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by

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Investor Protection: A Review of Plaintiffs' Attorney Abuses in Securities Litigation and Legislative Remedies

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Thank you, Mr. Chairman, and members of this Subcommittee, for your kind invitation to testify today about abuses in securities class action litigation and on H.R. 5491, the proposed Securities Litigation Attorney Accountability and Transparency Act.

I serve as Director of the AEI Liability Project, and as a Resident Fellow at the American Enterprise Institute for Public Policy Research, but I am not testifying here on their behalf and the views that I am sharing today are my own.

The problem of abuses by plaintiffs' attorneys in securities class action litigation have come to the forefront because of the recent indictment of the Milberg Weiss law firm. But I am reminded of what Michael Kinsley once said: "The scandal isn't what's illegal; the scandal is what's legal." I, along with many academics, believe that the same is true with much securities class action litigation.

But while there are areas of securities class action reform that are unavoidably divisive, this bill should not be one of them. The small steps taken by this bill are uncontroversial means to reduce corruption in the securities litigation process, benefiting shareholders and plaintiffs' law firms that play by the rules. I would like to see Congress to take more decisive action to protect investors and the American public from problems created by earlier Congressional action and judicial interpretations of these statutes, but this bill is a step in the right direction.

I. Background

When Congress first passed the 1933 and 1934 Acts, they provided only for government enforcement; there was no explicit private right of action. Such a right was created by judicial fiat in a 1946 district court opinion, and accepted as a *fait accompli* without serious discussion by the Supreme Court in 1971.[1]

Securities class actions affect almost every element of American business. Between 1997 and 2005, there were 225 securities class actions brought against members of the Fortune 500, 43 of them against members of the Fortune 50.[2] From 1996 to 2005, securities class action settlements totaled $37 billion.[3]

Not all of those $37 billion in settlements reflect wrongdoing. As Justice Stevens noted about securities class actions in a unanimous Supreme Court decision in March, "Even weak cases brought under the Rule may have substantial settlement value... because

[1] *Superintendent of Ins. of N. Y. v. Bankers Life & Casualty Co.*, 404 U. S. 6 (1971).
[2] PricewaterhouseCoopers 2005 Securities Litigation Study, released 2006, available at http://www.pwc.com/extweb/pwcpublications.nsf/docid/7999A70324592B738525715C0059A948.
[3] *Id.*

‘[t]he very pendency of the lawsuit may frustrate or delay normal business activity.’”[4] The Supreme Court has also said that securities litigation “presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general.”[5]

As an example of the pressures on defendants from weak cases, one need only look at the recent WorldCom settlements, where questionable decisions by a single federal district court judge generated billions of dollars of settlements from deep-pocket entities only remotely related to the underlying fraud. Using a divide-and-conquer strategy that gave a discount to the first banks that settled, and using the risk of a bankrupting judgment, the plaintiffs were able to force seventeen defendants to settle for between pennies and twenty cents on the dollar rather; the plaintiffs’ attorneys faced no risk litigating against the last defendants, because they were guaranteed a tremendous profit upon achieving the first settlement. If the case was about the merits, rather than about a quick windfall, it is hard to imagine why the plaintiffs were willing to settle for so little on the eve of trial. This problem is not unique to securities class actions. Seven years ago, plaintiffs’ firms sued eight HMOs, alleging, without evidence, a wildly implausible conspiracy to cheat doctors in reimbursements. Because of the risk and harassment of multi-billion-dollar litigation, six insurers settled for hundreds of millions of dollars. Two had the courage to continue fighting, and won summary judgment throwing out the claims for lack of evidence. But the plaintiffs’ lawyers are sanguine: they will receive $200 million for bringing a bogus case.[6]

It’s worth noting that diversified investors are made worse off by securities litigation, because settlements from such lawsuits provide money to plaintiffs’ left-hand pocket by taking it from their right-hand pocket, with a substantial commission to the plaintiffs’ attorneys for facilitating the transaction. A prominent recent example of this is, once again, the WorldCom litigation. As Forbes magazine reported:

