sup> Thus, the attorney will generally not expend the maximum effort necessary to increase the settlement amount.<sup>36</sup>

Other problems with percentage-based compensation depend upon the specific method chosen. Under a duration-based fee structure, which can be driven by the calendar or the stage of

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<sup>30</sup> See *id.* at 263-64.

<sup>31</sup> See *id.*; see also, Analisa Valle, *To the Lowest Bidder? The Private Securities Litigation Reform Act and Auctioning the Role of Lead Counsel*, 74 U. COLO. L. REV. 359, 382-83(2003)(Discussing the drawbacks of the lodestar and benchmark methods. The lodestar method creates incentives to spend exhaustive hours on simple cases to maximize reportable hours. The benchmark system allows the judge to look at current established practices, however, the judge rarely evaluates whether that benchmark is appropriate given the complexity of the current litigation).

<sup>32</sup> See Thomas & Hansen, *supra* note 2, at 432.

<sup>33</sup> See *id.*

<sup>34</sup> See *id.*

<sup>35</sup> See *id.*

<sup>36</sup> See *id.*; see also Kou *supra* note 2, at 265("At the end of the day, we may have too many weak cases filed and too many good cases settled out too cheaply.")

litigation, the proposed fee increases as the case moves closer to actual litigation. The inherent problem with this structure is that most litigation is controlled by plaintiffs' counsel.<sup>37</sup> Caps on percentages, which allow the law firm to receive a maximum amount but no more, discourage law firms from vigorously pursuing the case after that amount has been achieved.

In spite of these flaws with both the lodestar and percentage method of attorney compensation, the status quo has its supporters. Proponents of the status quo argue that FRCP 23 effectively addresses this problem. Initially the drafters of the 1966 amendment to Rule 23 he intended to give courts the power and ability to supervise class counsel in the same way that they supervise other types of litigation.<sup>38</sup> Under Rule 23 courts were granted wide latitude in managing class action suits such as the ability to choose counsel, set fees, and approve settlements.<sup>39</sup> Such safeguards purportedly ensure that the plaintiff class is not taken advantage of in its absence.<sup>40</sup>

But courts have largely failed in this supervisory function.<sup>41</sup> First, courts are “constrained by the institutional requirements of neutrality and passivity set by the adversary system.”<sup>42</sup> Second, courts rely on an adversarial process to ensure that all issues are fully litigated and argued on the merits. In a class action settlement, attorneys for both sides are often anxious to have the matter settled, and true adversity between the parties is rare.<sup>43</sup> Thus, the adversarial system fails to provide sufficient information to assist the court n effective policing of settlement agreements. Counsel for both sides have the same goal—settle the case quickly.

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<sup>37</sup> See Jill E. Fisch, *Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction*, 102 COLUM. L. REV. 650, 690 (2002).

<sup>38</sup> Alon Klement, *Who Should Guard the Guardians? A New Approach for Monitoring Class Action Lawyers*, 21 REV. LITIG. 25, 44 (2002).

<sup>39</sup> See *id.*

<sup>40</sup> See *id.*

<sup>41</sup> See *id.*

<sup>42</sup> See *id.* at 45.

<sup>43</sup> See *id.*

### C. PRIVATE SECURITIES LITIGATION REFORM ACT—THE “LEAD PLAINTIFF” PROVISION

In 1995 Congress tried to resolve some of the issues that arise from various fee arrangements and as a result of the systemic problems that arise due to the very nature of our adversarial nature. Congress’ answer was the Private Securities Litigation Reform Act of 1995 (“PSLRA”).<sup>44</sup> Congress enacted the PSLRA to assist courts in choosing both the lead plaintiff and the lead counsel with an eye toward reducing some of the perceived abuses by entrepreneurial attorneys that class action litigation in securities perpetuates:

Congress has been prompted by significant evidence of abuse in private securities lawsuits to enact reforms to protect investors and maintain confidence in our capital markets. The House and Senate Committees heard evidence that abusive practices committed in private securities litigation include...the routine filing of lawsuits against issuers...whenever there is a significant change in an issuer’s stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action...[and] the abuse of the discovery process to impose costs so burdensome that it is often economical for the victimized party to settle.<sup>45</sup>

The PSLRA establishes a number of important checks against the perverse incentives favoring settlement of securities actions regardless of the merits or the impact upon shareholders.<sup>46</sup> First, the PSLRA requires publication of notice of the lawsuit to allow other potential class members the opportunity to file a motion to be considered as lead plaintiff.<sup>47</sup> Second, the court must appoint the “most adequate” (i.e., the “lead”) plaintiff from the purported class responding to the lawsuit within 90 days of this publication.<sup>48</sup> The lead plaintiff is one who the court determines to be the most capable of adequately representing the interests of class

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<sup>44</sup> Pub. L. No. 104-67, 109 Stat. 737 (codified at 15 U.S.C. 77z-1 to 78u-5 (1994 & Supp., 1996)).

<sup>45</sup> H.R. CONF. REP. NO. 104-369, at 31 (1995).

<sup>46</sup> *See id.*

<sup>47</sup> *See* 15 U.S.C. 78u-4(a)(3)(B)(i).

<sup>48</sup> *See id.*

members.<sup>49</sup> In determining which plaintiff is the most appropriate to represent the class in the lead plaintiff capacity, the court must consider the factors listed in FRCP 23.<sup>50</sup> Additionally, the plaintiff seeking to serve as the lead plaintiff must provide a sworn, signed certification that demonstrates that the plaintiff complies with the additional requirements of the PSLRA.<sup>51</sup> The factors required by the PSLRA include that the plaintiff:<sup>52</sup>

- Has reviewed the complaint and authorized its filing
- Did not purchase the security at the direction of counsel in order to participate in the litigation
- Is willing to serve as a representative party on behalf of the class
- Is willing to provide testimony at deposition and at trial, if a trial proves necessary
- Provide information regarding any other litigation under 15 U.S.C. §§ 78(a) *et. seq.* that the plaintiff sought to be named lead plaintiff in.<sup>53</sup>

The most important of these factors is the financial interest that the person or group of persons has in the litigation.<sup>54</sup> The presumption is that the investor with the largest interest in the case is the most appropriate lead plaintiff.<sup>55</sup> Once the most appropriate lead plaintiff is selected, that entity or person has the authority to select and retain lead counsel, subject to the approval of the court.<sup>56</sup>

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<sup>49</sup> *See id.*

<sup>50</sup> Fed. R. Civ. P. 23 states that the court will evaluate several factors including the interest of the members of the class in individually controlling the prosecution or defense of separate actions; the extent and nature of any litigation already commenced; the desirability or undesirability of concentrating the litigation of the claims in the particular forum; the difficulties likely to be encountered in the management of a class action.

<sup>51</sup> *See* 15 U.S.C. 78u-4(a)(2)

<sup>52</sup> *See id.*

<sup>53</sup> *See* 15 U.S.C. 78u-4(a)(2)(ii)-(vi).

<sup>54</sup> *See* 15 U.S.C. 78u-4(a)(3)(B)(iii)(bb) (which states that the most adequate plaintiff in any securities action covered by this title will be the one that “in the determination of the court, has the largest financial interest in the relief sought by the class...”)

<sup>55</sup> *See* Fisch, *supra* note 37 at 702 (2002).

<sup>56</sup> *See id.* *See also*, 15 U.S.C. 78u-4(a)(3)(B)(v).

