Testimony of
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Members of the Task Force,

Thank you for the invitation to testify here today. My name is Jill Fisch. I am a Professor of Law at Fordham University School of Law. As an academic I have written and lectured extensively on selection of counsel issues in class actions.[1] I have also submitted expert affidavits concerning the merits of lead counsel auctions in two cases, In re Auction Houses Antitrust Litigation[2] and In re Microstrategy Inc. Securities Litigation.[3] In both cases I was retained and compensated by the firm of Kaplan, Kilsheimer and Fox. I appear today as a scholar and do not represent the views of any client or organization.

My testimony will focus on four points: 1) bid structure and auction design; 2) the costs and benefits of lead counsel auctions; 3) lead counsel auctions under the PSLRA; and 4) extension of the empowered plaintiff model beyond securities fraud litigation.

A few introductory remarks are in order. To determine whether lead counsel auctions are appropriate, it is necessary to consider the reasons for using an auction. Various justifications have been suggested, but three dominate: price, efficiency, and transparency. Lead counsel auctions could be beneficial if they reduce the price paid by the plaintiff class for legal services, if they lead to the selection of higher quality counsel, or both. Auctions are also used to address process goals. For example, auctions are used in government contracting to provide a more objective selection procedure and reduce the potential for collusion. Importantly, lead counsel auctions are substantially different from the claims auction proposed by Jonathan Macey and Geoffrey Miller,[4] among others, in that they do not address the agency problems created by the class action structure. Although some of the observations in this testimony are applicable to the claims auction proposal, I will leave an evaluation of that proposal to other witnesses.

It is difficult to use the results obtained in recent auction cases to evaluate the ability of lead counsel auctions to meet these objectives. Current experience with auctions is limited, and many existing cases involve flawed auction design or limited competition. The absence of comparable control groups makes it impossible to identify the extent to which auctions reduce

legal fees or, more problematically, whether any fee savings are the result of reduced attorney effort, poor attorney quality or both. Although identified flaws in traditional class action procedures lead to facile claims that auctions have reduced fees from the traditional 25% or 33% "benchmarks," these claims are misleading. In many recent non-auction cases, courts have awarded fees far lower than these benchmarks.[5] At the same time, it is hard to assess the reasonableness of fees in auction cases – the fee in Cendant, for example, was only 8.275% of the recovery, but totaled approximately $10,861/hour.[6] More importantly, fee structures in auction cases have created troubling incentives for plaintiffs' counsel. As a result, empirical analysis cannot readily address the effect of auctions on the net recovery to the plaintiff class.

Moreover, in order for any type of auction to be successful, the auction must be suitably designed. Designing an appropriate lead counsel auction presents substantial challenges, some of which I will address in the following section.

1. Bid Structure and Auction Design

Lead counsel auctions raise a variety of auction design questions. These questions are significant; even if lead counsel auctions are appropriate in theory, an improperly designed auction will not achieve the intended results.[7] An auction selects a winning bidder by comparing competing bids. The dominant focus of the auction is on bid price. In the case of a typical auction, price comparison is trivial; bids reflect discrete monetary amounts that can be readily compared. Similarly, it is possible to construct a lead counsel auction in which prospective bidders compete on the basis of fixed price fee structures or flat percentages of the eventual recovery.

Currently, lead counsel auctions do not operate in this manner, however. Instead, bid structures generally tailor the bid price to reflect a variety of contingencies, such as the amount of the recovery, the duration of the litigation, and the stage at which the litigation is concluded. Fee grids, such as those used in *Lucent*[8] and *Sherleigh Associates*,[9] encourage bidders to structure their bids this way. The inclusion of multiple contingencies creates an indeterminacy problem – the relative superiority of one bid may shift relative to another depending on the specified contingencies. The point at which this shift occurs is known as a crossover point. If competing bids contain crossover points, it is impossible to choose one bid as superior without estimating the likely occurrence of the specified contingencies.

This task requires the court to predict the recovery in the case and the future course of the litigation, both at a time when the court has relatively little information about the case. Indeed, limitations on judicial ability to assess the quality of recovery at a far later date – the time when a settlement is proposed – have been identified as one weakness of traditional ex post fee awards.[10] In addition, the process of making these predictions may bias the court with respect to the future course of the litigation. An erroneously low initial estimate may cause the court to accept too low a settlement; an erroneously high estimate may lead the court improperly to resist an appropriate resolution.