> “Judging by a plaintiff expert's own estimate of shareholder losses, New York's claim of a $317 million hit would entitle it to 1.1% of the kitty, or a mere $11 million .... [Comptroller Alan] Hevesi's suit cost New York's pension fund by deflating the value of its investments in the banks it sued. The Hevesi fund owns stakes in J.P. Morgan, Citigroup and BofA. These three banks took aftertax charges totaling $3.2 billion for WorldCom settlement costs. The fund's pro rata share of these losses, and those of smaller-fry defendants, totes up to $13 million.”[7]

The New York State Common Retirement Fund lost money; its lawyers—who had donated generously to Hevesi—made more than $300 million. This is ironic given that

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[4] *Merrill Lynch v. Dabit*, No. 04-1371 (Mar. 21, 2006), quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 740 (1975).
[5] *Blue Chip Stamps*, 421 U.S. at 739.
[6] Julie Kay, “HMO Suit Brings Big Payoffs to Lawyers but Leaves Unsettled Questions,” *Daily Business Review* (Jun. 27, 2006).
[7] Neil Weinberg, “Cui bono?”, *Forbes*, Apr. 25, 2005.

the lawsuits against the bystander banks accused the defendants of having conflicts of interest.

II. Abuses By The Plaintiffs' Bar In Securities Litigation: The Problem Of Kickbacks

Congress has long recognized the problem of abuses by the plaintiffs' bar in securities litigation. When Congress passed the Private Securities Litigation Reform Act (PSLRA) in 1995 with a two-thirds majority over a presidential veto, the House and Senate reports both noted that they wished to stop the problem of bounties paid to lead plaintiffs.[8] The Milberg Weiss[9] indictment handed down by the grand jury on May 18 is the most detailed accounting to date of illegal kickback allegations, but I would be tremendously surprised if the aberration in the Milberg Weiss indictment is that these are the only examples of illegal kickbacks, as opposed to the only examples of a law firm getting caught giving illegal kickbacks.

Milberg Weiss is the biggest player in securities class actions. By the Institute for Legal Reform's count from Securities Class Action Services data, Milberg Weiss has handled 43% of the hundreds of class action settlements between December 1995 (when the Private Securities Litigation Reform Act (PSLRA) went into effect) and August 2005, generating $1.7 **billion** in legal fees and expenses, several times that of its nearest competitor. Their website prominently features a Columbia Law professor who calls the firm "as dominant in their industry as IBM was in the 1960s and as Microsoft is today."[10]

To illustrate the problem of illegal kickbacks, I summarize the Milberg Weiss indictment from the government's complaint.

A. <u>The Importance Of Named Plaintiffs In Class Actions</u>

A firm like Milberg Weiss cannot simply file a class action complaint on its own. There must be a plaintiff named in the complaint who can allege damages, and can allege that he or she can represent the interests of the members of the class not directly participating in the lawsuit. The named plaintiff (and his attorneys) must demonstrate to the court's satisfaction, among other things, that: (a) the named plaintiff's claims are "typical" of the claims of the absent class members or shareholders; (b) the named plaintiff does not have a conflict of interest with the absent class members or shareholders; (c) the named plaintiff is not subject to unique defenses that could become the focus of the litigation to

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[8] *See* H.R. Conf. Rep. 104-369, at 32-33 (1995), reprinted in 1995 U.S.C.C.A.N. 730, 731-32; S. Rep. No. 104-98, at 6 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 685.

[9] The full name of Milberg Weiss is Milberg Weiss Bershad & Schulman LLP. The firm has changed its name a couple of times over the years as partners, most notably William Lerach, have left: it was formerly known as Milberg Weiss Bershad Hynes & Lerach LLP and Milberg Weiss Bershad Specthrie & Lerach. I will refer to these entities as "Milberg Weiss" throughout this testimony. In 2004, William Lerach and several other attorneys split from Milberg Weiss to create what became Lerach Coughlin Stoia Geller Rudman & Robbins.

