STATEMENT BY ARLIN M. ADAMS
IN RESPONSE TO
"QUESTIONS TO BE ADDRESSED BY THIRD CIRCUIT TASK FORCE ON APPOINTMENT OF COUNSEL IN CLASS ACTIONS"

1. ***Auction of class counsel appointment as an alternative to traditional appointment.***

a. *Does auctioning create a better result for class members than traditional appointment? Or do lower fees associated with auctioning cases correspond to proportionately lower recovery for the class?*

In theory, auctioning would appear to create a better result. Where there are multiple bids, the court is able to review and evaluate the bids, and select the lowest viable bid. The lower the percentage of any recovery awarded to class counsel, the higher the net recovery for the class. The bidding requirements established by the judge, and the circumstances of the case, would of course greatly affect the result. An excellent discussion of these issues is set forth in *In re Auction Houses Antitrust Litigation*, 197 F.R.D. 71 (S.D.N.Y. 2000).

The fact that bidding attorneys and firms must carefully evaluate the class claims and estimate the likelihood and amount of recovery, and the costs to obtain it, may mean that more realistic predictions as to amount of recovery will be made, that is, it may be less likely that the class will be offered unrealistic recoveries by law firms desirous to initiate class actions.

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

There also is some risk that if class counsel is selected principally on the basis of submitting the lowest viable fee bid, such counsel will have a disincentive to pursue a substantial verdict or settlement due to the relatively low marginal fee payment and, instead, seek a quick settlement at a lower "cost". However, this is a theoretical risk that does not seem to be borne out in experience.

There seem to be some exceptions to the general pattern in which many class action law firms avoid cases where auctioning is used. Not surprisingly, these are cases where much of the pre-bidding risk has been greatly reduced. For example, in *In re Auction Houses Antitrust Litigation*, putative class counsel were not the ones to conduct the initial investigation that led to discovery of the legal claims.

Rather, the United States Justice Department publicly announced its investigation and finding that it was likely that Sotheby's and Christies's had engaged in criminal antitrust violations. The risks in bidding were reduced for putative class counsel as the Justice Department report greatly increased the likelihood that a class action would result in a substantial recovery. In addition, there were "interim" lead counsel for the class prior to the court's decision to use auctioning. These interim lead counsel had retained damages experts who developed detailed analyses. Once the court announced it would use auctioning, other interested counsel moved to have these damage reports released to all bidding counsel, to "level the playing field, " and the court ordered that the damage reports be shared. The availability of these reports also greatly reduced the pre-bid costs, and associated risks, for potential bidders.

In addition to cases where evidence of claims and damages are well-developed in advance of bidding, law firms may be less reluctant about auctioning in securities cases, because much of the relevant information is publicly available, and therefore the pre-bid case development costs are likely to be lower.

Absent this type of circumstance, however, the pre-bid costs for law firms may discourage many of the best class action law firms from participating in cases where auctioning is used.

b. *The lodestar formula has been criticized for providing an incentive for class counsel to expend unnecessary hours, sometimes with the permission and even encouragement of the defendant. Is there any empirical evidence to indicate that such an incentive is operating? Does auctioning reduce that incentive? Does it instead create a contrary incentive to settle the claim at the earliest possible opportunity?*

The lodestar formula does create an incentive to bill, since the ultimate fee is principally based on the number of hours expended on the matter. The incentive to bill hours may be exacerbated when a "committee" of lawyers acts as class counsel, because there is pressure to share work assignments with all law firms in the committee, with the resulting loss of efficiency and increased "agency costs" from distributing work in this way.

Moreover, it has been easier for class lawyers to justify the number of hours, and costs, of the litigation in hindsight (that is, in the petition for approval of fees), while auctioning requires that estimates of hours, and expenses, be calculated in advance. Under the lodestar approach, clients are not paying out-of-pocket for either fees or expenses, thus lawyers have a freer hand to bill both.

Lodestar cases, in theory, have built-in restraints on unnecessary billing, namely, the risk of not winning and the risk that a court may find the hours unreasonable.

But, in practice, most fee awards in such cases are approved by the court, so the incentive to avoid unnecessary hours and expenses is low.

