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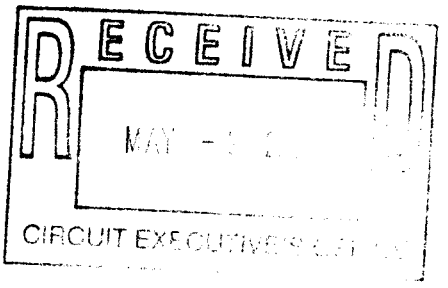

Dear Professor Saltzburg and Mr. Joseph:

On behalf of The Association of the Bar of The City of New York, we are pleased to submit the following comments in response to the invitation by the Task Force on Class Counsel for comments concerning the appointment of class counsel in class actions.

The Association of the Bar of the City of New York was organized in 1870 "for the purposes of cultivating the science of jurisprudence, promoting reforms in the law, facilitating and improving the administration of justice, elevating the spirit of integrity, honor and courtesy in the legal profession, and cherishing the spirit of collegiality among the members thereof." Ass'n of the Bar of the City of N.Y. Const. Art. II.

The Association's Federal Courts Committee is directed "to observe the practical working of [all federal] courts and to make such reports and recommendations as the Committee may deem advisable for the purpose of improving the administration of justice in such courts. " Ass'n of the Bar of the City of N.Y. By-Law XVI(a). The Committee's membership is broadly representative, including two Federal Magistrate Judges, lawyers employed by the Federal, State and City Governments, lawyers from large, medium-sized and small firms, and lawyers who primarily represent plaintiffs and defendants.

At the outset, we are mindful that the experience using auctions to select counsel in class action cases under Federal Rule of Civil Procedure 23 is highly limited. To date, there are relatively few cases in which auctions have been used by courts to select counsel: only 11 cases since 1990 were identified in our research. All of these cases arise in either the securities or

antitrust context. Moreover, the number of cases in which auctions have been suggested or considered but ultimately not utilized is not known.

The limited base of knowledge cautions us that reaching definitive conclusions at this early juncture is a hazardous endeavor. While some have hailed certain auctions as successes and some have viewed other auctions as failures, the base of knowledge is simply too meager to draw any firm conclusions. Our view is that greater experience with auctions is necessary before reaching any conclusions concerning the usefulness of auctions as a matter of practice or to list the circumstances, if any, in which auctions are appropriate.

We are also mindful of the fact that within this limited experience, the type of auction that has been used has varied among the cases, so that the experience and results are not necessarily comparable. Some auctions have included a request for bids of a single dollar figure below which counsel will take no percentage of any recovery as a fee; other auctions have requested bids providing a more complicated series of fee schedules with varying percentages based on the stage at which the litigation is resolved. The variations between the different fee arrangements can be, and are, significant, and each may present its own set of issues and benefits in any particular case.

While we do not believe that these considerations justify not addressing the use of auctions at all, the limited experience warrants some degree of caution in addressing a process as to which we may not fully understand or appreciate the benefits or dangers.

Having said this, we believe there are some general observations that can be made about the potential use of auctions, the potential benefits and the potential problems presented by auctions. We also address our particular concern that some auctions may involve the Court in a role that is inappropriate at an early stage of litigation.

Factors That Bear on the Appropriate Use of Auctions

To date, the experience with the use of auctions to select class counsel has been in securities and antitrust class actions. These auctions have taken place in a context where the case is already in the public eye and there is usually some available information about the scope of the case, the potential damages, and, perhaps, the size of the class. These factors create a situation in which there is a base of information such that an auction procedure may be viable. In other cases, and perhaps substantive areas, where these elements are not present, or at least are present to a lesser degree, auctions may be far less viable and may raise greater concerns. On the other hand, there may be certain cases outside of the securities and antitrust areas in which these factors are present.

A set of new questions would be presented by extending auctions to "class actions" generally. For example, in most civil rights and employment litigation, where there are statutes providing for recovery of fees by a prevailing plaintiff from the defendant based on the number of hours expended multiplied by a reasonable hourly rate, an auction based on proposed fee arrangements is unlikely to be useful or appropriate.

