Testimony of Lorna Goodman on Behalf of the City of New York

Third Circuit Task Force on Selection of Counsel.

Thank you for the opportunity to testify today on this important subject. I am Senior Assistant Corporation Counsel in the office of Michael D. Hess, Corporation Counsel of the City of New York. The Corporation Counsel is the outside counsel to the five New York City Pension Funds established for the benefit of New York City employees.[1] The New York City Comptroller's Office oversees the pension funds on a daily basis.

To date, the New York City Pension Funds and the Corporation Counsel's Office have been active participants in five private securities class action cases. I have personally been involved in four of the five, the most notable of which is *In re Cendant Corporation.* That case is currently on appeal before this Court. My remarks today are based on the City's experience in the Cendant case and delivered from the vantage point of a large public institutional investor whose only goal in securities litigation is to protect the interests of the plaintiff class.

When representatives from the Comptroller's Office first discussed the possibility of the pension funds seeking appointment as lead plaintiff in securities fraud class actions the advantages of such a designation were unclear to the Corporation Counsel. Why would the Funds want to expend significant time and money pursuing lead plaintiff status and, if successful, serving as lead plaintiff in class actions where we would receive the same recovery as any other member of the plaintiff class? Eventually, however, we came to realize that assuming

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[1] The five separate funds include the NYC Fire Department Pension Fund, the NYC Employees' Retirement System, the NYC Police Department Pension Fund, the NYC Teachers' Retirement System, and the NYC Board of Education Retirement System ("the Funds"). Together the Funds hold approximately $90 billion in assets.

a position of leadership in these cases, even at the risk of significant discovery burdens, was the best way to protect the interests of our injured pension holders. Without the presence of large institutions such as the New York City Pension Funds as lead plaintiff, securities fraud class actions would continue to be dominated by attorneys rather than clients often resulting in "huge profits for the firms and marginal recovery for the shareholders." *Gluck v. Cellstar Corp.*, 976 F. Supp. 542 at 544 (N.D. Tex. 1997). Moreover, in addition to having the requisite stake in the outcome of the litigation, pension funds have the advantage that they are, by their very nature, fiduciaries and experienced in safeguarding the interests of a multitude of individual investors. Finally, they regularly select outside counsel, negotiate attorneys' fees and monitor litigation to insure that their members are being well served. We believe lead plaintiffs in the *Cendant* case represent exactly the type of plaintiff Congress had in mind when it passed the Private Securities Litigation Reform Act ("PSLRA").

The City's case evaluation and counsel selection process on behalf of the Funds in *Cendant* was highly effective. It was accomplished by a team of lawyers with expertise on the transactional side -- counsel from the New York City Comptroller's Office -- and litigators from the office of Corporation Counsel. The use of independent litigators to evaluate the case mirrors the procedures of the State of Wisconsin Investment Board ("SWIB"). SWIB uses outside counsel on an hourly basis because such counsel, like Corporation Counsel, have no stake in the eventual outcome of the case and can be relied upon to give a completely impartial analysis.

In *Cendant,* the New York City Pension Funds selected a group of firms specializing in securities fraud class actions. After extensive interviews of these seven firms and a highly competitive fee negotiation, a firm of experienced class action litigators was selected. The details of this process are described in the accompanying Declaration of Roger Pugh, Assistant

Corporation Counsel, which is part of the record in *Cendant*. The City then negotiated a retainer agreement which we believe solves many of the problems associated with fee setting and attorney-controlled class actions. Specifically, the retainer requires consultation on all major aspects of the litigation, submission of time and expense records, and strict client control of settlement and attorneys' fees. With regard to the latter, the retainer fee represented a cap and lead counsel had to promise to obtain lead plaintiffs' approval before submitting any fee application to the court. (See retainer annexed as Exhibit B to the Pugh Declaration). In line with prevailing law in the Third Circuit, lead plaintiffs in *Cendant* structured the attorneys' fee in the retainer agreement on a declining scale.[2]

Some academics have recently opined on the importance of "incentivizing" counsel with an increasing percentage of compensation in order to align counsel's interest with that of the class. We believe that in the situation where there is active, involved supervision of the litigation by institutional plaintiffs, the concept of "incentivizing" is superfluous. Alert plaintiffs will not tolerate an early inappropriate settlement, a late inappropriate settlement, or an abandonment of the class' interest in maximizing recovery.