The legislative history indicates Congress' intent for the lead plaintiff provisions of the PSLRA was to encourage involvement in securities class actions by institutional investors such as investment banks, mutual funds, and state and union pension funds.<sup>57</sup> Congress assumed that institutional investors tend to be more sophisticated than the average investor in securities.<sup>58</sup> Congress believed that sophisticated institutional investors would be better able to monitor the behavior of their attorneys at all stages of the litigation.<sup>59</sup> Congress rationalized that institutional investors have the financial resources that would enable them to commit knowledgeable staff to monitor the process.<sup>60</sup> Additionally, since these investors typically have more at stake financially than do the average investor, they should have an incentive to "develop the necessary expertise" to ensure that the plaintiffs' attorneys are acting as "faithful champions for the plaintiff class."<sup>61</sup> In this respect, the PSLRA "was expected to revolutionize securities fraud class actions by encouraging greater participation by the investor clients, who traditionally were prevented by counsel from exercising any decisions in the class action suit."<sup>62</sup> The PSLRA in effect took the emphasis off of choosing lead plaintiffs' counsel and placed it squarely on choosing the lead plaintiff.<sup>63</sup>

Critics of the PSLRA assert that the Act has failed in its goals of decreasing entrepreneurial behavior by attorneys and increasing the benefit of security litigation to the plaintiff class. These critics cite several reasons for this assertion. First, they argue that the PSLRA has failed to

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<sup>57</sup> H.R. CONF. REP. NO. 104-369, at 32 (the PSLRA is "intended to increase the likelihood that parties with significant holdings in issuers, whose interests are more strongly aligned with the class of shareholders, will participate in the litigation and exercise control over the selection and actions of plaintiff's counsel").

<sup>58</sup> *See id.*

<sup>59</sup> *See id.* *See also*, Charles H. Gray, *An Economic Analysis of the Private Securities Litigation Reform Act: Auctions as an Efficient Alternative to Judicial Intervention*, 44 WM. and MARY L. REV. 829, 874-75 (2002).

<sup>60</sup> *See* Gray, *supra* note 59, at 875-76.

<sup>61</sup> *See id.* at 875 quoting Elliot J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2053, 2065 (1995).

<sup>62</sup> *See* Ashe P. Puri, *And the Winner Is... Interpreting the Lead Plaintiff and the Lead Counsel Provisions of the Private Securities Litigation Reform Act of 1995*, 47 VILL. L. REV. 491, 493 (2002).

<sup>63</sup> *See id.*

achieve its goal of increasing institutional investor involvement in securities fraud cases and decreasing opportunistic behavior by attorneys.<sup>64</sup> For numerous reasons, institutional investors have failed to step up to the plate, the most commonly cited of which is the large costs that they would incur if they were appointed lead plaintiff.<sup>65</sup> “Since the PSLRA has expressly limited the recovery of lead plaintiffs to reasonable costs and expenses directly relating to the representation of the class, institutional investors are better off not monitoring [in the position of lead plaintiff].”<sup>66</sup> Another often-cited reason is that institutions may be unwilling to open sensitive records for review by counsel on both sides of the table, which may become necessary if the institution assumes the role of lead plaintiff.<sup>67</sup> Additionally, institutions fear that becoming a lead plaintiff may have its own liability risks with respect to other class members.<sup>68</sup> Citing the aforementioned reasons, critics argue that auctions of securities class action litigation would better address the problems that seem endemic in this type of litigation.

## II. AUCTIONS—A DIFFERENT ROUTE

Critics of the PSLRA contend that the Act fails to protect the interests of shareholders. The PSLRA, they argue, does not do enough to attract qualified lead plaintiffs, thus, the status quo has been maintained with “strike suits” continuing unabated and with lawyers continuing to profit handsomely. These critics contend that a more effective way to eliminate these frivolous suits is to auction the right to serve as lead plaintiff’s counsel to the law firm that presents the most cost-effective bid for the right to represent the plaintiffs.

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<sup>64</sup> See Klement, *supra* note 4 at 58-59 (2002)(The author proposes a system whereby a monitor who is responsible for the litigation is appointed by the court).

<sup>65</sup> See *id.* at 58 (“Having to bear these costs while enjoying only their share of the accrued benefit, institutional investors prefer to monitor from the outside as unnamed class members rather than represent the class.”).

<sup>66</sup> See Klement, *supra* note 4, at 59. See also, 15 U.S.C. 77z-1(a)(4)(1994 & Supp. V 1999).

<sup>67</sup> See Klement, *supra* note 4, at 59.

<sup>68</sup> See *id.* at 58-59.

## A. WHY AUCTIONS BETTER SERVE THE PLAINTIFF CLASS

Advocates of auctions contend that competitive bidding could curtail abuses inherent in the class action process by giving control of the litigation back to the plaintiff class.<sup>69</sup> Auction proponents believe that the PSLRA failed to achieve its goals of reducing entrepreneurial behavior on the part of attorneys with its strategy of appointing a lead plaintiff because it fails to give courts any criteria in evaluating the lead plaintiff's choice of lead counsel.<sup>70</sup> Because the PSLRA failed to give courts any guidance, courts are reluctant to reject the plaintiff's selection and often fail to evaluate meaningfully plaintiff's choice at all.<sup>71</sup> Auctions attempt to mimic what the lead plaintiff's decision would be if there were truly an open, vigorous, and competitive market for class action attorneys.<sup>72</sup> Although fewer than fifteen cases have employed auction procedures, the percentage fees obtained by counsel in these cases have been substantially lower than in securities fraud cases where traditional methods of payment have been used. For example, in *In re Network Associates, Inc. Securities Litigation*<sup>73</sup> the attorneys received just seven percent of the \$30 million settlement. The highest settlement award using an auction occurred in *In re Wells Fargo Securities Litigation*<sup>74</sup> where the plaintiff's attorney received 21.2 percent of the \$13.5 million settlement. Thus, even at the high end, the awards generated by auctions are significantly lower than the current average of approximately 25 to 30 percent.

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<sup>69</sup> See Valle, *supra* note 31 at 359 (excessive attorney fees is a common criticism of the class action process).

<sup>70</sup> See *id.* at 368.

<sup>71</sup> See Jill E. Fisch, *Class Action Reform: Lessons from Securities Litigation*, 39 ARIZ. L. REV. 533, 533 (1997).

<sup>72</sup> See *In re Continental Illinois Securities Litigation*, 962 F.2d 566,572 (7<sup>th</sup> Cir. 1992) (“The object is to simulate the market where a direct market determination is infeasible. It is infeasible in a class action because no member of the class has a sufficient stake to drive hard—or any—bargain with the lawyer. So the judge has to step in and play surrogate client.”).

<sup>73</sup> No. C-99-01729 WHA (Notice of Proposed Settlement of Class Action, Mar. 14, 2001, N.D. Cal.).

<sup>74</sup> 157 F.R.D. 467 (N.D. Cal. 1995).

Auction supporters believe that the PSLRA has failed to entice institutional investors who are willing to make the substantial time, resources, and financial commitment necessary to monitor entrepreneurial behavior of firms.<sup>75</sup> Without institutional investors willing to expend this substantial effort, the system will remain relatively unchecked, and the problems which originally lead Congress to draft the PSLRA will continue unabated.<sup>76</sup> Auction proponents cite to a number of cases where judges have successfully auctioned the lead counsel position.<sup>77</sup> Additionally, auctions allow smaller firms to bid in this process which lessens the near monopoly that currently exists in such class action suits,<sup>78</sup> and the competitive nature of auctions drives fees downward, thereby increasing the distribution of the damage award actually paid to the plaintiff class.<sup>79</sup> Furthermore, auction proponents posit that the traditional adverse relationship between the parties simply does not exist in class action settlement proposals.<sup>80</sup>

#### B. LEAD PLAINTIFF AUCTIONS VERSUS CLAIMS AUCTIONS

There are two types of auctions. The first type involves auctioning off the position of the lead plaintiff (“Lead Counsel Auctions”). This auction method has been used in several cases.<sup>81</sup> The second type is both more controversial and untried. It involves auctioning off the entire claim to a firm (“Claim Auctions”).<sup>82</sup> Once the winning bid is selected, the money offered is

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<sup>75</sup> Joseph A. Grundfest, *More Questions than Answers and a Friendly Wager*, 74 TEMP. L. REV. 821, 823 (2001) (The author asserts that fewer than ten percent of plaintiffs, even institutional plaintiffs, contact more than one law firm. Thus, little if any, true fee negotiations take place under the current system).

<sup>76</sup> *See id.*

<sup>77</sup> *See id.* (The author details fee percentages that fall far below the “benchmark” of 25%-33% and fall in the range of 7-14%, with one exception which was granted 21%).

<sup>78</sup> *See Puri, supra* note 62 at 513; *see also, Thomas & Hansen, supra* note 2 at (Thomas and Hansen describe the current system of securities fraud class action as “anti-competitive” where a “small number of firms appear in nearly every case and effectively dominate the litigation.”).