[10] John Coffee, Professor of Law Columbia University, *Financial Times,* May 3, 2004, noted at http://www.milbergweissjustice.com/whatotherssay_investigation.php

the detriment of the absent class members or shareholders; and (d) the named plaintiff and his attorneys will be able to fairly and adequately represent the interests of the absent class members or shareholders. If a court determines that all of the requirements of a class action are met, it will "certify" a defined class to be represented by the named plaintiff.

In many instances, there are multiple complaints filed by multiple plaintiffs represented by multiple attorneys seeking to represent the same class. In these cases, the lawyers and law firms compete to be appointed by the court as "lead counsel" or "co-lead counsel" for the class. The lead counsel typically has the power to run the case and divvy up the work (and resulting contingent fees) in the litigation.

To protect the due process rights of the absent class members who have no say in the conduct of the litigation, the named plaintiff has fiduciary duties to the class. A named plaintiff may not place his or her own interests above those of absent class members, and is required to disclose any fact that reasonably could affect his or her ability to fairly or adequately represent the interests of the absent class members or shareholders. Thus, any settlement may not favor the named plaintiff above other class members. While a named plaintiff may be entitled to reimbursement of his or her reasonable costs and expenses incurred in connection with the lawsuit or a court-approved bonus payment above and beyond the plaintiff's *pro rata* share of the settlement, all such payments must be disclosed to the class members, and the class members must have the opportunity to object.

Any class action settlement presents a conflict of interest between the attorneys and their class clients, and that is the fact that every dollar paid to the attorneys is a dollar that does not go to the class, and vice versa. For this reason among others, the named plaintiff and the court are meant to act as watchdogs and scrutinize proposed settlements to ensure that they are fair to the absent class members.

B. <u>The Alleged Kickback Scheme</u>

A kickback of attorneys' fees to the named plaintiff divorces the plaintiff's incentives from those of the class. With such an arrangement in place, the named plaintiff's incentive is to maximize not the recovery to the class, but the recovery to the attorneys. Moreover, undisclosed kickbacks to influence a fiduciary's conduct are illegal under New York law; both New York and California law further prohibit attorneys from agreeing to share fees with persons not licensed to practice law.

The indictment charges the Milberg Weiss firm; two leading "name" partners of the firm, David J. Bershad and Steven G. Schulman; Seymour M. Lazar, who allegedly received kickbacks; and Lazar's attorney, Paul T. Selzer, who allegedly acted as an intermediary. They are charged with, among other crimes, conspiracy, racketeering, money laundering, and obstruction of justice. The indictment charges only two Milberg Weiss partners; but lists three other senior partners as unnamed co-conspirators working in conjunction with

Bershad and Schulman, suggesting that these kickbacks are not a case of individual attorneys going off the reservation, but one of business as usual.

According to the indictment, Milberg Weiss paid kickbacks to at least three groups of named plaintiffs using a variety of intermediaries to conceal the payments. The government alleges $2.4 million of kickbacks to frequent plaintiff Seymour Lazar and his family; $2.5 million of kickbacks to frequent plaintiff Howard Vogel and his family; and $6.5 million of kickbacks to frequent plaintiff Steven Cooperman and his family and some of his colleagues. In these lawsuits alone, Milberg Weiss obtained more than $216.1 million in attorneys' fees.

The government alleges that the kickback payments were sometimes given in cash, laundered through casinos or just distributed from a safe in a credenza in named partner David Bershad's office. In other instances, Milberg Weiss would send payments to intermediary law firms, falsely characterize the payments in accounting and tax records, and then provide instructions to the intermediaries to directly or indirectly pay the named plaintiffs.

The indictment, over the course of over forty pages, meticulously identifies and traces each check and payment, each false statement given to the court, each false statement given in a deposition, over the course of the alleged kickback scheme.

