The Expert's Corner

What We Now Know About How Lead Plaintiffs Select Lead Counsel (And Hence Who Gets Attorneys Fees!) In Securities Cases

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A key way to get class action fees is to be appointed lead counsel. In securities cases, firms conventionally achieved this goal by being first to file, often with a penny-ante plaintiff who was within their control. Believing that this situation created conditions for frivolous lawsuits and class action abuse, Congress, through the Private Securities Litigation Reform Act (PSLRA), authorized the largest intervening investor to gain control of a securities case and select lead counsel;[1] the PSLRA thereby placed a real client at the heart of securities litigation, a client who Congress authorized to select, monitor, and, ultimately, control class counsel.

Yet fifteen years later, entrepreneurial plaintiffs firms continue to dominate securities class actions, perhaps to an even greater extent than they did before the PSLRA. That they've accomplished this speaks to their entrepreneurial capacities, though the mechanisms by which they have been able to accomplish it have remained largely cloaked in urban legend.

Until recently.

An interesting trove of materials has turned up in litigation challenging the marketing of sub-prime mortgage backed securities. In *Iron Workers Local No. 25 Pension Fund v. Credit-Based Asset Servicing and Securitization, LLC,* ___ F. Supp. 2d ___, 2009 WL 1444400 (S.D.N.Y. 2009), federal district court Judge Jed Rakoff appointed the Public Employees' Retirement System of Mississippi (MissPERS) lead plaintiff with Bernstein Litowitz serving as lead counsel. This decision was made after a battle between MissPERS and the Iron Workers Local No. 25 Pension Fund (Iron Workers Fund), during the course of which the court discovered – to its apparent surprise – that both MissPERS and the Iron Workers Fund were involved in "monitoring agreements" with plaintiffs firms.

Specifically, in order to woo large institutional investors like public pension funds to participate in securities class actions, some plaintiffs firms have entered into arrangements whereby they monitor the funds' investments for irregularities and suggest possible grounds for litigation. If, after considering whether or not to bring suit, the funds do decide to commence litigation, the firm that did the monitoring leading to the suit is retained to do so (or at least has an inside track to be selected). The firms are paid nothing for this "service" other than the fees they receive from the cases it generates. Professor Coffee reports that, "most plaintiffs firms in this field are now offering such services, and openly advertising them on their Web sites."[2]

In *Iron Workers,* MissPERS and the Iron Workers Fund were vying to be appointed lead plaintiff of a putative class of investors who purchased subprime mortgage-backed certificates from defendant Merrill Lynch and/or its affiliates and who alleged that the defendant failed to disclose the extent of the underlying risk of these certificates. During the process of trying to decide which fund to appoint lead plaintiff, Judge Rakoff discovered that both funds had entered into monitoring arrangements with plaintiff firms. Judge Rakoff expressed surprise upon learning of the existence

1 The lead *plaintiff* provisions of the PSLRA provide for the "most adequate plaintiff," 15 U.S.C. § 77z-1(a)(3)(B)(i), to serve as the lead plaintiff, with the rebuttable presumption that the "most adequate plaintiff" is the one with the largest financial interest in the recovery of the class. 15 U.S.C. §77z-1(a)(3)(B)(iii)(I)(bb).

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2 John C. Coffee, Jr, *'Pay-toPlay' Reform: What, How and Why?,* May 21, 2009 N.Y.L.J. 5 (col. 1).

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of such "problematic relationships"[3] and solicited further briefing from the parties about them.[4]

What Judge Rakoff soon discovered was that the relationship between the Iron Workers Fund and its counsel, Coughlin Stoia, seemed to foster the very type of lawyer-driven litigation that the PSLRA intended to curtail. The arrangement specified that Coughlin Stoia would provide free monitoring services of the Funds' investments and would suggest that the Fund bring securities class actions if it found any irregularities. In return, if the Fund did choose to bring suit, Coughlin Stoia would be retained to represent the Fund on a contingent fee basis. Though Coughlin Stoia maintained in its briefs that the control of whether to bring suit and subsequently which firm to hire as class counsel rested squarely with the Iron Workers Fund at all times, Judge Rakoff seemed reticent to accept such an explanation.