<sup>79</sup> *See id.*

<sup>80</sup> *See Langlois, supra* note 13 at 864-65.

<sup>81</sup> *See In re Oracle Sec. Litig*, 131 F.R.D. 688 (N.D. Cal. 1990); *In re Wells Fargo Sec. Litig.*, 156 F.R.D. 223 (N.D. Cal. 1994); *see also infra* note 91 for a listing of other such cases.

<sup>82</sup> *See Thomas & Hansen supra* note 2. (The authors have proposed this system in an effort to curtail some of the inherent problems of auctioning of lead counsel positions such as under- or overbidding for a claim).

paid directly to the plaintiff class, which receives an immediate monetary settlement.<sup>83</sup> The lawyers then litigate the class action, retaining whatever monetary award is achieved.<sup>84</sup> If the award is more than the payment for the auction, less expenses, then the firm makes a “profit” on the litigation.

### 1. *Lead Plaintiffs’ Counsel Auctions*

Prior to the enactment of the PSLRA, auctions were used to address the systemic problems that are inherent within securities class action litigation. The first case in American jurisprudence to use the lead plaintiff auction method was *In re Oracle Securities Litigation*.<sup>85</sup> *Oracle* began when the corporation announced that it would not meet its earning projections for the first quarter of 1990.<sup>86</sup> Immediately after this announcement, the stock price fell dramatically.<sup>87</sup> A class action suit ensued and following a contentious meeting between firms vying for the position of plaintiffs’ counsel, Judge Vaughn R. Walker ordered the various competing firms to submit bids based on their predictions of the litigation budget.<sup>88</sup> Judge Walker believed 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.”<sup>89</sup> The court requested bids from those firms which were interested in representing the plaintiff class.<sup>90</sup>

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<sup>83</sup> *See id.*

<sup>84</sup> *See id.*

<sup>85</sup> 131 F.R.D. 688 (N.D. Cal. 1990).

<sup>86</sup> *See id.* at 689.

<sup>87</sup> *See id.* at 690.

<sup>88</sup> *Id.* at 690 (The opinion describes the meeting of the competing counsel in a humorous manner, describing a meeting in which two of the firms disparaged each other and further describes that these two firms actually filed a proposal to jointly represent the plaintiff class).

<sup>89</sup> *Id.*

<sup>90</sup> *See id.* at 697; *see also*, 132 F.R.D. 538, 539 (N.D. Cal. 1990)(Of the 29 firms which initially expressed an interest in representing the plaintiff class, only four actually submitted a bid.).

Since that case, several courts have experimented with lead plaintiff auctions within the context of securities fraud litigation.<sup>91</sup> The general procedure is simple. Through a competitive bidding process, counsel wishing to be named lead plaintiffs' counsel submit a proposal to the court by a given deadline.<sup>92</sup> The bid requirements proposed by the court in *In re Wells Fargo Security Litigation* are typical.<sup>93</sup> The Court required competing counsel to disclose the following information: (1) The firm's experience, and that of the individual attorneys; (2) the firm's qualifications, including its willingness to post a "completion bond or other security for the faithful completion of its services to the class;" (3) the firm's malpractice insurance coverage; (4) the percentage of any recovery the firm would charge in the event of recovery; and (5) other terms of the proposed fee arrangement.<sup>94</sup> Other factors considered by courts included the firm's reputational capital, for example its reputation as a firm that is a "tough bargainer," and the firm's fit with the lead plaintiff.<sup>95</sup> Once the information is obtained from the competing firms, the court usually determines the most qualified bidder and awards that firm the opportunity to represent the class.<sup>96</sup>

## 2. Claims Auctions

A proposed but untried variation of the auction procedure is an auction of the entire claim. Under a claim auction, legal counsel would bid to "purchase" the claim from the plaintiff class.

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<sup>91</sup> See *In re Oracle Securities Litig.*, 132 F.R.D. (N.D. Cal. 1990); *In re Oracle Securities Litig.*, 136 F.R.D. 639 (N.D. Cal. 1991); *In re Cendant Corp.*, 260 F.3d 183 (3<sup>rd</sup> Cir. 2001); *In re Comdisco Sec. Litig.*, 141 F. Supp. 2d 951 (N.D. Ill. 2001); *In re Bank One S'holders Class Actions*, 96 F.Supp. 2d 780, 784-85 (N.D. Ill. 2000); *In re Commtouch Software Ltd. Sec. Litig.*, No. 01-C-00719 (N.D. Cal. 2001); *In re Network Assocs. Inc. Sec. Litig.*, 76 F. Supp. 2d 1017, 1033-34 (N.D. Cal. 1999); *Wenderhold v. Cylink Corp.*, 188 F.R.D. 577, 587-88 (N.D. Cal. 1999); *In re Cal. Micro Devices Sec. Litig.*, 168 F.R.D. 257, 270-71 (N.D. Cal. 1996); *Sherleigh Assocs. LLC v. Windmere-Durable Holdings, Inc.*, 184 F.R.D. 688, 696 (S.D. Fla. 1999).

<sup>92</sup> See Puri *supra* note 74, at 511.

<sup>93</sup> 156 F.R.D. 223 (N.D. Cal. 1994).

<sup>94</sup> See *id.* at 228-29.

<sup>95</sup> See Lucian Ayre Bebhuck, *The Questionable Case for Using Auctions to Select Lead Counsel*, 80 Wash. U.L.Q. 889, 892 (2002) (The author argues that the fit of the firm with the plaintiff is often undervalued by courts to the detriment of the entire plaintiff class.).

<sup>96</sup> See Puri, *supra* note 62 at 511.

Theoretically, ownership of the claim would wipe out all of the attorney incentives in traditional fee arrangements, as well as answer most of the criticisms of those opposed to the auction of lead plaintiffs' counsel position. According to Macey and Miller, the leading proponents of claims auctions,<sup>97</sup> the judge should determine initially whether an auction is appropriate on a case-by-case basis.<sup>98</sup> This determination would require analysis of several factors including:

- whether the case was large-scale, small claim litigation
- how many complaints had been filed
- how the claims in the case are defined; and
- whether any other factors exist that would suggest that an auction is inappropriate.<sup>99</sup>

Once the judge determined that an auction was appropriate he or she defines the claim being sold, posts notice to ensure that interested bidders would participate, and selects a bidding method for the auction.<sup>100</sup> Discovery is allowed to the extent that would enable interested bidders to investigate the claim.<sup>101</sup> One of the more controversial aspects of the model proposed by Macey and Miller is that the defendant is also allowed to bid on the claim.<sup>102</sup>

Once the court determines the winning bid and awards the claim to that bidder, the bidder pays the amount of the claim to the court.<sup>103</sup> The court then deducts all appropriate expenses, including compensation for the attorneys who first filed the suit.<sup>104</sup> The court next distributes the net proceeds to the plaintiff class.<sup>105</sup> The plaintiff class is then all but completely removed from

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<sup>97</sup> See Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U.CHI. L. REV. 1, 97-105 (1991)(provides a global description of the proposed mechanics for conducting claims auctions).

<sup>98</sup> See *id.*

<sup>99</sup> See *id.* at 106

<sup>100</sup> See *id.*

<sup>101</sup> See *id.*

<sup>102</sup> See *id.*

<sup>103</sup> See *id.* at 107.

<sup>104</sup> See *id.*

<sup>105</sup> See *id.*

the litigation, being compensated quickly and efficiently for their respective injuries. The winning bidder then proceeds to litigate the case in whatever manner they deem appropriate, unless the winning bidder is the defendant. In the event that the defendant is the highest bidder in the auction, the defendant would petition the court for a dismissal with prejudice once the injured plaintiffs have been compensated with the bid money.<sup>106</sup>

### *3. Benefits of Claims Auctions*

The proponents of this type of auction argue that “auctioning ownership and control of the lawsuit in one party” minimizes agency costs and eliminates attorney incentives that harm plaintiffs.<sup>107</sup> Instead of incentives to settle too early for too little, the ownership component gives the winning bidder incentives to litigate aggressively and to expend the appropriate effort to maximize the recovery.<sup>108</sup> Additionally, the lack of adversity between the parties inherent in most settlement actions is virtually eliminated.<sup>109</sup> Another benefit is that the court would not have to spend its time or resources evaluating proposed settlement agreements between the defendant and the plaintiff class.<sup>110</sup>

### *4. Pitfalls of Claims Auctions*

Auctions of this sort are not without shortcomings. One of the most often cited criticisms include whether the judge would be knowledgeable enough about the entire process to properly conduct the auction.<sup>111</sup> Specifically, critics of the claims auction question whether the judge

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<sup>106</sup> *See id.* at 108.