For example, according to the indictment, and Vogel's plea agreement, on June 27, 2003, Milberg Weiss received its attorneys fees from the *Oxford Health* class action. Schulman then told Vogel to have his intermediary contact another Milberg Weiss senior attorney to arrange his payment. Vogel sent two memos to Schulman and "Partner A" in September 20 and October 15 submitting "material from 1997/1998 relating to my role as initiating plaintiff in the Oxford and Baan cases" and asking for a phone call to discuss the long-settled cases with his intermediary. Schulman told Vogel that Partner A would only meet the intermediary in person. That meeting occurred on November 10, and on December 18, 2003, Milberg Weiss paid Vogel's attorney two checks for $1.2 million, claiming that it was payment for attorneys' fees from two class action settlements; on January 8, 2004, the law firm wired $1.2 million to Vogel. Vogel admits that he falsely certified to the court that his claims were "typical of the claims of the members of the Class" and that he would not accept payment for serving as a class representative beyond his pro rata share of the settlement and reasonable costs and expenses.

Howard Vogel has pled guilty to one count of making a false declaration before a court, and admitted to receiving $2.5 million in kickbacks from Milberg Weiss. For example, in the *Oxford Health Plans* class action, Vogel owned fifty shares, lost $3000 from the alleged wrongful conduct by the corporate defendant, and collected a $1.1 million kickback. Vogel says he was told by a Milberg Weiss partner that his payment in that case was decreased because "Milberg Weiss would have other payment obligations in the case." Milberg Weiss was awarded $40 million in attorneys' fees in that case.

On May 22, Richard R. Purtich, identified in the indictment as “Cooperman Intermediary A,” entered into a plea agreement admitting that “he and certain law firms with which he was associated received checks from Milberg Weiss totaling more than $3.5 million for the benefit of Cooperman” even though he and his law firms never made any referrals, performed any work, or did anything to earn the payments from Milberg Weiss.

Further indictments could be forthcoming. The *National Law Journal* also reports that federal prosecutors are in negotiations with Vogel’s intermediary in the Oxford transaction, a Denver attorney.[11] If he agrees to testify, charges could be added against “Partner A.”

Some have suggested that the moneys were just what they were recorded as, referral fees. But this seems implausible. Milberg Weiss is notably aggressive in doing business, to the point that other plaintiffs’ firms complain about their conduct in recruiting plaintiffs. (In the WorldCom litigation, prominent plaintiffs’ law firm Bernstein Litowitz complained that Milberg Weiss submitted misleading solicitations to WorldCom bondholders in an effort to steal those clients from the main class action; the federal district court agreed and ordered corrective communications.) Why would Milberg Weiss passively pay millions of dollars of referral fees for the same plaintiff for dozens and dozens of cases to firms doing nothing to contribute to the underlying securities litigation? Why not simply ask Mr. Vogel or Mr. Lazar to contact Milberg Weiss directly and leave out the intermediary, unless the intermediary was serving some other role? (We see from Mr. Vogel’s 2003 memos that he was not shy about directly writing senior partners at Milberg.)

Milberg Weiss’s scenario is implausible from the other direction. There are famous tales of “professional plaintiffs” like Vogel and Lazar who are used as lead plaintiffs for case after case after case; who are willing, despite only small injury from holding small stakes, to be deposed at length again and again; who are willing, despite the irrationality of the investment strategy, to hold broad portfolios of small amounts of hundreds of different stocks instead of purchasing cheaper index funds or engaging in less expensive diversification. In the words of Columbia law professor John Coffee, “One does not logically do this free”[12]—and the behavior is far more consistent with under-the-table payments than with an altruistic hobby that makes others rich.

C. The Problem Of Kickbacks

Some argue that no one is hurt by kickbacks. Other plaintiffs’ firms who lost the opportunity to honestly represent plaintiffs and reap the rewards of doing so might argue otherwise. But, again, it is ironic that Milberg Weiss would suddenly suggest that kickbacks should be judged by their economic effect: the firm’s website brags about its lawsuits over kickbacks in dozens of cases.

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[11] Amanda Bronstad, “Denver Lawyer Could Sharpen Focus on Weiss in Milberg Probe,” *National Law Journal* (Jun. 19, 2006).
[12] John C. Coffee, Jr., “Milberg Weiss Indictment,” *National Law Journal* (Jun. 19, 2006).

