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Class Action Criminality

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Class Action Criminality

Lisa L. Casey*

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I. INTRODUCTION

Long before their arraignments on federal felony charges last year, class action lawyers Mel Weiss and Bill Lerach stood before the court of public opinion accused of abusing the legal system to enrich themselves. The partners received national attention for filing shareholder lawsuits against some of this country's best known corporations, usually alleging that top company management defrauded investors. Over the course of some three decades, Weiss and Lerach recovered on behalf of shareholders billions of dollars from corporate defendants; companies sued by the partners almost always chose to settle the fraud claims rather than risk judgment at trial. Compensated with multimillion dollar fee awards, Weiss and Lerach built their law firm, Milberg Weiss, into a litigation juggernaut, became multimillionaires themselves, and contributed generously to Democratic Party candidates and causes. In the process, Weiss and Lerach made numerous powerful enemies in executive suites from coast to coast. Directors and

1. This Article uses Milberg Weiss to refer to Milberg Weiss Bershad Hynes & Lerach and all of its subsequent iterations, including Milberg Weiss Bershad & Schulman and the current firm, Milberg LLP. In 2004, Weiss and Lerach ended their relationship as law partners. The firm of Milberg Weiss Bershad Hynes & Lerach split into two separate entities. See Julie Creswell, A Prominent Law Firm Prepares for Indictment, N.Y. TIMES, May 17, 2006, at C1. Co-founder Mel Weiss and the attorneys practicing law on the East Coast formed the law firm Milberg Weiss Bershad & Schulman in New York, while Bill Lerach and attorneys in California formed the firm Lerach Coughlin Stoia Geller Rudman & Robbins, based in San Diego. Id.
officers of public companies reviled Milberg Weiss and railed against defending lawsuits filed by its lawyers.  

In the early 1990s, Corporate America, Wall Street, and the accounting industry joined forces to lobby Congress for relief from securities fraud litigation. These politically influential interests complained to federal legislators that the plaintiffs’ bar filed frivolous securities class actions and employed unethical, “abusive” litigation tactics to extract settlements from law abiding companies, thereby profiting at the expense of the shareholders whom they purported to represent. Proponents of litigation reform depicted Milberg Weiss and its two (in)famous senior partners as the primary corruptors. Congress received testimony that Milberg Weiss failed to investigate its fraud charges before racing into court and filing boilerplate allegations against innocent companies, often within hours of a significant decline in the companies’ stock price. Legislators also heard that Milberg Weiss—rather than its shareholder clients—controlled the lawsuits, making even the most critical decisions without consulting the named plaintiffs representing the class. How did Milberg Weiss find compliant shareholders willing to lend their names to the lawsuits on such short notice? Rivals claimed that the law firm utilized a stable of “professional plaintiffs,” small investors paid by the lawyers to serve as class representatives in dozens of cases. Stockbrokers who referred professional plaintiffs to the law firm received compensation, too. Weiss and Lerach did not deny to Congress that Milberg Weiss recruited shareholders to serve as plaintiffs. However, what most seemed to influence federal lawmakers of the need for securities litigation reform was a statement made by Lerach outside the hearings, away from Capitol Hill. In a 1993 magazine interview, Lerach had boasted: “I have the greatest practice of law in the world. . . . I have no clients.”

Milberg Weiss’s foes spent almost $30 million on their lobbying and public relations campaign before they persuaded Congress to enact reforms, both procedural and substantive, restricting securities class actions. Thus was born the Private Securities Litigation Reform Act of 1995 (PSLRA). And yet, the PSLRA’s formidable limits on

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4. See id. (explaining the dynamics of securities fraud suits).
5. Id. Indeed, lead architects of the litigation reform campaign later acknowledged that they went to Capitol Hill “to destroy Lerach” and his law firm. Jeffrey Toobin, The Man Chasing Enron, NEW YORKER, Sept. 9, 2002, at 86.
7. Id.
securities class actions did not destroy Milberg Weiss’s lucrative practice. Nor was the firm decimated by a subsequent federal law barring securities class actions from state courts.\textsuperscript{12} Even multiple adverse decisions from a Supreme Court hostile to securities litigation did not devastate Milberg Weiss’s practice.\textsuperscript{13} In fact, Milberg Weiss solidified its position as the foremost plaintiffs’ securities firm in the country.\textsuperscript{14} Rather than killing off the firm, securities litigation reforms gave Milberg Weiss—with its superior resources and ability to invest in riskier lawsuits—a competitive advantage over rival plaintiffs’ law firms at the turn of the century.

Thus, following revelations of massive financial frauds and management wrongdoing at Enron, WorldCom, Tyco, and scores of other public companies, it was Milberg Weiss that led the vanguard of attorneys filing class actions and other lawsuits on behalf of aggrieved investors.\textsuperscript{15} In the aftermath of the scandals, the press praised Lerach as a “corporate crime fighter”\textsuperscript{16} and “America’s best hope for corporate reform,”\textsuperscript{17} a far different image than the media’s pre-Enron depictions of him as a greedy corporate extortionist.\textsuperscript{18} Milberg Weiss and other plaintiffs’ firms not only obtained enormous, unprecedented recoveries for deceived investors, but they also conditioned their settlements on directors instituting various corporate governance reforms favored by institutional investors.\textsuperscript{19} By the spring of 2006, Lerach had amassed a partial settlement fund for defrauded Enron shareholders totaling more than $7.3 billion—then the largest securities fraud recovery ever produced.\textsuperscript{20}

In the meantime, while the plaintiffs’ bar negotiated record-setting settlements for millions of shareholders, the Justice Department revived a dormant criminal investigation of Milberg Weiss for allegedly paying its clients who agreed to act as plaintiffs in class actions. The government’s inquiry began in 1999 with a tip from a former Milberg Weiss client, who was seeking a reduced prison sentence for an unrelated felony.\textsuperscript{21} He told federal authorities that Milberg Weiss shared ten percent of its fees with him for serving


\textsuperscript{16} Greider, supra note 2.

\textsuperscript{17} In Praise of Trial Lawyers, ECONOMIST, July 12, 2003, at 60.

\textsuperscript{18} See, e.g., Mike France, 23: Don’t Kill All the Trial Lawyers, BUS. WK., Aug. 26, 2002, at 156 (arguing against negative perceptions of plaintiffs’ attorneys).

\textsuperscript{19} See Andrew Countryman, Big Investors Turn to Lawsuits to Get Changes in Governance, CHI. TRIB., Jan. 18, 2004, at C1.

\textsuperscript{20} Bruce V. Bigelow, What's Leading Lerach to Think of Leaving Firm?, SAN DIEGO UNION-TRIB., June 2, 2007, at C1.

as a representative plaintiff in dozens of shareholder lawsuits. It took seven years before prosecutors had enough evidence to corroborate the felon's claims and indict any Milberg Weiss lawyer. However, still without sufficient evidence linking Weiss and Lerach to any crime, the government demanded that the law firm waive its attorney-client privilege and cooperate in the investigation. If Milberg Weiss refused to provide documents and testimony against Weiss and Lerach, prosecutors would seek an indictment of the entity, which could destroy the firm. When Milberg Weiss nonetheless rejected prosecutors' demand, the Justice Department made good on its threat.

On May 18, 2006, the Justice Department announced that a federal grand jury in Los Angeles had indicted Milberg Weiss for racketeering, conspiracy, and fraud. The 102-page indictment claimed that the law firm orchestrated a secret conspiracy to pay several clients a substantial portion of the attorneys' fees awarded to Milberg Weiss as class counsel, a total of some $11.3 million over a 21-year period. In exchange for a ten percent share of Milberg Weiss's fees, these clients and their family members agreed to participate as named plaintiffs in scores of securities class actions and derivative lawsuits, all but a few initiated before the PSLRA became effective. The fee sharing arrangements allegedly enabled Milberg Weiss to file complaints before its competitors—namely, any other law firms contending for court appointments as lead plaintiffs' counsel. Characterizing the fees shared with plaintiffs as "kickbacks," prosecutors demanded that Milberg Weiss forfeit some $216 million in "tainted" attorneys' fees awarded to the firm in lawsuits fronted by paid plaintiffs.

Never before had the Justice Department indicted a prominent national law firm. News of the case—dubbed the "Trial Lawyers' Enron"—diverted attention from the...
corporate financial scandals and generated widespread commentary. Some members of Congress and the legal academy questioned the prosecution's timing and its motives. The indictment largely concerned a defunct practice (almost all of the alleged payments to class action plaintiffs were made from 1979 to 1996) that Congress had already addressed through reforms included in the PSLRA. Why did the federal government spend almost eight years amassing evidence of outdated conduct? Was the prosecution politically motivated? Did Milberg Weiss's corporate enemies pressure the Bush Administration to pursue the case in order to discredit Lerach and Weiss and derail their efforts to recover billions in losses for Enron shareholders and other investors?

Observers criticized the prosecutors' tactics, including their decision to indict both Milberg Weiss and the partners allegedly responsible for the wrongdoing. Others attacked the DOJ for demanding a broad privilege waiver from Milberg Weiss and charging the law firm with felonies when it refused to cooperate. Pundits debated whether the indictment itself would bring down Milberg Weiss, just as an indictment doomed former accounting giant Arthur Andersen in 2002. Notably, however, commentators did not examine the government's primary theory of liability, nor have they considered the legal validity of the indictment's principal charge against Milberg Weiss—the charge of honest services fraud. Observers seemed to assume that some federal law prohibited Milberg Weiss from sharing fees with named plaintiffs, or that the law firm had committed a criminal fraud if its lawyers were found to have paid plaintiffs. Both assumptions are wrong.

advocated that former members of classes represented by Milberg Weiss file new putative class actions against the law firm asserting claims of fraud, breach of fiduciary duty, unjust enrichment, and even civil racketeering.

Id.

31. Peter Elkind, The Fall of America’s Meanest Law Firm, FORTUNE, Nov. 3, 2006, available at http://money.cnn.com/magazines/fortune/fortune_archive/2006/11/13/8393127/index.htm (reporting that several congressmen described the indictment as an “attempt by the Bush Administration to accomplish by bullying and intimidation what it has not been able to do by law—to end class action lawsuits”).


33. FSI, supra note 25, ¶ 24, 35, 37; SSI, supra note 28, ¶ 34, 37, 41.


35. See, e.g., Bruce H. Kobayashi & Larry E. Ribstein, The Hypocrisy of the Milberg Indictment: The Need for a Coherent Framework on Paying for Cooperation in Litigation, 2 J. BUS. & TECH. L. 369, 371 (2007) (comparing class counsel’s payments to plaintiffs with prosecutors’ “payments” to criminal defendants—in the form of substantial charging and sentence reductions—offered in exchange for defendants’ promise to cooperate with the government and testify against other prosecution targets).


38. Id.; see also E. Scott Reckard & Josh Friedman, Class-Action Law Firm Indicted in Fraud Case, L.A. TIMES, May 19, 2006.

39. I do not analyze the government’s secondary charges (what Professor Gabaldon calls the “peripheral charges”) against Milberg Weiss, including money laundering and criminal forfeiture. See Gabaldon, supra note 37, at 212. Nor does this Article explore at any length the individual partners’ criminal liability for conspiring to conceal the fee sharing agreements. Few would disagree that persons who commit perjury or conspire to do so
No federal criminal statute specifically prohibits plaintiffs’ class action lawyers from sharing their court-awarded fees with their clients who serve as representative plaintiffs. Nor does federal law require that plaintiffs’ counsel make any certifications to the court regarding its relationship, financial or other, with the investors named as plaintiffs. That this statutory gap exists is important. Consistent with Congress’s traditional deference to the states in policing the legal profession, the PSLRA did not directly regulate attorneys’ conduct. Rather than prohibiting class counsel from sharing its fees or otherwise making it illegal for attorneys to solicit and pay class action plaintiffs, Congress instead targeted the utilization of so-called professional plaintiffs induced by the courts’ “first to file” convention. The PSLRA ended the then-common practice among plaintiffs’ counsel of racing to the courthouse with their “ready-made” clients, prepared to file suit at the drop of a stock. The PSLRA’s reforms limit the number of times that shareholders may serve as lead plaintiffs and restrict judicial awards compensating and rewarding representative parties. Congress also mandated that plaintiffs accompany their complaints with sworn certifications disclosing, among other information, their involvement in certain prior lawsuits and forswearing acceptance of future payments beyond amounts authorized by the statute.

Although fee sharing between class counsel and named plaintiffs is not per se illegal under the PSLRA or any other federal law, the government nonetheless indicted Milberg Weiss by charging the entity with honest services fraud. Specifically, the Justice Department claimed that the law firm violated federal mail and wire fraud statutes by depriving absent class members of their intangible rights to receive honest services from the named plaintiffs and from counsel. The indictment asserted that named plaintiffs are fiduciaries to absent class members and that, as fiduciaries, named plaintiffs could not have any financial interest in shareholder litigation other than as allowed under the PSLRA. Accord ing to prosecutors, Milberg Weiss caused the paid plaintiffs to breach their fiduciary duties by inducing them to serve as class representatives in exchange for a share of Milberg Weiss’s attorneys’ fees. The fee sharing arrangements allegedly created conflicts of interest for the paid plaintiffs, causing them to favor themselves over the absent class members and engendering in them “a greater interest in maximizing the amount of attorneys’ fees awarded to Milberg Weiss than in maximizing the net recovery to absent class members’ and shareholders.” In this way, the plaintiffs deprived absent class members of their right to receive honest services; that is, services untainted by

should be subject to some kind of criminal liability.


41. See infra Part II.A.4.


43. SSI, supra note 28, ¶¶ 21–22.

44. This Article uses “named plaintiffs” or “named parties” to refer generically to persons who serve as representative plaintiffs and/or lead plaintiffs in class actions, whether before or after such persons receive judicial appointment to serve as lead plaintiffs, and whether before or after such persons receive judicial certification as class representatives.

45. SSI, supra note 28, ¶¶ 24, 27.

46. Id. ¶¶ 18, 26.
conflicts of interest.\textsuperscript{47} The named plaintiffs and Milberg Weiss committed honest services fraud—a violation of the mail and wire fraud statutes—by sharing fees. In addition, the government accused Milberg Weiss of conspiracy, racketeering, and money laundering, all charges deriving from prosecutors’ claim that the payments to named plaintiffs deprived absent class members of their representatives’ honest services. In other words, the government grounded its primary case against Milberg Weiss on the theory that named plaintiffs in class actions are fiduciaries of absent class members.

In fact, the fiduciary duties upon which prosecutors based their honest services claim—duties ostensibly arising from the relationship of named plaintiffs to absent class members—have never been delineated, much less enforced. The legal relationships among named plaintiffs, absentees, and class counsel are much more complex and unsettled than the indictment reveals. Despite this doctrinal void, prosecutors not only pleaded a dubious theory charging Milberg Weiss with honest services fraud, but they included in the indictment the demand that the law firm forfeit its court-awarded attorneys’ fee totaling more than $250 million, potentially bankrupting the entity. With substantial criminal liability turning on vague notions of fiduciary responsibility and changeable sensitivities to conflicts of interest,\textsuperscript{48} prosecutors’ novel honest services charge warranted careful judicial scrutiny.

Yet, the government’s honest services theory never ran the gauntlet of trial and appellate review. Like most defendants charged with federal felonies, four former Milberg Weiss partners—including Lerach and Weiss—elected to plea bargain with prosecutors rather than bear the risk and expense of fighting the government’s claims through trial. Having settled with the individual defendants,\textsuperscript{49} the Justice Department dropped its demand that Milberg Weiss waive the attorney-client privilege and cooperate with prosecutors. Indeed, the government consented to dismiss all charges against

\textsuperscript{47} Id. ¶ 30. Although the indictment also charges that the defendant partners and named plaintiffs concealed the fee sharing arrangement, the charges against Milberg Weiss that carry the greatest penalties derive from the agreement to share fees.

\textsuperscript{48} United States v. Bloom, 149 F.3d 649, 654 (7th Cir. 1998) (noting that “it is frightening to contemplate the prospect that the federal mail fraud statute makes it a crime punishable by five years’ imprisonment to misunderstand how a state court in future years will delineate the extent of impermissible conflicts,” in which case “we would have a federal common-law crime, a beastie that many decisions say cannot exist”).

\textsuperscript{49} The government obtained guilty pleas from Bershad, Lerach, Schulman, and, ultimately, even Mel Weiss, whom prosecutors finally indicted in September 2007. Jonathan D. Glater, High-Profile Trial Lawyer Agrees to Guilty Plea, N.Y. TIMES, Mar. 21, 2008, at C1; Barry Meier, Top-Class Action Lawyer Faces Federal Charges, N.Y. TIMES, Sept. 21, 2007, at C3. Not surprisingly, the defendants, ages 56 to 72, preferred the certainty of 18 months to three years in a federal detention camp to the risk of spending the rest of their lives in a higher security prison. See Julie Creswell, Ex-Partner at Milberg Pleads Guilty to Conspiracy, N.Y. TIMES, July 10, 2007, at C1 (Bershad, age 67); Carrie Johnson, Lerach Gets Two Years in Prison for Kickbacks: Prominent Plaintiffs Lawyer Loses Appeals for Leniency, WASH. POST, Feb. 12, 2008, at D1 (Lerach, age 61); Barry Meier, Top Class-Action Lawyer Faces Federal Charges, N.Y. TIMES, Sept. 21, 2007, at C3 (Weiss, age 72); Michael Parrish, Ex-Partner at Law Firm Pleads Guilty in Kickback Case, N.Y. TIMES, Oct. 10, 2007 (Schulman, age 56). Former Milberg Weiss partners Bershad and Schulman each pleaded guilty to a single felony count with a short statutory maximum sentence, as did Lerach and Weiss. Id. Lerach pleaded guilty to one count of conspiracy to obstruct justice in September, 2007, and was sentenced to 24 months in federal prison. Johnson, supra. Weiss pleaded guilty to one count of racketeering conspiracy and was sentenced in June, 2008, to serve 30 months in prison. Gina Keating, U.S. Class Action King Weiss Sentenced to 30 Months, REUTERS, June 2, 2008, available at www.reuters.com/article/ousiv/idUSN304103542008080603.
Milberg Weiss in exchange for the firm paying some $75 million over a five-year period. Federal prosecutors also agreed to issue a public statement attesting that no current Milberg Weiss lawyer had any involvement in the alleged wrongdoing. Attorneys defending the entity undoubtedly sought this important concession to enable lawyers still in practice at Milberg Weiss to seek appointments as lead counsel in future class action lawsuits.

