

WRITTEN STATEMENT OF KEITH JOHNSON
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TO THE THIRD CIRCUIT TASK FORCE ON SELECTION OF CLASS COUNSEL
May 5, 2001

I would first like to express my appreciation to Chief Judge Becker for appointing this task force and to each of the members for taking on this assignment. I believe your job is more important and more difficult than it sounds. Selection of counsel to represent the plaintiffs in class litigation touches issues that involve core values upon which our system of justice is founded. Furthermore, there are widely varying views on how to choose class counsel and little scientific data to guide your deliberations. One might liken your assignment to navigating through an alligator infested swamp on a dark night without a flashlight. Let me assure you that I've been in that swamp, and I'll do my best today to help you identify where some of those alligators are.

My main caution is that your attention may be diverted in the wrong direction. From my perspective, the primary challenge in securities litigation is not how courts should select class counsel but **HOW COURTS CAN FACILITATE THE PROPER SELECTION OF CLASS COUNSEL BY LEAD PLAINTIFFS**. Indeed, legislative history of the Private Securities Litigation Reform Act (the "Reform Act") is rife with statements of Congressional intent that the purpose of the Reform Act was to revitalize the role of the plaintiff in class actions by encouraging sophisticated clients with significant claims at stake to select and manage lead counsel.¹

Today I would like to speak from the client's perspective, a viewpoint that does not appear to have been represented by anyone else who has testified before the task force. Yet, it seems to have been the viewpoint Congress had in mind when it enacted the Reform Act.

I am the Chief Legal Counsel at the State of Wisconsin Investment Board ("SWIB"). SWIB manages the 10th largest public pension fund in the U.S., with almost a half million members. As a large investor, SWIB is a regular class member in securities lawsuits. Over the last 5 years, we have been a class member in 100 cases and received over \$27 million in

¹ The views contained in this statement are solely those of the author and do not reflect an official position of the State of Wisconsin Investment Board.

recoveries. More than \$12 million was taken out of those recoveries as our share of legal fees, an amount that was three times our expenditures for legal fees on all other matters.

SWIB was also appointed to serve as a lead plaintiff, and has selected class counsel, in four securities class actions.² Our role in the CellStar case was cited by the SEC as “a blueprint for future class actions involving institutions.”³ Indeed, the SEC said, “The potential benefits of institutional investors becoming lead plaintiff, as envisioned by Congress, can best be seen in [the CellStar case].”⁴

Speaking from the plaintiff’s perspective, as a client, there are several goals that should be taken into consideration when selecting class counsel. I consider selection of lead counsel to be the MOST IMPORTANT responsibility of a lead plaintiff and believe that most shareholder class members have the following mutual goals in any given case:

- Maximization of the recovery;
- Obtaining payments as quickly as possible;
- Minimization of the costs to obtain that recovery; and
- Deterrence of future losses to illegal conduct.

These goals, in many respects, are likely to be at odds with the interests of other players in the litigation. For instance, class counsel has no economic interest in minimizing the plaintiffs’ legal fees. A court with a crowded calendar may have a disincentive to maximize the recovery if it requires holding a complex and lengthy trial.

In addition, these goals may conflict with each other. The quickest resolution may not be the largest one. Attorneys who submit the lowest bid may not have the skills or credibility to maximize the plaintiffs’ recovery. Individual defendants may want to agree to a larger insurance settlement in order to avoid a highly deterrent personal judgment and, if the larger settlement would generate a bigger fee, class counsel is likely to have a similar incentive.

It’s hard enough for a sophisticated lead plaintiff to balance these interests when selecting class counsel and establishing fee arrangements. It involves consideration of counsel’s expertise,

¹ For example, H.R. Rep. No. 369, 104th Cong., 1st Sess. 31, at 34, states, “Institutional investors and other class members with large amounts at stake will represent the interests of the plaintiff class more effectively than class members with small amounts at stake.”