As Walter Olson notes, "Although there are many debatable cases, concealed payoffs to named plaintiffs in class actions aren't one of them: They're clearly improper under virtually any analysis."[13] As discussed above, named plaintiffs owe a duty to absent class members to place the interests of the class first. Instead, Milberg Weiss and its named plaintiffs were more concerned about divvying up the spoils between themselves, something the class and court surely would have wanted to know when deciding whether to approve the settlement. There is already a systematic problem in class action litigation where named plaintiffs fail to exercise sufficient oversight of their attorneys to protect the interests of the class. Those who defend kickbacks are arguing that it should be acceptable for law firms to completely buy off that oversight.

Indeed, plaintiffs' firms Cohen, Milstein, Hausfeld & Toll PLLC and Berger & Montague PC, arguing for the investigation of an attorney linked to the Milberg Weiss indictment, filed a brief stating "Far from generalized allegations of amorphous misconduct, the allegations of the indictment… go to the very core of a class counsel's duties to the class and the court."

D. <u>Other Abuses By Plaintiffs' Firms</u>

Milberg's website says about the indictment that the government's allegations "just a small number of these payments"—which perhaps suggests that more investigation is needed. And, indeed, there are press reports that indicate that what is alleged in the indictment is only the tip of the iceberg for wrongful conduct by the plaintiffs' bar.

The Recorder reports that there is an investigation over whether Milberg Weiss was also paying undisclosed kickbacks to one of its expert witnesses, John Torkelson, and whether the firm was laundering campaign contributions through Torkelson, who has already pled guilty to a scheme to defraud the U.S. Small Business Administration.[14]

A KPMG employee has testified that a lead plaintiff in a Milberg Weiss class action against KPMG told him that he and others agreed to become lead plaintiffs because "they would get more money."[15] U.S. District Judge Dennis Cavanaugh refused to delay the settlement fairness hearing to investigate the charges.[16] (The plaintiff in question denies that he is due any additional money.)

On June 19, two prominent securities firms, Cohen, Milstein, Hausfeld & Toll, PLLC, and Berger & Montague, P.C., filed a brief in the *GMH Communities Trust* litigation in Philadelphia seeking to remove Milberg Weiss spin-off Lerach Coughlin from lead-plaintiff status, making a series of allegations against William Lerach. The firms, against

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[13] Walter Olson, "Inside Milberg's Credenza", *Wall Street Journal* (May 22, 2006).
[14] Justin Scheck, "Federal Prosecutors Put Pressure on Milberg Weiss' Star Expert", *The Recorder* (Jun. 9, 2006); Nathan Koppel, "Prosecutors Probe Milberg Payments To Witness", *Wall Street Journal* (Jun. 10, 2006).
[15] David Reilly, "KPMG Letter May Complicate Milberg Weiss-Led Class Action", *Wall Street Journal* (May 26, 2006).
[16] Anna Driver, "U.S. judge approves KPMG settlement with investors", Reuters (Jun. 3, 2006).

their own financial self-interest, withdrew the motion almost immediately after Lerach issued a scathing press release. One can only imagine what the reaction would be if Kerr-McGee and Halliburton withdrew from bidding on a government contract within hours of Enron criticizing them for seeking an investigation.

And just Thursday, the Chicago Tribune revealed that Milberg Weiss and Lerach Coughlin, which represented several Illinois union pension funds, paid more than $750,000 in undisclosed fees to the pension funds' attorney, William K. Cavanagh.[17] Federal law prohibits paying pension attorneys referral fees; Lerach Coughlin claims that the payments reflected work Cavanaugh did, but Cavanaugh's hours were not submitted to the courts approving Lerach Coughlin's settlements. Attorneys' fees in the affected cases totaled $44 million. The paper interviews a judge who approved one of the settlements:

> Richard H. Kyle of Minnesota, who presided over one of the cases in which Cavanagh received fees, said he, too, was unaware of Cavanagh's involvement in the case.
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> "It seems to me if there are side deals like that where fees are going back to the general counsel, that's something I should be told," Kyle said. "The bottom line is I have to choose lead plaintiff and counsel based on whether they can fairly and adequately represent the entire class.
>
> "That kind of relationship would certainly lead me to ask a lot more questions, and very well could lead me to choose someone else to lead."[18]

None of these cases are mentioned in the indictment.