Comparison of competing bids is further complicated by the fact that different bid structures create different litigation incentives for class counsel. As a result, the choice of bid structure may affect the ultimate recovery in the case. To consider these incentive effects, it is

insufficient for the court to calculate the fee award produced by two competing bids at comparable levels of recovery, the court must consider the likelihood that the competing bids produce different levels of recovery.

Incentive problems arise under a variety of different bid structures.[11] A fee award that is structured as a declining percentage of the recovery, for example, encourages counsel to settle a case early even at a low level of recovery. Many class actions do not present a serious risk of nonliability and, a quick cheap settlement may provide lawyers who have added little value with a substantial fee. Agency costs are increased when counsel is to receive only a small portion of the total recovery; thus a fee structure in which counsel receives a small percentage fee may provide an insufficient incentive for counsel to maximize recovery to the plaintiff class. This effect is magnified in the case of a capped fee, which eliminates any financial incentive for counsel to pursue recovery beyond the level of the cap. Increasing percentage fee structures eliminate this moral hazard problem but can lead to high fees at large levels of recovery, a problem that is exacerbated if, as suggested above, the court is poorly positioned to predict the eventual recovery. Increasing percentage awards also poorly reflect the true economics of litigation and, at very high levels may induce counsel to pursue high risk litigation strategies.

Bids with calender or litigation stage contingencies have similar incentive effects. Early settlement bonuses, for example, reward counsel for negotiating a quick cheap settlement. Structures that provide counsel with increased fees at later stages of the litigation encourage unnecessary work and reward delay regardless of whether that delay is correlated with increased attorney effort or higher recovery. Many of the specified contingencies are, at best, marginally relevant – it is extremely rare, for example, for a class action to be resolved after a trial or a post-trial appeal. By including a variety of marginally relevant contingencies, litigation milepost grids increase the cost of bid preparation and complicate the task of bid comparison.

Finally, bid structures that emphasize non-lawyer litigation costs may lead to inappropriate litigation decisions. Bids that require counsel to internalize non-lawyer costs require lawyers to manage such costs in terms of profit maximization rather than focusing on the best interests of the case. Cost caps, although superficially appealing, create a stark conflict of interest for counsel and may discourage counsel from incurring useful expenditures. At the extreme, lawyers may face pressure to settle a case once they have reached the cap and must bear the full cost of any additional expenditures.

When the court selects class counsel and designates a fee structure, it acts as a fiduciary for the plaintiff class. The interests of the plaintiff class are served by maximizing the net recovery to the class, not by minimizing counsel fees. Because the fee structure may affect counsel's incentive to litigate, the bid that minimizes counsel fees, either in percentage or absolute terms, may not maximize class recovery and, accordingly, may not be the best from the perspective of the plaintiff class.

Although this discussion has focused thus far on bid price, the emphasis on price in the auction context presents another serious problem. Unlike most auctions, in which price is the only relevant consideration, lead counsel auctions must consider bidder quality. The quality of class counsel may affect both the likelihood and the amount of plaintiffs' recovery. Moreover, in the market for legal services, price and quality are correlated. Higher quality lawyers generally command a higher price than lower quality lawyers.

Failure adequately to consider lawyer quality is, of course, not limited to the auction context; courts have been faulted for failure to evaluate lawyer quality in traditional lead counsel appointments, such as by mechanical application of the first to file rule or by undue reliance on negotiated solutions among competing lawyers. Within the auction context, however, quality evaluation presents a special concern.

First, the design of an auction that considers two separate variables, such as price and quality is particularly complex. The relative importance of quality may vary at different price levels, and vice-versa. As a result, the ideal lead counsel auction would incorporate a preference function which assigned appropriate weights to price and quality. Arguably such a preference function would replicate the market process, in which clients select lawyers based on an evaluation of price and quality characteristics and an assessment of the relative importance of each factor. Obviously the specification of a preference function is highly complex; and the relative importance of price and quality are likely to vary with the nature of the case.[12] Additionally, even if the court could specify an appropriate preference function, standard bidding processes are likely to malfunction in multidimensional auctions, causing the auction results to deviate from the desired objectives.[13]