<sup>107</sup> *See* Thomas & Hansen, *supra* note 2, at 435.

<sup>108</sup> *See id.*

<sup>109</sup> *See id.*

<sup>110</sup> *See id.*

<sup>111</sup> *See id.* at 435.

would be capable of defining the scope of the claim to be auctioned, and whether the claim would be appropriate for an auction.<sup>112</sup>

Other commonly cited criticisms of claims auctions include the potential for collusion among bidders to devalue the claim, the possibility of too few or too many bidders, whether the bidders could arrange appropriate financing, the difficulty of appropriately valuing the claim, and the uncertainty of whether the individual members of the plaintiff class would cooperate once they had been compensated for their injuries.<sup>113</sup>

Valuation of the securities fraud claim seems to be a relatively objective process measured by the decrease in stock value as a result of the alleged fraud compared to mass tort litigation, where the value of the individual claims may be hotly disputed and contingent upon many subjective factors. Thus, it appears that claims auctions could be more easily implemented in securities fraud class actions than in other areas of the law because they often lack a significant subjective component.<sup>114</sup>

The problem of quantity of bidders could be a factor that decreases the effectiveness of the bidding process of this type of auction.<sup>115</sup> However, this factor could be greatly diminished, if not completely eliminated if competing firms did not know the identity of other law firms involved in the process, or the number of other bidders in the process.<sup>116</sup> In a situation where all participants are blind, the bids submitted by each participant are not influenced by other participants in the process.<sup>117</sup>

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<sup>112</sup> *See id.*

<sup>113</sup> *See id.* at 435-36.

<sup>114</sup> *See* Fisch, *supra* note 37 (critics contend that calculation of damages in securities litigation is really not as objective as it appears and involves subjective valuation testimony by experts).

<sup>115</sup> *See* Gray, *supra* note 59 at 842.

<sup>116</sup> *See id.*

<sup>117</sup> *See id.*

### III. GENERAL CRITICISMS OF THE AUCTION PROCESS ITSELF

Critics of auctions maintain that they are fundamentally flawed.<sup>118</sup> These critics maintain that the flaws exist regardless of the type of auction utilized. The most common criticisms of auctions include that:

- they appear to be more concerned with the bottom-line price as opposed to the quality of the firm,<sup>119</sup>
- there is no way to truly ascertain whether auctions are effective,<sup>120</sup>
- auctions reduce counsels' incentives to assertively litigate on behalf of their clients,<sup>121</sup> and
- judges may not be the an appropriate choice to be auctioneers.<sup>122</sup>

Furthermore, critics of auctions posit that the PSLRA, with its lead plaintiff requirements, will eventually increase sophisticated investors' involvement in securities fraud litigation to an acceptable level.<sup>123</sup>

The main criticisms of auction methodology can be broken down into four categories:

(1) Auctions deter experienced investors from securities litigation; (2) the process of bidding is inconsistent with the PSLRA; (3) the inappropriateness of having a judge assume the role of auctioneer; (4) acceptance of settlement offers that are too low.

#### A. AUCTIONS DETER EXPERIENCED INSTITUTIONAL INVESTORS FROM PARTICIPATING

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<sup>118</sup> See William J. Friedman, *Litigation in a Free Society: The Questionable Case for Using Auctions to Select Lead Counsel*, 80 WASH. U.L.Q. 889, 892 (2002) (Competitive bidding reduces the expected recovery of the plaintiff class in two ways. First, the bidding process focuses almost exclusively on the price, and does not focus on the qualitative differences between firms. Second, the bidding process results in less incentive for attorneys to aggressively advocate for their clients).

<sup>119</sup> See *id.*

<sup>120</sup> See *id.*

<sup>121</sup> See Fisch *supra* note 37 at 702-03.

<sup>122</sup> See *id.*

<sup>123</sup> See 15 U.S.C. 78u-4(a)(3)(B)(i) (defines lead plaintiff as the plaintiff with the most financial stake in the litigation).

Those who favor allowing the lead plaintiff to choose the lead position counsel argue that “the greatest strength of the PSLRA...is its provision allowing these investors to appoint lead counsel.”<sup>124</sup> This provision is important because it gives institutional investors, those whom Congress most wanted to encourage to participate in this type of litigation, the ability to select counsel with whom they are comfortable and familiar.<sup>125</sup> Stripping this decision-making ability from institutional investors and arranging “shotgun marriages” of the plaintiff with counsel not of their choosing discourages these entities from participating.<sup>126</sup> The Securities and Exchange Commission (“SEC”) argued in an amicus brief that the court should not ordinarily interfere with the lead plaintiff’s choice of counsel.<sup>127</sup> Rather, courts should trust the judgment of a lead plaintiff “who possesses the qualities and acts in the manner contemplated by Congress” because “failing to do so could enhance counsel’s control of the litigation, which is contrary to Congress’ intent” and could also “deprive institutional investors of a core reason for serving as lead plaintiff.”<sup>128</sup> Furthermore, there are a number of factors of securities fraud class actions that make the lead plaintiff provision of the PSLRA the most appropriate means of choosing auctions. These factors include:

(1) homogeneous damages that can be fairly and objectively allocated in a settlement agreement, (2) the probability of repeat performances by institutional investors as lead plaintiffs, thereby increasing their influence over lead counsel, and (3) an objective factor, namely, the size of the investor’s stake, to use in easily determining the most adequate lead plaintiff in terms of both sophistication and financial resources.<sup>129</sup>

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<sup>124</sup> See Langlois *supra* note 13, at 878.

<sup>125</sup> See *id.* at 878-79.

<sup>126</sup> See *id.* at 879.

<sup>127</sup> See Brief of Amicus Curiae Securities and Exchange Commission at 23, *Moore v. Network Assocs., Inc.*, (N.D. Cal. 2000) (No. 00-70006), available at <http://www.sec.gov/litigation/briefs/netwkbr2.html> (last visited January 28, 2004).

<sup>128</sup> See Brief of Amicus Curiae Securities and Exchange Commission, *In re Cendant Corp. Litig.*, 109 F.Supp. 2d 285 (D.N.J. 2000) (Nos. 00-2769, 00-3653), available at <http://www.sec.gov/litigation/briefs/cendnt.htm> (last visited January 28, 2004).

<sup>129</sup> See Langlois, *supra* note 13, at 904.

## B. BIDDING IS INCONSISTENT WITH THE PSLRA

Critics of auctions believe that auctions are directly contradictory to the statutory clear language of the PSLRA. The Act states that the person or group of persons who are selected by the court to serve as lead plaintiff *shall* select counsel.<sup>130</sup> The legislative history of the PSLRA indicates that “judicial discretion in approving the selection of counsel should be guided by ‘existing law.’”<sup>131</sup> Courts should evaluate the experience, competence, and resources of the firm attempting to represent the plaintiff class and should “withhold approval only when necessary to protect the interests of the plaintiff class.”<sup>132</sup> These critics argue that auctions are not part of the “existing law” that the authors of the Act contemplated.<sup>133</sup> According to those who believe that the PSLRA does not allow for competitive bidding, the role of the courts is simple and finite: judges must ensure only that the counsel selected by the lead plaintiff is adequate, using already existing mechanisms to make that determination.<sup>134</sup>

Several courts have considered and rejected bidding as inconsistent with the requirements and objectives of the PSLRA.<sup>135</sup> In *In re Cendant Corp. Sec. Litig*<sup>136</sup> the Third Circuit invalidated the trial court’s lead counsel auction because it concluded that the auction in that case was inappropriate.<sup>137</sup> The appellate court did not expressly prohibit auctions, but expressed that auctions were generally inconsistent with the statutory scheme of the PSLRA.<sup>138</sup> The Third Circuit felt that the correct question to ask was “not whether another movant might do a better

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<sup>130</sup> H.R. CONF. REP. NO. 104-369, at 35 (1995), reprinted in 1995 U.S.C.C.A.N. 730, 734 (emphasis added).