The United States Court of Appeals for the Third Circuit evaluated the lodestar approach in a comprehensive report in 1985. See Court Awarded Attorney Fees, Report of the Third Circuit Task Force, 108 F.R.D. 237 (1985)("Task Force Report"). The Task Force Report determined that the percentage-of-recovery basis for awarding fees was preferable to the lodestar approach, and outlined five factors a court should examine (amount of work needed; nature of work; number of hours anticipated; risks faced; and likelihood of winning or losing) for purposes of evaluating a proposed percentage-of-fee award to class counsel.

If, as experience suggests, the lower percentage-of-fee awards in auctioning cases make such cases less desirable for class action counsel, then counsel in auctioning cases may also have an incentive to resolve the cases at the earliest opportunity in order to be free to pursue other class action matters where auctioning is not used, and for which fee awards are higher.

c. *Why isn't the judge's ability to set fees at the end of the case sufficient to address all issues that bidding is used to address?*

At the conclusion of a case, a judge tends to be deferential on the issue of fees to lawyers who actually have done the work on the case. Judges tend to believe that these lawyers are in a better position, in terms of direct knowledge, to evaluate both the work anticipated and the work actually done.

The structure of class actions supports the judges' view on this point. Most classes consist of large numbers of individual claimants who do not know one another and/or have claims that are too small (and too expensive) to litigate individually. The class action addresses these limitations, but does so at a price. Individual class members cannot monitor the conduct of their counsel, nor monitor time and expenses. This role is left to the judge.

At the end of the case, however, while class counsel is well-equipped to submit a fee request (with supporting evidence), the court has no corresponding source of legal advice or evidence against which to weigh the proposed fee request.

Auctioning addresses some of these problems by forcing putative class counsel to estimate these expenses in advance, and to agree in advance on a compensation plan that reflects the pre-litigation analysis.

In contrast to the control a court can exert at the beginning of a case through auctioning, the federal courts, and some state courts, have held in traditional percentage-of-the-fee matters that a court cannot reduce a requested fee award that

is supported by evidence in the absence of contrary evidence. As a result, even where a court believes that the fees requested are excessive, the court is unlikely to have appropriate, and competent, contrary evidence to support the court's view, because no one has the role of presenting it. Clearly, it is not the court's role to develop contrary evidence and, as a practical matter, the court is not equipped to do so. *Charles v. Goodyear Tire and Rubber Company*, 976 F. Supp. 321, 325 (D. N.J. 1997), citing *Rush v. Scott Specialty Gases, Inc.*, 934 F. Supp. 152, 155 (E.D. Pa. 1996), in turn citing *Bell v. United Princeton Properties, Inc.*, 884 F.2d 713, 721 (3d Cir. 1989).

See also Coleman v. Kaye, 87 F.3d 1491, 1509 (3d Cir. 1996), *cert. denied*, 117 S.Ct. 754 (1997)("a district court may not set attorneys' fees based upon a generalized sense of what is customary or proper, but rather must rely upon the record.")

There is some empirical evidence to support the view that the judge's ability to modify proposed fees at the end of the litigation is limited. Objections by class members to requested fee awards are rare, and are even more rarely sustained. This is due in part to the inability of individual class members to develop the kind of evidence that can hold up in a comparison to the evidence amassed by the law firm that actually handled the case.

In recent decades, the percentage-of-the-fund approach has led to substantial (25-40%) awards, and judges seem reluctant to depart from this range. This is probably one factor leading to the introduction of auctioning as an alternative to the traditional process.

For these reasons, the judge's "ability to set fees" does not perform the same function as the bidding process, which puts the burden on the lawyers to make at least a *prima facie* showing in advance that the proposed attorneys' fees appear to be reasonable.

d. Does the auction process unfairly benefit large firms over small firms?

In theory, large firms are more likely to be able to conduct the investigations and legal research necessary to develop class action matters, and to assess fees and costs in advance. In addition, large firms frequently can achieve economies of scale that are not available to smaller firms.

In practice, however, the great majority of class actions are handled by small law firms in Philadelphia, New York and other cities around the country that specialize in class action work. These firms have become expert in researching and developing class action litigation, and they are among the leading class counsel in the country.