² The cases are CellStar, 96-CV-1353-R (N.D. Tex.); Physicians Computer Network, Civil No. 98-981 (D.N.J.); Just for Feet, CV 99-BU-3097 (N.D. Ala.); and Anicom, 00-CV-04391 (N.D. Ill.).

³ Securities and Exchange Commission, *Report to the President and the Congress on the First Year of Practice Under the Private Securities Litigation Reform Act of 1995*, at page 58, (April 1997).

⁴ *Id.*

client responsiveness, fee expectations, case analysis, litigation plan, reputation, prior investigation of the case, knowledge of the judge, experience with the defendants and their counsel, understanding of corporate governance principles, trial experience, and potentially a host of other factors. Chances are good that the defendants take similar factors into consideration when selecting counsel to represent them.

I don't think it's realistic to expect that judges can play a surrogate client role in selection of class counsel without either sacrificing their objectivity in the case or selling the plaintiffs short. Integrity of the process is better served by keeping the judge in his or her role as the neutral arbiter. Due process requires nothing less. Previous commentators have suggested criteria that courts could use to determine whether a lead plaintiff has performed as a real client would in selecting class counsel.⁵ I concur with the suggestion of Professor Weiss at the March 16 hearing of the Task Force that, where a lead plaintiff is found to have failed in effectively performing its counsel selection function, the better course would be for the court to appoint a special master pursuant to Federal Rule of Civil Procedure 53 to engage in the type of process that a real client would in selecting class counsel.

In my view, the plaintiff class should be put in the same stead regarding selection of counsel as the defendants. A similar level of sophistication, client control, competitive fee sensitivity, and concern for quality should be brought to counsel retention on both sides of the litigation. One might ask, when a judge directly selects class counsel for the plaintiffs through a bidding process, shouldn't fairness require the defendants to undergo the same process?

While the prospect of this scenario seems silly, I think it aptly illustrates the concerns that Congress had in mind when it passed the Reform Act. Congress wanted to put real clients in charge of the plaintiffs' case. I believe the Federal Courts should focus on implementing this stated intent of the Reform Act by facilitating active participation of institutions and other large claimants as lead plaintiffs in securities class actions. In cases where such efforts fail, the plaintiff class should be afforded a level of integrity in the selection of lead counsel that is similar to what the defendants enjoy. I see no other realistic mechanism for providing a level playing field to all litigants other than appointment of a special master to engage in a balanced and informed competitive selection process.

⁵ See March 16, 2001 Written Statement of Elliott J. Weiss and Statement of Vaughn R. Walker to the Task Force.

As the Chief Legal Counsel for an institutional client that has served as lead plaintiff, I offer the process SWIB has used to select lead counsel as an example of what this Task Force might consider for recommendation. SWIB's is not the only process that could be used nor is it necessarily the best. I encourage the Task Force to also evaluate procedures that have been used by other experienced lead plaintiffs.

I also believe it would be appropriate for the Task Force to commission further academic research on effective methods for obtaining and compensating class counsel. Indeed, our justice system might benefit from greater application of modern scientific methods of inquiry to these kinds of legal issues.

I have attached SWIB's procedures for selection of lead counsel to the written statement I am submitting to the Task Force for your review. In general, SWIB uses special securities litigation counsel to assist us in selecting lead counsel and negotiating fee arrangements. To avoid bias, our special counsel is not eligible for selection as lead counsel. We invite litigation plan and fee proposals from several firms that we identify as potentially having the skills required for the particular case. Receipt of analyses from different law firms provides an incredible benefit to prosecution of the case, as varying insights and approaches are often submitted. The proposals are reviewed by a counsel selection committee with investment staff, State Department of Justice, SWIB legal staff, and special securities litigation counsel membership. Finalists are interviewed, and the final selection decision is made by SWIB legal staff, upon recommendation from the selection committee, in the same way all other SWIB counsel retention decisions are made.

Fee levels are one of the most significant factors considered in the selection process. However, they are not the only factor. Experience, claim analysis, litigation strategy, investigation results, client responsiveness, reputation, and trial capabilities are among the other factors that might be taken into consideration. If the firm identified as the best choice for a particular case did not submit the most competitive fee proposal, SWIB will engage in fee negotiations.