As representatives of New York City's Pension Funds, we object to the widely articulated notion that there is a need to "incentivize" attorneys in order to insure performance in accordance with professional responsibilities. As legal practitioners, we have an ethical obligation to act in the best interests of the class. While it is understandable that counsel may need an incentive to

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[2] In our experience, declining percentages do not deter the eager plaintiffs' lawyers who continue to seek to represent the City's pension funds. After all, 7% of $500 million is a lot more than 8% of $250 million. We agree, however, with Keith Johnson of the SWIB that different cases may require different fee arrangements.

bring a case, once representation is undertaken counsel has an unwavering ethical obligation to maximize recovery for the class. This is no different in a class action than it is in any other case. Nor can counsel drop the representation because it no longer appears to be profitable. See ABA Model Rules of Professional Conduct, Declining or Terminating Representation, Rule 1.16. The whole notion of incentivizing attorneys needs to be reexamined in light of an attorney's inherent professional responsibilities to his client as well as in light of the fact that the vast majority of securities fraud class actions filed result in settlement, thereby minimizing risk. *Goldberger v. Integrated Resources, Inc.*, 209 F. 3d 43 (2d Cir. 2000).

The most important provision of the *Cendant* retainer is the clause which gives the Pension Funds the right to review the fee structure <u>after</u> the litigation has been concluded. This protects the class should, taking the extreme example, a defendant settle the day after the complaint is filed in order to consummate a merger or to rid itself of a liability depressing the price of its stock. This is part of the reason the *Cendant* case was settled so quickly and favorably for the class. At the time there were no less than five stories in the Wall Street Journal, all of which suggesting that the class action was an "albatross" widely viewed as holding down the value of Cendant's stock. Lead plaintiffs need to retain the right to review the fee at the end of the case in light of what happened in the course of litigation to ensure that counsel fees can meet the "reasonable" requirement in the PSLRA.

Lead plaintiffs and lead counsel were mutually satisfied with our retainer in *Cendant*. At a court hearing our chosen attorneys lauded the agreement and called the process by which it had been achieved "the hardest bargain ever driven in a securities fraud class action case." Thus when the Judge, without finding any inadequacy in the process of choosing lead counsel or any reason for rejecting our choice of counsel or retainer arrangement, decided to hold an auction, the Funds, along with the representatives of our co-lead plaintiffs, The New York State Common Fund and the California Pension Fund (CalPERS), were literally stunned. We had invested a good deal of time and energy in choosing counsel and negotiating a fee. Despite the Court's agreement that our chosen counsel could match the "low" bid, we had no assurance that they would agree to do so. We actually considered withdrawing our application for lead plaintiff. Since an appeal to the Circuit was plainly premature we made our objection to the District Court and tried to salvage whatever control we could by lobbying for recognition of the remaining provisions in the retainer agreement. After the auction, our chosen counsel, which, by the way, did not bid in accordance with the retainer fees, decided to match what the Judge considered the lowest responsible bid. A situation could easily be envisioned, however, where counsel of our choice would decide not to compete with the "low" bidder. As Judge Rakoff stated in *In re Razorfish, Inc. Securities Litigation,* 2001 U.S. Dist Lexis 5736, by no reasonable reading of the PSLRA "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." In such an eventuality, lead plaintiff would be deprived of its right under the PSLRA to select counsel and denied the type of control over the litigation envisioned by the statute.

It was at this point that 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 our counsel was undermined. Lead counsel was the court's choice. While our relations remained cordial and the City has no complaint about the overall conduct of the litigation, "ownership" of the case had been ceded to the court. Just one example – when lead plaintiffs sought to attend one of the many meetings between court and counsel, objections were raised by counsel lest our presence "disturb" the working relationship between the two.

The auction in the *Cendant* case not only drove a wedge between lead plaintiff and lead counsel: it failed to identify the low bidder and resulted in an exorbitant fee. Under the retainer, the maximum fee, if approved by the funds, would have been $186 million. Pursuant to the auction, counsel applied for and was awarded a fee of $262 million, representing a multiplier of 32 times lodestar and an hourly fee of over $10,000. Needless to say, the Court's refusal to honor the parties' retainer has engendered particularly unfortunate litigation--a fight between attorney and client.

Under the PSLRA, we urge that the only time lead plaintiff's right to choose class counsel should be interfered with is when the court deems that choice to be adverse to the interests of the plaintiff class. See S. Rep. 104-98 at p. 13, also *In re Milestone Scientific Securities Litigation*, 187 F.R.D. 165, 176 ("[Congress] 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.*") (Emphasis added).

In addition to relating our experience in the *Cendant* case, we would like to make a few remarks about auctions in a non-PSLRA context. Auctions will generally be effective only in cases where there is a single percentage for the whole case. Yet in most auctions bidders are asked to submit different figures for different stages of the case. In a bidding situation where the scope and timing of recovery is unknown it is extremely difficult to compare bids to determine the "lowest." The *Cendant* auction required bidders to proffer percentages for four stages of the case. (See auction grid annexed as Exhibit D to the Pugh Declaration). Thus, the Court in

Cendant rejected what turned out to be the lowest bid as "philanthropic" stating that the recovery would have to be over a billion dollars for that bid to make sense. The recovery was $3 billion.

Other problems with auctions include the difficulty of choosing counsel only by price. That 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. Also, if the judge is to get involved in designing an auction procedure in an ex parte fashion, isn't the court compromising its impartiality with regard to the defendants' side of the case? More than one commentator has highlighted the impropriety of a court's early involvement in the plaintiff's side of the case.