Regardless of the settlement, examining the Justice Department's untested theory of criminal liability remains an important exercise for several reasons. First, prosecutors ignored Congress's efforts to regulate the alleged conduct by enacting the PSLRA. Furthermore, the government's attempt to extend honest services fraud to cover fee-sharing by plaintiffs' lawyers also disregarded Congress's intent when it passed the honest services statute. Furthermore, class action law neither recognizes nor enforces the plaintiffs' alleged fiduciary duties to absent class members. Despite these critical flaws in their theory, federal prosecutors going forward may very well rely on this or similar expansive constructions of the honest services statute.

In addition, the Justice Department's prosecution of Milberg Weiss implicates fundamental public policies relating to securities class actions. This Article contributes to the literature on shareholder litigation by examining some important effects of the indictment. By charging Milberg Weiss with criminal fraud, prosecutors substantially damaged an important element of this country's securities enforcement regime. Furthermore, despite the favorable resolution eventually achieved by Milberg Weiss, the prosecution undermined private enforcement. Politically powerful corporate executives and their allies on Wall Street and in the accounting firms now have launched a new campaign to persuade Congress and the Securities and Exchange Commission to impose further restraints on securities class actions. Not surprisingly, they have pointed to the Milberg Weiss indictment as Exhibit A in support of their contention that securities class actions benefit only the greedy "criminals" who purport to represent defrauded investors. Two bills introduced in Congress would not simply make fee sharing illegal but would further restrict securities litigation and limit defrauded investors' potential recoveries. The SEC has indicated that it, too, may reassess the private enforcement regime. With a better understanding of the Milberg Weiss prosecution and the government's foundational theory for indicting the law firm, policymakers may have a more informed, accurate debate about the need for further class action reform.

My analysis is organized as follows. Part II describes, in brief, the events leading to the indictment of Milberg Weiss. The investigation that culminated in the firm's prosecution began in 1999, but its roots stretch back much further. After reviewing the

51. Id.
52. Beyond the scope of this Article is an examination of whether prosecutors could have convicted Milberg Weiss for the alleged failures by its partners and the accused plaintiffs to disclose the fee sharing agreements to the courts.
53. See infra Part VI.E (describing the potential legislation).
54. Id.
relevant background, this section summarizes the charges against Milberg Weiss and the individual defendants before describing the honest services fraud allegations in more detail. The vast majority of the charges against Milberg Weiss—and the charges that carried the most substantial penalties—proceed from the honest services (mail and wire fraud) counts.

Part III examines the Justice Department's case for finding Milberg Weiss criminally liable and, more specifically, considers prosecutors' efforts to extend the honest services provision of the mail and wire fraud statutes to cover fee sharing by the law firm. Applying 18 U.S.C. § 1346 (the honest services provision) to purely private conduct, such as that alleged in the indictment, belies Congress's primary intent when it enacted the statute. Employing the honest services doctrine to criminalize Milberg Weiss's conduct also runs counter to contemporary case law. Recent court decisions interpret the statute more narrowly and focus more precisely on the nature of the relationship giving rise to the "duty" to provide honest services.

Part IV assesses the central premise of class action criminality—that investors acting as named plaintiffs owe fiduciary duties to putative class members and, thus, can be held criminally liable, along with their attorneys, for breach of those duties. Legal support for this proposition is sparse. Under well-settled principles of fiduciary law, investors do not become fiduciaries to absent class members by initiating class action lawsuits. Even named plaintiffs appointed by the courts as lead plaintiffs and class representatives lack legal authority to control the litigation and affect the net recovery to the class. In function and in fact—perhaps with the exception of a small number of closely watched megafund cases filed by institutional lead plaintiffs after Enron collapsed—plaintiffs' attorneys control the prosecution of securities class actions, subject to judicial supervision and approval.

After examining the inchoate relationship between representative plaintiffs and absent class members, Part V evaluates the honest services fraud charge leveled against Milberg Weiss based on that relationship. I show that because representative plaintiffs are not fiduciaries of absenteeees, the government's honest services fraud claim should have failed, weakening the prosecution's case considerably. Furthermore, the claim asserted against Milberg Weiss extended well beyond any theory of honest services liability upheld by the courts to date. Concerns of fair notice and lenity reinforce the view that the firm's indictment was not merited by the facts, the applicable law, or sound policy.

Part VI completes the analysis by considering the normative implications of class action criminality as well as some consequences of the Milberg Weiss prosecution.

II. THE INDICTMENT OF MILBERG WEISS

A. Congress Regulates Securities Class Actions

1. Why Private Enforcement?

When it enacted the PSLRA, Congress emphasized that securities class actions provide defrauded investors with "an indispensable tool with which . . . [to] recover their

56. See infra Part III (evaluating the role of representative plaintiffs as fiduciaries of absent members of the class action).
losses without having to rely upon government action.57 In addition to its compensatory function, class action litigation supports (at least in theory) optimal enforcement of the securities statutes. Because the loss to each public company shareholder is small compared to the total harm caused by the fraud, collective action and free riding problems discourage most aggrieved shareholders from pursuing their claims.58 For the same reasons, investors will not organize themselves to prosecute their fraud claims in a group action.59 Without a mechanism to aggregate shareholder claims, culpable issuers, their managers, and their professional advisors will not internalize the full social costs of their illegal conduct.60 Wrongdoers thus can derive relatively large benefits from imposing comparatively small losses on each shareholder. Violators not only benefit from their unlawful conduct, but they also are not deterred from violating again. Securities class actions serve to deter future frauds by the defendants, and, too, such litigation functions to dissuade others from engaging in similar frauds.61

Common fund class actions enable, at least in theory, the economic prosecution of investors' securities fraud claims. Rule 23(b)(3) of the Federal Rules of Civil Procedure makes possible the efficient litigation of investors' claims in an opt-out class action, avoiding the need to adjudicate the same issues multiple times. The class action mechanism facilitates the cost-effective joinder of investors' similar fraud claims, spreading the costs of prosecution, including attorneys' fees, over a single, collective action. By permitting plaintiffs' counsel to aggregate and file like securities fraud claims under court supervision, the case becomes large enough to attract experienced plaintiffs' attorneys willing to represent injured shareholders on a contingent fee basis, pursuing claims that otherwise would remain unlitigated.62 Then, assuming the attorney can create a fund benefiting the investor class, either through settlement or judgment on the merits, she may recover her fees and expenses from that fund at the conclusion of the case.63 While the return to absent class members is necessarily reduced by the attorneys' fees and costs paid from the common fund, the amounts awarded to class counsel are determined by the courts at the conclusion of the litigation.64

The availability of common fund class actions for litigating securities fraud claims stimulated the development of private law enforcers who specialized in representing shareholders in such cases.65 Private securities litigation, like most class actions, differs from traditional bipolar lawsuits insofar as "lawyers for the class ... have all the initiative and are close to being the real parties in interest."66 Because of the nature of the claims and idiosyncratic structure of the lawsuits, attorneys specializing in securities

59. Id. at 8–9.
60. Id. at 8.
63. Id. at 1252.
64. Id. at 1251.
65. Id. at 1256.
fraud class actions do not follow traditional norms for providing professional legal services.\textsuperscript{67} Clients typically do not come to them seeking services. Instead, lawyers for the potential class must be willing to investigate potential violations of the antifraud statutes, and they must devote significant time and resources to these inquiries. Their incentive to do so is the potential for collecting attorneys' fees calculated as a percentage of the investors' total recovery.\textsuperscript{68} Without the initiative of attorneys willing to undertake these investigations, significantly fewer suits would be filed.\textsuperscript{69} Without the commitment of the attorneys' financial resources and human capital to the putative class actions, fewer still suits would proceed.\textsuperscript{70} Plaintiffs' counsel, rather than the named plaintiffs or absent class members, assumes the true risk that presiding judges will dismiss the securities fraud claims or refuse to certify the investors' class.\textsuperscript{71} It is no surprise, then, that plaintiffs' attorneys control the litigation. Counsel identifies potential claims, investigates their merits, decides whom to sue and where, determines the theories of liability, describes the class, and drafts a complaint designed to withstand defendants' inevitable motions for dismissal. Before filing the complaint, however, counsel also must find one or more injured investors willing to serve as the putative lead plaintiff(s).\textsuperscript{72} To be sure, counsel often will have to recruit investors who not only are willing to serve but can also qualify to serve as the representative plaintiffs.\textsuperscript{73} Yet, the named plaintiffs who volunteer for this role do not finance the class action suits, nor do they have special characteristics distinguishing them from other investors in the putative class. Like their fellow putative class members, named plaintiffs relinquish control over their claims to plaintiffs' counsel.\textsuperscript{74}

2. Paid Plaintiff Practices Before Securities Litigation Reform

Milberg Weiss recognized that it was time-consuming and expensive for the firm to conduct separate searches whenever it needed to find investors with standing ready and willing to file fraud claims and serve as class representatives. Because judges frequently awarded the role of lead counsel to the law firm that had filed the first complaint against the defendants, time was of the essence for plaintiffs' lawyers.\textsuperscript{75} Sometimes Milberg Weiss received client leads from other law firms and entered into fee sharing contracts with referring counsel.\textsuperscript{76} Lawyers with little knowledge of securities law or insufficient resources to litigate class action complaints would refer their investor clients with potential claims to specialists, such as Milberg Weiss, who had the experience and

\textsuperscript{67} Casey, Reforming Securities Class Actions, supra note 14, at 1330.

\textsuperscript{68} Id. at 1251.

\textsuperscript{69} Id. at 1250.

\textsuperscript{70} Id. at 1248.

\textsuperscript{71} Id. at 1251.

\textsuperscript{72} Casey, Reforming Securities Class Actions, supra note 14, at 1251.

\textsuperscript{73} See Randall S. Thomas et al., Megafirms, 80 N.C. L. REV. 115, 189-90 (2001) (describing the lead plaintiff provisions of the PSLRA).

\textsuperscript{74} See infra text accompanying notes 463-65, 468-73 (discussing lead plaintiffs' lack of control over class action litigation).

\textsuperscript{75} See, e.g., Garr v. U.S. Healthcare, Inc., 22 F.3d 1274, 1277 (3d Cir. 1994) ("The lead attorney position is coveted as it is likely to bring its occupant the largest share of the fees generated by the litigation.").

\textsuperscript{76} Julie Creswell, Ex-Partner at Milberg Pleads Guilty to Conspiracy, N.Y. TIMES, July 10, 2007, at Cl.
financial capacity to litigate complex class actions. Milberg Weiss also had formed relationships with securities brokers. These brokers supplied the names of clients who owned particular securities and would participate as named plaintiffs.\textsuperscript{77}

At some point, apparently, Milberg Weiss cut referring lawyers and brokers out of the middle. Milberg Weiss partners instead dealt directly with investors who owned diversified stock portfolios and were prepared to serve as named parties in class actions alleging securities fraud, usually for some consideration.\textsuperscript{78} In essence, Milberg Weiss retained investors to standby in reserve, ready to initiate cases as soon as promising fraud claims materialized. The arrangements benefited Milberg Weiss by reducing its search costs and allowing the firm to avoid unnecessary delays in filing complaints. By establishing relationships with prospective plaintiffs in advance of detecting securities fraud violations, Milberg Weiss also mitigated its risk of failing to locate shareholders with standing who were ready, willing, and able to serve as plaintiff representatives. These investors purchased the securities of various targeted corporations, presumably in collaboration with the lawyers.\textsuperscript{79}

Investors who served as the named party in multiple class actions, and who were believed to have negotiated with counsel some fee or “bounty” for their repeated service as a named party, became known (pejoratively) as “professional plaintiffs.”\textsuperscript{80} Their identities were known to the corporate lawyers who specialized in the defense of shareholder litigation. In the late 1980s and early 1990s, the securities defense bar deposed these investors, tracked their case filings, and exposed their identities to the courts, arguing that repeat plaintiffs were subject to unique defenses and could not serve as class representatives.\textsuperscript{81} Indeed, defendants persuaded a number of courts to deny class certification to claims filed by repeat plaintiffs.\textsuperscript{82} The media also spread the word about

\begin{footnotes}
\item[77] Peter Elkind & Doris Burke, \textit{The King of Pain Is Hurting}, \textit{FORTUNE}, Sept. 4, 2000, at 3–4 (profiling Bill Lerach).
\item[80] \textit{Id.} These investors also were known as “frequent filers” or “repeat plaintiffs.” \textit{See} Peter Elkind, \textit{The Law Firm of Hubris Hypocrisy & Greed}, \textit{FORTUNE}, Nov. 13, 2006, at 154.
\item[81] \textit{See, e.g.}, Melder v. Morris, 27 F.3d 1097, 1099 n.2 (5th Cir. 1994) (noting the district court had described Cooperman as “one of the unluckiest and most victimized investors in the history of the securities business” because he had been a plaintiff in at least 38 class action securities fraud cases); \textit{In re} Gibson Greetings Sec. Litig., 159 F.R.D. 499, 501 (S.D. Ohio 1994) (identifying the plaintiff as “one of a growing group of people who may be classified as ‘professional class action plaintiffs’”); \textit{In re} ML-Lee Acquisition Fund II, L.P., 149 F.R.D. 506, 508 (D. Del. 1993) (noting that one plaintiff had brought seven class action suits within previous two years and that plaintiff’s counsel had represented him in at least three of the seven prior actions); Koenig v. Benson, 117 F.R.D. 330, 334–36 (E.D.N.Y. 1987) (observing that the plaintiff, who had filed 39 securities fraud claims within three years, seemed to treat any loss from stock speculation as a “fresh opportunity to gamble on a possible recovery in the courtroom”).
\item[82] \textit{See, e.g.}, Hanon v. Dataproducts Corp., 976 F.2d 497, 508 (9th Cir. 1992) (denying class certification based on plaintiff’s extensive experience in prior securities litigation, his relationship with his lawyers, his practice of buying a minimal number of shares of stock in various companies, and his uneconomical purchase of only ten shares of stock in the defendant corporation); Welling v. Alexy (\textit{In re} Cirrus Logic Sec.), 155 F.R.D. 654, 658–59 (N.D. Cal. 1994) (determining that plaintiff’s 13 prior appearances in securities class actions filed by the same attorney rendered plaintiff inadequate to serve as class representative); Shields v. Smith, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,449, 96,449–50 (N.D. Cal. 1991) (refusing to certify class due to plaintiff’s “consistent pattern” of purchasing a few shares of stock in troubled companies to possibly pursue
the controversial use of professional plaintiffs, even identifying Dr. Steven Cooperman (the convicted felon whose cooperation launched the Milberg Weiss investigation) as one of Milberg Weiss’s professional plaintiff clients.\textsuperscript{83} As one commentator noted:

Many believed that securities class actions frequently featured so-called "professional plaintiffs." These plaintiffs were thought to have long-term relationships with plaintiffs’ attorneys pursuant to which they agreed to buy stock in likely litigation targets and to serve as representative plaintiffs in any ensuing action in exchange for payments from the lawyer.\textsuperscript{84}

Published opinions reflect not only widespread judicial awareness of professional plaintiff practices but also the courts’ overwhelming, consistent disapproval of such practices.\textsuperscript{85}

Nonetheless, Milberg Weiss and other lawyers specializing in shareholder lawsuits enjoyed some success in litigating securities fraud claims as class actions, especially after 1988, the year that the Supreme Court endorsed the fraud-on-the-market theory of reliance.\textsuperscript{86} The Court’s 4–2 ruling in \textit{Basic v. Levinson} not only made the certification of investor classes more likely, but also allowed plaintiffs’ counsel to define the putative class more broadly, increasing the potential damages recoverable against public companies.\textsuperscript{87} Following the Court’s decision in \textit{Basic}, the plaintiffs’ bar filed an increasing number of putative securities class actions, although empirical studies differed significantly in their reporting of this development. High technology companies, the so-called Big 8 auditors, and national securities firms certainly perceived that they had become favorite targets of the plaintiffs’ bar.\textsuperscript{88} Executives of Fortune 500 corporations and Wall Street investment banks teamed with the accounting industry and the equity-dependent entrepreneurs running Silicon Valley companies to oppose any expansion of shareholders’ remedies for securities fraud.\textsuperscript{89} The allies began collaborating about how they might overturn laws and rules that they viewed as favorable to plaintiffs. In 1992,
the coalition launched a multi-year lobbying effort to persuade Congress to reform securities fraud litigation.90

3. The Case for Reforming Securities Litigation

The anti-litigation alliance complained to Congress that the plaintiffs' securities bar, lead by Milberg Weiss, had hijacked the securities laws for their own personal gain. They argued that most fraud-on-the-market lawsuits filed by plaintiffs' lawyers were strike suits initiated solely for their settlement value.91 According to reform advocates, Milberg Weiss and other plaintiffs' firms exploited the litigation system by manufacturing vexatious complaints designed to harass innocent corporations and embarrass their officers, directors, and outside advisors.92 Reform advocates argued that, motivated by the prospect of huge fee awards, lawyers would monitor the securities markets for litigation targets (typically companies with volatile shares), waiting for firms to report some unexpected bad news to the market, and suing if the price of the company's shares dropped significantly.93 Because courts calculated damages for securities fraud as the difference between the price paid by buyers and the market price immediately following the disclosure of bad news (the corrective disclosure),94 public companies and their jointly liable co-defendants faced exposure to massive damages claims. Although the claims could bankrupt even large corporate defendants, plaintiffs' lawyers purportedly crafted their lawsuits at little expense, even copying verbatim allegations from complaints they had filed previously against other companies.95

Plaintiffs' lawyers who testified before Congress (including Weiss and Lerach) denied corporate executives' accusations that they filed class action complaints every time a company's stock price fell significantly and without undertaking sufficient investigation. They acknowledged, however, their motivation to race one another to the courthouse.96 Insofar as judges appointed as lead counsel the law firm filing the earliest complaint, time was of the essence. Lead counsel managed the lawsuit on behalf of all plaintiffs and controlled the strategy. Lead counsel assigned the various litigation projects among the participating plaintiffs' law firms and almost always garnered the most work. Lead counsel received the largest share of the legal fees, if any, awarded by the court from the fund created through settlement or judgment.97

Both chambers of Congress also heard testimony that plaintiffs' counsel hired

92. See id.
95. See, e.g., In re Philip Morris Sec. Litig., 872 F. Supp. 97, 98 (S.D.N.Y. 1995) (lawsuit against cigarette maker Philip Morris, claiming company made misstatements regarding its "success in the toy industry"), aff'd in part, rev'd and remanded in part, 75 F.3d 801 (2d Cir. 1996).
97. Julie Creswell & Jonathan D. Glazer, For Law Firm, Serial Plaintiff Had Golden Touch, N.Y. TIMES, June 6, 2006, at A1 ("[T]he lead counsel in a lawsuit typically has considerable influence over how the fees will be awarded to other law firms after a settlement is reached . . . .").
"professional plaintiffs"—investors with standing to sue who received money or other consideration from the attorneys in exchange for their willingness to lend their names and their claims to shareholder lawsuits—to assert class action claims. These repeat plaintiffs purportedly invested nominal sums in many corporations, purchasing just a few shares of stock from each company, with the intention of filing putative class action lawsuits if and when counsel directed them to do so. Firms using professional plaintiffs positioned themselves to file complaints within days, or even hours, and often won the race to the courthouse. They became lead counsel for the putative class, controlling the litigation on the plaintiffs' side.