III. H.R. 5491: the Securities Litigation Attorney Accountability and Transparency Act

The Milberg Weiss indictment shines a small light on a small portion of a great problem of corruption in the plaintiffs' bar. The very fact of kickbacks exhibits that the PSLRA's attempt to impose market discipline in securities litigation has failed. If securities class action attorneys were facing market competition, there would be no windfall worth fighting for with millions of dollars in under-the-table payments, much less the risk of prosecution. I would argue that sweeping reform is needed. This bill is not that sweeping reform, but it presents some incremental reforms that improve the system for honest players on both sides of the table and therefore should be uncontroversial.

A. Section 2: Fee-shifting where a claim was not substantially justified

As noted above, there is a great imbalance in the current securities laws in that even a weak case has substantial settlement value because of the costs it can impose upon a

[17] David Kidwell, "Illinois lawyer tied to indicted law firm", *Chicago Tribune* (Jun. 22, 2006).
[18] *Id*.

defendant unjustly accused. According to NERA Economic Consulting, over 39% of PSLRA cases are dismissed because the complaint is insufficient to meet PSLRA standards. Still other cases are resolved on summary judgment after extensive and expensive discovery. But a defendant unjustly accused has almost no recourse under current law; it bears its own costs, thus encouraging plaintiffs to file indiscriminately.

The United States is the only Western democracy that permits this sort of fundamental injustice. In every other country, the losing side in litigation is required to make the other side whole by compensating its litigation expenses. In securities cases, that requirement is entirely one-sided: defendants' pay winning plaintiffs' fees, but plaintiffs do not pay winning defendants' fees. As a result, many of the securities settlements—70% of securities settlements in 2004—are actually nuisance settlements of under $10 million,[19] an amount to settle that is cheaper than litigating. The plaintiffs' attorneys walk away with millions in what is effectively legalized extortion.

This bill is not a "loser pays" provision. A losing plaintiff will pay nothing if the defendant cannot prove that the case was not "substantially justified"; the defendant has the burden of persuasion. This is the same standard used in the fee-shifting under the Equal Access to Justice Act, 5 U.S.C. § 504, and for discovery disputes under the Federal Rule of Civil Procedure 37, so courts will not need to create new jurisprudence to resolve any such disputes. (This bill is narrower than those rules in that it specifies the winning party has to prove lack of substantial justification. In the context of Rule 37 and EAJA, it is the burden of the losing party to prove that its position was substantially justified.) Moreover, courts have two safety valves to prevent unjust awards: the court, before awarding reasonable attorneys' fees and expenses, must also find that "imposing fees and expenses on the plaintiffs' attorney would be just" and that "the cost of such fees and expenses to the defendant is substantially burdensome or unjust."

Such recourse for defendants, which corrects a fundamental unfairness in the status quo, will have no effect on plaintiffs who bring legitimate claims. The only cases it will affect are the nuisance cases brought to extort a small settlement; defendants can now credibly decide to fight a meritless case. The result will be fewer meritless cases brought harassing corporations and fewer unjust results when meritless cases are brought.

If anything, the provision does not go far enough. Attorneys' fees and costs are not the only costs experienced by defendants unjustly sued; this provision will leave defendants undercompensated. The problem is compounded by the discretionary nature of the award; there will be collateral litigation over whether the original litigation was "substantially justified," and I am concerned that the toothlessness of the discretionary fee-shifting in Federal Rule of Civil Procedure 11 will be duplicated here. Defendants do not get to avoid paying attorneys' fees by showing their defense was substantially justified. Fairness dictates a symmetry missing from the status quo, and that this bill only partially corrects.

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[19] NERA Economic Consulting, "Recent Trends In Shareholder Class Action Litigation: Bear Market Cases Bring Big Settlements" (2005).