Second, the evaluation of quality within the auction context is problematic. A review of auction decisions reveals relatively little emphasis on quality considerations. Even those courts that claim to evaluate quality have done so in a limited manner and applied standards that appear somewhat arbitrary.[14] If an auction is to evaluate bids on the basis of quality factors, it should specify objective standards for the evaluation. An example of this approach is the quality scoring systems used by the Department of Defense in procurement auctions.[15] Counsel selection may not readily lend itself, however, to the specification of objective quality criteria. Clients report the importance of such quality factors as lawyer style, agreement with the lawyer's proposed litigation strategy, and the lawyer's receptiveness to client input. Although a client may be able to evaluate these factors through face-to-face meetings such as beauty contests, it is difficult to incorporate them into a formal bidding process.

Third, the limitations on reducing quality evaluation to a set of objective standards force the court to exercise its subjective judgment about lawyer quality. This in turn reduces the objectiveness and transparency of the auction. In addition, a court may be motivated by different quality considerations than the plaintiff class. A managerial judge concerned about docket management, for example, may prefer conciliators who will favor a quick settlement over protracted litigation. A politically sensitive judge may prefer a lawyer who is sensitive to public opinion about the terms of the settlement. At the extreme, a court can mask the basis for its decisions by grounding them in quality criteria that are difficult to quantify or review. Moreover, the task of making quality judgments further compromises the court's neutrality.

Before leaving the subject of auction design, Judge Kaplan's approach in the *Auction Houses Antitrust Litigation*[16] should be addressed. Judge Kaplan used a unique structure in *Auction Houses*, designed to address some of the bid evaluation and incentive problems identified above. Under the *Auction Houses* approach, bidders were asked to specify a threshold dollar amount of recovery that would go entirely to the plaintiff class. Counsel would receive 25% of any recovery over this threshold.[17] In essence, the *Auction Houses* bid structure was an increasing percentage contingency fee with an initial rate of zero.

By some accounts, the *Auction Houses* bidding procedure was a great success.[18] The winning firm, Boies, Schiller & Flexner submitted a bid that was far superior to that of any competing bidder; indeed the Boies bid was more than three times that of the average bid. The case subsequently settled for $412 million in cash, and another $125 million in coupons, resulting in counsel fees of $26.75 million. Judge Kaplan explained that the auction was successful both in minimizing counsel fees and minimizing the conflicts of interest between counsel and the plaintiff class.

Closer examination reveals problems with both the *Auction Houses* structure and its results. First, the structure created pressure for some firms to underbid. Because, under Judge Kaplan's structure, a firm that specified too high a threshold stood to recover no compensation, bidders may have discounted their bids to reflect this risk. Second, the structure created pressure for some firms to overbid, that is, to specify an unreasonably high threshold in order to obtain the lead counsel position in this high profile case. An overbid could cause a firm to sacrifice class interests by pursuing inappropriately high risk litigation strategies in a futile attempt to obtain some compensation. Alternatively, a firm that discovered, after further investigation, that recovery was unlikely to exceed the threshold, would have little incentive to invest further resources in the litigation, and would be unlikely to maximize recovery to the class.

The bid structure also created the incentive for counsel to structure a settlement in a manner that maximized its fee award. Arguably the settlement reached in the case reflected this pressure. Although it is perhaps difficult to determine the true value of the coupons, it is unclear that they should be valued at face value; courts have frequently been criticized for overvaluing coupon-based settlements. It is worth noting that, without the coupons, the Boies firm would have received a fee of less than $2 million.

Finally, it difficult to evaluate the Auction Houses fee award in terms of reasonableness. In retrospect the Boies bid produced far lower fees than would have been produced by competing bids. This result does not demonstrate the reasonableness of the Boies fee award, however. Indeed, although the fee represents only 5% of the total recovery, $26.75 million is still fairly generous compensation for six months' work in a case in which the private lawsuit was preceded by a Department of Justice investigation, one of the defendants, Christie's, publicly acknowledged that it was cooperating in that investigation, and the other defendant, Sotheby's, pled guilty. Moreover, the auction results demonstrate the serious risk that an auction will produce suboptimal prices in the absence of adequate competition.[19] The Boies bid was reportedly more than twice the next highest bid.[20] If the Boies firm had not participated, the auction could have been won for a bid of $205 million, which would have produced a fee award of approximately $77 million.