<sup>131</sup> *See id.*

<sup>132</sup> *Id.*

<sup>133</sup> *Id.*

<sup>134</sup> *See Id.* at 383-84. *See also* Fed. R. Civ. P. 23 (The author argues that the PSLRA simply mirrors the factors listed in Fed. R. Civ. P. 23)

<sup>135</sup> *See* Fred B. Burnside, “Go Pick a Client”—And Other Tales of Woe Resulting from the Selection of Class Counsel by Court-Ordered Competitive Bidding, 8 FORDHAM J. CORP. & FIN. L. 363, 383-390 (2003) (The author argues that Rule 23 guides the court in determining whether the attorney selected by lead counsel is adequate and that the PSLRA merely codifies existing Rule 23 law).

<sup>136</sup> 264 F.3d 201, 233 (2001).

<sup>137</sup> *See id.*

<sup>138</sup> *See id.*

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 have done a ‘fair and adequate’ job.”<sup>139</sup> It further stated that any fee request that was properly submitted pursuant to a retainer agreement enjoyed a presumption of reasonableness that could only be rebutted by a showing that the agreement was “clearly excessive.”<sup>140</sup>

Another case in which the court rejected competitive bidding after an exhaustive analysis was *In re Microstrategy Inc. Sec. Litig.*<sup>141</sup> The court believed that auctioning of lead plaintiff positions was outside the scope of the PSLRA and the court was simply unauthorized to order such an auction.<sup>142</sup> The court seemed to believe that existing mechanisms would ensure that the interests of the plaintiff class were adequately protected.<sup>143</sup> In reaching this decision the court relied heavily on its ability to approve the selection of counsel and to ensure that the ultimate fee structure proposed by the attorneys was reasonable.<sup>144</sup>

Notably, the SEC filed an amicus brief arguing that the court’s approval of the lead plaintiff’s selection of counsel should be based on a Rule 23(a)(4) four-factor analysis.<sup>145</sup> The factors which the courts historically have used include (1) the competence, experience and expertise of the counsel in handling a similar class action suit; (2) the financial resources, diligence and personal motivation of the attorney to advocate for the class; (3) the absence of any conflict of interest; (4) the appropriate number of counsel necessary to properly litigate the class

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<sup>139</sup> See *id.* See also, Burnside, *supra* note 135, at 380-82 (The author provides a detailed analysis of this holding).

<sup>140</sup> See *In re Cendant Corp. Sec. Litig.*, 264 F.3d 201, 233 (2001).

<sup>141</sup> 110 F.Supp. 2d 427,437-38 (E.D. Va. 2000).

<sup>142</sup> *Id.*

<sup>143</sup> See *id.*

<sup>144</sup> *Id.* at 437-38 (“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.”).

<sup>145</sup> 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).

action without causing unnecessary disorganization or delay or increased costs.<sup>146</sup> The SEC was concerned that auctioning of lead counsel positions would lead to decision-making based heavily on the projected costs, rather than the quality of the firms competing for the position.<sup>147</sup>

The ultimate goal of class action litigation is to maximize the benefit to the class members if the litigation proves successful.<sup>148</sup> For opponents of auctions, this goal is best achieved by limiting the role of the court to determining the most appropriate lead plaintiff.<sup>149</sup> Once the court has been satisfied that the proper individual, group, or institution has been placed in that position, the court should adopt a “hands-off” approach, intervening only when it is clear that fees are unreasonable or that the counsel selected by the lead plaintiff is clearly inappropriate.<sup>150</sup> Opponents of competitive bidding argue that this approach is the only way in which courts can be true to the legislative intent of the PSLRA.

#### C. IT IS INAPPROPRIATE OF JUDGES TO ASSUME THE ROLE OF AUCTIONEER

Judges are not “surrogate clients.”<sup>151</sup> They are not motivated by the same set of factors that the client would be, nor do they have the same overall concerns.<sup>152</sup> Judges may be motivated by self-interest, personal goals, and a simple desire to expedite the litigation to a quick settlement in order to clear up an over crowded docket.<sup>153</sup> Overcrowded dockets may cause a court to inadvertently weigh price more heavily rather than delve into the subtle, yet distinctive, differences of various law firms competing for the position of lead plaintiff.<sup>154</sup> Additionally, evaluating what auction design is appropriate for a particular case is complex. Properly

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<sup>146</sup> See Burnside, *supra* note 135, at 384.

<sup>147</sup> See Brief of the Securities and Exchange Commission as Amicus Curiae in Support of Appellants on the Issue Specified at 18, *In re Cendant Corp. Sec. Litig.*, Nos. 00-2769, 00-3653 (3d Cir. Dec. 22, 2000).

<sup>148</sup> See Valle, *supra* note 31 at 372.

<sup>149</sup> See Fisch, *supra* note 37 at 690.

<sup>150</sup> See *id.*

<sup>151</sup> See *id.*

<sup>152</sup> See *id.*

<sup>153</sup> See *id.*

<sup>154</sup> See *id.*

designing an auction and administering it is something that could potentially involve a “substantial expenditure of judicial resources.”<sup>155</sup> Judicial experience in conducting such auctions is limited, and due to the few cases that have actually utilized auctions, it is impossible to fairly evaluate whether judges have done an adequate job of conducting these auctions.<sup>156</sup>

Another common criticism of auctions is that judges conducting them are too focused on the price of litigation, often sacrificing quality for a “cheaper” firm.<sup>157</sup> The Third Circuit Task Force on the Selection of Class Counsel expressed this fear when it concluded that this focus on the bottom line price without giving sufficient weight to other factors creates a risk that the plaintiff class will be saddled with “low quality representation.”<sup>158</sup> In order for judges to consider the quality of the firm, the judge would have to have access to a variety of information in order to consider non-price variables.<sup>159</sup> Further complicating this analysis is the fact that as with many other areas of business, the price an attorney charges is often directly correlated to his or her quality.<sup>160</sup> A number of cases offer some insight into the struggle that courts have had in attempting to evaluate the firm’s overall quality. Although Judge Walker in *Oracle* attempted to evaluate the quality of the various firms submitting bids, the information that the firms provided was unhelpful in this determination.<sup>161</sup>

Advocates of auctions argue that this concern is overstated. As courts become more experienced at conducting auctions, they are beginning to request more information about the

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<sup>155</sup> See *id.* at 691.

<sup>156</sup> See Jill E. Fisch, *Complex Litigation at the Millennium: Aggregation, Auctions, and Other Developments in the Selection of Lead Counsel under the PSLRA*, 64 LAW & CONTEMP. PROB. 53, 82 (2001).

<sup>157</sup> See Valle, *supra* note 31, at 374-75.

<sup>158</sup> See Third Circuit Task Force Report on the Selection of Class Counsel 45 (Jan. 2002), available at <http://www.ca3.uscourts.gov/classcounsel/final%20report%20of%20third%20circuit%20task%20force.pdf> (last visited March 10, 2004).

<sup>159</sup> See Fisch, *supra* note 156 at 83.

<sup>160</sup> See *id.*

<sup>161</sup> See *In re Oracle Sec. Litig.*, 132 F.R.D. 538, 542 (N.D. Cal. 1990).

firms vying for the position of lead counsel.<sup>162</sup> Information that judges have requested from firms include descriptions of qualifications, willingness to post bonds, demonstration that the firm has evaluated the case, malpractice coverage, all in addition to bid price and structure.<sup>163</sup> The increased quality of information has allowed courts to better compare and contrast the relative strengths and weaknesses of each firm's bid, thus making a more educated decision regarding who is best qualified to represent the plaintiff class.<sup>164</sup> Judge Walker concluded that it was “impossible objectively to distinguish among these firms in terms of their background, experience and legal abilities.”<sup>165</sup>

The court in *Cendant* claimed to take the quality of the firm into account when rendering its decision as to which firm would be awarded the position of lead plaintiff's counsel.<sup>166</sup> However, its analysis of quality was primarily based on litigation experience to the exclusion of other relevant factors.<sup>167</sup> Notably, the court did not consider the reputation of the firm, nor the quality of the investigation that the firm did in preparing its bid. The *Cendant* court's emphasis on the litigation experience of the firm it ultimately selected is interesting, particularly since most securities litigation cases do not go to trial.