To date, we have always opted for an increasing percentage fee arrangement. I believe that structure tends to align the interests of lead counsel with the class and simplifies supervision of counsel as the case progresses. We have also demanded that a minimal recovery result in a minimal fee in order to avoid rewarding class counsel for pursuing a frivolous case. Otherwise,

the structure of SWIB's fee arrangements has varied between cases. In some cases we have agreed to a fee add-on for early settlements. In others, we have agreed to support a higher fee award for non-insurance recovery amounts, to acknowledge the added deterrence benefits and additional difficulty of obtaining personal damage payments. Some fee schedules have provided for larger fee awards as the case progresses and others have applied a uniform percentage regardless of when a recovery is obtained.

My experience is that every case is different. A fee award that is competitive for one case might be exorbitant for another. Different structures may also be appropriate for cases with different types of claims or issues. In all cases, SWIB treats lead counsel fee agreements the same way it does fee arrangements in non-class litigation. If the circumstances change such that the fee agreement is impeding successful pursuit of the plaintiffs' claims, SWIB reserves the right to modify it later where doing so is expected to produce a better net result. We have never done that in a class action, but retention of some flexibility is, in my mind, a hallmark of client-directed litigation.

In SWIB's experience, the typical court-awarded fee of 30 percent or more would generally not be competitive. The cases I have been involved in all produced standard competitive fee levels between 15 and 20 percent. While fee ranges have varied depending on the size and difficulty of each case, I hope the Task Force will note the significant financial benefits that SWIB's client-directed competitive selection process has provided to the class.

If you wish to encourage more institutions and large investors to play the lead counsel selection role contemplated for them by the Reform Act, the courts will have to be proactive and take steps to facilitate their involvement. I hope this Task Force will see that as within its charge. Recommendations that would have a positive impact include:

- Elimination of the practice some courts have adopted of forcing shotgun marriages of competing lead plaintiffs. I have seen first-hand the havoc that these arrangements can cause and advantage they provide to defendants;
- Requiring the courts to defer to counsel selection decisions made by lead plaintiffs where a reasonable, client-controlled process was used to obtain competent representation at a fair price, much like the courts defer to decisions of corporate boards under the Business Judgment Rule;

- Prohibiting courts from forcing a lead plaintiff to accept a lead counsel firm that it does not want to accept. If the court finds the process used by a lead plaintiff to retain lead counsel lacking, it should appoint a new lead plaintiff rather than saddle the class with a dysfunctional attorney-client relationship;
- Rationalizing the process for giving the class notice of lead counsel fee applications and reviewing applications for fee abuse. For example, many courts allow lead counsel to file information supporting its fee application after the deadline for objections has passed, approve payment of compensation and cost reimbursements for the loser in lead plaintiff battles, judge reasonableness of fees based on exorbitant hourly rates, richly compensate class counsel for poor settlements, and permit class counsel to pile on three or four times the number of law firms than is required for effective prosecution of the case. These practices help to protect interests of lead counsel over those of the plaintiff class. I have attached to the written statement I am submitting to the Task Force a recent article I co-authored highlighting some of the lead counsel fee application abuses that are common;⁶
- Allowing special masters to create flexible mechanisms for involvement of sophisticated class members in the class counsel selection process where the lead plaintiff is not capable of providing a similar level of expertise to the decision as is being brought to the defendants' counsel selection decisions. Use of advisory committees or institutional investor special masters would help to level the playing field between the defendants and plaintiff class without making the judge a surrogate plaintiff.

I hope my comments will be of assistance to the Task Force in navigating the class counsel swamp. I encourage you to think like a client when deliberating on how to structure a process to protect rights of the plaintiffs' class.

I intend to stay for the remainder of the hearing and would be happy to answer any questions you might have.

⁶ Keith L. Johnson and Douglas M. Hagerman, *The Elephant in Securities Class Actions: Lessons Learned About Legal Fees*, *The Corporate Governance Advisor* (March/April 2001).