2. The Costs and Benefits of Lead Counsel Auctions

Even overcoming these problems in auction design and bid structure will not necessary lead auctions to produce the selection of qualified counsel at competitive prices. As the *Auction Houses* example suggests, inadequate levels of competition, discounting, and investigation costs, may seriously affect auction results. The branch of economic literature dealing with auction theory formalizes these risks by explaining the conditions under which auctions work well and

identifying factors that may limit the viability of the auction for selecting qualified counsel at low cost.

Importantly, auction theory demonstrates that the operation of an auction is highly context-specific. How an auction functions depends critically on auction type. Theorists have developed two different models of auctions - the independent private values auction and the common value auction.[21] Under the classic assumptions, bidders in an independent private values auction know the value of the auctioned object, but each bidder's valuation is different and unknown to the other bidders. Each bidder's dominant strategy is to bid his or her private value and, assuming perfect competition, the auction structure has the effect of maximizing the seller's revenue and awarding the object to the bidder who values it most highly.

In the alternative common value auction, the value of the auctioned object is common to all the bidders, but that value is unknown. Because the bidders lack complete information, they must engage in costly investigation in order to formulate their bids. These investigation costs will be reflected in bid price, reducing the seller's revenues.[22] Uncertainty over the item's true value will also cause bidders to reduce their bids. In particular, the winning bidder faces the risk that he or she has overpaid, a phenomenon known as the winner's curse.[23] Bidders respond to this risk by discounting their bids.

In my opinion, the common value auction more closely describes the operation of a lead counsel auction for several reasons. First, the dominant factors in determining bid price are likely to be characteristics of the case, such as the likely amount of recovery, the risks associated with the recovery, and the characteristics of the case that affect the projected cost of litigation. These factors will be common to all bidding firms. Second, to the extent that firm specific factors, such as firm opportunity costs, are relevant, they are likely to be both unknown and unknowable. Third, the classic assumptions of the independent private values auction – complete information and perfect competition – do not appear applicable.

As a result, there is a substantial risk that lead counsel auctions will lead both to poor price production and to the selection of firms of sub-optimal quality. Poor price production is likely because the plaintiff class will bear the multiple investigation costs incurred by bidding firms. To the extent that these investigation costs are borne by unsuccessful bidders, they are also socially wasteful. Bidder discounting to avoid the potential winner's curse problem will further affect bid price. To the extent that an auction produces aggressive bids, low bids are more likely to be submitted by lower quality firms, which face lower opportunity costs. These lowball bids may have the dual effect of driving high quality bidders out of the auction, the classic lemons problem,[24] and providing the court with poor quality information about the case and the projected recovery.

Sufficient competition is also essential if an auction is to produce reasonable prices. To the extent that a lead counsel auction generates limited participation, the resulting prices do not accurately reflect the market for legal services, and do not justify judicial deference. Indeed, auction theorists have demonstrated that the additional competition provided by one more bidder is more valuable to the seller than any amount of bargaining power.[25] To date, however, lead counsel auctions have not attracted large numbers of bidders.[26] The limited participation may be the result of a variety of factors such as the high cost of case investigation and bid preparation – costs that are unrecoverable unless the firm is the winning bidder, exit by high quality firms that

are unwilling to compete with lowball bids, or inability to predict the basis on which the court will evaluate competing bids. Whatever the reason, this absence of competition severely limits the potential that a lead counsel auction will produce reasonable prices or select qualified counsel.

Finally, any analysis of the costs and benefits of the auction procedure must reflect the potential that lead counsel auctions will discourage lawyers from investigating misconduct. Original investigations require lawyers to expend their own resources; these expenditures are recouped if the investigation results in successful litigation. In an auction, latecomers are able to free ride on the investigations conducted by others and, because they have incurred no investigation costs, such latecomers can often submit lower bids. By awarding the lead counsel position to a lower bidding latecomer, the auction thus deters investigation. Accordingly, the widespread acceptance of lead counsel auctions may reduce the effectiveness of entrepreneurial litigation in deterring misconduct.

3. Lead Counsel Auctions Under the PSLRA

In my opinion, lead counsel auctions are inconsistent with both the text of the PSLRA and the statutory objectives. More importantly, as a practical matter, judicial use of auctions, even in some PSLRA cases, is likely to impede the participation of institutional investors as lead plaintiffs and to reduce their ability to improve the selection and compensation of class counsel.