Probably the most detrimental aspect of a court-conducted auction is the tendency of the court that conducted it to become wedded to the result. The existence of an auction shouldn't relieve the court of its responsibility to weigh a variety of factors (litigation risk, outside inputs, percentage of recovery, amount of discovery, lodestar[3]) in order to establish a "reasonable" fee.

There seems to be a widely accepted notion that lead counsel has a vested right to a fee set at the beginning of the litigation and that for lead plaintiffs or the court to modify the original fee is tantamount to a breach of contract. But lead counsel can have no realistic expectation that the fee established at the outset will be the final fee since the court has always been charged with the duty of reviewing the reasonableness of the fee at the end of the case under the PSLRA and prior law.

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[3] *Gunter v. Ridgewood Energy Corp.*, 223 F. 3d 190 (3rd Cir. 2000)

The Court in the *Cendant* case awarded lead counsel the auction fee without, we believe, a proper review of those factors which govern a reasonable fee. As you know, that decision is on appeal now in this Court. This is similar to what happened in another much discussed case – *In re Auction Houses Antitrust Litigation,* 2001 U.S. Dist. Lexis 1713, lexis 1989.

In *Auction Houses,* the settlement, like in *Cendant,* was far more than anyone expected. In his decision the Court points out that "there was no risk of non-recovery on the plaintiffs' side of this controversy" and that the case was "like finding a pot of gold in the middle of the side walk." Undoubtedly class counsel did a good job of negotiating and achieved a fine result for the class. But given the low litigation risk, the extensive work done by the prosecutors and prior counsel in the case, and the paucity of motions, a $26 million fee seems excessive. At the very least, there should have been a lodestar cross check, as recommended by the Third Circuit.[4]

The Court in *Auction Houses* was very hard on the fee applications of interim lead counsel. The Court downplayed the drafting of the complaint and made light of the class certification motion. Ultimately, it refused to award any multiplier of the lodestar. Yet not a single word is spent analyzing the auction winner's $26 million fee request. It is unlikely that

[4] By lodestar "cross-check" we do not mean a full court inquiry into the hours spent and the fee charged but rather the more limited inquiry embodied in Third Circuit precedent. In *Cendant* we were willing to accept at face value the hourly rate and time records of our attorneys. Cross-check means only a rough estimate of the hourly fee class attorneys are to receive. The Report of the Third Circuit Task Force, while recommending the abandonment of the lodestar method in favor of a percentage method still recommended that time and expense records be filed with the District Court along with each fee application. 108 FRD 237 at 271-72.

this fee award would pass muster under this Circuit's precedent in *In re Cendant Corporation Prides Litigation, 243 F. 3d 721 (3rd Cir. 2001).*

The problem, as illustrated both in *Cendant* and in *Auction Houses*, is the tendency of the court to view the results of the auction as sacrosanct, as a bargain between the court and the bidders, which must be honored despite what happens during the course of litigation. Judge Walls, who made some of the same pronouncements about the outcome of the *Cendant* case (this is a "slam dunk") as Judge Kaplan did in *Auction Houses,* held an unsuccessful auction (one in which the Court grossly underestimated the amount of recovery and arguably rejected the "lowest" bid) and was still wedded to the result.

Much has been said in this forum and others about the importance of setting the attorneys' fee at the outset of the litigation and strictly adhering to that fee. We urge this panel to reject any notion which would render a fee established at the inception of the case off limits to later scrutiny for reasonableness. Even Professor Arthur Miller who has recently argued for the irrevocability of fees established by court auction in the *Cendant* case, has clearly testified to exactly the opposite. Professor Jill Fisch, in her statements before this Task Force at Note 28 called this panel's attention to Professor Miller's testimony before Congress in which he urged legislators to be wary of the shortcomings of court ordered auctions. Specifically in refuting prior testimony which had described Judge Walker's use of competitive bidding in the *Oracle* case in favorable terms, Professor Miller testified: "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 sliding scale) of the recovery, no matter how the attorney performs.... It [competitive price auctions] also distracts the court from looking at the qualitative differences among the applicants, which frankness requires me to say can be considerable." *Securities Litigation Reform: Hearings before the Subcommittee on Telecommunications and Finance of the House Committee on Energy and Commerce*, 103rd Cong., 2d Sess. 142, 159(1994).

In fact, we believe that the Third Circuit got it exactly right in the *Prides* case. While it is time consuming and perhaps not an exact science, fee setting should be done in the light of the seven *Gunther* factors- either by the court, or in the first instance, by the institutional lead plaintiff. 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 responsibility and a fiduciary duty. Despite the "parade of horribles" I doubt that there will ever be a paucity of highly qualified counsel ready and able to take on private securities and other class action cases subject to a post judgment fee evaluation.