Because class action and other contingent-fee litigation constitutes a large percentage of these firms' work, it appears that these firms use the substantial fee awards they receive from time-to-time as a funding stream for ongoing efforts to research and develop new cases. To the extent that auctioning forces these firms to bid at lower percentages than they seek in traditional cases, the ongoing ability of these firms to develop new class action cases may be diminished. As a result, it is possible that greater opportunities for larger firms to bid may appear, as large firms have other revenue streams with which to fund the costs of developing potential class action matters.

e. *Does the auction process discourage plaintiff's attorneys from conducting a thorough pre-complaint investigation? Will lawyers invest money to work up class actions if there is a significant risk that they will not be selected as counsel for the class?*

As noted above, it seems likely that the auction process has discouraged many law firms from participating in many kinds of class action litigation. On the other hand, for those cases where much of the pre-filing case research and development has been done by others, such as government agencies, and where the risks of not obtaining recovery appear slim because of readily-available evidence or other evident circumstances (such as the *In re Auction Houses* case), arguably auctioning may be a superior means for selecting counsel because bidding counsel, freed of the uncertainties in most class actions, can more carefully evaluate the most reasonable fee to charge potential class members in the case.

f. *It has been suggested that one benefit of an auction is that it allows firms that have not previously had the opportunity to serve as lead counsel to do so. Is there any evidence to suggest that this has happened or are the same firms continually winning the bidding process?*

The limited experience with auctioning suggests that this process does "level the playing field" for those law firms that choose to bid, since typically the bids are sealed and law firms are barred from consulting one another with regard to any aspect of their potential bids.

A comparison of two auctioning cases in which the "right of first refusal" became an issue is useful on this subject. In *In re Cendant Corporation Securities Litigation*, 109 F. Supp. 2d 285 (D.N.J. 2000), a case in which the court was applying the Private Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. § § 77k *et seq.*, certain plaintiffs had selected certain well-known law firms as counsel prior to the court's decision to employ auctioning. In an effort to accommodate both the PSLRA's provision that lead plaintiffs have an opportunity to choose their counsel, subject to court approval, and the court's own

determination of the optimal bid at the end of the bidding process, Judge Walls announced the terms of the optimal bid and then gave original counsel selected by plaintiffs prior to the auction a "right of first refusal," that it, the opportunity to represent the class if these original counsel were willing to do so on the same terms as those submitted by the law firm that had proposed the terms that the court had determined was the optimal fee bid.

By contrast, in *Sherleigh Associates LLC v. Windmere-Durable Holdings, Inc.*, 184 F.R.D. 688 (S.D. Fla. 1999), another PSLRA case, the court refused to grant a right of first refusal to similarly-situated "original counsel" because the court determined that certain of these counsel had realigned their proposed client groups to serve the best interests of the lawyers themselves, and not the best interests of the clients.

Thus, to the extent that auctioning gives the court greater flexibility in designing the structure for proposed bids and in appointing counsel in a manner that ensure that the clients' best interests are served, the auction process may well make available opportunities for law firms to serve as lead counsel that have not had the opportunity to do so before.

g. *Are the costs associated with traditional appointment of class counsel (e.g., ex post fee determinations) eliminated or reduced by auctioning?*

Auctioning does not eliminate all costs associated with traditional methods of appointing counsel. Federal Rule of Civil Procedure Rule 23(d) imposes a duty on the court in all class action cases to protect the best interests of the class. Similarly, the PSLRA requires that selection of counsel be approved by the court, and that selection of counsel must otherwise meet the requirements of Rule 23.

Where auctioning is appropriate, it can reduce the costs to the court as the bid selected by the court places specific limitations on the fees and expenses class counsel may charge going forward. Thus, in appropriate cases, auctioning can eliminate the need to appoint special masters to review detailed affidavits and supporting documents in evaluating a fee request at the conclusion of the litigation.

h. *What costs are imposed by auctioning? (e.g., determining the worth of the claim ex ante, scrutinizing bids. etc.)*

To some extent, the time and effort courts expend in reviewing proposed fee awards at the conclusion of class action matters is shifted to the "front end" of the litigation when auctioning is used.