The PSLRA clearly vests the lead plaintiff, not the court, with the authority to select lead counsel.[27] Although the statute permits the court to veto the lead plaintiff's selection, there is no basis for the court to exercise independent authority to substitute its choice of counsel for that of the lead plaintiff. Neither the text nor the legislative history authorize judicial selection of counsel. Importantly, Congress had the auction alternative available to it at the time it adopted the PSLRA, yet it did not incorporate auctions into the statutory scheme.[28]

Moreover, lead counsel auctions are inconsistent with the statutory objectives. Congress concluded that lead plaintiffs, particularly institutional investors, had a sufficient interest to justify active participation in litigation decisions and the sophistication and power to participate effectively. The lead plaintiff model is designed to encourage such participation. By displacing the lead plaintiff's authority over counsel selection, lead counsel auctions undermine the statutory objective of client empowerment.

An empowered lead plaintiff can improve class action litigation by 1) developing and implementing procedures to select appropriate class counsel; 2) negotiating a fee structure that minimizes counsel fees while maintaining appropriate incentives for counsel; 3) injecting market forces into the fee award; and 4) exercising ongoing monitoring of class counsel. In fact, institutional investors are actively developing guidelines concerning participation in securities litigation and procedures for selecting and retaining class counsel. Developing practices by institutions are consistent with the goals articulated by Congress.

In the course of my research, I have interviewed decisionmakers for a number of institutional investors, including CalPERS, the State of Wisconsin Investment Board and the New York City Pension Funds. In summary, my research reveals that institutional investors have adopted a variety of procedures for the selection of counsel, all of which involve a high

level of competition. Institutions actively invite a range of firms to compete for the lead counsel position by obtaining recommendations, circulating requests for proposals, and, in some cases, retaining a law firm specifically to assist in the process of selecting class counsel. Many institutions have affirmatively sought the involvement of firms that do not traditionally represent plaintiffs in securities fraud litigation.

Following the identification of these firms, institutions conduct a rigorous evaluation process utilizing both quality and price criteria. Institutions report checking references, reviewing performance in comparable cases, and reviewing writing samples. Institutions typically conduct beauty contests akin to those used by corporate clients – face to face meetings in which they evaluate familiarity with the case, general legal expertise, and proposed litigation strategy. Institutions report placing a premium on firm style and client relationship issues, stressing the importance of selecting a firm that is willing to engage in joint decisionmaking and regular reporting. Through this factor, institutions seek to maintain counsel's accountability.

By soliciting price proposals, institutions are developing increasing familiarity with the market for legal services. Through their role as repeat players, institutions can economize on the information costs of learning the market. Many institutions (and some wealthy individual investors as well) have extensive familiarity with selecting counsel and negotiating fee agreements through their activities outside securities litigation and can apply this expertise to their role as lead plaintiff. Institutions also claim that they can exercise considerable leverage in fee negotiations. Retainer agreements negotiated by institutional investors consistently reflect lower fees than traditional class action benchmarks. In addition, institutions are continuing to work toward innovating fee structures that maintain appropriate litigation incentives for counsel and that permit flexibility in order to address unanticipated litigation contingencies.

Institutional involvement typically does not end with the selection of counsel. Most institutional investors seek a continuing role both in supervising litigation decisions and in monitoring the work effort of class counsel. Institutions frequently review billing time records and similar data on an ongoing basis. Institutions may review pleadings and participate in strategy discussions. And institutions are particularly active participants in settlement negotiations.

Institutional participation may also increase the social value of litigation. Because of their continued presence in the marketplace, institutions may give greater emphasis to priorities such as market safety and deterrence of misconduct. Indeed, some institutions report negotiating fee structures that emphasize these objectives and provide greater compensation for recoveries that maximize individual accountability. Institutions may also deter frivolous litigation through their unwillingness to participate in cases they view as meritless. Finally, institutions may be able to work cooperatively with entrepreneurial lawyers to facilitate pre-filing investigations and to reward lawyers who engage in original work.