Corporate lobbyists portrayed plaintiffs' lawyers as self-interested extortionists. They explained that company management had no choice but to settle most class actions in order to avoid the enormous cost of litigation and the uncertainties of trial. Although defendants routinely moved to dismiss the investors' complaints and sanction plaintiffs' counsel for filing groundless actions, the federal courts, especially judges presiding in the Ninth Circuit, purportedly interpreted the fraud pleading rules too liberally and dismissed only patently frivolous lawsuits on early defense motions. Meanwhile, before defendants even answered the complaints, plaintiffs' lawyers inundated their adversaries with discovery demands. Corporate defendants bristled at the substantial cost associated with responding to plaintiffs' burdensome requests for documents and information. The lawsuits also made life miserable for the companies' executives, who were diverted from performing their job responsibilities by depositions and other discovery requests whether or not they were named as defendants themselves. Despite the potential recovery of enormous damages at trial, Milberg Weiss and other plaintiffs' law firms usually settled the claims for "token" amounts of investors' losses, according to reformers—that is, so long as defendants agreed that they would not contest the attorneys' request for contingency fee awards totaling 25%–33% of the settlement fund.

4. Congress Regulates Lead Plaintiff Selection and Compensation

After three years of intense lobbying, Congress enacted the PSLRA in 1995 in an effort to curb the number of securities class actions filed against corporations and to stop costly "strike suits" filed by "entrepreneurial" plaintiffs' lawyers against securities issuers, accountants, and other "deep pocket" defendants. The law limited the rights of

101. See id. at 18–19.
102. In re GlenFed, Inc. Sec. Litig., 42 F.3d 1541 (9th Cir. 1994) (en banc).
104. Id.
106. See id.
shareholders to file class action lawsuits, reduced the liability of securities issuers and their advisors, and made securities class actions more expensive and risky to prosecute. The statute also discouraged securities litigation practices that Congress determined were abusive to corporate defendants, their executives, and their professional advisors. Among the practices that Congress found abusive was the “manipulation” by class action lawyers of the plaintiff-investors whom they purported to represent.\(^\text{107}\) According to the joint House and Senate Conference Report accompanying the new law, Congress enacted the PSLRA in order to “return the securities litigation system to [the] high standard” that private enforcers exhibited before they employed professional plaintiffs and other abusive practices.\(^\text{108}\)

To end the race to the courthouse and the filing of spurious class actions by professional plaintiffs, federal lawmakers sought to encourage the participation of large institutions and other investors with significant financial stakes in the litigation.\(^\text{109}\) Rather than appointing as lead plaintiff the investor whose counsel filed the first complaint, Congress mandated that courts instead appoint as lead plaintiff the putative class member or members determined by the court to be most capable of adequately representing the interests of class members.\(^\text{110}\) Under the PSLRA’s lead plaintiff provision, the volunteer investor with the largest losses is presumptively the “most adequate plaintiff.”\(^\text{111}\) Courts must appoint the most adequate plaintiff as lead plaintiff, provided that the most adequate plaintiff otherwise satisfies the requirements of Rule 23. To inform institutional investors and other potential lead plaintiffs of the pending litigation and provide them with adequate time to decide whether to participate, Congress devised a notice procedure. The first shareholder to file suit must publish a notice advising fellow investors of their opportunity to seek appointment as lead plaintiff.\(^\text{112}\) Shareholders then have 60 days from the issuance of the notice to file a motion seeking appointment as lead plaintiff.\(^\text{113}\) The lead plaintiff appointed by the court then may select and retain lead counsel, subject to court approval.\(^\text{114}\)

In addition to new procedures regulating the appointments of lead plaintiffs and lead counsel, the PSLRA created economic disincentives for investors to serve as lead plaintiffs by effectively limiting judicial discretion to compensate them for their service.\(^\text{115}\) Specifically, Congress prohibited courts from awarding to lead plaintiffs a share of the settlement or judgment greater than their proportional share of the settlement.\(^\text{116}\) Nor could the courts grant any bonus payments to lead plaintiffs for their participation in the litigation other than the reasonable costs and expenses (including lost wages) directly relating to the representation.\(^\text{117}\) In addition to limiting judicial discretion

109. Id. at 34.
110. Id.
111. Id.
113. Id.
114. Id. § 78u-4(a)(3)(B).
115. Id. § 78u-4(a)(4).
116. Id.
to compensate and reward representative parties, the PSLRA prohibited securities brokers and dealers from soliciting or accepting remuneration for assisting plaintiffs’ counsel in obtaining representation for the class.\textsuperscript{118} Finally, Congress restricted the number of times that shareholders could serve as lead plaintiffs,\textsuperscript{119} a provision crafted to prevent counsel from using the same lead plaintiffs repeatedly. To this end, the PSLRA provides that no shareholder may serve as the lead plaintiff in more than five securities class actions during any three-year period.\textsuperscript{120} In order for courts to police plaintiffs’ compliance with this restriction, the statute mandates that they accompany their complaints with sworn certifications personally signed by each plaintiff. In addition to providing information about their transactions in the subject securities, plaintiffs must disclose their involvement as a representative party in certain prior lawsuits and must state that they did not purchase their shares at the direction of counsel or for the purpose of participating in a securities suit.\textsuperscript{121} Congress even required each plaintiff to forswear acceptance of any payment for serving as a representative party on behalf of the class beyond plaintiff’s pro rata share of the recovery or other amounts authorized by the statute.\textsuperscript{122}

Following enactment of the law, advocates who helped draft the PSLRA boldly acknowledged that the statute was intended to destroy Milberg Weiss’s securities practice.\textsuperscript{123} Not only did the lead plaintiff selection provisions disadvantage Milberg Weiss’s individual clients, but the law firm had no client relationships with large institutional investors, such as pension funds, favored under the statute as lead plaintiffs.\textsuperscript{124} Milberg Weiss’s foes assumed that the firm would no longer win appointments as lead counsel. As the presumptive most adequate plaintiffs, institutional shareholders would become lead plaintiffs and select and retain attorneys other than Milberg Weiss—perhaps even traditional corporate law firms—as lead counsel.\textsuperscript{125} Surprisingly, however, Milberg Weiss did not fail. Rather, Milberg Weiss unexpectedly became stronger than ever.\textsuperscript{126} The law firm shifted its resources toward investigating and pleading accounting and financial fraud cases.\textsuperscript{127} In order for plaintiffs to plead satisfactory claims that corporate executives had “cooked the books”—allegations sufficient to survive defendants’ inevitable motions to dismiss—Milberg Weiss hired forensic accountants and in-house investigators to work alongside its experienced

\begin{thebibliography}{12}
\bibitem{118} Id. § 78o(c)(8).
\bibitem{119} Id. § 78u-4(a)(3)(B)(vi).
\bibitem{124} Toobin, \textit{supra} note 5, at 88.
\bibitem{125} See John F. Olson et al., \textit{Pleading Reform, Plaintiff Qualification and Discovery Stays Under the Reform Act}, 51 BUS. LAW. 1101, 1144-45 (1996) (stating that Congress believed institutional shareholders were best suited as lead counsel).
\bibitem{126} Grundfest & Perino, \textit{supra} note 15.
\bibitem{127} Toobin, \textit{supra} note 5, at 90; see also Tamara Loomis, \textit{In Spite of Reform Law, Milberg Weiss Emerges as Winner in Securities Suits}, N.Y. L.J., Apr. 22, 2003, at 1.
\end{thebibliography}
The partnership invested in proprietary software to record analyst calls.\textsuperscript{128} In order to attract institutional investors as clients, Lerach and his partners marketed Milberg Weiss's services to public and labor pension funds, making presentations, attending and sponsoring conferences, and producing newsletters with articles of interest to government and union officials.\textsuperscript{130} Milberg Weiss also established relationships with potential lead plaintiffs by offering litigation monitoring services. For a nominal fee, if any, the law firm identified newly-filed shareholder complaints or prospective fraud actions affecting securities held in the institutions' portfolios. Milberg Weiss partners then were in position to calculate the funds' losses and advise the institutions' decision-makers about possible claims for recovery. These services enabled public and union pension funds to make timely choices as to whether to participate in, and even file motions to lead, putative class actions. Lerach and Weiss preached to institutions that their leadership of class actions not only provided the opportunity to select class counsel but also offered the potential to influence corporate governance reforms at the defendant companies. Milberg Weiss retained the services of Robert Monks, the well-known corporate governance expert and activist, to provide advice to institutional clients on such nonpecuniary settlement terms.\textsuperscript{131}

For all of these reasons, and perhaps others, Milberg Weiss continued to lead the plaintiffs' securities bar in the prosecution of shareholder class actions. During the first five years following enactment of the PSLRA, the firm participated in 60% of all such lawsuits filed nationwide.\textsuperscript{132}

5. The Government's Investigation of Milberg Weiss

The government's investigation of Milberg Weiss began in 1999,\textsuperscript{133} several years after Congress enacted the PSLRA. It would be another seven years before the grand jury indicted Milberg Weiss, and more than eight years before prosecutors charged the ultimate targets of their investigation, Lerach and Weiss. In 1999, federal prosecutors convicted Dr. Steven Cooperman, a Los Angeles ophthalmologist, on charges of insurance fraud.\textsuperscript{134} Facing a ten-year prison term and hoping to reduce his felony sentence, Cooperman offered prosecutors information about receiving "large sums as kickbacks" from Milberg Weiss.\textsuperscript{135} A wealthy investor in the late 1980s and early 1990s, Cooperman had participated as named plaintiff in numerous securities and derivative lawsuits filed by Milberg Weiss. Cooperman told federal officials that Milberg Weiss had

\textsuperscript{128} See Milberg LLP, Other Legal Professionals, http://www.milberg.com/people/people.aspx?search=no&emptytype=5242 (last visited Oct. 18, 2008) (noting that "the firm's professional staff includes a team of investigators ... and four full-time forensic accountants").

\textsuperscript{129} Id. at 92-93.

\textsuperscript{130} Id. at 90.

\textsuperscript{131} See Marc Gunther, The Kings of Pain Team Up, FORTUNE, Dec. 9, 2002, at 40.

\textsuperscript{132} Carney, supra note 123.


\textsuperscript{134} Id.

\textsuperscript{135} According to the judge in Cooperman's divorce proceeding, Cooperman received "large sums as kickbacks from attorneys in one of the leading class-action firms in the nation"—Milberg Weiss—and Cooperman had implicated "members of the Milberg Weiss law firm." Id.
paid him, through disguised means, approximately 10% of its fee awards for serving as a 
plaintiff in various class actions. Although the plea bargain that Cooperman signed 
with the government was filed under seal, his sentence was delayed for two years, until 
July 2001, and substantially reduced. Cooperman eventually served just twenty-one 
months in federal prison.

The government built its case against Milberg Weiss from Cooperman's tip, 
utilizing controversial strategies and practices condemned by lawyers representing 
corporations and accounting firms when applied to their clients. Developed by the Justice 
Department to fight corporate fraud, critics have denounced prosecutors' tactics as not 
only hypocritical but coercive. Here, as in other high profile, white collar 
prosecutions, government lawyers substantially built their case against their ultimate 
targets, Lerach and Weiss, by persuading other accused individuals to cooperate in the 
action. Government lawyers started at the bottom of a culpability pyramid, negotiating 
with paid plaintiffs and their personal lawyers—persons whom they deemed less responsible for the allegedly criminal activity. Prosecutors promised the paid plaintiffs favorable treatment in exchange for their cooperation. The incentives to plea bargain with the government were substantial. Prosecutors offered generous reductions in charges and potential sentences in exchange for these individuals' agreements to plead guilty and assist in the investigation. Since only the government could request that the sentencing judge reward defendants' cooperation (plea agreements provide that only prosecutors, in their sole discretion, may file such a motion), commentators contend that these deals encourage witnesses to lie in order to please prosecutors.

Still, the U.S. Attorney's office in Los Angeles used this strategy to great effect in 
constructing its case against the nation's most active securities lawyers. In late 2004, 
prosecutors obtained the cooperation of Paul Tullman, then 70, a former stockbroker and 
lawyer from New York. Tullman agreed to assist prosecutors with their investigation 
after the government charged him with fraud and making false statements on tax 
returns. Federal prosecutors claimed that he had accepted fees from Milberg Weiss for

136. Id.
137. Id..
139. See Kobayashi & Ribstein, supra note 35, at 371 (noting the similarities between the government's 
and defendants' actions).
140. Most notably, Justice Department lawyers used similar strategies to obtain convictions arising from 
the financial fraud at Enron, as revealed in a recent book authored by a former lead prosecutor on the DOJ's 
Enron Task Force. See JOHN KROGER, CONVICTIONS: A PROSECUTOR'S BATTLES AGAINST MAFIA KILLERS, 
141. Julie Creswell, Ex-Partner at Milberg Pleads Guilty to Conspiracy, N.Y. TIMES, July 10, 2007, at C1 
("Yesterday's guilty plea also put renewed pressure on William S. Lerach and Melvyn I. Weiss . . . ").
142. See, e.g., Creswell & Glazer, supra note 97 ("In exchange for his cooperation, Mr. Vogel was not 
charged with being part of the conspiracy that Milberg Weiss is accused of.").
143. See, e.g., Jeralyn Merritt, Milberg Weiss [sic] Partner Pleads Guilty in Kickback Scheme, TALKLEFT, 
reduced sentence is conditional on government's cases against others, which gives him an incentive to lie).
144. John R. Wilke & Scot J. Paltrow, Ex-Broker to Aid Milberg Inquiry: Cooperation Underscores Wide 
145. Id.
referring to the firm investors who could serve as plaintiffs in securities class actions. Like Tullman, attorney Richard Purtich also accepted an offer from the government to plead guilty to a single tax charge ("corrupt endeavor to obstruct due administration of the internal revenue code") and to aid prosecutors. Purtich admitted in April, 2006, that he failed to report about $900,000 of income to the Internal Revenue Service, monies that he had accepted from Milberg Weiss and passed on to his client, Steve Cooperman.

Prosecutors' strategy faltered somewhat in 2005 when former plaintiff Seymour Lazar refused to cooperate with them. Like Cooperman, Lazar's repeated participation as a named plaintiff in shareholder lawsuits was notorious. However, the retired entertainment lawyer insisted that he received only referral fees from Milberg Weiss for his involvement in class actions and derivative lawsuits. Although he was 78 years old and in poor health, prosecutors nonetheless indicted Lazar on more than a dozen charges, including money laundering, conspiracy, and mail fraud. The same indictment charged Lazar's attorney, Paul Selzer, for allegedly funneling monies from Milberg Weiss to Lazar. In early 2006, with neither defendant backing down, prosecutors reportedly told counsel for Bill Lerach and Mel Weiss that their clients would not be indicted any time soon. Meanwhile, the government focused attention on another former plaintiff for Milberg Weiss, real estate investor Howard Vogel. At the end of April, 2006, the Justice Department announced that it had reached a deal with Vogel. Vogel agreed to plead guilty to a single count of making false statements in federal court and cooperate in the government's on-going investigation of Milberg Weiss.