One important difference is that, in an appropriate case where several bids have been submitted, the court has the opportunity to compare both quantitative and qualitative factors in selecting counsel. This may reduce the amount of time and effort required to determine an appropriate fee award. Unlike the auction process, the court evaluating a requested fee award at the conclusion of a class action is more likely to rely on the evidence and argument of class counsel – without the benefit of any comparable input from either class members or other lawyers.

i. Are the costs associated with auctioning greater or less than those associated with traditional appointment?

I am not aware of much empirical evidence to answer this question. However, in those limited cases where auctioning appears to be a superior approach, it seems likely that the costs to the class members and the court may be reduced.

2. Professional responsibility questions.

a. Which procedure, auction or traditional appointment, better promotes counsel's loyalty to the class by aligning the interests of class counsel with those of the class?

In cases where pre-filing research and development has been done by others, such as government agencies, and where the risks of obtaining a substantial recovery appear greater based on readily-available evidence, auctioning may be a superior means for selecting counsel because counsel, freed of the uncertainties and risks in most class actions, are more likely to submit bids and can more carefully evaluate the most reasonable fee to charge potential class members in the case.

In this limited category of cases, auctions may better align the interests of class members and class counsel because the competitive process is apt to reduce the fee percentage ultimately selected as the "winning bid," thus leaving a larger percentage of any recovery for the class.

b. Some winning bids have included caps on fees or costs. Do these caps affect counsel's independent judgment on behalf of the class?

Some concerns have been raised that caps create conflicts of interest because there may be undue pressure on class counsel to keep fees or expenses below the cap, regardless of the best interests of the class. In *In re Oracle Sec. Litig.*, 136 F.R.D. 639, 642 (N.D. Cal. 1991), Judge Walker rejected any concern about the cap on expenses in that matter, stating that "[i]f expenditures . . . produce a larger recovery, class counsel would simply shortchange themselves by refusing to make

those outlays." *Id.* at 643. However, it should be noted that, in that matter, the winning bidder proposed a cap of $325,000 in expenses in the original case and actually incurred expenses of approximately $320,000, and proposed a cap of $500,000 on expenses in a collateral case and actually incurred about $472,000. That the actual expenses incurred were so close to -- but just below -- the proposed cap suggests concern that a law firm may be more inclined to settle when approaching caps. Of course, settlements occur for any number of reasons and may have no connection whatever with caps. Indeed, the similarity between the proposed expenses cap and actual expenses may simply be the result of a careful prediction by class counsel.

In *In re Amino Acid Lysine Antitrust Litig.* the winning bid included a cap on the total amount the firm could recover, suggesting a possible tension between the interests of class counsel and the best interests of the class. However, the concern did not materialize in that case, as the total recovery ultimately turned out to be twice the highest amount on the attorneys' pay scale – that is, the attorneys did not receive any additional payment for any additional recovery above $25 million, yet the total recovery was over $50 million. *See In re Amino Acid Lysine Antitrust Litig.*, 918 F. Supp. 1190, 1199 (N.D. Ill. 1996) and *In re Bank One Shareholders' Class Action*, 96 F. Supp. 2d 780, 785 n.5 (N.D. Ill. 2000) (describing outcome in *Lysine* litigation).

While it is not clear whether such caps actually influence the outcomes of the cases, the potential affect on counsel's independent judgment appears to exist.

c. *Some winning bids have included a promise not to take a fee if the settlement is below a certain number. Does this arrangement create a conflict of interest for class counsel?*

Bid provisions of this kind do not create a conflict of interest, since bidding counsel understand the potential for not receiving a fee from the outset. The more likely result is that, where a provision of this sort is included, few firms will make bids, in which case the objectives of the auction process will not be achieved. The risk of investing a substantial amount of time and expense in investigating and developing claims is simply too great for many firms to go uncompensated for their pre- and post-bid work. The costs associated with this process appear to be an expense that these firms are not willing to incur.

d. *How might the auction procedure be structured to best preserve class counsel's independence and loyalty on behalf of the class?*

In those limited cases in which auctioning may be appropriate, the competitive process may be the best guarantee of the independence of class counsel and its

loyalty on behalf of the class. As discussed herein, caps on expenses and fees are not necessary to insure, in auction-appropriate cases, that counsel acts in the best interests of the class. As discussed below, in cases where large recoveries can be anticipated, a declining percentage of the award approach seems most likely to preserve class counsel's independence while also protecting the best interests of the class.

e. *Are there other professional responsibility concerns raised specifically by the auction procedure?*

I am not aware of any other such concerns.