Still another approach was taken by the court in *Sherleigh Assocs. v. Windmere-Durable Holdings, Inc.*<sup>168</sup> The court in *Sherleigh* attempted to structure auction bids to take qualitative factors such as the firm's experience in securities litigation, its qualifications to complete the work, and the firm's investigation of the case.<sup>169</sup> But, the court did not explain how these factors

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<sup>162</sup> See Fisch, *supra* note 156 at 81.

<sup>163</sup> See *id.*

<sup>164</sup> See *In re Oracle Sec. Litig.*, 132 F.R.D. 538, 542 (N.D. Cal. 1990).

<sup>165</sup> See *id.*

<sup>166</sup> See *In re Cendant Corp. Litig.*, 191 F.R.D. 387, 390 (D.N.J. 2000).

<sup>167</sup> See *id.* (the *Cendant* court viewed litigation experience, fiscal ability, and the proposed fee scheduled as the most pertinent criteria in selecting lead counsel).

<sup>168</sup> 186 F.R.D. 669, 671 (S.D. Fla. 1999).

<sup>169</sup> See *id.* at 696.

would be considered and weighed in the final selection process.<sup>170</sup> “If a court does not specify precisely which factors demonstrate firm quality, it can use quality factors to rationalize the selection of whichever firm it chooses.”<sup>171</sup>

A completely different set of criteria were used by the court in *Wenderhold v. Cylink*.<sup>172</sup> The court threw out traditional factors—if such a word can be used to describe the competitive bidding process—when making its lead counsel determination. Instead of relying on the various firm’s securities litigation experience, presence in the area, access to resources such as an office in the area, the court decided that the chosen firm’s smaller size gave it a greater incentive to succeed.<sup>173</sup> “A court’s assessment of firm quality seems arbitrary when a firm’s small size or lack of litigation experience can be either a benefit or a detriment for purposes of quality evaluation.”<sup>174</sup>

These cases illustrate the difficulty that various courts have had in making decisions regarding who should become lead plaintiff’s counsel. Without any guidelines to follow, courts struggle to find their own definition of “quality.” How quality is defined varies dramatically based on which judge in which district is hearing the case. Importantly, these criteria never consider the “fit” of the firm to the lead plaintiff class representatives.<sup>175</sup> In the optimal situation the firm selected by the court would be able to work cohesively with the lead plaintiff representatives. However, if this is not the case, the entire litigation could suffer as a result of the poor relationship between the plaintiffs’ representatives and the lead counsel.

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<sup>170</sup> See Fisch, *supra* note 156, at 84 (surveying all the cases cited in this section).

<sup>171</sup> See *id.*

<sup>172</sup> 191 F.R.D. 600 (N.D. Cal. 2000).

<sup>173</sup> See *id.* at 602-03.

<sup>174</sup> See Fisch, *supra* note 156, at 84.

<sup>175</sup> See *id.*

Even if the court limits itself to selection of a firm based solely on the price of the bid, the ultimate price is not easy to determine.<sup>176</sup> There are a variety of bid structures which must be evaluated, each with its inherent incentives.<sup>177</sup> Additionally, bids have various “cross over” points, in which the bid appears to be the best bid until a certain point in the litigation is reached.<sup>178</sup> Since courts are making the decision of lead plaintiff’s counsel at the beginning of the litigation, it is difficult to know how far the litigation will progress or whether it will settle prior to trial.<sup>179</sup> Thus, the court may itself make an assessment of how far the case will progress and decide to choose a firm based on that assessment. However, if that assessment is incorrect, the plaintiff class loses.

#### D. SETTLING TOO QUICKLY; TOO CHEAPLY—AND OTHER SELF-SERVING BEHAVIOR

There are several fee structures that have been used in auctions. Each creates its own incentive problems.<sup>180</sup> These most common fee structures include the “capped” fee structure, the declining percentage of fee recovery structure, fixed percentage structure, and the duration-based fee structure.<sup>181</sup>

Under a capped fee structure, the lawyers receive a percentage which is limited to a certain amount. Once that amount is achieved, the law firm will receive no additional monies regardless of the settlement actually achieved. This has the unfortunate effect of eliminating any “incentive beyond the point at which fees are capped.”<sup>182</sup> This effect is illustrated in *In re Bank One S’holders Class Actions*.<sup>183</sup> In this case, the court estimated that the recovery to the plaintiff

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<sup>176</sup> See *id.* at 85.

<sup>177</sup> See *id.*

<sup>178</sup> See *id.*

<sup>179</sup> See *id.*

<sup>180</sup> See Fisch, *supra* note 37 at 679-80.

<sup>181</sup> See *id.*

<sup>182</sup> See *id.* at 679.

<sup>183</sup> 96 F. Supp. 2d 780 (N.D. Ill. 2000).

class would be \$4.6 to \$4.8 billion.<sup>184</sup> The court had previously rejected a bid by a firm that estimated recovery at \$65 million, stating that such a low recovery “defies reality.”<sup>185</sup> Yet the court subsequently approved a settlement of \$45 million, an amount that was approximately one percent of the court’s own estimate of the worth of the case.<sup>186</sup> Ironically, the settlement was proposed at precisely the point where plaintiff’s attorneys’ fees were capped. Thus, it is at least open to discussion that the fee cap of \$25 million negotiated by plaintiff’s attorneys had an impact on the decision to settle for one percent of the court’s valuation of the case.<sup>187</sup>

The declining percentage bid structure contemplates a higher percentage initially, and a decreasing percentage after the settlement reaches certain defined amounts:

Because it fails to align counsel’s interests with those of the plaintiff class at high levels of recovery, a declining percentage of recovery fee structure is especially likely to create a significant moral hazard problem. The last dollars of a recovery are generally the most costly to produce, limiting counsel’s motivation to pursue them. The incremental value to counsel of additional dollars recovered is particularly small when counsel will receive a very low percentage of those dollars....Thus, under typical litigation conditions, the declining percentage fee may produce a windfall return to counsel while, at the same time, shortchanging the plaintiff class.<sup>188</sup>

Another type of fee structure is the duration-based fee structure. There are two variations of the duration-based fee structure. The first is a simple calendar based contingency, the more common is a litigation stage contingency. These contingencies create perverse incentives to delay litigation. This becomes a particularly compelling issue when considering the fact that it is plaintiffs’ counsel who typically controls the duration of most litigation.<sup>189</sup> Courts are generally

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<sup>184</sup> See *id.* at 788.

<sup>185</sup> See *id.* at 788 & n.11.

<sup>186</sup> See Notice of Pendency and Proposed Settlement of Class Action and Settlement Hearing Thereon, Exhibit A to Preliminary Approval Order in Connection with Settlement Proceedings, In re Bank One S’holders Class Actions, No. 00-C-880 N.D. Ill. March 20, 2001); See also Fisch, *supra* note 185 at 668-670 & n.107-109 (describing Bank One estimate and settlement result).

<sup>187</sup> See Fisch, *supra* note 156 at 679.

<sup>188</sup> See *id.* at 678-79.

<sup>189</sup> See *id.* at 680.

unable to monitor the progress of litigation sufficiently to detect and appropriately sanction unnecessary delay resulting in a situation where the plaintiff class is paying for litigation that is not benefiting them, and in fact is detrimental to the class' overall net recovery.<sup>190</sup> A related problem is the incentives created by early-settlement bonuses. “[E]arly settlement bonuses can give defendants additional leverage in negotiating a cheap settlement by creating a time-based discontinuity in the returns to effort of plaintiffs’ counsel.”<sup>191</sup>

Opponents of auctions argue that the various incentives created by the fee structures commonly used in auctions negate any potential advantage they have in reducing the overall attorney awards. Of the existing systems, the fixed percentage fee structure is the least problematic in creating agency incentives. The fixed percentage fee structure offers an easy, concrete way of evaluating competing bids while minimizing the importance of an accurate prediction of the litigation’s value.<sup>192</sup> While auction opponents have a valid point with respect to fee structures when the auction involves the lead plaintiff position, these arguments dissipate when considering claims auctions.