With Vogel's testimony and cooperation, prosecutors believed that they had enough evidence for the grand jury to indict senior Milberg Weiss partners David Bershad and Steve Schulman. However, even after seven years of investigation, the government still lacked evidence directly linking Weiss and Lerach to the alleged conspiracy. After Bershad and Schulman still refused the government's offer to plea bargain, prosecutors pressed Milberg Weiss to cooperate, subjecting the law firm to the same tactics used

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146. Id.
149. Pamela A. MacLean, Closer Look at Key Figure in Milberg Case: The Colorful Career of Seymour M. Lazar, NAT'L L.J., July 4, 2005, at 6.
150. Id.
152. Id.
154. See, e.g., Creswell & Glazer, supra note 97 ("In exchange for his cooperation, Mr. Vogel was not charged with being part of the conspiracy that Milberg Weiss is accused of.").
against (and denounced by) public corporations and the accounting industry in recent years.\(^{156}\) Government attorneys threatened to indict the law firm for racketeering if it did not waive its attorney-client privilege and cooperate with them by providing evidence against Weiss and Lerach.\(^{157}\) When Milberg Weiss refused to acquiesce to prosecutors’ demands,\(^{158}\) the Justice Department “went nuclear,” filing seven felony counts against the entity in May, 2006.\(^{159}\) When she announced the grand jury’s indictment of the law firm, U.S. Attorney Debra Wong Yang justified the government’s unprecedented decision by stating simply, “This case is about protecting the integrity of the justice system in America.”\(^{160}\)

Along with Milberg Weiss, the grand jury also charged Bershad and Schulman in the same indictment.\(^{161}\) Bershad and Schulman immediately left Milberg Weiss,\(^{162}\) and prosecutors again tried to convince the two men to provide evidence against Weiss and Lerach.\(^{163}\) Instead, all three new defendants pled not guilty and filed voluminous motions to dismiss the government’s charges.\(^{164}\) However, after the trial court rejected the defendants’ motions to dismiss, and as the first scheduled trial date approached, David Bershad relented. Facing the possibility of spending the rest of his life in prison, the 71-year-old former partner agreed to plead guilty to a reduced charge (one conspiracy count) and to cooperate with prosecutors going forward.\(^{165}\) Significantly, Bershad accepted the extensive “statement of facts” drafted by the government and attached as an exhibit to his plea agreement. The government’s recitation implicated named plaintiffs Cooperman,
Lazar, and Vogel as well as Bershad's former partners Schulman, Lerach, and Weiss in a conspiracy to conceal from judges the payment arrangements between the firm and certain representative plaintiffs in class actions.\textsuperscript{166}

Shortly after learning that Bershad had succumbed to pressure by the government, Lerach's attorney contacted the Justice Department. Although not yet charged with any crime, Lerach agreed to plead guilty to one count of conspiracy to obstruct justice, accept a one-to-two-year sentence of confinement, forfeit $7.8 million, and pay a $250,000 fine. The court later sentenced him to the maximum term allowed by his deal with the government, two years in prison.\textsuperscript{167} Even without Lerach's agreement to cooperate with the government, prosecutors now had enough evidence to charge Milberg Weiss's founding partner.\textsuperscript{168} The grand jury's indictment against Mel Weiss himself came down in September, 2007.\textsuperscript{169} Six months later, after the presiding judge summarily (and without argument) denied Weiss's motions to dismiss and refused to move the trial to New York from Los Angeles, Weiss capitulated. The 72-year-old co-founder of the firm agreed to plead guilty to a single charge of racketeering rather than risk serving a 40-year sentence in federal prison, a term that no doubt would have confined him for the rest of his life.\textsuperscript{170} Under his plea agreement with the government, Weiss agreed to serve almost three years of jail time, pay a $250,000 fine, and forfeit $9.75 million, his purported ill-gotten gains derived from the criminal enterprise.\textsuperscript{171}

As for the pending charges against the law firm, Weiss's resignation from the partnership and his guilty plea opened the door to productive negotiations between prosecutors and new management of the firm, which by that time had changed its name to Milberg LLP. The parties resolved the criminal action by entering into a comprehensive nonprosecution agreement. In exchange for the firm's agreement to pay $75 million over five years, the government agreed to drop all charges against the entity, dismiss the indictment, and represent that none of the firm's current lawyers had participated in the former partners' activities.\textsuperscript{172} Prosecutors also withdrew their demand that the law firm cooperate with the government, and the partnership maintained, intact, its attorney-client and work product privileges.

6. Overview of the Government's Charges

Before examining the legal validity of the charges, it is important to understand that

\textsuperscript{166} Creswell, supra note 141. Bershad agreed to forfeit $7.75 million and pay a $250,000 fine, but his jail time depended on his cooperation with prosecutors at the trials of other defendants, and his sentencing was delayed for a little under a year. Id. Ultimately, Bershad was sentenced to six months in prison, despite the government's recommendation that he serve just half that amount of time in light of his cooperation. Nathan Koppel, Milberg's Bershad Sentenced to Six Months in Kickback Case, WALL ST. J., Oct. 28, 2008, http://sec.online.wsj.com/article/SB122512000223472087.html?mod=rss_Law.

\textsuperscript{167} Michael Parrish, Leading Class-Action Lawyer Is Sentenced to Two Years in Kickback Scheme, N.Y. TIMES, Feb. 12, 2008, at C3.

\textsuperscript{168} Barry Meier, Top Class-Action Lawyer Faces Federal Charges, N.Y. TIMES, Sept. 21, 2007, at C3.

\textsuperscript{169} Id.

\textsuperscript{170} O'Brien & Glater, supra note 133.

\textsuperscript{171} Id.

prosecutors focused on a practice—sharing fees with professional plaintiffs—that was essentially old news by the time Milberg Weiss was indicted. Indeed, Milberg Weiss made, and the paid plaintiffs received, almost all of the allegedly criminal payments a decade or more before a grand jury indicted the firm. In fact, with few exceptions, the putative class actions filed by these plaintiffs were commenced before Congress enacted the PSLRA in December, 1995. Moreover, of the 77 problem lawsuits identified in the indictments, only 48 were filed in federal court, and only three of those federal court cases were filed after the PSLRA became effective. The PSLRA has never applied to actions filed in state court, where the other 29 identified cases were filed. Finally, the government included both securities class actions and shareholder derivative cases in the indictments, despite the fact that the PSLRA does not apply to derivative lawsuits and fundamental differences exist between the two forms of shareholder litigation.

In any event, it was only prior to the PSLRA that the fee sharing agreements would have benefited Milberg Weiss, according to the government’s own theory. Prior to the PSLRA, Milberg Weiss’s ability to file the first complaint enhanced the likelihood that it would receive judicial appointment as lead counsel. Lead counsel generally performed more work in the litigation and therefore obtained a larger share of the attorneys’ fees awarded in a class action than other counsel. Having formed relationships with shareholders invested in a portfolio of targeted securities, Milberg Weiss could file securities fraud class actions more quickly than would be possible absent such arrangements. With a group of representative plaintiffs qualified and willing to sue, Milberg Weiss could beat out other plaintiffs’ firms competing for appointment as lead counsel and, according to the government, win more races to the courthouse. After Congress passed the PSLRA in December, 1995, the race to the courthouse ended. Investors with large shareholdings (and, correspondingly, large losses) were, presumptively, the most adequate plaintiffs and, absent exceptional circumstances, were appointed by the courts as lead plaintiffs. Professional plaintiff practices all but disappeared. Individual investors with nominal shareholdings could not assist plaintiffs’ counsel in obtaining the coveted position of lead counsel, and Milberg Weiss would not have entered into new fee sharing agreements with them.

Significantly, too, the Justice Department did not indict Milberg Weiss for violating the PSLRA or any other securities laws. Instead, prosecutors alleged that Milberg Weiss conspired to commit mail and wire fraud by depriving absent class members of the honest services of their class representatives and class counsel. These mail and wire fraud

173. FSI, supra note 25, ¶¶ 24, 35, 37; SSI, supra note 28, ¶¶ 34, 37, 41.
174. Most importantly, shareholder derivative lawsuits benefit the corporation. Derivative claims belong to the corporation, any recovery obtained in the derivative lawsuit goes to the corporation, and neither the named plaintiffs nor plaintiffs’ counsel represent absent shareholders in derivative litigation. See, e.g., Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1036 (Del. 2004) (explaining the distinction).
175. Id.
176. Id.
177. FSI, supra note 25, ¶ 25; Creswell, supra note 141.
178. The indictment names Milberg Weiss in counts one, six through eight, and nine. SSI, supra note 28. The first count alleges that the law firm and others conspired to: commit obstruction of justice in violation of 18 U.S.C. § 1503(a); make false material declarations in violation of 18 U.S.C. § 1623(a); commit commercial bribery, violating New York Penal Law section 180.00 and 18 U.S.C. §§ 1952(a)(1), (3); commit mail and wire fraud in violation of 18 U.S.C. §§ 1341, 1343, and 1346; and (4) make illegal payments to witnesses in violation
counts not only stated the essential scheme to defraud the absent class members, but these same counts formed the backbone of the government’s case against Milberg Weiss. These charges make up the bulk of the indictment and are the ones with the largest penalties. Prosecutors also constructed the money laundering and racketeering charges principally from the accusations of mail and wire fraud, the “specified unlawful activity” and “predicate acts,” respectively. Furthermore, mail and wire fraud were the principal crimes underlying the criminal forfeiture counts, which sought to divest Milberg Weiss of over $250 million in attorneys’ fees awarded by the courts. Under the government’s view, those monies represented criminal proceeds. By charging Milberg Weiss with honest services fraud, prosecutors could claim that the firm itself was a racketeering enterprise, and prosecutors could seek forfeiture of hundreds of millions in attorneys’ fees awarded to the law firm over more than two decades. By indicting the law firm under these malleable statutes, the government could charge Milberg Weiss with racketeering even though the alleged illegal conduct was decades old and involved no threats of violence. Without the mail and wire fraud charges, the government would lose three substantive counts, and the RICO, money laundering, and forfeiture counts would be substantially weakened. The remaining counts alleged crimes based upon the defendants’ purported attempts to hide the honest services fraud. The irony is that most of the alleged concealment also took place 15 to 20 years ago, before Congress enacted the PSLRA. In any event, without the honest services charges, the Milberg Weiss prosecution is a minor cover-up case, not a major racketeering conspiracy.

The next section considers the crime of honest services fraud. After examining the theory’s development and its use as a weapon in public corruption cases, I review honest services claims filed by the government against private actors engaged in private activity.

B. The Government’s Honest Services Claims

The linchpin of prosecutors’ criminal liability theory is the indictment’s allegation that “[t]he kickback arrangements created a conflict of interest between the paid plaintiffs and those to whom they owed fiduciary duties because, as a result of the kickback arrangements, the paid plaintiffs had a greater interest in maximizing the amount of attorneys’ fees awarded to Milberg Weiss than in maximizing the net recovery to the absent class members and shareholders.” Allegations supporting this claim are sparse. According to the indictment, both the named plaintiffs (whether in a class action or shareholder derivative action) and class counsel owe “legally imposed” fiduciary duties to absent class members or shareholders. A named plaintiff:

of 18 U.S.C. § 201(c)(2). Id. ¶ 37. Counts six through eight allege mail fraud, and count nine alleges money laundering. Id. ¶¶ 58–69. Counts 18 through 20 are the criminal forfeiture counts. Id. ¶¶ 78–86.
179. See FSI, supra note 25, ¶¶ 55–56 (RICO), ¶¶ 66–73 (money laundering); SSI, supra note 28, ¶ 52 (RICO), ¶¶ 62–69 (money laundering).
180. See FSI, supra note 25, ¶¶ 82–84; SSI, supra note 28, ¶¶ 84–86.
181. Although the indictment alleges other acts (including, at various points, bribery, obstruction, and travel act violations) in support of the money laundering, RICO, and forfeiture counts, those alleged acts are given short shrift in the indictment. See FSI, supra note 25, ¶ 56; see also SSI, supra note 28, ¶ 52.
182. FSI, supra note 25, ¶ 29.
183. Id. ¶¶ 20–21; SSI, supra note 28, ¶¶ 17–18. There is no substantive difference between the FSI and the SSI with respect to the government’s fiduciary duty allegations and the specific honest services charges. The
(a) may not place her own interests above those of absent class members or shareholders; (b) may not act in a deceitful or unethical manner toward the court or the absent class members or shareholders; and (c) is required to disclose to the court facts that reasonably could affect her ability to fairly or adequately represent the interests of the absent class members or shareholders. 184

The named plaintiff's attorney has the same duties and responsibilities, according to the indictment. 185

More specifically, because the named plaintiff is purportedly a fiduciary to all absent class members "and is required to remain free of any conflict of interest toward them," the named plaintiff cannot have any financial interest in the outcome of the case other than her pro rata share of the recovery and perhaps a "modest bonus payment," provided that the bonus payment has been disclosed to absent class members who have then been given an opportunity to object. 186 The indictment alleged that the kickback arrangements created a conflict of interest between the so-called "paid plaintiffs" and the absent class. 187 The government also charged that, because of the secret and illegal kickbacks, the absent class was deprived of the honest services of the paid plaintiffs and their lawyers, including:

(i) the services of a named plaintiff who was free from any conflict of interest that might impair her ability to fairly and adequately represent their interests;
(ii) the services of attorneys who could fairly and adequately represent the class without preference to the interests of a named plaintiff; and (iii) the services of a named plaintiff and attorneys who would not act in a deceitful, unethical, or unlawful manner to them or the court. 188

Additionally, absent class members were deprived of "material economic information that affected their right and ability to influence and control class actions brought on their behalf" and "the amount of any kickback that Milberg Weiss paid using attorneys' fees obtained in the Lawsuit." 189

most important substantive changes in the SSI are: (1) the addition of Mel Weiss as a defendant; (2) the deletion of Bershad and Schulman (who had pleaded guilty) as defendants; (3) the deletion of allegations concerning certain plaintiffs (Vogel and Cooperman) linked to payments by Bershad and Schulman; and (4) the addition of two claims against Weiss with respect to false statements allegedly made by Weiss during the course of the investigation respecting missing documents which were later discovered. Because the SSI does not differ substantively from the FSI regarding the honest services claims, this Article cites to the FSI only except where there is a distinction.

184. FSI, supra note 25, ¶ 20.
185. Id. ¶¶ 20-21.
186. Id. ¶¶ 24-25.
187. Id. ¶ 29.
188. Id. ¶ 33. The indictment also asserted that the concealment of payments deprived the court of the ability to determine whether the lawsuits should proceed as class actions, whether the named plaintiffs could fairly and adequately represent the class, whether the law firm could represent the class, the fairness of the settlements, and the extent to which the firm should be awarded fees. FSI, supra note 25, ¶ 32; SSI, supra note 28, ¶ 30.
189. FSI, supra note 25, ¶ 33. The FSI alleged that attorneys' fees "are paid, directly or indirectly, from proceeds that otherwise would be available to the absent class members or shareholders." Id. ¶ 23. According to the indictment, Milberg Weiss and Lazar furthered this scheme by mailing at least five checks and a letter in
Distilling the indictments down to the core charges, prosecutors alleged that, by agreeing to share its attorneys' fees with named plaintiffs, Milberg Weiss caused the named plaintiffs to breach their fiduciary duties to absent class members, depriving the absent class members of the honest services owed to them. Furthermore, neither Milberg Weiss nor the paid plaintiffs disclosed the purported conflict of interest to absent class members, despite fiduciary duties that each of them allegedly owed to the absentees requiring such disclosure. Finally, the paid plaintiffs allegedly lied about their receipt of monies under oath, and Milberg Weiss allegedly conspired with them in this regard.

My inquiry does not concern the truth of the factual allegations made in the indictment; for purposes of this inquiry, I assume that Milberg Weiss shared its attorneys’ fees with the named plaintiffs in the cases identified in the indictment. This Article instead examines previously unexplored questions concerning the relationship of the named plaintiffs to absent class members, their fiduciary duties, if any, as plaintiffs, and whether their actions and inactions, as alleged in the indictment, would support a conviction for honest services fraud as a matter of law.

III. CLASS ACTION CRIMINALITY EXTENDS THE HONEST SERVICES FRAUD DOCTRINE

The government’s indictment centers on its charges that Milberg Weiss and the firm’s named plaintiff clients engaged in honest services fraud. A defendant commits honest services fraud—a form of mail and wire fraud—when he engages in “a scheme or artifice to deprive another of the intangible right of honest services.” Controversial since its inception, federal judges have expressed frustration with prosecutors’ recent

2000 and 2001. Id. ¶¶ 61, 64. Counts III through V charged only Lazar. Each count involved the mailing of a single check connected to a pre-PSLRA federal class action (W.R. Grace). Id. ¶ 34, at 17. Counts VI through VIII charged both Milberg Weiss and Lazar. These counts alleged the mailing of two checks and one letter, all arising out of the settlement of a single post-PSLRA federal class action (Schein Pharmaceutical). Id. The two checks were disbursements from Milberg Weiss to the Palm Springs law firm. The letter was a cover letter purporting to forward the second check. Apparently, the second check was sent with the letter, but the letter was improperly addressed so the letter was returned. The check was sent again several weeks later. See FSI, supra note 25, ¶ 52, at 50 (describing Overt Acts 108–09), ¶ 64. In other words, Count VII might have resulted in a mail fraud conviction for a letter that the intended recipient never received.

The pleading of these mail fraud counts demonstrates how use of the mail has become a vestigial element of the alleged crime. See Peter J. Henning, Maybe It Should Just Be Called Federal Fraud: The Changing Nature of the Mail Fraud Statute, 36 B.C. L. Rev. 435, 438 (1995) (discussing the fact that the mail fraud statute has shifted away from its traditional application of protecting against the misuse of mail and has become a tool to fight political corruption); see also Pereira v. United States, 347 U.S. 1, 8–9 (1954) (holding that the mailing need not be a necessary or even an intended part of the scheme, but it must at least be reasonably foreseeable). Indeed, since the mailing element of mail fraud still requires that the mailing be “in furtherance” of the fraudulent scheme, it might have been difficult for prosecutors to show how a letter that is allegedly sent and returned unopened does that. See Schmuck v. United States, 489 U.S. 705, 710–11 (1989) (holding that the mailing must be “a step in [the] plot”). In fact, a number of the alleged payoffs did not involve the use of the mails or wires. At least one unnamed stockbroker testified by affidavit that Schulman met him at a restaurant and literally paid the broker money under the table. Peter Elkind, Milberg Weiss Hits the Canvas, FORTUNE, Oct. 15, 2007, at 40.


91. For histories of the genesis and expansion of the honest services doctrine and insightful proposals to bound its use, see John C. Coffee, Jr., Paradigms Lost: The Blurring of the Criminal and Civil Law Models—And What Can Be Done About It, 101 YALE L.J. 1875, 1879 (1992) [hereinafter Coffee, Paradigms Lost]; John
attempts to expand applications of the vague and malleable statute. For their part, academics continue to question the constitutionality of the law, the boundaries of which seem to be limited only by a prosecutor's ingenuity.