B. Section 3: Disclosures regarding conflicts of interest

Current law already requires sworn certifications with the filing of the complaint.[20] The bill adds a requirement of disclosures of direct and indirect payments between attorneys and affiliated persons of the plaintiff. This is a minor addition whose main effect will be to make it more difficult to hide kickbacks through intermediaries. A law firm would not be able to claim that an ambiguous payment with an oral side-deal was really a legal one without first disclosing the ambiguous payment and encouraging judicial scrutiny.

Again, this should be uncontroversial: the sole economic effect will be a wealth transfer from dishonest plaintiffs' firms to plaintiffs' firms that play by the rules; from dishonest named representatives who receive kickbacks to class members and investors as a whole.

C. Section 4: Permitting auctions at lead counsel

Under the current law, "[t]he most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class."[21] Innovative, creative judges like Jimmy Carter appointee Milton Shadur of the Northern District of Illinois and George H.W. Bush appointee Vaughn Walker of the Northern District of California have solicited bids at the beginning of litigation from several firms that compete for the right to represent the class as lead counsel.[22]

Auctions provide several advantages. *First*, they permit courts to exercise greater control over counsel quality, a prime goal of the PSLRA that has not been realized. *Second*, auctions lead to lower-priced representation. When a court appoints a law firm without setting the fees, the attorneys' incentive is to maximize their take. But if the law firm is selected by auction, attorneys compete to provide the lowest reasonable bid. In a contested battle for lead counsel, this is much more likely to lead to market pricing than an attempt to establish attorneys' fees after the case has settled. A final advantage is an obvious one in the wake of the Milberg Weiss indictment: auctions would end kickbacks, because there would be no surplus to be had.

Empirical research supports these theoretical contentions. Michael Perino, in a 2006 working paper,[23] found that auctions substantially reduced attorneys' fees, a finding duplicated by Judge Shadur's experience. Though the sample size was small, there was no question that the difference was statistically significant, with a predicted reduction in fees of 55%. This money, which amounts to hundreds of millions of dollars a year, could be going directly into investors' pockets instead of attorneys. It further suggests (consistent with the observation of illegal kickbacks) that class action attorneys are gouging at a price twice what a fair market competition would produce, the equivalent of

[20] *E.g.*, 15 U.S.C. § 78u-4(a)(2).
[21] 15 U.S.C. § 78u-4(a)(3)(B)(v).
[22] *E.g.*, *In re Oracle Securities Litig.*, 131 F.R.D. 688 (N.D. Cal. 1990); *In re Amino Acid Lysine Antitrust Litig.*, 918 F.Supp. 1190 (N.D. Ill. 1996).
[23] Michael Perino, "Markets and Monitors: The Impact of Competition and Experience on Attorneys' Fees in Securities Class Actions."

one's local service station charging six dollars a gallon for gasoline on a normal spring day in 2006 without extenuating circumstances. In the case of a service station, one can choose to buy gasoline somewhere else, or (like I have done since 2001) drive a fuel-efficient hybrid car. But unnamed class members have little recourse to limit fees obtained by plaintiffs' firms who did not agree to a market-based price at the front end.

But there is controversy over whether the PSLRA permits district courts to hold auctions. The Third Circuit, though it recognized that it had previously recommended the auction process in other class action contexts, has interpreted the statute to say that it does not.[24] As a result, courts rarely implement auctions and the benefits they provide to investors and to honest plaintiffs' law firms who lack political connections are rarely realized. No judge likes to be reversed, and the existence of the Third Circuit opinion makes most judges reluctant to experiment with auctions.

This section of the bill fixes the ambiguity in the law by making it clear that the securities laws permit competitive bidding to choose lead counsel. Courts need no longer worry that an order for an auction will be struck down. But the language in the bill is permissive. Thus, courts will have the freedom to attempt alternative approaches. Some judges will choose competitive bidding; others will adopt a traditional method; still others might come up with innovative hybrid solutions that none of us here have yet thought of. This judicial discretion will provide helpful data on how to best help investors when Congress next revisits the securities laws.

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[24] *In re Cendant Corp. Litig.*, 264 F.3d 201, 258 (3d Cir. 2001).