3. Auction procedures and implementation.

a. *Assuming that auctioning is a viable alternative to traditional appointment, is it more appropriate in some circumstances than others (e.g., antitrust actions, mass tort actions, small claimant actions)? Should there be different procedures for different types of cases? Are there some kinds of cases in which auctioning is never appropriate?*

There are certain circumstances when "price competition" that comes from the auctioning process appears salutory. Generally, those circumstances are ones in which the pre-bid costs, and related risks, are greatly reduced, either because some non-law firm entity, such as a government agency, has already identified the alleged wrongdoing that would serve as the gravamen of a class action lawsuit, or because the investigative work underlying both the legal claims and the likelihood of substantial damages has already been done or is readily available through public records.

Where these pre-bid costs have already been incurred, and where the likelihood of a substantial recovery by the class is high, then potential class counsel begin on a more level playing field and a competition on the basis of price is more likely to generate detailed bids by law firms interested in taking on the class matter.

Antitrust and securities litigation may be more amenable to the auction process because there is extensive governmental regulation in these business areas, as well as numerous public filing and public record requirements that increase the availability of relevant information to lawyers investigating possible misconduct. By contrast, consumer class actions and health-related claims may be less amenable to auctions because, as a general matter, lawyers may need to expend far greater resources to uncover alleged misconduct and, in the absence of extensive governmental regulation, the quantum of evidence necessary to succeed in these kinds of class action litigation may be much greater.

b. *What considerations other than price, if any, should the court take into account in awarding the appointment? Should the court attempt to replicate the considerations that a client would take into account in addition to price, e.g., experience, financial resources, etc.? If so, how?*

Whether the court should take other considerations, beyond price, into account in awarding the appointment and, if so, what considerations are appropriate will depend on the circumstances of the potential claims, and the likelihood that there will be multiple bids for the representation.

Some judges and experts suggest that evaluating lawyer and law firm qualifications to do the work, including relevant experience and legal expertise, is a most difficult task. For example, in *In re Oracle Securities Litigation*, 132 F.R.D. 538, 542 (N.D. Ca. 1990), Judge Walker declared that background information submitted by bidding law firms was not helpful, and that it was "impossible objectively to distinguish among these firms in terms of their background, experience and legal abilities."

While that may have been true in the circumstances of *In re Oracle*, it may not always be true. In some cases, courts have considered a mix of price and quality considerations in evaluating bids. For example, in *Sherleigh Associates LLC v. Windmere-Durable Holdings, Inc.*, 184 F.R.D. 688, 700, Judge Lenard determined that "qualitative factors are to be weighed along with price considerations," and that the court should evaluate bids in a manner that meets the court's duty under Federal Rule of Civil Procedure 23(d) to protect the interests of the class, as well as its duty under the PSLRA to approve appointment of class counsel after evaluation of the Rule 23 requirements. Among the factors taken into account in *Sherleigh Associates* were bid structures, firm experience in securities litigation, the nature of the case evaluation and qualifications to do the work.

Some experts argue that auctions do not work because such evaluations of quality are subjective and will vary greatly depending upon the elements of the bid structure proposed by the judge. Yet, some judges have been able to consider relevant experience and subject matter expertise on the basis of the bids submitted.

Moreover, in non-auction class actions, most class members have no opportunity whatever to evaluate potential class counsel as to *either price or quality*. In traditional cases where the court is asked to approve a percentage-of-the-fund fee after the case is concluded, the court's only opportunity to consider "quality factors" is in the context of a settlement or verdict that has already been reached, and on the basis of detailed (and to some degree self-serving) materials from the

petitioning class counsel, suggesting that the work performed was of the highest caliber and rendered in the most efficient manner.