In some class action cases, including some securities and antitrust cases, at the outset of a case the nature of the likely relief, if any, may be unclear, and in some cases injunctive relief may likely be the primary form of relief. An auction procedure would be unworkable in cases where injunctive relief is likely to be the sole or major form of relief or where the form of likely relief is unclear.

A related concern arises from the fact that class actions often reflect the investment of extensive resources, investigation and development by counsel, particularly in cases in which the alleged wrong is not obvious and has not been publicly revealed. An auction procedure, if used in such cases, might create a disincentive for counsel to invest time and resources in such cases because it would make it possible that the counsel who had developed the case would not be selected. On the other hand, this concern may be addressed in the auction setting by providing for compensation for such counsel either by directing payment out of an ultimate recovery to him or her or requiring that all bids allocate a portion of the recovery to his or her fees. Such compensation might appropriately include an incentive in the form of a multiplier or some other means to reward development of such a case.

Auctions are presumably used by courts in an effort to replicate the private market for legal services by fostering competition between contenders for the role of class counsel with the expectation that the competition will result in the selection of class counsel who will achieve the best result for the class. Where there is a sophisticated lead plaintiff with both the capability and resources to locate and choose counsel, an auction procedure is less likely to be necessary and the choice of counsel can be left to established procedures and oversight by the court.

A particular application of this principle is in cases governed by the Private Securities Litigation Reform Act ("PSLRA"). The PSLRA was enacted at least in part to encourage entities or individuals with large financial stakes to become the lead plaintiff by identifying the "most adequate plaintiff." One responsibility of the lead plaintiff is to select and retain counsel to represent the class "subject to the approval of the court." To the extent that PSLRA identifies a lead plaintiff who has a sufficient stake in the outcome to select and negotiate the best representation from its perspective, an auction procedure may encroach on the statutory scheme. This concern is particularly acute because the purpose of the PSLRA was to encourage large and sophisticated investment entities to assume a leadership role in securities class actions. These large and sophisticated entities are perhaps better situated to evaluate potential class counsel than a judge. When such a plaintiff is involved, its choice should be given substantial if not definitive weight. Significantly, of the 11 cases that we have identified in which auctions have been held, nine are securities cases.

To the extent an auction procedure seeks to replicate the private market for legal services, there is at least one potentially significant difference in an auction. All fee agreements contain incentives, intentional or otherwise, that may influence counsel's strategy and actions. When a court approves a fee arrangement or structure arrived at by an auction at a relatively early stage of an action, there may be consequences that are not present when a client negotiates a fee arrangement. For example, if an auction includes a floor below which counsel will not receive

any fee, if the counsel subsequently concludes that he or she is unlikely to exceed that floor, counsel's interest may be to terminate the action since further work is unlikely to result in any monetary reward. Such a situation could lead to conflict with the class' interest, which would still be to maximize the settlement amount even if below the floor. A similar problem could occur under more traditional methods if, for example, it appears that the likely recovery will not exceed the lodestar amount.

Where the plaintiff has negotiated the fee and selected counsel, however, counsel might well approach the client and seek to adjust the fee arrangement in these circumstances. Of course, this may not be possible in a class action in which there is no sophisticated or large client with whom to negotiate. If an auction had been conducted, counsel would not have this option, but could follow one of three courses: seek court approval for a revised fee arrangement at the time it appears the recovery will not exceed the floor; seek court approval for a revised fee arrangement at the conclusion of the case; or abide by the agreement without seeking revision. Each of these paths creates concerns for the court that had approved the fee arrangement, the class, the class counsel and the competing counsel who did not win the appointment.

The Potential Benefits and Drawbacks of Auctions

The question of auctions arises because of a perception that the current system of appointing class counsel is faulty in at least some circumstances. To the extent that this perception is based on the notion that class action litigation is controlled by counsel as opposed to controlled by clients and their interests, auctions do not address this perception. Where a case involves many individuals each of whom suffered a small wrong, but who collectively suffered a large wrong, the auction procedure may affect the fee arrangement but does not make the stake of an individual class member any larger. Counsel will likely remain with a larger stake in the litigation than the individuals who suffered the harm.