Congress contemplated precisely these types of institutional activities in adopting the lead plaintiff provision of the PSLRA. Active participation by institutional investors is threatened, however, by judicial selection of counsel. First, there is little reason for an institutional investor to spend time or money screening cases, developing procedures, and selecting appropriate counsel if a court is free to substitute its decision for that of the institution. As one institutional investor related to me after its selection decision was thwarted by the court, frustration over the

court's disregard for the careful and time-consuming selection procedures was likely to reduce the institution's willingness to participate in future cases. Second, judicial selection of lead counsel and determination of fee structure reduces both the lead plaintiff's familiarity with the market and the lead plaintiff's potential leverage in fee negotiations. Third, as indicated above, courts are less likely to employ nuanced quality criteria in selecting counsel. The failure of courts to emphasize client accountability, coupled with the fact that lead counsel is less likely to develop a close working relationship with a lawyer appointed by the court reduces the lead plaintiff's ability both to monitor class counsel and to affect litigation decisions. Finally, when the court selects counsel and awards counsel fees, it eliminates client control over counsel's compensation, which eliminates the lead plaintiff's incentive and ability to monitor counsel's efforts on an ongoing basis. Elimination of these monitoring efforts increases the burden imposed on the court to determine, on an ex post basis, if counsel's efforts were reasonable.

Even an auction like that used in the *Cendant* case[29] interferes with institutional efforts to maintain the accountability of counsel. In addition to producing higher fees than those negotiated by the lead plaintiffs, the *Cendant* auction resulted in a fee structure in which the plaintiffs lost the right that they had retained under the previously-negotiated fee agreement to adapt the ultimate fee award to the outcome of the case.[30] Once an auction fee structure is in place, lead counsel has a diminished incentive to report regularly to the lead plaintiff and to adhere to the plaintiff's instructions. Finally, by disrupting the results of the lead plaintiffs' negotiations, the court reduced the likelihood that institutional investors would engage in similar efforts in the future.

4. Extending the Empowered Plaintiff Model

Although the PSLRA is the only statute currently to formalize the empowered lead plaintiff position, the lead plaintiff model can readily be extended beyond securities litigation. In a current working paper, I present a general model to determine the types of cases in which such an extension is appropriate.[31] I argue that the delegation of selection of counsel, fee negotiation, and case supervision to an empowered lead plaintiff is an appropriate method for increasing the role of the market whenever three criteria are met. First, the class must include members with a sufficient financial stake in the litigation to justify the incursion of costs identifying and negotiating with class counsel. Second, the interests of the potential lead plaintiff should be qualitatively similar to those of other class members. Third, the size of a class member's interest should be correlated with the class member's sophistication and ability to handle the selection, negotiation and monitoring processes. This correlation enables to court to use an objective metric, such as the size of the plaintiff's interest, as the basis for selecting the lead plaintiff.

Applying this model, I argue that the empowered lead plaintiff model is particularly appropriate in securities fraud litigation. The model can readily be extended, however. Antitrust cases, intellectual property, and shareholder derivative litigation are all areas in which the foregoing three criteria are likely to be met. The plaintiff class in the *Auction Houses* case, for example, consisted of class members with substantially similar interests and included a number of wealthy and sophisticated members who had suffered substantial losses. Similarly, the real party in interest in shareholder derivative suits is the shareholder class, which typically includes a

number of large investors with sufficient stakes to benefit from active participation. Indeed, even in the absence of a formal mechanism for their involvement, some institutions have attempted to participate in derivative litigation.[32]

The empowered lead plaintiff model is not suitable for all class litigation. The same characteristics that limit the viability of the empowered lead plaintiff model, however, indicate that lead counsel auctions are similarly inappropriate in certain cases. In classic small claimant cases such as consumer fraud, for example, no class member is likely to have a sufficient stake in the case to overcome collective action problems. Accordingly, there is no suitable candidate to act as lead plaintiff. Small claimant class actions, however, produce the most extreme collective action problems, and it is unsurprising that such cases have produced some of the most egregious examples of opportunistic behavior by counsel.[33] Because the lead counsel auction sacrifices ex post review by the court of counsel's performance in favor of an ex ante fee determination, it further reduces counsel's accountability in these cases. Small claimant cases are also the most likely candidates for lowball bids, in auctions, that lead to quick cheap settlements.