While a judge in such a case has the benefit of hindsight and the submissions by class counsel, the trade-off for the judge is that, unlike the auction process, there is no input at that point on behalf of class members or other lawyers.

c. *How should court and counsel obtain enough information about the claim to determine its value for bidding purposes?*

In those specific situations in which auctions are appropriate because many law firms of similar high quality are seeking to represent the class, the court should solicit the necessary information about the claim by directing in the order calling for bids that such information be provided.

d. *Should a court consider the degree of concentration in the market of class counsel? Should it be an objective of the bidding process to expand the field of attorneys who serve as lead counsel?*

In cases where the auction process is appropriate because law firms begin on a level playing field, and there is substantial likelihood that some kind of recovery will be obtained, the competitive bidding process, whatever its details, should be sufficient to ensure that all interested lawyers and law firms have an opportunity to submit competitive bids and be selected as class counsel.

In an auction-appropriate case, the court should not focus on the degree of concentration in the market of class counsel, nor should the court seek to expand the field of attorneys who serve as lead counsel. In the limited category of cases where auctioning is appropriate, market concentration will not be a significant factor and all interested bidders will have an equal opportunity to bid. Assuming (i) that sealed bids are used, (ii) that firms are forbidden from sharing bid information or colluding in bids, and (iii) that the court outlines the minimum necessary bid information relating to price and quality, each bidding law firm will be on the same footing throughout the process.

e. *Is there evidence of collusion or incentives to collusion in the auctioning process? If so, what procedures can be employed to prevent collusion?*

While some early cases involving auctions raised concern about possible collusion, the courts in auction cases generally forbid any collusion between or among law firms submitting bids. It appears that court orders seeking bids, and prohibiting any collusion, have been successful in preventing collusion.

f. *What are the advantages or disadvantages of the following features of auction procedures?*

i. Sealed bids. Sealed bids help prevent collusion as to price and other aspects of the proposed representation.

ii. Disclosure of the terms of the winning bid. There is some concern that disclosing the terms of the winning bid may influence defendants to offer to settle at lower, or higher, sums if the winning bid provides compensation incentives to class counsel, such as a decreasing or increasing percentage award, that diverge from the best interests of the class itself. For example, where the percentage award decreases as the size of the settlement fund increases, some experts assert that defendants are more likely to offer, and class counsel are more likely to accept, a settlement offer that compensates counsel at the maximum permitted percentage, that is, before the percentage begins to decline. The view is that class counsel may accept such an offer because the marginal benefits of pursuing the case further are diminished, even though the merits of the case suggest that a larger settlement on behalf of the class might be obtained at a later stage of the litigation. Some courts have resolved this issue by directing that the terms of the winning bid not be disclosed until the case is resolved either by settlement or verdict, at which point the winning bid is disclosed in the course of the fee approval process.

iii. Permitting or prohibiting bids from a consortium of firms. In theory, there is an advantage to permitting consortiums of firms to submit bids because those firms can combine resources to investigate and develop claims, and achieve economies of scale. In practice, however, those benefits may not be significant in cases that are appropriate for the auction process. In auction-appropriate cases, the pre-bid costs and risks associated with investigation and development of the claims are greatly reduced, and therefore the benefits of consortiums are significantly diminished. In fact, in many such cases, the great majority of the actual bidders are small law firms.

iv. Caps on expenses. The limited experience courts have had with placing caps on expenses suggests that such caps are questionable. In the *In re Oracle Securities Litigation* case, for example, Judge Walker approved a bid calling for a cap on expenses of $325,000, while other bidders proposed that their full expenses be paid outside the percentage-of-settlement-fund amount, or suggested that expenses were too difficult to estimate. The case was later settled at the point when counsel nearly reached the cap on expenses, suggesting that class counsel may have been reluctant to pursue the case further when it alone would be responsible for additional expenses. While the settlement may well have had no relationship whatever to the cap on expenses, experience suggests that: (1) in most cases, expenses are very difficult to estimate, and (2) expense caps may

discourage bids by well-qualified law firms. Moreover, there is no special benefit to such a cap, because the court can review appropriate expenses at the end of the litigation as part of the fee approval process.

v. Caps on the fee. For the same reasons that caps on expenses are questionable, caps on fees may increase the divergence between the best interests on the class and the interests of class counsel. In auction-appropriate class actions, the bidding process itself is a superior method for limiting the total fees awarded to class counsel.