A. The Doctrine's Inception and Evolution Before McNally

Before examining the government's honest services fraud theory as asserted against Milberg Weiss and exploring the nature of the relationships between the absent class members, lead plaintiffs, and lead counsel, it is necessary to understand how the honest services doctrine evolved. 192

Congress first enacted the mail fraud statute in 1872 to combat illegal schemes plied by urban con men on unsuspecting country folk via the mails. 193 For decades, lower courts differed as to how broadly to interpret the statute. 194 In 1914, the Supreme Court opted for a broad interpretation of "scheme to defraud" that encompassed many types of activities that were not closely connected to the use of the mails. 195 Congress has amended the statute numerous times over the past century, each time widening the spectrum of activity that falls within its prohibition. 196 The mail fraud statute (and its cousin, the wire fraud statute) now prohibit devising or intending to devise a "scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent


192. Section 1346 "can be understood only in the light of the long history of the mail- and wire-fraud statutes, which were intentionally written broadly to protect the mail and, later, the wires from being used to initiate fraudulent schemes." United States v. Brown, 459 F.3d 509, 519 (5th Cir. 2006). Entire articles address this history more thoroughly than this Article attempts to do. See, e.g., Rakoff, supra note 191, at 779–822. My objective here is simply to orient the government's case within the larger continuum of honest services mail fraud cases.

193. United States v. Bronston, 658 F.2d 920, 931 (2d Cir. 1981) (Van Graafeiland, J., dissenting) ("[T]he statute was originally aimed at flimflam artists who use the mails to defraud the gullible."); Geraldine Szott Moohr, Mail Fraud and the Intangible Rights Doctrine: Someone to Watch Over Us, 31 HARv. J. ON LEGIS. 153, 158 (1994) (discussing the enactment of the original mail fraud statute to address sending counterfeit currency through the mail); Rakoff, supra note 191, at 780.


pretenses, representations, or promises,” and taking or receiving any matter or thing or knowingly causing any matter or thing to be delivered by mail for the purpose of executing such scheme or artifice. \(^{197}\) Courts construe section 1341 (and the wire fraud statute, section 1343)\(^{198}\) to require proof of three elements: (1) a scheme to defraud; (2) intent to deprive another of money or property; and (3) use of the mails in furtherance of that scheme.\(^{199}\)

The mail fraud statute itself has been the subject of extensive controversy. Prosecutors praise the law as an adaptable catch-all weapon necessary to combat criminal activity not specifically addressed by other criminal laws.\(^{200}\) Chief Justice Burger, characterizing the statute as a “first line of defense,”\(^{201}\) famously stated that “[w]hen a ‘new’ fraud develops—as constantly happens—the mail fraud statute becomes a stopgap device to deal on a temporary basis with the new phenomenon, until particularized legislation can be developed and passed to deal directly with the evil.”\(^{202}\) On the other hand, it is precisely the statute’s adaptability that generates extensive criticism by both judges and scholars.\(^{203}\) Commentators argue that, in enacting the mail fraud statute, Congress has created “essentially element-free criminal liability”\(^{204}\) enabling prosecutors to employ “virtually unbridled discretion”\(^{205}\) to combat “virtually every type of untoward activity known to man.”\(^{206}\) Today, it seems to be the exception, rather than the rule, that criminal conduct falls outside the scope of the statute.\(^{207}\) Because the act of mailing is little more than a “jurisdictional hook,”\(^{208}\) rather than a substantive element of the offense, the statute essentially criminalizes a scheme to defraud (which, in some cases, is little more than intent to defraud) and the otherwise innocuous act of using the mails. Its critics argue that the mail fraud statute creates fair notice problems\(^{209}\) as well as

\(^{197}\) 18 U.S.C. § 1343 (2000). The same prohibition applies under the wire fraud statute to the use of wire, radio, or television communication in interstate commerce to execute any scheme or artifice to defraud. \textit{Id.}

\(^{198}\) Pasquantino v. United States, 544 U.S. 349, 355 n.2 (2005) (noting that mail and wire fraud statutes are in \textit{pari materia} and interpreted the same); Carpenter v. United States, 484 U.S. 19, 25 n.6 (1987) (“The mail and wire fraud statutes share the same language in relevant part, and accordingly we apply the same analysis to both sets of offenses here.”).

\(^{199}\) See, e.g., United States v. Turner, 465 F.3d 667, 680 (6th Cir. 2006); United States v. Leahy, 464 F.3d 773, 786 (7th Cir. 2006); \textit{see also} United States v. Maze, 414 U.S. 395, 405 (1974) (finding that a bank’s mailing of fraudulent receipts to a drawee bank did not further the defendant’s credit card fraud).

\(^{200}\) Rakoff, \textit{supra} note 191, at 772.

\(^{201}\) Maze, 414 U.S. at 405 (Burger, C.J., dissenting).

\(^{202}\) \textit{Id.} at 405–06.

\(^{203}\) See Daniel W. Hurson, Comment, \textit{Mail Fraud, The Intangible Rights Doctrine, and the Infusion of State Law: A Bermuda Triangle of Sorts,} \textit{38} \textit{Hous. L. Rev.} \textit{297}, 302 (2001) (calling “the mail fraud statute one of the most criticized yet utilized of federal criminal statutes”).

\(^{204}\) Hurson, \textit{Limiting Mail Fraud, supra} note 191, at 425.

\(^{205}\) \textit{Id.} at 436.

\(^{206}\) \textit{Id.} at 424; \textit{see also} Gagliardi, \textit{supra} note 191, at 907–08.

\(^{207}\) \textit{Id.} at 225–27 (asserting that the confusion and ambiguity caused by the statute “permits its haphazard application to a wide spectrum of criminal conduct”).

\(^{208}\) United States v. Sawyer, 85 F.3d 713, 723 n.5 (1st Cir. 1996); \textit{see also} Schmuck v. United States, 489 U.S. 705, 722–23 (1989) (Scalia, J., dissenting) (“[T]he law does not establish a general federal remedy against fraudulent conduct, with the use of the mails as the jurisdictional hook . . . . In other words, it is mail fraud, not mail and fraud, that inures liability.” (citations omitted)).

vagueness concerns and due process challenges.210

In the early 1970s, as public corruption received increased attention following the Watergate scandal, prosecutors began using the mail fraud statute to prosecute public officials. These targets allegedly had deprived the public, not of money or property, but of its “intangible right” to a government official’s “honest services.”211 Those cases established that citizens have the “right to conscientious, loyal, faithful, disinterested and honest government” and, further, a scheme to defraud citizens of those rights “that involves bribery and non-disclosure and concealment of material information may come within the purview of the federal mail fraud statute even though no state or federal statute or common law is transgressed in terms.”212 The Justice Department initially limited its use of this theory to schemes involving public corruption; prosecutors did not invoke honest services in cases involving alleged breaches of private fiduciary duties.213 However, once the statute's effectiveness as a weapon against officials' breaches of fiduciary duty to the public became clear, prosecutors began turning to this tool to penalize conduct involving purely private fiduciary relationships heretofore primarily governed by state tort law and, to a lesser extent, state criminal law.214 Courts aided this expansion of criminal liability by using extraordinarily broad language to describe how the mail fraud statute applied in cases involving government officials, particularly the judicial gloss placed on the term “scheme or artifice to defraud.” For example, the court in United States v. Mandel held that the mail fraud statute could be used to prosecute any “scheme involving deception that employs the mails in its execution that is contrary to public policy and conflicts with accepted standards of moral uprightness, fundamental honesty, fair play and right dealing.”215

Expansion of honest services fraud to breaches of private fiduciary duties began with judicial recognition that employees owe employers duties of loyalty, and, therefore, that employers had a right to the honest services of their employees.216 The rationale proved to be surprisingly successful and adaptable. In some circuits, it spread beyond employer-employee to other principal-agent relationships and even to situations where no


210. See Buell, supra note 209, at 2040 (discussing how consciousness of wrongdoing as a condition of liability remedies current due process and vagueness concerns of fraud law generally).

211. Perhaps the first use of the mail fraud statute to combat public corruption was in Shushan v. United States, 117 F.2d 110 (5th Cir. 1941), overruled on other grounds by United States v. Cruz, 478 F.2d 408 (5th Cir. 1973). However, it was not until the post-Watergate investigations of (primarily state) elected officials, like Maryland Governor Marvin Mandel and Illinois Governor Otto Kerner, that federal authorities used the statute more routinely to combat public corruption. See, e.g., United States v. Mandel, 591 F.2d 1347 (4th Cir. 1979), vacated, 602 F.2d 653 (4th Cir. 1979) (en banc); United States v. Isaacs, 493 F.2d 1124 (7th Cir. 1974); United States v. States, 488 F.2d 761, 765 (8th Cir. 1973) (holding that election fraud fell within the statute because it involved a scheme to defraud the public of “intangible political and civil rights”).

212. Mandel, 591 F.2d at 1359-60.


214. See, e.g., Podgor, supra note 191, at 232-36 (listing numerous cases to demonstrate the rapid expansion of the mail fraud statute in the 1970s and 1980s).

215. Mandel, 591 F.2d at 1361.

216. See, e.g., United States v. Brown, 459 F.3d 509, 519 (5th Cir. 2005) (“‘Honest services are services owed to an employer under state law,’ including fiduciary duties defined by the employer-employee relationship.” (quoting United States v. Caldwell, 302 F.3d 399, 409 (5th Cir. 2002))).
fiduciary relationship between the criminal defendant and the putative victim was apparent.

As quickly as the theory spread, however, so did criticism of its growth. Professor John Coffee’s work explained the concerns. Federal prosecutors interpreted the theory to encompass “virtually the entire range of commercial activity.” Moreover, once divorced from the “money or property” requirement of the mail fraud statute, prosecutors could file charges in cases wherein the putative victim not only suffered no financial or property loss but was not even threatened with such a loss. Over time, the government used the honest services theory to charge putative fiduciaries who failed to disclose their purported conflicts of interest. Because “fiduciary duty” itself is both amorphous and fact-sensitive, reliance on a breach of fiduciary duty as the benchmark for criminal liability greatly expanded the reach of the mail fraud statute. During this period,

most any action undertaken by a fiduciary, agent, or employee which causes detriment to his beneficiary, principal, or employer and which involves some material deception, will likely trigger a responsibility to make disclosure. Failure to disclose will be construed as a breach of fiduciary duty and subject the actor to federal prosecution for mail fraud.

217. See, e.g., Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 502 (1985) (Marshall, J., joined by Brennan, Blackmun, & Powell, J.J., dissenting) (criticizing lower courts for permitting “extraordinary expansion” of §§ 1341 and 1343 “to permit federal prosecution for conduct that some had thought was subject only to state criminal and civil law” (internal quotations omitted)); United States v. Holzer, 816 F.2d 304, 309 (7th Cir. 1987) (criticizing a fundamental honesty and fair play formulation as “much too broad”); United States v. Margiotta, 688 F.2d 108, 141 n.4, 142 (2d Cir. 1982) (Winter, J., concurring and dissenting in part) (protesting expansion of the mail fraud statute by “judicial fiat”).


219. Hurson, Limiting Mail Fraud, supra note 191, at 429, 432 (“[T]he mail fraud statute has expanded to embrace almost any set of facts that involves deception by one who can be said to owe a duty of honesty to another.”); Id. at 424 (finding that the statute “has been expansively interpreted to invite federal prosecution of virtually every type of untoward activity known to man”).

220. See, e.g., Margiotta, 688 F.2d at 121 (“In the private sector, it is now a commonplace that a breach of fiduciary duty in violation of the mail fraud statute may be based on artifices which do not deprive any person of money or other forms of tangible property.”).

221. For criticism of doctrine’s vagueness, see, e.g., SEC v. Chenery Corp., 318 U.S. 80, 85–86 (1943) (noting that to call a person “a fiduciary only begins [the] analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge those obligations? And what are the consequences of his deviation from duty?”); Margiotta, 688 F.2d at 142 (Winter, J., concurring in part and dissenting in part) (“The words fiduciary duty are no more than a legal conclusion and the legal obligations actually imposed under that label vary greatly from relationship to relationship. . . . Partners, employees, trustees and corporate directors are all fiduciaries, yet their legal obligations may be wholly dissimilar.”). Even the Margiotta majority, which concluded that an unelected political party leader actually owed the same fiduciary duty that a public official did to disclose conflicts of interest because he participated substantially in governmental decisions, had to admit that “[w]hile Cardozo described the standard of behavior governing a fiduciary as ‘the punctilio of an honor the most sensitive,’ such rhetoric does not assist in determining when a fiduciary duty arises.” Id. at 125 (quoting Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928)).

222. Hurson, Limiting Mail Fraud, supra note 191, at 429; see also Coffee, Tort/Crime, supra note 218, at
At times, it seemed that prosecutors added honest services mail fraud to their indictments like "insurance" that they "used as a 'catchall' device to prosecute any dishonest activity which the federal government chooses to bring within the ambit of its criminal jurisdiction."\textsuperscript{223} As prosecutors employed their charging discretion largely unchecked "by judicial fiat,"\textsuperscript{224} honest services fraud "overgrew the legal landscape in the manner of the kudzu vine until . . . few ethical or fiduciary breaches seemed beyond its potential reach."\textsuperscript{225} As a result, the intangible right to honest services doctrine became the way to criminalize conduct that otherwise might be subject only to state criminal, or tort, law.\textsuperscript{226}

\textit{United States v. Bronston} epitomizes the troubling reach of the doctrine.\textsuperscript{227} In \textit{Bronston}, the Second Circuit upheld the conviction of a partner in a law firm for violating section 1341. The lawyer represented a client seeking a franchise with New York City to build bus stop shelters while his firm represented another group (the BusTop investors) that also sought the same license. The lawyer did not disclose to the firm or the BusTop investors that he represented a competitor for the same franchise, though there was no evidence that the lawyer used any confidential information received from the BusTop investors while representing the competitor.\textsuperscript{228} The lawyer billed the competitor \$12,500 in fees not contributed to the firm.\textsuperscript{229}

Appealing his conviction, Bronston argued there was no evidence that he misused his fiduciary position to benefit himself or his client at the expense of the firm's client.\textsuperscript{230} The court demurred, holding that, while there must be proof that "some actual harm or injury was at least contemplated,"\textsuperscript{231} prosecutors need not prove "that the fiduciary relationship was used or manipulated in some way."\textsuperscript{232} As a partner in the firm, Bronston owed a fiduciary duty to the BusTop investors, who were "entitled to the undivided loyalty of [all the firm's] partners," including Bronston.\textsuperscript{233} His failure to disclose the conflict of interest violated the mail fraud statute.

Over time, the intangible rights theory ensnared more and more dishonest conduct. Ultimately, the statute protected "rights" as disparate as (1) the public's right to the honest and loyal services of their governmental officials; (2) the public's right to an~

\textsuperscript{204} (arguing that honest services fraud turned mail and wire fraud statutes into mandatory disclosure statutes requiring all public officials and private fiduciaries to disclose any conflict of interest to which they were subject).

\textsuperscript{223}. Hurson, \textit{Limiting Mail Fraud}, supra note 191, at 435.
\textsuperscript{224}. \textit{Margiotta}, 688 F.2d at 141 n.4 (Winter, J., concurring in part and dissenting in part).
\textsuperscript{225}. Coffee, \textit{Modern Mail Fraud}, supra note 209, at 427.
\textsuperscript{226}. Podgor, \textit{ supra} note 191, at 232–36 (listing numerous cases to demonstrate the rapid expansion of the intangible rights doctrine in the 1970s and 1980s).
\textsuperscript{227}. United States v. Bronston, 658 F.2d 920 (2d Cir. 1981). In the context of "public fiduciary duties," perhaps the most notable was \textit{Margiotta}, 688 F.2d 108, which the Second Circuit decided less than a year after \textit{Bronston}.
\textsuperscript{228}. \textit{Bronston}, 658 F.2d at 929–30.
\textsuperscript{229}. \textit{Id.} at 926.
\textsuperscript{230}. \textit{Id.} at 931 (Van Graafeiland, J., dissenting) ("This is not a case in which the defendant took advantage of or used his fiduciary relationship with firm clients to do them harm. . . . The Government did not even prove that there was information of a confidential nature that might have been wrongfully disclosed.").
\textsuperscript{231}. \textit{Id.} at 927.
\textsuperscript{232}. \textit{Id.} at 926.
\textsuperscript{233}. \textit{Bronston}, 658 F.2d at 927.
honest election; (3) in the private sector, an employer or union or, in some cases, an individual’s right to the “honest services” of those with “clear fiduciary duties” to him; and (4) various other individual privacy and other nonmonetary rights.\textsuperscript{234}

\section*{B. McNally, Carpenter, and Congress’s Response}

Prosecutors’ authority to charge honest services mail fraud came to an abrupt halt in 1987 when the Supreme Court handed down its surprising decision in \textit{McNally v. United States}.\textsuperscript{235} In \textit{McNally}, the Court held that the mail fraud statute did not criminalize deprivations of “intangible rights to honest services.”\textsuperscript{236} The case concerned a self-dealing patronage system in Kentucky involving the head of the state’s Democratic Party (Hunt), the secretary of the Governor’s cabinet (Gray), and McNally, who owned an insurance company.\textsuperscript{237} After Hunt pled guilty to mail fraud, a federal jury convicted Gray and McNally of mail fraud for devising a scheme to defraud the citizens of Kentucky of their intangible rights to honest and impartial government.\textsuperscript{238}

The Supreme Court reversed the convictions. The majority concluded that the mail fraud statute safeguarded only rights to property and money and did not extend to protect the intangible right of the citizenry to good government.\textsuperscript{239} Rejecting the statutory interpretation adopted unanimously by the federal courts of appeal,\textsuperscript{240} the majority noted that appellate courts had read the “or” in section 1341 as disjunctive, meaning that Congress had prohibited “any scheme or artifice to defraud,” or any scheme “for obtaining money or property by means of false or fraudulent pretenses, representations, or promises.”\textsuperscript{241} Appellate courts thus had concluded incorrectly that the “money or property” language did not address schemes to defraud, which still could encompass schemes that deprived individuals of intangible rights.\textsuperscript{242} The Court disagreed with that statutory interpretation and determined that, rather than being read disjunctively, the “second phrase [of section 1341] simply made it unmistakable that the statute reached false promises and misrepresentations as to the future as well as other frauds involving

\begin{itemize}
\item \textsuperscript{234} McNally v. United States, 483 U.S. 350, 362–64 (1987) (Stevens, J., dissenting) (cataloging cases in each of these categories). Justice Stevens further subdivided the first category—the public’s right to the honest services of its governmental officials—into cases in which the governmental official was the defendant and others in which it was a private individual who was convicted of devising schemes through which public servants defrauded the public. \textit{Id.} at 362 n.1.
\item \textsuperscript{235} See \textit{McNally}, 483 U.S. 350.
\item \textsuperscript{236} \textit{Id.} at 360.
\item \textsuperscript{237} \textit{Id.} at 352.
\item \textsuperscript{238} \textit{Id.} at 352–54.
\item \textsuperscript{239} \textit{Id.} at 356–57.
\item \textsuperscript{240} At the time, section 1341 stated, in pertinent part:
\begin{quote}
Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, . . . for the purpose of executing such scheme or artifice or attempting so to do, [uses the mails or causes them to be used], shall be fined not more than $1,000 imprisoned, not more than five years, or both.
\end{quote}
\end{itemize}


\begin{itemize}
\item \textsuperscript{241} \textit{McNally}, 483 U.S. at 350–51.
\item \textsuperscript{242} \textit{Id.} at 358.
money or property."