> *Some plaintiffs firms have entered into arrangements whereby they monitor pension funds' investments for irregularities and suggest possible grounds for litigation.…The firms are paid nothing for this "service" other than the fees they receive from the cases it generates [if they are chosen lead counsel].*

Despite finding that MissPERS entered into similar monitoring arrangements with plaintiffs firms, Judge Rakoff was able to articulate three distinctions between MissPERS's agreements and the Iron Workers Fund's agreements, which tipped the balance in favor of appointing MissPERS lead plaintiff. *First,* MissPERS has monitoring agreements with a dozen firms, none of which is guaranteed to be selected to bring a potential suit which it has identified through its monitoring. By soliciting the aid of twelve firms, MissPERS claims it is able to play each one off against the other in terms of determining the fee arrangement. *Second,* the decision of whether to bring suit following the monitoring firm's suggestion and the oversight of any such litigation is entrusted to lawyers in the Attorney General's Office of Mississippi; Judge Rakoff found that this group brought a level of expertise to bear on the litigation not exhibited by the managers of the Iron Workers Fund.[5] *Third,* the basis for this litigation was brought to the attention of MissPERS not by one of the firms monitoring its investments, but by another Mississippi firm, Pond Gadow, a firm which was not selected to be lead counsel in this case. Together, Judge Rakoff believed that these three distinctions made MissPERS the more adequate choice for lead plaintiff than the Iron Workers Fund.

Was he right? Maybe. Two of his three distinctions don't seem that meaningful upon close analysis. The fact that MissPERS had twelve firms vying for its business may not necessarily mean increased competition, but could simply increase campaign donations for Mississippi Attorney General Jim Hood – and perpetuate the notion that this is all a big "pay-

3 *Iron Workers Local No. 25 Pension Fund v. Credit-Based Asset Servicing and Securitization, LLC,* __ F. Supp. 2d __ , 2009 WL 1444400, at *1 (S.D.N.Y. 2009).

4 Other cases have acknowledged such arrangements without analyzing them in as much depth. *See, e.g., In re Am. Italian Pasta Co. Sec. Litig.,* 2007 WL 927745, at *5 (W.D. Mo. 2007) ("the Court is not surprised Lead Plaintiff has arranged for a law firm to keep it apprised of events (including lawsuits) that might be of interest"); *Plumbers & Pipefitters Local 572 Pension Fund v. Cisco Sys., Inc.,* 2004 WL 5326262, at *4 (C.D. Cal. 2004) ("Nothing about these [monitoring agreements] renders Carpenters inadequate as a class representative.").

5 Specifically, Judge Rakoff found that "Special Assistant Attorney General George W. Neville, the MissPERS client representative responsible for this case, who testified at the evidentiary hearing, plainly had a sophisticated knowledge of such matters." *Iron Workers,* 2009 WL 1444400, at *4. Whereas, as to the Iron Workers Fund, Judge Rakoff stated that:

> The Court, from its own observation of the testimony and demeanor of the Funds administrator, readily perceived that he was not particularly sophisticated in evaluating securities class actions and, indeed, had only a rough idea of what this lawsuit was all about. But who were the "sophisticated advisers, financial and legal" who would advise him and the Fund "in determining whether to bring suit"?-why, the very lawyers who would be bringing the suit, Coughlin Stoia. . . . What is crystal clear to the Court is that the Iron Workers Fund is in no position to adequately monitor the conduct of this complex litigation when it has not even taken the necessary steps to assure itself that the advice it is getting from its monitors is disinterested, let alone take the necessary steps to find out much about the lawsuit it is being asked to oversee.

Id.