At the other end of the spectrum, mass tort cases are unsuitable for the empowered lead plaintiff model both because of the divergence of interests within the plaintiff class and the lack of correlation between the size of the plaintiff's stake and his or her ability to serve as an effective lead plaintiff. The conflicting interests within the plaintiff class are a similar obstacle to permitting representation of the entire plaintiff class by a single winning bidder. The appointment of lead counsel in mass tort litigation presents a variety of issues, such as the ability of lead counsel to represent class members with disparate interests, the potential interference with existing lawyer-client relationships, the risk that a lead counsel appointment will undermine prior litigation efforts by individual plaintiffs' lawyers, and the appropriate division of fee awards between lead counsel and other participating lawyers. Using an auction may focus the court on the methodology of the appointment process at the risk of masking these serious issues.

Conclusion

My research leads me to believe that lead counsel auctions are not beneficial to the plaintiff class. The auction process is unlikely to reduce legal fees, select qualified counsel or increase objectiveness. Lead counsel auctions are particularly dangerous in that they may reduce judicial supervision and encourage complacency in precisely those cases in which continued regulation by the court is essential. Auctions do not address complex issues of contract design, performance evaluation, and the criteria for determining a reasonable fee. For the foregoing reasons, I do not recommend that this Task Force adopt the auction model.

In contrast, early experience with the empowered lead plaintiff approach of the PSLRA is promising. If institutions and other class members with substantial interests continue to participate actively, the empowered lead plaintiff model offers an alternative market-based approach that is likely to reduce legal fees and improve accountability in class action litigation. This model can and should be extended to other suitable cases such as antitrust and shareholder derivative litigation.

1. Recent publications on class action litigation and selection of counsel issues include Jill E. Fisch, *Aggregation, Auctions and Other Developments in the Selection of Lead Counsel Under the PSLRA*, 64 Law & Contemp. Probs.

__ (forthcoming 2001), avail. at http://papers.ssrn.com/sol3/papers.cfm?cfid=105586&cftoken=73796518&abstract_id=261580; Jill E. Fisch, *Class Action Reform, Qui Tam, and the Role of the Plaintiff*, 60 Law & Contemp. Probs. 167 (Autumn 1997); Jill E. Fisch, *Class Action Reform: Lessons from Securities Litigation*, 39 Ariz. L. Rev. 533 (1997). I am currently writing an article that focuses specifically on lead counsel auctions and the empowered lead plaintiff alternative, *Lawyers on the Auction Block: Evaluating the Selection of Class Action Counsel by Auction*. The conclusions in my paper form the basis for my testimony. I expect to complete a revised draft later this spring and will be happy to furnish a copy to the Task Force upon request.

2. 197 F.R.D. 71 (S.D.N.Y. 2000).

3. 110 F.Supp.2d 429 (E.D. Va. 2000).

4. See Jonathan Macey & Geoffrey Miller, *The Plaintiffs' Attorney's Role in Class Actions and Derivative Suits: Economic Analysis and Recommendations for Reform*, 58 U. Chi. L. Rev. 1 (1991).

5. See, e.g., Goldberger v. Integrated Resources, Inc., 209 F.3d 43, 46-47 (2d Cir. 2000) (upholding award of 4% of recovery); In re the Prudential Ins. Co. Sales Practices Litig., 106 F. Supp. 2d 721, 735-36 (D. N.J. 2000) (awarding 4.8% of recovery in case involving "extraordinary risk"); In re NASDAQ Market-Makers Antitrust Litigation, 187 F.R.D. 465, 470 (S.D.N.Y. 1998) (awarding 14% of the recovery).

6. See Memorandum of Law by Corporation Counsel of the City of New York in Opposition to the Application of Lead Counsel for Attorneys' Fees, May 31, 2000, at 1, 8, In re Cendant Corp. Litig., 191 F.R.D. 387 (D.N.J. 1998) (No. 98-1664) ("*Cendant* Memorandum").

7. See, e.g., Paul Klemperer, *What Really Matters in Auction Design*, (working paper dated June 21, 2000), avail. at www.nuff.ox.ac.uk/economics/people/klemperer.htm (explaining the importance of appropriate auction design and describing poor results that can follow from using an improperly designed auction).