The Court further noted that the jury had not found that the Commonwealth lost any money or property. There was no evidence that Kentucky would have paid lower premiums or obtained better coverage and, although Hunt and Gray received some of the commissions, those commissions were paid by the insurance companies, not the Commonwealth. Instead, the deprivation of honest governmental affairs simply was the failure by Hunt and Gray to disclose their financial gain to other state officials whose actions could have been affected. The Court deemed this deficiency too far removed from the mail fraud statute's focus on money and property to fall within its ambit.

Six months later, with prosecutors still reeling from McNally, the Court revisited the mail fraud statute and clarified the scope of its earlier opinion. In Carpenter v. United States, the Court concluded that the mail fraud statute did protect intangible property rights. In that case, the Court held that the Wall Street Journal had an intangible property right to its confidential business information that could be protected from misuse by its reporters via the mail fraud statute. The Court noted that "confidential business information has long been recognized as property." The "intangible nature" of the Journal's confidential business information "does not make it any less 'property' protected by the mail and wire fraud statutes... McNally did not limit the scope of § 1341 to tangible as distinguished from intangible property rights." However, the Court reiterated that the Journal's "contractual right to [the reporter's] honest and faithful service" remained "an interest too ethereal in itself to fall within the protection of the mail fraud statute."

Federal lawmakers worked quickly to attempt to redress McNally. Even before the Supreme Court decided Carpenter, representatives introduced a House bill to amend 18 U.S.C. § 1341 by defining "fraud or defraud" to include "defrauding another... of intangible rights of any kind whatsoever in any manner or for any purpose

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243. Id. at 359.
244. Id. at 360.
245. Id. at 360–61.
247. The Court clearly had concerns about lenity and federalism as well. Interpreting the mail fraud statute more narrowly, the Court reasoned that:

Rather than construe the statute in a manner that leaves its outer boundaries ambiguous and involves the Federal Government in setting standards of disclosure and good government for local and state officials, we read [the mail fraud statute] as limited in scope to the protection of property rights. If Congress desires to go further, it must speak more clearly than it has.

Id. at 360.
249. Id. at 28.
250. Id.
251. Id. at 26. The specific business information at issue was the content of certain articles, as well as the timing of their publication, which had the potential to move stock prices. A reporter from the Wall Street Journal, along with two others, had engaged in a scheme to profit from the reporter's inside information by trading ahead of the publication of such information. Id. at 22–23.
252. Carpenter, 484 U.S. at 25.
253. Id.
That legislation stalled and was not enacted. The next year, both chambers introduced legislation to address McNally. In the Senate, separate bills were introduced to address honest services in the public and the private sector, but neither passed. Ultimately, Congress passed the Anti-Drug Abuse Act of 1988, enacted on November 18, 1988, which included an amendment that later became 18 U.S.C. § 1346. In its entirety, the amendment stated: “For purposes of this chapter [18 U.S.C. §§ 1341–50], the term ‘scheme or artifice to defraud’ includes a scheme or artifice to deprive another of the intangible right of honest services.”

The amendment’s sparse legislative history provides little guidance. The amendment’s sponsor, Representative John Conyers (D-MI), inserted the language into the bill the same day it passed in both chambers. Legislators did not discuss the amendment on the floor before they voted. Representative Conyers submitted comments stating that he “intended merely to overturn the McNally decision. No other change in the law is intended.” However, Mr. Conyers ultimately voted against the bill.

254. See Fraud Amendments Act of 1987, H.R. 3089, 100th Cong. (1st Sess. 1987), in 133 CONG. REC. 22341 (1987). The Senate Judiciary Committee did the same just after the Carpenter decision. See S. 1898, 100th Cong. (1st Sess. 1987), in 133 CONG. REC. 33254 (1987). Another bill was introduced in the House in 1987 which would have addressed “honest services” in government only, but it, too, was not enacted. See Mail Fraud Amendment Act of 1987, H.R. 3050, 100th Cong. (1st Sess. 1987), in 133 CONG. REC. 21466 (1987).

255. Senator Joseph Biden (D-DE) introduced legislation which would have defined a “scheme or artifice to defraud” to include: “a scheme or artifice to deprive an organization of the intangible right of honest services in which the defendant received or attempted to receive, for the defendant or another person, anything of value or in which the defendant intended or contemplated loss or harm to the organization.” 134 CONG. REC. 23954 (1988) (statement of Senator Biden).

He intended that the bill would allow the government to prosecute persons who violate the trust placed in them by their employers or some other organization and do so in order to get a bribe or kickback . . . It is not intended to criminalize mere breaches of fiduciary duty, or private confidence, or violations [of] ordinary rules of the workplace . . . [T]he codification of pre-McNally law in the bill is specifically limited to situations where the defendant is acting to obtain a thing of value, or to harm the organization. This provision will foreclose the abuse of the statute to prosecute trivial, noncriminal matters.


257. United States v. Brumley, 116 F.3d 728, 742 (5th Cir. 1997) (en banc) (Jolly & DeMoss, J.J., dissenting). The court in Brumley noted:

The text of what is now section 1346 was never included in any bill as filed in either the House of Representatives or the Senate. As a result, the text of section 1346 was never referred to any committee of either the House or the Senate, was never the subject of any committee report from either the House or the Senate, and was never the subject of any floor debate reported in the Congressional Record.

Id.

258. Id.

259. See 134 CONG. REC. H11108, H11251 (daily ed. Oct. 21, 1988) (statement of Rep. Conyers). In discussing the amendment, Representative Conyers stated:

This amendment restores the mail fraud provision to where that provision was before the McNally
The Senate Judiciary Committee submitted a post-enactment report into the Congressional Record describing the meaning of section 1346. The report stated that lawmakers intended that the amendment would "overturn[] the decision in McNally" and "reinstate all of the pre-McNally case law pertaining to the mail and wire fraud statutes without change." A number of courts have relied on the post-enactment report to conclude that section 1346 effectively nullified McNally and reinstated the "intangible right to honest services" doctrine as it existed before the Supreme Court issued its decision. However, as members of the Fifth Circuit have noted, post-enactment legislative history is disregarded often by courts tasked with construing statutory language.

More recent caselaw suggests that section 1346 did not revive all pre-McNally case law. In 2000, the Supreme Court revisited the mail fraud statute in Cleveland v. United States. The question before the Court was whether making false statements to governmental officials to obtain video poker licenses constituted mail fraud. In considering this, the Court stated that "Congress amended [section 1341] specifically to cover one of the 'intangible rights' that lower courts had protected ... prior to McNally: 'the intangible right of honest services.'" Congress covered only the intangible right of honest services even though federal courts, relying on McNally, had dismissed, for want of monetary loss to any victim, prosecutions under [section] 1341 for diverse forms of decision. The amendment also applies to the wire fraud provision, and precludes the McNally result with regard to that provision. ... Thus, it is no longer necessary to determine whether or not the scheme or artifice to defraud involved money or property. This amendment is intended merely to overturn the McNally decision. No other change in the law is intended.


262. See United States v. Frost, 125 F.3d 346, 364 (6th Cir. 1997) (holding that Congress intended section 1346 to restore the "intangible right to honest services" doctrine); United States v. Czubinski, 106 F.3d 1069, 1076 (1st Cir. 1997); United States v. Waymer, 55 F.3d 564, 568 n.3 (11th Cir. 1995).


264. Subsequent legislative history demonstrates the same thing. In 1989, the year after Congress enacted section 1346, Senator Biden introduced the Anti-Corruption Act again, Anti-Corruption Act of 1989, S. 327, 101st Cong. (1989), explaining that the prior Congress had amended the mail and wire fraud statutes only "to define fraud to include a scheme to deprive a person of the intangible right to another's honest services." 135 CONG. REC. S1025-02 (daily ed. Feb. 2, 1989) (statement of Sen. Biden), cited in United States v. Turner, 465 F.3d 667, 667 (6th Cir. 2006). Senator Biden described section 1346 as a "stoppgap," "temporary fix," and "partial solution" that had allowed the government to resume prosecution of public corruption cases involving the honest services of public officials, as well as some commercial bribery and other serious breaches of fiduciary duty. Id. However, Senator Biden also stated that section 1346 did "not permit prosecution of election fraud because such offenses do not involve anyone's 'honest services.'" Id. Had Senator Biden, one of the sponsors of the Senate bill that paralleled the Anti-Drug Abuse Act (which included section 1346) believed that section 1346 completely reversed McNally, he presumably would not have proposed an amendment to the statute.


266. Id. at 15.

267. Id. at 19-20.
of public corruption, including licensing fraud."268 Because *Cleveland* dealt with licensing fraud, rather than honest services fraud, the Court determined that such cases had not been resurrected by section 1346.269

The Court also "reaffirm[ed its] reading of [section] 1341 in *McNally*" when it reiterated that, while the two phrases in section 1341 might appear to be independent because they are disjunctive, the two phrases were not separate.270 Therefore, under section 1341, a mail fraud victim still must be deprived of "money or property."271 Since "the thing obtained" by the misstatements—the license—was not "property in the hands of the victim," section 1341 did not criminalize that conduct even though "the object of the fraud may become property in the recipient's hands."272 The Court reasoned that, if "the second phrase of [section] 1341 defines a separate offense, the statute would appear to arm federal prosecutors with power to police false statements in an enormous range of submissions to state and local authorities."273

Importantly, animating the Court's decision was a concern that a contrary holding would "approve a sweeping expansion of federal criminal jurisdiction in the absence of a clear statement by Congress" and "subject to federal mail fraud prosecution a wide range of conduct traditionally regulated by state and local authorities."274 The Court underscored that "unless Congress conveys its purpose clearly, it will not be deemed to have significantly changed the federal-state balance in the prosecution of crimes."275 Lenity also counseled in favor of interpreting section 1341 narrowly.276 Because section 1341 serves as a predicate offense under RICO, the Court cautioned that the "harsher alternative" should not be chosen unless Congress has "spoken in language that is clear and definite."277 The appropriate scope of section 1346, how it fits with decisions interpreting section 1341, and its interplay with pre-*McNally* case law are just some of the issues that remain unsettled, as discussed next.

### C. Judicial Review of Prosecutions Under Section 1346

Questions arising from section 1346's sparse text and cryptic provenance make honest services fraud even more muddled now than before *McNally*. In the 20 years since Congress enacted section 1346, questions about its interpretation and application have proliferated. Despite the confusion, Congress has not elaborated on the meaning of

268. Id. at 20 (emphasis added).
269. Id.
271. Id. at 15.
272. Id. The Sixth Circuit followed this analysis in *United States v. Turner*, 465 F.3d 667 (6th Cir. 2006). The court overturned the conviction of a political candidate prosecuted under sections 1341 and 1346, concluding that the defendant had not violated section 1346 because a candidate for office, unlike an elected official, did not owe the public fiduciary duties. *Id.* at 675. In addition, section 1346 did not resurrect election fraud claims because it "was a limited revival of intangible rights." *Id.* at 673. According to the court, "the right to honest elections was separate and distinct from the right to honest services before *McNally*." *Id.*
274. Id. at 24.
275. Id. at 25 (quoting *Jones v. United States*, 529 U.S. 848, 858 (2000)).
276. Id.
277. Id.
“scheme or artifice to deprive another of the intangible right of honest services.”

What are the “honest services” to which “another” has a right? From what sources do such rights arise? State law? Federal law? What proof must the government proffer of the fiduciary duty giving rise to such a “right”? If the defendant is the actor alleged to have deprived the victim of her right to honest services, is it enough that the victim was deprived of the defendant’s honest services, or must the government prove that the defendant’s actions deprived the victim of some other person’s honest services? Disagreement abounds.

Courts also differ on whether they can (or must) rely on pre-McNally case law, and they continue to disagree about the standard for a misrepresentation (Is it material? Is it reasonably foreseeable that it would cause harm? Both?). Does the prosecution need to show tangible harm to a victim or economic benefit to the defendant? How broad does honest services fraud really sweep? Can it actually mean that, as one court noted, “dishonesty by an employee, standing alone, is a crime”? The vague and open-ended nature of the statutory text itself continues to provide the potential for abuse of prosecutorial discretion. In the hands of a zealous federal prosecutor, use of the honest services doctrine may criminalize activities or conduct better regulated through civil law.

This Article does not attempt to analyze, let alone resolve, all of the current interpretive questions. Instead, my objective is to examine how some of these issues relate to the Milberg Weiss indictment and, more broadly, to determine what kind of duty, owed to whom, must be breached such as to constitute honest services fraud. Case law and commentary have not focused adequately on the requirement for and nature of the duty that must be present to give rise to an honest services fraud charge. Addressing this question explicitly should assist the development of a more coherent honest services fraud jurisprudence. Initially, I focus specific attention on several seminal honest services fraud cases as well as a number of cases involving attorneys insofar as those decisions provide some analytical insights into class action criminality.

1. Lessons from Recent Case Law

Two recent cases, including one arising from the Enron financial fraud and bankruptcy, provide helpful counterpoints in assessing current interpretations of section 1346. In United States v. Rybicki, the Second Circuit tried to establish a framework to analyze charges of honest services fraud. More recently, the Fifth Circuit’s 2006 decision in United States v. Brown offers an alternative perspective. Neither court could

278. 18 U.S.C. § 1346 (2000); see United States v. Brown, 459 F.3d 509, 519 (5th Cir. 2006) (“[T]he statute provides no perimeters . . . .”); United States v. Rybicki (Rybicki II), 354 F.3d 124, 135 (2d Cir. 2003) (acknowledging that one would “labor long and with difficulty” to try to discern the “plain meaning” of section 1346).
279. Rybicki II, 354 F.3d at 163 (Jacob, J., dissenting).
280. Id.
281. Id. at 162–63.
282. United States v. Frost, 125 F.3d 346, 368 (6th Cir. 1997).
283. United States v. Thompson, 484 F.3d 877, 884 (7th Cir. 2007) (encouraging “Congress to take another look at the wisdom of enacting ambulatory criminal prohibitions” like section 1346).
harmonize the contradictory body of honest services fraud opinions, although the Second Circuit made a concerted effort to do so.

While section 1346 makes it criminal to engage in a scheme “to deprive another of the intangible right of honest services,” the statute does not identify who has such a right. Even before McNally, the “intangible right of honest services” did not extend to the world at large. That interpretation would surely have raised constitutional fair notice or vagueness problems. Generally, the “intangible right of honest services”—or perhaps the right to receive honest services—did not even arise from an arm’s length, contractual bargain. To include rights derived from arm’s length bargains within the intangible right to honest services “could easily include a wealth of nefarious conduct” not intended to be criminal “if not constrained by the judiciary.”

Rather, courts usually limited the intangible right to honest services to situations in which someone owed a fiduciary duty to provide honest services, such as an employer-employee relationship. That is, the right to receive honest services arose from “another’s” fiduciary duty to provide honest services, despite the fact that the statute does not mention the word fiduciary, let alone define it. Later, I examine the duties alleged in the Milberg Weiss indictment; specifically, the duties the named plaintiffs and the plaintiffs’ attorneys owe, and to whom. For now, though, we need only consider the following organizing questions: (1) who has a fiduciary duty?, (2) what is that duty?, (3) to whom is that duty owed?, (4) did the criminal defendant breach that duty?, and (5) did the defendant’s breach intend to, and in fact, cause damages to the person entitled to receive fiduciary services, or at least were such damages reasonably foreseeable? While these questions seem straightforward, a discordant body of case law suggests otherwise.

287. United States v. Handakas, 286 F.3d 92, 96–97 (2d Cir. 2002); United States v. Cochran, 109 F.3d 660, 667 (10th Cir. 1997) (“[W]here a private actor or quasi-private actor is deprived of honest services in the context of a commercial transaction, it would give us great pause if a right to honest services is violated by every breach of contract or every misstatement made in the course of dealing.”).
289. See, e.g., United States v. Turner, 465 F.3d 667, 675 (6th Cir. 2006) (“This circuit’s pre-McNally honest services precedents, as examined in Frost, require the finding of a fiduciary duty owed by the defendant to the victim.”); Gagliardi, supra note 191, at 905. However, not every court has agreed with this assertion either. See United States v. Sancho, 157 F.3d 918, 921 (2d Cir. 1998) (“[W]e need not ask whether the duty owed is properly considered a ‘fiduciary duty.’”).
290. The Rybicki II court construed section 1346 to prohibit a scheme or artifice to use the mails or wires to enable an officer or employee of a private entity (or a person in a relationship that gives rise to a duty of loyalty comparable to that owed by employees to employers) purporting to act for and in the interests of his or her employer (or of the person to whom the duty of loyalty is owed) secretly to act in his or her or the defendant’s own interests instead, accompanied by a material misrepresentation made or omission of information disclosed to the employer. Rybicki II, 354 F.3d at 126–27. At least in the Second Circuit, this included not only employees but other persons who “assume a legal duty of loyalty comparable to that owed by an officer or employee to a private entity.” Id. at 142 n.17.
291. Id. at 163 (Jacobs, J., dissenting) (noting the “lack of coherence” in case law on issues including, inter alia: (1) whether the defendant must cause actual tangible harm; (2) the duty that must be breached; and (3) the source of that duty).
a. United States v. Rybicki

In *United States v. Rybicki (Rybicki II)*, two personal injury lawyers and their law firm were convicted for honest services fraud for paying secret gratuities to claims adjusters employed by insurance companies against whom the defendants' clients asserted claims. The government did not try to prove that the amount of any insurance settlement connected with a payment was inflated beyond what a reasonable settlement would be. Instead, the theory was that payments induced the adjusters to expedite the settlement of the clients' claims. First a panel, and then the en banc Second Circuit, affirmed the convictions. The lawyers and their firm argued that they had not violated section 1346 because the prosecution had not proven that the insurance companies had been harmed. In its decision, the Second Circuit extensively reviewed honest services fraud case law, both before and after *McNally* and following enactment of section 1346.