vi. Modifications of caps at the time of the fee award. This approach may raise questions, as it diminishes the credibility of the caps agreed upon through the bidding process and neutralizes to some extent the benefits of the auction process. However, caps should be imposed very carefully. If there are some truly extraordinary expenses that none of the bidders could have reasonably anticipated that go beyond the terms of the accepted bid, the court is amply able to review the expenses detailed in the fee petition submitted at the end of the litigation and make adjustments. Exceptions to the terms of the bid, including modifications to caps, should be rare, since an exception may detract from the integrity of the auction process itself.

vii. Structuring the bids, e.g., time-escalators, stage of proceedings escalators, etc. The advantages or disadvantages of using these vehicles will depend upon the specific facts of the case. It is difficult to generalize about them.

viii. Use of an x factor, i.e., a figure below which 100% of the amount goes to the class. The principle disadvantage of using an x factor is that the law firm that submits the winning bid may have an incentive to reject a proposed settlement that is below the x factor, even though discovery and other developments in the case suggest that such a settlement is the optimal result for the class. Another disadvantage is that requiring an x factor in all bids is likely to cause many firms to decline to participate, for the same reasons that many categories of class actions are not suitable for auction at all. Many law firms simply cannot sustain the extensive pre-bid investigation costs and risks, if there is a significant possibility that, although their work results in recoveries for class members, the law firms themselves will not be compensated at all.

Although the x factor has been recommended as a device to prevent early, low settlements, experience suggest that, in those cases where auctions are appropriate, the likelihood of early, low settlements is itself quite minimal.

ix. Use of rising, falling or straight percentages as the basis for auctioning.

Courts in auction cases have expressed differing views on the merits of rising and falling percentages. For example, in *In re Oracle Securities Litigation*, Judge

Walker expressed a preference for a declining percentage, stating that "increasing amounts of recovery do not require correspondingly increased levels of attorney effort." 132 F.R.D. at 543. *See also In re Prudential Ins. Co. of Am. Sales Practice Litig.*, 148 F.3d 283, 339 (3d Cir. 1998), *cert. denied*, 525 u.S. 1114 (1999)("economies of scale" warrant reducing the percentage as recoveries increase) and *In re NASDAQ Market-Makers Antitrust Litigation*, 187 F.R..D. 465, 486 (S.D.N.Y. 1998)("It is generally not 150 times more difficult to prepare, try and settle a $150 million case than it is to try a $1 million case.")

On the other hand, in *In re Cendant Corporation Securities Litigation*, 109 F. Supp. 2d 285, (D.N.J. 2000), the court approved an increasing percentage approach, stating that "the difficulty lies in getting a defendant to increase its initial offer" and citing ABA, Formal Opinion 94-389 § J ("it is the last dollars ... of recovery that require the greatest effort and/or ability on the part of the lawyer.")

While the appropriate percentage may vary by the circumstances, as a general matter a declining percentage would seem appropriate. This is particularly true for cases where large recoveries are anticipated. Although ABA Formal Opinion 94-389 § J concludes that the last dollars may require the greatest effort, there does not seem to be any direct correlation between the degree of effort and increased recoveries to support this general conclusion. Because a higher recovery can be the result of any number of factors, and does not require that attorney time and effort increase at exactly the same rate at which the recovery increases, a direct correlation of this kind may not be an appropriate basis for making the award. Moreover, the intuitive conclusion that a declining percentage creates a divergence between counsel's interests and those of the class has not been borne out in practice.

Perhaps more important is a factor not discussed in most opinions, namely, the public perception that fee awards in large class action matters are attorney windfalls. Some experts have stated that Congress' enactment of the PSLRA is the result in large part of public perception that class action counsel in securities litigation were obtaining unjustified windfalls. As in all other areas of the law, the public's perception of what is fair and just is an important factor to consider in determining what is appropriat compensation for class action counsel.

x. Permitting certain bidding counsel to have the right to match the best bid. Please see the discussion in Section I(f) above. In cases under the PSLRA, which specifically provides that lead plaintiffs should have the opportunity to select their counsel, subject to court approval, and in other cases where lead plaintiffs have selected counsel *prior to the announcement that an auction will be used*, it seems appropriate to provide initially-selected counsel the opportunity to match the best bid. Otherwise, all counsel should participate in the auction without preference.

f. *How does the court determine whether the winning bid is "too good," i.e., such a "good deal" for the class that it raises a question about counsel's qualifications or ability to assess the case?*

In auction-appropriate cases, there should be enough information available, either because entities other than investigating counsel (such as government agencies) have already uncovered the alleged wrongdoing, or because the relevant information is available through public records, to enable the court to detect bids that are "too good."