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to-play" regime.[6] And the conclusion that MissPERS needed Pond Gadow, a three-lawyer bankruptcy firm in Jackson, Mississippi,[7] to bring the idea of a sub-prime mortgage case to their attention, and none of their twelve monitoring firms would have thought of this, strains credulity.[8]

What ultimately seems most convincing is Judge Rakoff's reliance on the intervening decision of a knowledgeable actor within the institutional framework concerning whether or not to file the lawsuit and whom to hire as counsel. Such a skilled intermediary ought to both soften the pay-to-play allegations and provide a bulwark against the filing of frivolous strike suits. This is more or less the conclusion Professor John Coffee reaches in a recent article in the *New York Law Journal*. There, Professor Coffee argues that portfolio monitoring "does not inherently close or corrupt a market,"[9] but that cause for concern arises at the point at which the client is captured by the lawyer; the presence of an active in-house counsel suggests client independence and control. Professor Coffee's distinction predicts Judge Rakoff's comfort in appointing MissPERS lead plaintiff because of the knowledgeable attorneys at the state AG's office that ultimately monitored the fund's litigations, as compared with the relatively inexperienced managers at the Iron Workers Fund.

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So what's the bottom line? The same as the first: that the key to getting fees is to be appointed lead counsel. When the PSLRA changed the rules of the lead counsel game, entrepreneurial plaintiffs' attorneys reacted accordingly, developing the "portfolio monitoring" scheme as a way to ingratiate themselves with the major institutional investors so as to get cases rolling and get lead counsel assignments. I find it neither outrageous nor inherently problematic that the plaintiffs' firms did this: after all, private attorney general litigation is premised on the very idea that non-governmental lawyers will invest their own resources in enforcing securities laws if there is return for them in doing so. That these lawyers seek to maximize their return (through either campaign contributions or portfolio monitoring programs) should neither be surprising nor upsetting when it is this same entrepreneurial instinct that we are enlisting to get the law-enforcement job done. Moreover, this new regime, even with the pay-to-play warts, is better than the one-share professional plaintiff regime that pre-existed the PSLRA – and it is made even better where plaintiffs' counsel are forced to pitch their litigation ideas to true litigation managers within state attorney general offices.

Although Judge Rakoff likely reached the right conclusion for the right reason, it is as likely that this is not the last battle in this war. Judicial oversight of pay-to-play allegations generally and portfolio monitoring practices specifically has likely just begun.

6 A recent article published on law.com, "Securities Case? Bring It On!" seems to suggest that Attorney General Hood, the man in charge of deciding which cases to bring on behalf of MissPERS, has been running a "pay-to-play" state, receiving tens of thousands of campaign dollars in recent years from New York plaintiff firms, many of which have been appointed lead counsel in securities class actions (a list which includes Bernstein Litowitz, the lead counsel in the current action). Andrew Longstreth, *Securities Case? Bring it On!*, LAW.COM, May 1, 2009, http://www.law.com/jsp/PubArticle.jsp?id=1202430178187.

Relatedly, a former associate from the plaintiffs firm, Labaton Sucharow, similarly alleges that one of the firm's partners claimed that the New Mexico pension fund, which generated $118 million in fees for the firm, became a client after the partners contributed to New Mexico governor Bill Richardson's campaign at the request of his campaign manager. See Nate Raymond, *New Suit by Former Labaton Sucharow Lawyer Offers Glimpse at Plaintiffs Bar Business Tactics,* AMERICANLAYWER.COM, May 1, 2009, http://www.law.com/jsp/tal/digestFriendlyTAL.jsp?id=1202430371619. Labaton denies the allegations.

7 See www.michaelgpond.com.

8 In fairness, the MissPERS submissions in the case note that Pond Gadow "identified issues with lending practices" that led the fund to consult with securities firms and ask Pond Gadow to associate with one of the conventional securities firms. By contrast, in a recent bar journal article, Professor Coffee provides another explanation for the appearance of random small firms in securities cases:

> A state official advises a traditional plaintiffs law firm that the official will name the firm as its proposed class counsel in a case where the law firm has been seeking such an appointment if, and only if, the firm will agree to name another firm as its co-counsel. The other firm is not known for its experience (if any) with securities litigation, but a political crony of the state official is a prominent partner there.

Coffee, *'Pay-to-Play' Reform, supra* n.2.

9 *Id*.