The court began by presuming that, despite the lack of clarity in section 1346's language or its legislative history, Congress must have meant to overrule *McNally* "at least in part." It looked to pre-*McNally* case law to determine the "well-settled meaning" of "scheme or artifice to deprive another of the intangible right of honest services" when section 1346 was enacted. The court believed that Congress intended to "recriminalize" schemes to deprive others of the "intangible right of honest services" which had been protected before *McNally*, "not all intangible rights of honest services whatever they might be thought to be." Cognizant of both the potential for "too much uncontrolled discretion to police or prosecutors" and federalism concerns, the court reasoned that "[t]here is no reason to think that Congress sought to grant carte blanche to federal prosecutors, judges and juries to define 'honest services' from case to case for themselves."

The court divided pre-*McNally* private sector honest services cases into two categories: (1) bribes or kickbacks and (2) self-dealing. Bribery/kickback cases were those cases in which "a defendant who has or seeks some sort of business relationship or transaction with the victim secretly pays the victim's employee (or causes such a payment to be made) in exchange for favored treatment." By contrast, "[i]n the self-
dealing cases, the defendant typically causes his or her employer to do business with a corporation or other enterprise in which the defendant has a secret interest, undisclosed to the employer. The distinction between the two categories was that, in bribery/kickback cases, the undisclosed bribery established the crime; but in the self-dealing cases, the existence of a conflict of interest, by itself, was not enough. In such cases, the defendant’s behavior must also harm or potentially harm the employer.

In *Rybicki II*, the lawyers used the mails to induce employee insurance adjusters, who owed a duty of loyalty to their employer insurance companies, “secretly to expedite insurance claims in order to advance their own interest in receiving payments from the defendants. These actions were not disclosed to [their employers], and hence were accompanied by a material omission.” The Second Circuit Court of Appeals held that section 1346 “clearly prohibits” this conduct, which it described as:

> a scheme or artifice to use the mails or wires to enable an officer or employee of a private entity (or a person in a relationship that gives rise to a duty of loyalty comparable to that owed by employees to employers) purporting to act for and in the interests of his or her employer (or of the person to whom the duty of loyalty is owed) secretly to act in his or her or the defendant’s own interests instead, accompanied by a material misrepresentation made or omission of information disclosed to the employer or other person.

The court also addressed several other aspects of a section 1346 claim. It concluded that to establish a section 1346 violation, “actual or intended economic or pecuniary harm to the victim need not be established.” The court adopted a materiality standard for the alleged misrepresentation/omission, holding that “the misinformation or omission would naturally tend to lead or is capable of leading a reasonable employer to change its conduct.” When the victim’s knowledge of the misrepresentation would cause her to change her behavior, the misrepresentation is material.

When focusing on duty-related questions, the *Rybicki II* majority grounded its analysis in the fiduciary duty of loyalty. However, under its interpretation, the defendant need not owe the fiduciary duty to the victim.

303. *Rybicki II*, 354 F.3d at 140.
304. Id. at 141.
305. Id.
306. Id. at 142.
307. Id. at 141–42. The court noted that, while most pre-McNally honest services cases involved employees, the doctrine could also apply to other persons who “assume a legal duty of loyalty comparable to that owed by an officer or employee to a private entity.” *Rybicki II*, 354 F.3d at 142 n.17.
308. Id. at 145 (citing United States v. Rybicki (*Rybicki I*), 287 F.3d 257, 261 (2d Cir. 2002)).
309. Id. The court opted not to adopt the “reasonably foreseeable harm” test adopted by the *Rybicki* panel and several other circuits. See, e.g., United States v. Vinyard, 266 F.3d 320, 327–29 (4th Cir. 2001) (adopting the “reasonably foreseeable harm” test), cert. denied, 536 U.S. 922 (2002); United States v. Martin, 228 F.3d 1, 17 (1st Cir. 2000) (same); United States v. deVegeter, 198 F.3d 1324, 1328–30 (11th Cir. 1999) (same); United States v. Sun-Diamond Growers of Cal., 138 F.3d 961, 973–74 (D.C. Cir. 1998) (same). The materiality test comports with the Supreme Court’s conclusion in *Neder v. United States*, 527 U.S. 1, 25 (1999), but *Neder* may mean that materiality is a necessary but not sufficient threshold.
311. Although prosecutors charged the defendants with violating both 18 U.S.C. § 371 and 18 U.S.C. § 1346, the opinion makes clear that the defendant lawyers were convicted of direct violations of section 1346...
their employer that created the "intangible right of honest services." The majority distinguished between cases where a breach of fiduciary duty, by itself, is not enough (the self-dealing cases), and those where it is sufficient (bribery/kickbacks). If the defendant procured the fiduciary's breach of his duty of loyalty by paying a bribe or kickback, the lack of damage to the victim arising from that breach is immaterial. However, if the breach of duty of loyalty is not accompanied by a bribe or kickback to the agent, and instead the agent is self-dealing, there must also be a failure to disclose that self-dealing; and the agent's actions must be reasonably capable of causing harm to the victim, though that need not be intended.\textsuperscript{312} As a bribery/kickback case, the \textit{Rybicki II} majority concluded that the defendant lawyers violated section 1346 even though the agents to whom they had paid the kickbacks did not apparently cause financial harm to the employers to whom they owed a duty of loyalty.

The dissent disagreed with much of the majority's analysis, both in terms of its creative statutory interpretation and also its ramifications, concluding that section 1346 "flunks the test for facial vagueness."\textsuperscript{313} According to the dissent, the text's lack of clarity provides "insufficient constraint on prosecutors, gives insufficient guidance to judges, and affords insufficient notice to defendants."\textsuperscript{314} Cobbling together the meaning of honest services fraud from some but not other pre-McNally cases is a task that ordinary people could not perform, only the "rare" attorney could, and no two lawyers could be expected to agree independently on the elements of an offense so defined.\textsuperscript{315} Neither the materiality requirement nor the requirement of a showing that an employee secretly preferred her own interest to her employer's placed any limits on prosecutorial discretion.\textsuperscript{316} In particular, the dissent noted that "it is naïve to assume that this preference [of the employee's interest over the employer's] is not the most common premise of private employment."\textsuperscript{317} Ultimately, to the dissent, the majority's reading was "as standardless as the statute itself" and further refuted the notion that section 1346 "has any settled or ascertainable meaning or that the offense it describes has known contours."\textsuperscript{318} In effect, the dissent viewed the majority decision as "criminaliz[ing] all in addition to conspiracy and focused its analysis on those claims. In fact, nothing in the opinion suggests that the insurance adjusters who actually had the employer-employee relationship were ever indicted or tried for violating section 1346.

\textsuperscript{312} \textit{Rybicki II}, 354 F.3d at 141 ("In the self-dealing context, though not in the bribery context, the defendant's behavior must thus cause, or at least be capable of causing, some detriment—perhaps some economic or pecuniary detriment—to the employer.").

\textsuperscript{313} \textit{Id.} at 156 (Jacobs, J., dissenting). Judge Jacobs noted that, in the Second Circuit's "long experience" with the statute, apparently eight judges in the court "failed to understand" its meaning and "most lawyers and judges, not to speak of ordinary laymen or prospective defendants, cannot be expected to understand the statute." \textit{Id.} at 158.

\textsuperscript{314} \textit{Id.} at 157.

\textsuperscript{315} \textit{Id.} at 160.

\textsuperscript{316} \textit{Rybicki II}, 354 F.3d at 161.

\textsuperscript{317} \textit{Id.} (Jacobs, J., dissenting). Other courts have likewise noted that "[e]mployee loyalty is not an end in itself, it is a means to obtain and preserve pecuniary benefits for the employer. An employee's undisclosed conflict of interest does not by itself necessarily pose the threat of economic harm to the employer." United States v. deVegter, 198 F.3d 1324, 1328 (11th Cir. 1999) (quoting United States v. Lemire, 720 F.2d 1327, 1336 (D.C. Cir. 1983)).

\textsuperscript{318} \textit{Rybicki II}, 354 F.3d at 161–62 (Jacobs, J., dissenting).
material acts of dishonesty by employees or by persons who owe analogous duties."

The dissent also noted that the circuits diverged on key issues concerning section 1346, including: (1) what mens rea must be proven;\(^\text{320}\) (2) whether the defendant must have caused actual tangible harm;\(^\text{321}\) (3) what duty must be breached to violate section 1346, and whether that duty arise from state or federal law;\(^\text{322}\) and (4) the extent to which section 1346 revived pre-McNally case law, and how such case law should be interpreted.\(^\text{323}\) The dissent also could have focused on the fact that the defendants were not themselves fiduciaries of the victim. As a result, section 1346 directly extended—not simply indirectly through the conspiracy count—to anyone who interacts with a person owing a fiduciary duty to another. Thus, the statute’s potential reach extended beyond even the holding in Bronston.

b. United States v. Brown

*Rybicki II* has served as a paradigm, or at least a reference point, for subsequent cases. Despite the concerning analytical questions identified by the *Rybicki II* dissent, numerous courts have relied on the majority’s analysis.\(^\text{324}\) Many courts also have cited the dissent’s analysis, highlighting the interpretive problems with section 1346.\(^\text{325}\) Perhaps most prominently, *Rybicki II* served as the starting point for the Fifth Circuit’s decision overturning convictions in a benchmark honest services fraud case arising from the Enron scandal.

In *United States v. Brown*,\(^\text{326}\) the court of appeals reversed the convictions of four former Merrill Lynch investment bankers who allegedly had deprived Enron of its employees’ honest services in connection with the sale by an Enron subsidiary of

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319. *Id.* at 164.
320. *Id.* at 162 (comparing circuits where an intent to achieve a personal gain is required to the Eighth Circuit, where intent to cause "financial or economic harm" describes the mens rea element, to the Sixth Circuit, which seems to require intent to breach a fiduciary duty).
321. *Id.* (comparing the Eighth Circuit, where tangible harm is required, with the Sixth Circuit, where it is not, and other circuits which disagree over whether misrepresentation must be material or be reasonably foreseeable for the victim to suffer economic harm).
322. *Id.* at 163 (comparing the majority opinion with the Fifth Circuit, which appears to be limited to an employee’s duty to an employer, versus others, which require a breach of fiduciary duty); *Rybicki II*, 354 F.3d at 163 (Jacobs, J., dissenting) (noting that circuits are split as to whether the duty arises from federal law (per the Sixth Circuit) or state law (per the Fifth Circuit)).
323. *Rybicki II*, 354 F.3d at 163 (comparing the Fifth Circuit, which had concluded that “Congress could not have intended to bless each and every pre-McNally lower court ‘honest services’ opinion”). *Compare United States v. Brumley*, 116 F.3d 728, 733–34 (5th Cir. 1997) (citing precedent of other circuits), with *United States v. Frost*, 125 F.3d 346 (6th Cir. 1997) (relying on just Sixth Circuit precedent), and the majority opinion (which attempts to synthesize pre-McNally law between circuits).
324. *See*, e.g., *United States v. Turner*, 465 F.3d 667, 672 (6th Cir. 2006) (discussing legislative responses to McNally); *United States v. Brown*, 459 F.3d 509, 521 (5th Cir. 2006) (relying on *Rybicki’s* (Second Circuit) majority opinion for honest-services fraud); *United States v. Williams*, 441 F.3d 716, 722 (9th Cir. 2006) (using the *Rybicki* holding to discuss whether the “intangible rights theory should apply to private defendants after the passage of § 1346”).
325. *See*, e.g., *Brown*, 459 F.3d at 534 (DeMoss, J., concurring in part and dissenting in part) (urging Congress to “repair” section 1346 to provide “minimal guidelines to govern law enforcement”).
326. *Id.* at 509.
Nigerian barges to Merrill Lynch. According to the government, the $7 million transaction was, in fact, part of a scheme to artificially inflate Enron’s earnings. For its part, Merrill Lynch received a $250,000 advisory fee and a 15% annual return on its investment. The factual crux of the case was whether Enron promised Merrill Lynch that it or an affiliate would buy the barges back if Enron could not find a third-party buyer for them in six months. If Enron had made such a promise, the transaction would not have qualified as a true sale, and the revenue generated from the transaction was not properly income to Enron.

Under Enron’s incentive compensation system, Enron employees who negotiated the deal received substantial year-end bonuses for helping to meet Enron’s annual revenue target. Andy Fastow, Enron’s former CFO, supposedly had approved the transaction. Within six months, Merrill Lynch did sell the barges to a special-purpose entity, LJM2, for the agreed upon price. Fastow and several other Enron senior executives owned interests in LJM2.

On appeal, the Fifth Circuit reversed the investment bankers’ convictions, concluding that, even if the government’s contentions were true, the Merrill Lynch employees had not deprived Enron of its intangible right to the honest services of its employees. As in Rybicki II, the Fifth Circuit found “no perimeters” to the crime within the language of section 1346. It expressed concern that trying to attribute meaning to the statutory text comes perilously close to “defining a common law crime.” The appellate court turned to pre-McNally case law to set those limits. The court defined “honest services” as “services owed to an employer under state law,” including fiduciary duties defined by the employer-employee relationship. However, so that “not every breach of fiduciary duty owed by an employee to an employer constitute[s] an illegal fraud,” the court also “required some detriment to the employer,” meaning at least that, had the employer received accurate, material information, it would have changed its business conduct. The Fifth Circuit also appeared to adopt the Seventh Circuit’s requirement that the duty-breaching employee derive some personal benefit from the fraud.

327. Id. at 513. At trial, there were two Enron employees who were defendants as well. One was acquitted, and one was convicted. Neither of them appealed. Id.
328. Id.
329. Brown, 459 F.3d at 513.
330. Id.
331. Id. at 513–15.
332. Id. at 520.
333. Id. at 515.
334. Brown, 459 F.3d at 516.
335. Id. at 516 n.2.
336. Id. at 517.
337. Id. at 520. It determined the “outer boundary” of section 1346 by focusing on facts supporting affirmed convictions rather than cases where convictions were reversed. Id. at 520.
338. Brown, 459 F.3d at 519.
339. Id.
340. Id. This theory contrasts sharply with the government’s most expansive theory. Prosecutors contended that, if a duty under state law had been violated, no other proof was required for the jury to convict defendants of honest services fraud. Id.
341. Id. at 520 (citing United States v. Bloom, 149 F.3d 649 (7th Cir. 1998)); see also United States v.
Rather than employ the *Rybicki II* framework of bribery/kickback and self-dealing cases, the *Brown* court focused mainly on whether the Enron defendants' interests clearly diverged from Enron's and whether that divergence harmed Enron. The harm caused by that divergence must be more than simply the fact of a knowing breach of fiduciary duty. Moreover, the court noted that this was not a "typical bribery and self-dealing case[]" where there is "no question that the defendant understood the benefit to him resulting from his misconduct to be at odds with the employer's expectations." In *Brown*, by contrast, the Enron employees were pursuing what they thought was a corporate goal. As a result, the fiduciary duty-breaching conduct that benefited the employees furthered Enron's own immediate interest. In fact, Enron's own incentive structure tied the corporation's interest to the employees' private, personal interest. The court reasoned that where an employee believes his actions benefit both him and his employer, and where the employee's conduct is consistent with that perception, such conduct cannot give rise to honest-services fraud as it hitherto has been applied. Because the Enron employees' behavior did not violate the statute, the Merrill Lynch employees' conduct also did not violate the law. As a result, the court concluded that the government could not use section 1346 to punish this conduct. To hold otherwise would risk creating an "ever-expanding and ever-evolving federal common-law crime" that would "reach all manner of accounting fraud and securities fraud, which have not generally been prosecuted as honest-services fraud and are heavily regulated under other statutes."

The Fifth Circuit stressed that it did not determine that "no dishonest, fraudulent, wrongful, or criminal act ha[d] occurred." It held simply that the honest services theory of fraud did not apply to the facts. Rather than incrementally expand a statute that the court deemed "vague and amorphous on its face," a statute which "depends for its constitutionality on the clarity divined from a jumble of disparate cases," the court invoked the rule of lenity to adopt the narrower, reasonable reading of section 1346 which excluded such conduct.

Judge DeMoss, writing separately, worried that the statute's constitutionality "may well be in serious doubt." He noted that the text of section 1346 is "undeniably vague and ambiguous and is subject to wide variation in application by the lower courts."

The vagueness forced courts to exceed their constitutional powers by "defin[ing] what

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Thompson, 484 F.3d 877, 883–84 (7th Cir. 2007) (holding that honest services fraud, for public officeholder, requires misuse of public office for private gain).

343. See id. at 521–22 (cautioning against "making every knowing fiduciary breach a federal crime").
344. Id. at 522.
345. Id. at 521.
346. Id. at 522.
348. Id.
349. Id. at 523 n.13.
350. Id. at 523.
351. Id.
353. Id. at 534 (DeMoss, J., concurring in part and dissenting in part).
354. Id.
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constitutes criminal conduct on an ex post facto and ad hoc basis.”