Most other kinds of class actions do not seem well-suited to auctions. In most types of class actions, such as consumer fraud matters, it is likely that one or two law firms have done most of the investigation and have far superior knowledge than other potential bidders. Bidding is not an appropriate option for most class action counsel in such cases, because as noted above, the pre-bid investigative costs and risks are too great to permit the preparation of bids when the statistical likelihood is that most bidders will then walk away completely uncompensated.

g. *Should the court compensate lawyers who conduct the initial investigation and file the initial complaint if they do not win the auction?*

As a general matter, I do not believe so. As noted above, it is my view that auctions should be limited to certain types of class actions. For auction-appropriate class actions, the investigative costs for bidding law firms are greatly reduced.

Most other class actions are not suited to the auction process, and paying each potential bidder in such cases would result in a major charge against the potential recovery in such class actions The class members, in essence, would be subsidizing the bidding law firms and there is nothing to suggest that it is in the class members' best interests to do so.

h. *Are any special considerations necessary for "coattail" or "follow-on" class actions?*

As a general matter, I believe the answer is no. But, there may be exceptions based on the facts and circumstances of particular cases.

i. *Should the appointment of lead counsel go to a single lawyer or a single law firm?*

There do not seem to be any special reasons unique to auction cases that would favor appointment of a single lawyer or a single law firm. However, as in all class

actions, there may be certain additional agency costs when class counsel consists of a consortium or committee of lawyers or law firms.

4. ***Auctioning of class counsel and the Private Securities Litigation Reform Act.***

Please see the discussion of issues raised by the PSLRA set forth above.

5. ***Suggested procedures for traditional appointment of class counsel.***

a. *What procedures can be suggested for improving the traditional process of appointing class counsel?*

In traditional appointment cases, it may be beneficial to develop specific criteria to assist courts in determining how to evaluate proposed fee awards that include rising, falling or standard percentage of the award provisions.

6 and 7. ***Other solutions and related questions.***

Federal Rule of Civil Procedure 23(d), and provisions of the PSLRA, impose a duty upon the court to insure that the best interests of class members are protected, and give the court the authority to take any appropriate measures with regard to appointment and compensation of class counsel that may be required to protect the best interests of the class.

The auction process, when used in appropriate cases, seems likely to advance the best interests of the class because the court will select the lowest viable bid. The lower the percentage of the recovery awarded to class counsel, the higher the net recovery for the class.

But the court's obligations under Rule 23 do not end with the selection of the optimal bid. In a case where the plaintiff class obtains a recovery in the hundreds of millions, or even billions, of dollars, the court has a duty under Rule 23(d) to reexamine the compensation provisions, including the selected percentage award, in light of the facts and circumstances at the end of the case to insure that it is in the best interests of the class to award compensation that may amount to hundreds of millions of dollars to class counsel.

Put simply, the lower fee percentage achieved through the bidding process may not, alone, be sufficient to protect the interests of class members.

While the auction-determined percentage will be proper in many cases, it may not be in certain others. There is no question that, in every case yielding a "mega-fund" for the class, the hard work and high quality of legal services rendered by class counsel will be a significant factor in the result achieved. However, other factors such as substantial adverse publicity for defendants, the threat of other,

related litigation, and the threat of adverse legislative or regulatory actions taken in response to defendants' conduct may be significant factors in the size of the class action settlement or verdict. In some cases, these additional factors contribute significantly to the size of the "mega-fund" settlement or verdict, and these factors may not be directly attributable to the work of class counsel.

Therefore, in auction cases, the court should announce at the beginning of the auction process that, even though the bidding process is expected to result in an optimal bid that will govern the terms of representation and compensation, the court nonetheless retains the authority under Rule 23(d) and, where appropriate, under the PSLRA to review all aspects of the representation and compensation agreements at the conclusion of the case. The court's duty is to protect the best interests of the class members, and not class counsel, and the court would not be serving class members' best interests to permit excessive awards to class counsel that are not directly tied to the quality and extent of legal services rendered.