To the degree that some of the discomfort with the current regime of class action litigation and fees emanates from reports of cases in which the class members received coupons or other rights which seem of questionable value to the class members, but in which counsel received significant fees, it is not clear that auctions will address the problem. Such "coupon" settlements have most often arisen in consumer class action contexts where auctions have not been tried for the most part. In the one arguable exception of the *Auction Houses* settlement, significant efforts were made to assure that the coupons have a market value and counsel accepted fees in the same proportion as the class members accepted coupons. *See, In Re Auction Houses Antitrust Litigation*, No. 00 Civ. 0648 (LAK) (S.D.N.Y. February 22, 2001). More fundamentally, if such coupon settlements are insufficient for the class, current law contains ample authority to reject such a settlement.

The use of auctions to appoint class counsel can result in fee arrangements that provide incentives for counsel to (i) minimize costs, if he or she will not be compensated based on the number of hours worked; (ii) maximize recovery totals; and (iii) minimize the relative amount of the recovery that goes to counsel and maximize the relative amount of the recovery that goes to the class. In these respects, one benefit of auctions is thought to be that an auction can arrive at

terms for payment to class counsel that better aligns the interests of class counsel with the interests of the class than might otherwise exist. Depending upon how an auction is structured and the particular circumstances in the case, achieving these benefits may be more or less likely.

In situations where there is no client with a sufficient stake in the litigation, resources or knowledge of the market for legal services, auctions may provide a means of reaching a fee arrangement similar to that which a client with such a stake, resources and knowledge might achieve. The criteria to be used to determine an auction should result, or at least be designed to result, in the appointment of counsel more likely to obtain the optimal result for the class. To the extent auctions can replicate the decision of such a client, there should be an undoubted benefit to the class.

However, it is not at all clear that auctions can readily achieve this result in the way that private negotiations by a client achieve this end. The fee agreements obtained in auctions can take many forms. As we noted, an auction can request bids of a single dollar figure below which counsel will not receive a percentage and above which counsel will receive a percentage. The percentage itself may be the subject of the bidding procedure and thereby vary or be determined by the court. Other auctions may involve bids that set forth (i) a declining contingency fee, *i.e.*, counsel's percentage share declines as the amount of the recovery increases, (ii) an increasing contingency fee, *i.e.*, counsel's percentage share increases as the amount of the recovery increases, or (iii) a percentage fee linked to the stage of litigation at which the case is resolved, *i.e.*, prior to discovery, before motions for summary judgment, after such motions or after trial. In addition, bids may include early settlement bonuses, caps, or limits on costs and expenses.

Each of these fee models may be appropriate in a particular case to provide incentives for counsel to reach an optimal result for the class. However, a court may find it difficult to compare bids that do not follow the same format. A court could, of course, establish a particular model for bids, but to the extent that bids have more than one variable, the court may still have difficulty choosing the optimal bid without making judgments concerning the merits and likely outcomes of the case. For example, if one bid is better for the class at one level of recovery but another bid is better at a different level of recovery, a court may need to assess which level of recovery is more likely in order to decide which bid is better for the class. Even an auction involving a single variable may present a court with this issue if the bids vary significantly. In this circumstance, a court must assess whether a significantly better bid is realistic.

Certainly in the *Auction Houses* case, there is some evidence that the auction obtained a successful bid that was significantly more advantageous to the class than other alternatives, that the amount recovered exceeded what other contenders for the class counsel role believed was possible, and, according to the court, the fee received was less than the fee that would have been received if it had been the subject of a contingency agreement derived by more traditional methods. Whether the apparent benefit to the class can be replicated in other cases is not clear, and the decision in the *Auction Houses* emphasizes the presence of several factors that may have made it a particularly appropriate case for an auction. The case also illustrates how the structure that appears to have encouraged an optimal result, also may carry with it substantial risks. For example, if, in a case in which an auction is based on a bid of a dollar amount below which

counsel will receive no fee, it becomes apparent that the recovery will not reach the dollar amount, counsel's incentive may be to resolve the case, even if the interest of the class would be to obtain a larger recovery (though still lower than the dollar amount of the bid).