#### IV. PROPOSED SOLUTION—AUCTIONS OF ENTIRE CLAIM USING PENALTIES TO SAFEGUARD THE CLAIM AGAINST OPPORTUNISTIC LOW BIDDING

Claims auctions, defined as the auctioning of an entire claim to the litigating firm, which then owns the claim outright, offer a unique way of minimizing agency costs and addressing problems left by the PSLRA’s reliance on the lead plaintiff provision as well as problems that are created by lead plaintiff’s counsel auctions. The PSLRA’s reliance on the lead plaintiff provision of the Act to safeguard the plaintiff class’ rights seems misplaced. Since the Act was enacted, there has

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<sup>190</sup> *See id.*

<sup>191</sup> *See id.*

<sup>192</sup> *See id.* at 680.

not been a noticeable trend in reduction of attorney fees.<sup>193</sup> Furthermore, there is no evidence that lead plaintiffs are at all successful in negotiating fees downward.<sup>194</sup> Finally, reliance on benchmarks to determine what the appropriate fee should be may not be reasonable. These customary benchmarks were established pre-PSLRA and may constitute a “clearly unreasonable fee arrangement,” when it “was not the result of hard bargaining.”<sup>195</sup> A recent article estimates that less than ten percent of lead plaintiffs actually engage in any bargaining at all with the lead counsel.<sup>196</sup>

Additionally, the data suggests that even though courts have the authority to lower a benchmark rate when it is inappropriate, they rarely do so.<sup>197</sup> The Third Circuit Task Force suggested that courts regularly lowered benchmark rates, yet could cite to only eighteen situations in which fees awarded to attorneys in non-auction situations were lower than the standard 25 to 30 percent.<sup>198</sup> Given the prevalence of securities litigation—300 securities lawsuits were filed after the adoption of the PSLRA through December of 2001--eighteen instances out of 300 is not a very significant statistical percentage.<sup>199</sup> An examination of the actual percentages awarded to attorneys further negates the argument that courts routinely lower benchmark awards that they deem to be inappropriately. There were 733 federal class action

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<sup>193</sup> Joseph A. Grundfest, *More Questions than Answers and a Friendly Wager: Observations on the Third Circuit Task Force Report on the Selection of Class Counsel*, 74 TEMP. L. REV. 821, 825 (2001).

<sup>194</sup> *See id.*

<sup>195</sup> *Cendant Corp. Litig.*, 264 F.3d 201,266 (quoting *Raferty v Mercury Fin. Co.*, No. 97 C 624, 1997 WL 529553 at 2 (N.D. Ill. Aug. 15, 1997)).

<sup>196</sup> *See Grundfest, supra* note 193, at 825; *see also* John C. Coffee, Jr., *Litigation Governance: A Gentle Critique of the Third Circuit Task Force Report*, 74 TEMP. L. REV. 805, 806 (Arguing that the plaintiff’s bar in securities class actions engages in “cartel-like” behavior because those attorneys are extremely concentrated and “becoming more so, thus negating the lead plaintiff’s ability to truly negotiate.”)

<sup>197</sup> *See Grundfest, supra* note 193, at 826.

<sup>198</sup> Third Circuit Task Force Report, *Selection of Class Counsel*, at 42-43 & n.121, available at <http://www.ca3.uscourts.gov> (last visited March 10, 2004).

<sup>199</sup> *See Grundfest, supra* note 193, at 827.

securities class action fraud cases filed between January 1991 and May 1999.<sup>200</sup> The average award given to the attorneys litigating these cases was 30.12 percent of the total settlement amount.<sup>201</sup> The obvious conclusion is that the instances where a court has reduced a benchmark award have been so slight as to not disturb the average, thus, courts are not exercising this authority often.<sup>202</sup> In other words, “downward departures from the benchmark are possible in theory but occur rarely in fact.”<sup>203</sup>

Critics of a price comparison method argue that a lower fee award is not always in the best interests of the class if it causes the attorneys involved to devote less time and energy into litigating the case. However, there “is an equally relevant and unassailable observation...higher fees are also not in the best interests of the class if they fail to optimize net recovery to class members.”<sup>204</sup>

Conversely, critics of lead counsel auctions also raise compelling arguments why that method may be sub-optimal. Thus, the most advantageous approach may be the more radical approach of auctioning an entire claim to the firm.

Securities litigation is one area of law that could legitimately be litigated in such a manner because the claims can be more accurately and objectively valued at least as compared to other types of mass tort regulation.<sup>205</sup> For example, a securities class action claim could be evaluated by calculating the drop in the price of shares to determine the value of the entire lawsuit. Unlike tort claims that involve many factual disputes and subjective issues regarding the extent of the injury and other uncertain elements, the stock market price in a securities litigation claim is

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<sup>200</sup> Denise Martin, Fred Dunbar, Vinita Juneja, Louis Guth, and Todd Foster, *Recent Trends VI: Trends in Securities Litigation and the Impact of the PSLRA* (National Economic Research Analysis, June 1, 1999), at 7.

<sup>201</sup> *Id.*

<sup>202</sup> See Grundfest, *supra* note 193, at 827.

<sup>203</sup> See *id.*

<sup>204</sup> *Id.* at 828.

<sup>205</sup> See Gray, *supra* note 59 at 842.

mostly ascertainable and is not open to debate. As a result, teams of lawyers could readily evaluate the worth of the claim.

Perhaps one of the most compelling advantages to such a system is the elimination of the agency incentives that exist in nearly all other forms of attorney compensation. Even the most virulent critics of the auction process concede that the auction process allows courts to avoid many problems traditionally associated with class counsel in mass securities actions.<sup>206</sup> The sale of an entire claim “is the optimal method, in theory, to overcome the agency costs that result from the plaintiffs’ attorneys overlooking the interests of their class action clients.”<sup>207</sup> The firm, having committed its financial resources to a claim has every incentive to litigate it fully and completely to recoup its initial investment. The danger of undervaluing a claim could be countered by the imposition of a penalty should the amount recovered exceed the amount paid by a certain percentage. That penalty in turn could be used to further compensate the plaintiff class.

Auctioning a claim versus auctioning the position of lead counsel has the additional advantage of freeing the court from the responsibility of supervising the quality of bidders.<sup>208</sup> The court would no longer have to ponder whether the low bidder is able to win the auction “simply because he or she is a poor quality attorney who is willing to work for a low return.”<sup>209</sup> Such auctions also remove the concern that the firm involved will recommend a settlement agreement that is achieved quickly and cheaply to the detriment of the plaintiff class.<sup>210</sup> Yet

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<sup>206</sup> See Fisch, *supra* note 156 at 91 (stating that auctions at least appear “no more problematic than the [benchmark] or lodestar methods of determining counsel fees.”).

<sup>207</sup> Jonathan R. Macey & Geoffrey P. Miller, Symposium: *A Market Approach to Tort Reform Via Rule 23*, 80 CORNELL L. REV. 909, 914 (1995).

<sup>208</sup> See *id.*

<sup>209</sup> See *id.* See also, Langlois *supra* note 13 at 904:

Selecting lead counsel through a bidding process does not adequately protect class interests because the lowest bidder may provide lower quality representation, be reluctant to expend more than he can recover due to a fee cap in the bidding contract, and be risk-averse to pursuing a larger settlement that would actually be a truer reflection of the class action’s worth.