8. In re Lucent Techs. Inc. Secs. Litig.,194 F.R.D. 137 (D.N.J. 2000).

9. Sherleigh Associates LLC v. Windmere-Durable Holdings, Inc., 184 F.R.D. 688 (S.D. Fl. 1999).

10. See, e.g., Macey & Miller, *supra* note 4, at 44-48.

11. For a detailed analysis of the incentive issues created by various bid structures see Andrew K. Niebler, *In Search of Bargained-For Fees for Class Action Plaintiffs' Lawyers: The Promise and Pitfalls of Auctioning the Position of Lead Counsel*, 54 Bus. Law. 763 (1999).

12. See, e.g., Martin Cripps & Norman Ireland, *The Design of Auctions and Tenders with Quality Thresholds: The Symmetric Case*, 104 Econ. J. 316, 317 (1994) (arguing that the environment required to implement a multidimensional auction reflecting price and quality criteria is unlikely to exist).

13. See Yeon-Koo Che, *Design Competition Through Multidimensional Auctions*, 24 Rand. J. Econ. 668 (1993).

14. See Fisch, *Aggregation, Auctions and Other Developments*, *supra* note 1 (criticizing judicial evaluations of quality in In re Cendant Corp. Litig., 191 F.R.D. 387, 390 (D.N.J. 2000) and Wenderhold v. Cylink, 191 F.R.D. 602-3 (N.D. Cal. 2000)).

15. See Che, *supra* note 13, at 668-69 (describing Department of Defense procurement auctions).

16. 197 F.R.D. 71 (S.D.N.Y. 2000).

17. Judge Kaplan initially chose a more complex structure but subsequently revised the auction terms. *Id.* at 73-74.

18. See, e.g., Mark Hamblett, *Lead Counsel Bid Formula Seen as Success*, N.Y.L.J., Feb. 5, 2001 at 1, col. 3.

19. See *infra* part 2.

20. See John C. Coffee, Jr., *Untangling the 'Auction Houses' Aftermath*, N.Y.L.J., Nov. 30, 2000, at 1, col. 1.

21. See generally Paul R. Milgrom & Robert J. Weber, *A Theory of Auctions and Competitive Bidding*, 50 Econometrica 1089 (1982) (describing both auction models).

22. See, e.g., Kenneth R. French & Robert E. McCormick, *Sealed Bids, Sunk Costs, and the Process of Competition*, 57 J. Bus. 417 (1984) (explaining that bidders must incorporate the costs of the auction procedure, such as investigation and bid preparation costs, into their bids).

23. See R. Preston McAfee & John McMillan, *Auctions and Bidding*, 25 J. Econ. Lit. 699, 720-21 (1987) (describing winner's curse problem).

24. See George Akerlof, *The Market for "Lemons": Quality, Uncertainty and the Market Mechanism*, 84 Quart. J. Econ. 488 (1970) (describing lemons problem).

25. See Jeremy Bulow & Paul Klemperer, *Auctions Versus Negotiations*, 86 Am. Econ. Rev. 180 (1996).

26. See Fisch, *Aggregation, Auctions and Other Developments, supra* note 1 (detailing limited bidder participation).

27. See 15 U.S.C. § 78u-4(a)(3)(B)(v) ("The most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class").

28. See *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) (testimony of Arthur Miller, Professor of Law, Harvard Univ. Law School) (identifying shortcomings of auction procedure to Congress).

29. In re Cendant Corp. Litig., 191 F.R.D. 387 (D.N.J. 2000).

30. See *Cendant* Memorandum, *supra* note 6 at 29 (describing retainer agreement as providing caps which enabled plaintiffs to negotiate for lower fees at the end of the case).

31. See Fisch, *Lawyers on the Auction Block, supra* note 1.

32. See, e.g., CalPERS v. Felzen, 134 F.3d 873 (7th Cir. 1998) (denying attempt by CalPERS to appeal from decision approving derivative suit on the basis that CalPERS had failed to intervene in the original action), *aff'd sub nom.*, California Pub. Employees' Retirement Sys. v. Felzen, 525 U.S. 315 (1999) (per curiam) (4-4 decision).

33. See, e.g., Susan P. Koniak & George M. Cohen, *Under Cloak of Settlement*, 82 Va. L. Rev. 1051, 1057-58 (1996) (describing settlement and $12 million fee award in Hoffman v. BancBoston Mortgage Corp., No. 91-1880 (Ala. Cir. Ct. Jan. 24, 1994)).