Thus, the potential for success of a particular auction may lie in the court's ability to fully and adequately assess what type of fee arrangement will best serve the class by providing incentives for the optimal resolution of the case at the early stage of the litigation when the court appoints class counsel. This may not only be a difficult task for a court, particularly at the early stage of the litigation, but it also may lead to court involvement in assessing the litigation that may be inappropriate.

The Impact of Auctions on the Role of the Court

Our most serious concern with an auction procedure is the impact it may have on the role of the court as a neutral arbiter. However an auction is structured - whether it is a relatively straightforward submission of a dollar amount above which counsel will receive a preset percentage of any recovery or sliding scales of percentages based on point of recovery and amount of recovery - the auction procedure includes a risk that the court becomes more than a neutral arbiter. An inherent problem arises because the evaluation of auction bids may require the court to evaluate the merits of the case at an early stage. For example, the two parameters which bids often include involve the size of the recovery and the stage of the litigation at which that recovery is achieved. Evaluating competing bids based on these factors may require an evaluation of one or more merits issues. Where competing bids appear more advantageous for the class at different levels of recovery, a court would need to assess whether a certain level of damages might be achieved and the possible or likely timing of a recovery. Such an assessment requires an evaluation and judgment of the merits of a case. Notably, one of the judicial proponents of auctions recently expressed concern about making such judgments. *See Werner v. Quintus Corp.*, No. C-00-4263 VRW (N.D. Cal. February 16, 2001) and *Hernandez v. Copper Mountain Networks, Inc.*, No. C-00-3894 VRW (N.D.Cal. February 16, 2001).

In an auction in which a court is in fact required to make these types of assessments, to the extent that the individual deciding the auction is the same individual who will preside over the action, there is a risk that a bias for or against a particular view of a case may be created, or at least an inclination toward a view of the case, and that such bias may influence later proceedings. Although a judge might refer the task of implementing an auction to a magistrate judge or even a special master, the ultimate authority would remain that of the court and any challenge would presumably be heard by the district court.

An additional concern is the potential that presentations concerning the case may be made only by advocates for plaintiffs who are submitting bids. During an auction, a court may need to assess theories of the case or the implications of a factual description of the case based on presentations by plaintiffs' advocates. Given that the actual bids may reveal counsel's financial analysis of the claim and provide valuable information on their theory of the case and negotiation posture, as a general matter it would be inappropriate to share the bids and proposals with

defense counsel. Such an *ex parte* contact by one side's counsel, however, is inconsistent with the usual rules of our adversary system.

Our final concern is that a court's involvement in setting a fee structure at the early stage of a litigation when an auction would take place may create a tension with the court's supervisory role at the end of a class action when it must approve a fee for class counsel and any settlement. In particular, when a court uses an auction procedure to select counsel, one view is that the terms arrived at in the auction should control the fee awarded at the end of the case. Otherwise, the integrity of the auction structure is not maintained and the very incentives sought to be created by the auction are jettisoned which could be detrimental to the class and counsel. On the other hand, another view is that the court always must exercise its supervisory authority at the end of the case to assess the reasonableness of the fees even if that means the court may or should disregard the terms arrived at in the auction. The circumstances that may have appeared to be present at the time of the auction may not be borne out by subsequent events and a fee set according to the terms arrived at in an auction could, at the conclusion of the litigation, appear unreasonably high or low. One thought on this topic that was raised in our Committee's deliberations is that a court faced with these conflicting views may find some guidance by analogy in Section 328 of the Bankruptcy Code, 11 U.S.C. §328, which provides for approval of the terms and conditions of retention of professionals and allows a court later to approve compensation on different terms if the original terms prove to be "improvident in light of developments not capable of being anticipated at the time" of the initial approval.

Thank you for the opportunity to comment on the use of auctions to select counsel in class actions. Please do not hesitate to let us know if there is any other information we can provide to the Task Force that would be helpful to you in your deliberations.

Very truly yours,

Guy Miller Struve