<sup>210</sup> See *id.*

another advantage of the claims auction system is that the court would no longer need to concern itself about which fee structure would best suit the litigation. It would be freed from expending any resources evaluating which fee structure proposed by competing bidding firms is in the plaintiff class' best interests. It would simply choose the highest bidder and distribute the funds to the plaintiff class. Thus, an adoption of the claims auction system would eliminate the fears of cross-over costs in which the court, believing that the litigation would end at an earlier stage, mistakenly selects one bidder when another bidder would have ultimately proven to be more cost effective. Additionally, concerns about the court remaining neutral and being the appropriate auctioneer are minimized in a claims auction system. In this system, the judge is only choosing the highest price and is not personally invested in any subjective or objective analytical decision making which critics contend could unconsciously color the judge's neutrality when the judge has selected a lead plaintiff based on a proposed fee structure.<sup>211</sup>

Another advantage that claims auctions would have is that it would allow other firms and lawyers into the currently oligopolistic market of securities fraud plaintiffs' counsel. Currently, an empirical study of shareholder class actions filed in the Delaware Court of Chancery in 1999 and 2000 demonstrates that sixteen firms were involved in over 75% of all such class action suits.<sup>212</sup> When so few players dominate the mass securities litigation market, it can not be seriously debated that no true free marketplace exists. Currently, only a selected few firms in the United States engage in mass securities litigation. The behavior of these firms has been described as anti-competitive and even "cartel-like."<sup>213</sup> The existing system whereby only a few

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<sup>211</sup> See Thomas and Hansen *supra* note 2.

<sup>212</sup> Robert B. Tompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 56 VAND. L. REV. (forthcoming 2003). The empirical study is available at [http://ssrn.com/abstract\\_id=407580](http://ssrn.com/abstract_id=407580) (last visited March 10, 2004).

<sup>213</sup> See John C. Coffee, Jr., *Litigating Governance: A Gentle Critique of the Third Circuit Task Force Report*, 74 TEMP. L. REV. 805, 806 (2001).

firms participate in mass securities litigation is likely to be disadvantageous to plaintiffs. Because so few firms are able to participate, they have little—if any—incentive to be cost-effective or to be responsive to the plaintiff class.

Contrast this to the situation that would exist in a claims auction system where any firm that could finance the cost of the litigation would be able to participate, not just those firms with an established reputation in mass securities litigation. “The auction approach would tend to break down the existing, anticompetitive structure of plaintiffs’ class action securities litigation, in which a small number of firms appear in nearly every case and effectively dominate the litigation.”<sup>214</sup> Opening up this legal arena to other firms will likely prove beneficial to the plaintiff class. With the possibility of true competition and a real chance that established securities litigation firms may not get the majority of the business by simply showing up, these firms may have added incentives to appropriately evaluate claims, ensuring that the plaintiff class is adequately compensated and to ensure that their fees are appropriate for the complexity of a given case.

An additional advantage of a claims auction is to ensure that the plaintiff class receives compensation quickly, rather than after years of litigation proceedings.<sup>215</sup> The plaintiff class is paid soon after the winning bidder places the money with the court and the court deducts appropriate costs.<sup>216</sup> Many, if not most, plaintiffs would see this arrangement as advantageous. Once the plaintiff class is removed from the picture, the firm which now “owns” the claim, can litigate it fully, using all appropriate strategies to achieve the optimal outcome with little in the way of agency incentives.

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<sup>214</sup> Jonathan R. Macey and Geoffrey P. Miller, *Auctioning Class Action and Derivative Suits: A Rejoinder*, 87 Nw. U.L. REV. 458, 463 (1993).

<sup>215</sup> *See id.* at 469.

<sup>216</sup> *See id.*

Much has been said about the potential concrete, measurable advantages that a properly administered claims auction system could provide. However, there are also intrinsic advantages to such a system, that while not quantifiable, are significant in their own right. First, the auction process could minimize the public's opportunity to discredit plaintiff's attorneys who are engaged in this type of litigation, which ultimately demeans the entire legal profession.<sup>217</sup> Second, and more importantly, a claims auction system would allow for a truly adversarial proceeding to go forward. In a claims auction system, both sides have every incentive to engage in complete discovery of the claims, to investigate fully, to litigate aggressively and vigorously, and to object to settlement offers that are too low or that are premature. In this situation, the court is able to hear and decide arguments that are presented on the merits, and are fine-tuned as a result of the parties' adversity because neither side is inclined to simply settle quickly and walk away.

An additional potential intrinsic advantage to the auction approach is that "disappointed bidders are likely to be on the lookout for shortcomings in the performance of the winner" in order to successfully challenge that winner in the next auction and to make themselves a stronger competitor overall.<sup>218</sup> Thus, with firm's performance being evaluated by unsuccessful bidders, the litigating attorneys have additional incentives to apply themselves and to achieve the best possible outcome of the case.<sup>219</sup>

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<sup>217</sup> See Macey and Miller, *supra* note 214 at 463 (arguing that "the auction approach would allow the judicial system to dispense with the embarrassing fictions which pervade current practice (such as the fiction that plaintiffs' attorneys do not solicit their clients) and which in our view bring unnecessary discredit on the process in general and on plaintiffs' attorneys in particular.")

<sup>218</sup> *In re Oracle Sec. Litig.*, 136 F.R.D. 639, 648 (N.D. Cal. 1990); See also, Valle, *supra* note 66 at 384 (while the author's discussion is limited to lead plaintiff auctions, the idea that competition can help ensure diligence performance applies with equal force in the claims auction situation. After all, there were still losing firms here as well.).

<sup>219</sup> See Valle, *supra* note 31 at 384.

## CONCLUSION

The PSLRA has not been as effective at curtailing abusive entrepreneurial behavior on the part of attorneys as it was initially hoped at its inception. This is a result of a number of factors: (1) the failure of institutional investors to step forward and assume the role of lead plaintiffs; (2) the lack of meaningful judicial oversight and review of settlement agreements; and (3) the lack of true adversity between the plaintiffs' attorney and the defendants so that a settlement truly reflects a hard-fought series of negotiations with the plaintiff class' best interest in mind. With both the plaintiffs' attorney and the defendants eager to settle, neither has any incentive to object to a proposed settlement agreement.

Auctions of lead plaintiff positions are also not without significant problems. The most commonly cited problems of lead plaintiff auctions include the inability of a judge to estimate appropriately which bid is the most cost-effective, the lack of meaningful measurements to determine the best firm or lawyer for the position, and improper agency incentives for attorneys. The most troubling of these aforementioned problems are inappropriate incentives for the attorneys involved to settle cases at too early a stage in the litigation, or to engage in "make-work" knowing that any request for payment that falls within the standard benchmark rates of 25-30% will likely be unquestioningly approved by the court. Thus, lead plaintiff's counsel auctions, while certainly innovative, have not altogether addressed the problems inherent in securities class action suits.

The most promising solution to the problem of opportunistic behavior on the part of attorneys to the detriment of the plaintiff class appears to be that of auctioning an entire claim to the highest bidder. This solution removes many of the problems inherent in the lead plaintiff auction. It appears particularly well-suited to the securities class action case because damages

are more objectively calculated than they are in other types of mass litigation such as mass torts. The fact that damages are more objectively evaluated helps ensure that the claim will not be undervalued excessively by bidders. Including a “penalty” provision will also ensure that the plaintiff class does not receive less than what is truly owed them. For example, if the ultimate recovery is more than 50% above that of the bid, a penalty could provide that a portion of those earnings is returned to the members of the plaintiff class. Ownership of the entire claim also addresses the problem of improper agency incentives that benefit the lawyer at the disadvantage of the plaintiff class.

Additionally, ownership of the claim takes the guesswork out of the equation for the courts. Under this system, a judge would not have to evaluate different bidding structures, attempt to estimate where in the proceedings a class action will end, and evaluate the relative strengths and weaknesses of competing counsel. In this system, the highest bidder wins.

Finally, this structure also ensures that the plaintiff class is compensated efficiently for its losses. Once court costs are calculated, the plaintiff class is immediately paid, and is effectively out of the litigation. This is at least arguably better for the plaintiff class which under the current system could face years of uncertainty as the case progresses to trial.

Although no system would perfectly address all problems inherent in securities class action cases, the claims auction system appears to be the most comprehensive solution. If properly conducted, it offers the promise of litigation that is the most beneficial to the real party in interest, which to the chagrin of some attorneys and some law firms, is actually the plaintiff class and not themselves.