Like the Rybicki II dissenters, he asked Congress to “repair” the statute to provide “minimal guidelines to govern law enforcement.” He also noted that extending section 1346 by the use of conspiracy allegations casts the prosecutorial net even more broadly to potentially ensnare third-parties who lack the employer-employee relationship that gave rise to a duty to provide honest services to which pre-McNally honest services cases were limited (at least in the Fifth Circuit). Finally, Judge DeMoss faulted the government’s theory that harm occurred when Enron unquestionably received about $7 million. Such a theory of harm ignored the real, initial gains to Enron and focused exclusively on its later collapse, a loss only “tangentially connected” to the transaction pleaded in the indictment. Judge DeMoss warned that “[t]he cumulative effect of a vague criminal statute, a broad conception of conspiracy, and an unprincipled theory of harm” could pose a significant threat to legitimate business relationships.

The Brown majority failed to discuss the Enron employees’ fiduciary duty to their employer with much precision. According to the majority, the Enron employees owed a fiduciary duty to Enron arising from their capacity as employees, which duty required them to disclose material information to the firm, provided that the information would change Enron’s business conduct. The government had argued that there was a breach of that duty, and that Enron suffered harm by that breach because Enron purportedly did not know of Fastow’s alleged side deal with Merrill Lynch. Enron also suffered financial harm, according to the government, because the company paid an advisory fee to Merrill Lynch and compensation bonuses to Enron’s employees. The court ultimately concluded that prosecutors must prove both the breach and harm to the

355. Id. Judge DeMoss wrote in an earlier opinion that construing section 1346 required courts to assume “a role somewhere between a philosopher king and a legislator.” United States v. Brumley, 116 F.3d 728, 736 (5th Cir. 1997) (Jolly & DeMoss, JJ., dissenting).


357. Id. at 534–35. By contrast, Rybicki II is an example of a case where it was the third-parties (in that case, the attorneys) who were convicted of honest services fraud even though they had no employer-employee relationship that gave rise to a fiduciary duty. It may be, therefore, that Rybicki II would have been decided differently in the Fifth Circuit.

358. Id. at 535.

359. Id.

360. Id. After reviewing the Fifth Circuit’s decision in Brown, the Enron Task Force dismissed, on its own motion, parallel honest services charges in two other corporate fraud cases. United States v. Howard, 517 F.3d 731 (5th Cir. 2008) (affirming district court’s vacation of Howard’s conviction for falsifying Enron’s books and records because it was intertwined with the honest services conviction; the government did not oppose Howard’s motion to vacate honest services conviction); United States v. Calger, No. CR–H–05–286 (S.D. Tex. Mar. 30, 2007). The Fifth Circuit also recently refused the government’s invitation to read section 1341 broadly in an “election fraud” case because, citing Cleveland, it would result in “a sweeping expansion of federal criminal jurisdiction in the absence of a clear statement by Congress.” United States v. Ratcliff, 488 F.3d 639, 649 (5th Cir. 2007) (quoting Cleveland v. United States, 531 U.S. 12, 14 (2000)) (relying on Turner).

361. Brown, 459 F.3d at 519.

362. Id. at 519–20.

363. Id. at 520. The government also argued in the alternative that no detriment was necessary other than the fiduciary breach itself. The majority cautiously disagreed with that approach because it would criminalize every known breach of fiduciary duty. Id. at 521–22.
principal caused by the breach. In *Brown*, it appeared that the employees' fiduciary breach furthered Enron's "legitimate interests" and that the employees' actions "mutually benefit[ed]" the employees and Enron.\(^{364}\) Moreover, the benefit to the employees arose within the context of their fiduciary relationship with Enron.\(^{365}\) At least short-term, therefore, there was no harm to Enron arising from the fiduciary breach and, thus, no honest services fraud.

Judge DeMoss examined the duty issue further in his separate concurrence. He noted that the Merrill Lynch defendants had no fiduciary relationship with Enron. He expressed concern that "[t]he limitation of criminal activity to relationships giving rise to a duty of honest services is ignored when any person who negotiates with an employee of another corporation is potentially entangled by the combination of section 1346 with our very broad understanding of conspiracy."\(^{366}\) Although the *Brown* majority glossed over this difficult problem (perhaps because the government also charged conspiracy), Judge DeMoss's analysis focuses appropriate attention on the duty inquiry. However, the question remains: can a defendant with no fiduciary duty to the alleged victim commit honest services fraud? The frequent intertwining of section 1346 claims with section 371 conspiracy claims, as in *Rybicki II* and *Brown*, has allowed the case law on this issue to develop without much precision. In fact, the majorities in both appellate cases seem to presume that a defendant can commit honest services fraud even though she herself owes no fiduciary duty to the victim, provided that some other person who owes a fiduciary duty to the victim has breached his duty.\(^{367}\) Whether such an approach makes sense, doctrinally or normatively, is not apparent.

**c. Other Lessons Learned from Recent Case Law**

The opinions in *Brown* and *Rybicki II* highlight the key fiduciary duty questions in honest services fraud cases: (1) who has the fiduciary duty?; (2) what is that duty?; (3) to whom is that duty owed?; (4) did the defendant breach that duty?; and (5) did the defendant's breach intend to, and in fact, cause damages to the beneficiary entitled to receive fiduciary services, or, were such damages at least reasonably foreseeable? In *Rybicki II*, the defendant attorneys were convicted even though they themselves owed no fiduciary duty to the victims, and prosecutors offered no evidence that the victims were harmed by their employees' breach of their fiduciary duty to act exclusively for their employers' benefit by receiving kickbacks from the defendants. Although the *Brown* court addressed the traditional breach of fiduciary duty questions for the Enron employees only superficially, the decision focused on the fact that, even if the Enron employees breached their duties to Enron, they neither caused Enron reasonably

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\(^{364}\) *Id.* at 522.

\(^{365}\) *Brown*, 459 F.3d at 522.

\(^{366}\) *Id.* at 535 (DeMoss, J., concurring in part and dissenting in part).

\(^{367}\) The broad net cast in *Rybicki II* seems counter to the logic supporting a more narrow interpretation of section 10(b) civil liability, as most recently articulated by Justice Kennedy in his opinion for the majority in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., 128 S. Ct. 761, 771 (2008). While questions of statutory interpretation ultimately are resolved by specific statutory texts, it is noteworthy that one can be criminally liable for being a third party to a transaction in which the agent breaches a fiduciary duty of disclosure, but one cannot be civilly liable for being a third party to a transaction in which a corporation breaches its duty of disclosure to the investing public.
foreseeable harm, nor intended to do so. Only Judge DeMoss argued that the Merrill Lynch employees should not be convicted for honest services fraud because they owed no fiduciary duties to Enron.

A sample of other recent honest services cases reveals that these questions recur repeatedly but are not addressed in analytically coherent ways. In almost all cases, the courts require prosecutors to establish a fiduciary duty and breach. More importantly, it is generally the defendant who has the fiduciary obligation to the putative victim. As an example, in Turner, a candidate for public office had his honest services fraud conviction reversed because he had not yet won office, and, therefore, he owed no fiduciary duty to the public; he could not have breached a duty that would give rise to honest services fraud. By this measure, both Brown and Rybicki are outliers; neither opinion requires that the defendant charged with the section 1346 violation be the fiduciary who actually breached his duty to the victim.

A conflict of interest that merely creates a breach of the fiduciary duty of loyalty owed by the defendant to the victim is insufficient, on its own, to support a conviction for honest services fraud. Courts emphasize that "[n]ot every breach of every fiduciary duty works a criminal fraud," but the line between mere breaches of fiduciary duty and criminal conduct is evasive. What is necessary, precisely, more than proof of a conflict of interest? Some courts have determined that a defendant commits honest services fraud by also breaching her duty to disclose her conflict of interest. However, expanding the fiduciary's duties to include a duty to disclose the conflict of interest does little to alter the analysis. It simply reduces honest services fraud to a mandatory disclosure statute that criminalizes any conflict of interest that a fiduciary fails to self-report.

368. See, e.g., United States v. Turner, 465 F.3d 667, 675 (6th Cir. 2006) ("This circuit's pre-McNally honest services precedents, as examined in Frost, require the finding of a fiduciary duty owed by the defendant to the victim."); United States v. Williams, 441 F.3d 716, 723 (9th Cir. 2006) ("[W]e and other circuits have recognized the viability of the 'intangible rights' theory when the private defendant stands in a fiduciary or trust relationship with the victim of the fraud."); United States v. Welch, 327 F.3d 1081, 1107 (10th Cir. 2003) ("The right to honest services is not violated by every breach of contract, breach of duty, conflict of interest, or misstatement made in the course of dealing."); United States v. Hausmann, 345 F.3d 952, 956 (7th Cir. 2003) ("[A] defendant used the interstate mails or wire communications system in furtherance of a scheme to misuse his fiduciary relationship for gain at the expense of the party to whom the fiduciary duty was owed."); United States v. Czubinski, 106 F.3d 1069, 1077 (1st Cir. 1997) (stating that the duty must be fiduciary in nature); United States v. Frost, 125 F.3d 346, 366 (6th Cir. 1997) ("[P]rivate individuals . . . may commit mail fraud by breaching a fiduciary duty and thereby depriving the person or entity to which the duty is owed of the intangible right to the honest services of that individual."). But even this basic proposition is not without disagreement. See United States v. Sancho, 157 F.3d 918, 920 (2d Cir. 1998) (stating that there "is no such requirement" of a "genuine fiduciary relationship").

369. Turner, 465 F.3d at 675–76 ("The potential for a subsequent breach of an actual fiduciary duty once a candidate takes office cannot create a fiduciary duty before a candidate is even elected. Aside from the speculative nature of this proposition, it ignores the fact that honest services fraud is 'anchored upon the defendant's misuse of his public office for personal profit.'" (quoting United States v. Gray, 790 F.2d 1290, 1295 (6th Cir. 1986))).

370. United States v. Bloom, 149 F.3d 649, 654 (7th Cir. 1998) (quoting United States v. George, 477 F.2d 508, 512 (7th Cir. 1973)).

371. United States v. Rybicki (Rybicki II), 354 F.3d 124, 142 (2d Cir. 2003) (noting that the breach of duty of loyalty must be "accompanied by a material misrepresentation made or omission of information disclosed to the employer or other person").

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Such an approach also separates the conflict of interest from any analysis of actual or reasonably foreseeable harm to the victim.\textsuperscript{373} Professor Coffee examined this separation even before section 1346 was enacted and advocated maintaining the distinction between "means" and "ends." The "ends" of a scheme to defraud is typically the deprivation of a victim's property or money. The means by which that scheme is accomplished may be through a breach of fiduciary duty owed to the victim. According to Professor Coffee, "if merely depriving the victim of the loyalty and faithful service of his fiduciary constitutes criminal [mail] fraud, the ends/means distinction is lost. Once the ends/means distinction is abolished and disloyalty alone becomes the crime, little remains before every civil wrong is potentially indictable."\textsuperscript{374} The conduct creating the harm has become defined as the harm itself. When the failure to provide honest services is both the means by which a victim is damaged as well as the actual injury to the victim, section 1346 becomes little more than an exercise in circular logic by definition.\textsuperscript{375}

To avoid this result, courts should continue to differentiate between the ultimate harm of the victim's injury and the deprivation of the honest services and require both to be present before convicting the defendant for honest services fraud.\textsuperscript{376} Examining the actual harm, or at least the reasonably foreseeable harm, to the victim by the breaching fiduciary not only returns the focus to the prevention of injury, one of the bedrock purposes of criminal law, but also impedes the criminal law from expanding to prohibit even more conduct than civil law.

Many courts have required proof that harm to the principal—the victim owed the fiduciary duty—occurred or, at a minimum, have required proof that such harm was reasonably foreseeable to the defendant.\textsuperscript{377} This approach makes sense because, as one court characterized the concern:

\begin{quote}
Employee loyalty is not an end in itself, it is a means to obtain and preserve pecuniary benefits for the employer. An employee's undisclosed conflict of interest does not by itself necessarily pose the threat of economic harm to the employer. . . . A public official's undisclosed conflict of interest, in contrast, does by itself harm the constituents' interest in the end for which the official serves—honest government in the public's best interest. The "intangible right of honest services" must be given an analogous interpretation in the private
\end{quote}

\textsuperscript{373} Id. at 11.
\textsuperscript{374} Coffee, \textit{From Tort to Crime}, supra note 191, at 167.
\textsuperscript{376} Id. at 42-43 (citing Coffee, \textit{From Tort to Crime}, supra note 191, at 124–25 n.40).
\textsuperscript{377} See, e.g., United States v. Lamoreaux, 422 F.3d 750, 754 (8th Cir. 2005) ("[I]n a business context, proof of actual financial harm to the victim is highly relevant in distinguishing criminal fraud from a mere breach of fiduciary duty."); United States v. Frost, 125 F.3d 346, 368 (6th Cir. 1997) ("[T]he employee foresaw or reasonably should have foreseen that his employer might suffer an economic harm as a result of the breach."); United States v. Cochran, 109 F.3d 660, 669 (10th Cir. 1997) (finding no violation for nondisclosure of a fee received by a municipal bond underwriter where payment did not impact tax-exempt nature of the bonds or otherwise injure the bond issuer or the bondholders); United States v. Lemire, 720 F.2d 1327, 1337 (D.C. Cir. 1983) (holding that the defendant must "reasonably have contemplated some concrete business harm to his employer stemming from his failure to disclose the conflict along with any other information relevant to the transaction"); United States v. Ballard, 663 F.2d 534, 540 (5th Cir. Unit B Dec. 1981) ("[A] breach of fiduciary duty can constitute an illegal fraud under § 1341 only when there is some detriment to the employer.").
sector. Therefore, for a private sector defendant to have violated the victim’s right to honest services, it is not enough to prove the defendant’s breach of loyalty alone. Rather, as is always true in a breach of loyalty by a public official, the breach of loyalty by a private sector defendant must in each case contravene—by inherently harming—the purpose of the parties’ relationship.378

In private party honest services fraud cases, therefore, the courts must not consider the breach of fiduciary duty or deprivation of honest services in a theoretical vacuum. Instead, judges must determine the real world impact, if any, arising from the breach of duty. Was there in fact harm to the victim owed the fiduciary duty or was it at least reasonably foreseeable? Even the Rybicki II en banc majority required that, for self-dealing cases, some detriment to the victim must be reasonably foreseeable.379 The Fifth Circuit, in Brown and before, formulated this inquiry somewhat differently. There, the question is whether there is a conscious divergence of interest between the fiduciary and the victim,380 but the focus remains on whether it was at least reasonably foreseeable that the fiduciary’s breach of duty would harm the person to whom the duty was owed. The government may not simply prove breach of the duty itself.

In some cases, the analysis as to whether the victim owed a fiduciary duty suffered harm caused by the fiduciary’s breach has turned on fairly speculative suppositions. In United States v. Haussman, for example, the Seventh Circuit affirmed a conviction of a lawyer who referred his personal injury clients to a chiropractor in return for payments from that chiropractor to third parties as directed by the lawyer.381 The chiropractor was paid from the client’s portion of a settlement after the defendant-lawyer already received his fees.382 The defendant attorney argued that his clients suffered no harm because the chiropractor charged market rates, the clients received appropriate care, and the clients were not entitled to the portion of the chiropractor’s fees paid back to the defendant.383 The court disagreed based on its assumption that the chiropractor would have charged the attorney’s clients less but for the kickbacks to the attorney.384

379. United States v. Rybicki (Rybicki II), 354 F.3d 124, 141 (2d Cir. 2003) (“In the self-dealing context, though not in the bribery context, the defendant’s behavior must thus cause, or at least be capable of causing, some detriment—perhaps some economic or pecuniary detriment—to the employer.”).
380. United States v. Brown, 459 F.3d 509, 522 (5th Cir. 2006) (asking whether “the defendant understood the benefit to him resulting from his misconduct to be at odds with the employer’s expectations”); United States v. Brumley, 116 F.3d 728, 734 (5th Cir. 1997) (noting “‘honest services’ contemplates that in rendering some particular service or services, the defendant was conscious of the fact that his actions were something less than in the best interests of the employer—or that he consciously contemplated or intended such actions. For example, something close to bribery,” and concluding that “[i]f the employee renders all the services his position calls for, and if these and all other services rendered by him are just the services which would be rendered by a totally faithful employee, and if the scheme does not contemplate otherwise, there has been no deprivation of honest services”).
382. Id. at 954.
383. Id. at 957.
384. Id.
By contrast, in *United States v. Jain*, an analytically identical situation led to the opposite result. There, a physician (not an attorney) received payments from a hospital for referring patients to that hospital. The Eighth Circuit concluded that no honest services fraud had occurred because “[t]he essence of a scheme to defraud is an intent to harm the victim.” Because the patient received the same level of services from the hospital that he would have received otherwise, the court dismissed the fact that the physician had “extracted undisclosed, unethical referral fees from an interested third party provider.” According to the court, “[w]hen there is no tangible harm to the victim of a private scheme, it is hard to discern what intangible ‘rights’ have been violated.

In both cases, the defendant received undisclosed kickbacks from another provider. The defendant owed a fiduciary duty (either attorney-client or physician-patient) to the person he was directing to that provider. In *Jain*, the court found no honest services violation because, despite the kickback, the referred patient received all the appropriate care, so there was no tangible harm to the victim. In *Hausmann*, the court found an honest services violation because it presumed that, absent the kickback, the referred client/patient would have paid less for the other provider’s services (despite any discussion of evidence supporting that presumption in the opinion). The court also posited that the attorney had a fiduciary obligation to disclose any and all sources of compensation to the client with respect to that relationship. How to distinguish these cases doctrinally is not obvious. Perhaps the difference stems from the degree to which it was reasonably foreseeable that the third-party medical provider would or would not have reduced their charges absent the referral fees.

Whether a victim is harmed correlates closely, but not perfectly, to the question of whether the defendant received some pecuniary gain as a result of his breach of his fiduciary duties. Courts seem divided about whether a breaching fiduciary’s gain is sufficient injury in its own right to convert a mere breach of fiduciary duty into the crime of honest services fraud. For example, in *Hausmann*, the Seventh Circuit assumed that the attorney-defendant’s gain was closely tied to, if not the same as, the injury that his clients allegedly suffered by overpaying the chiropractor. By the same analysis, because the Enron and Merrill Lynch employees’ gains (their receipt of either bonuses or advisory fees) were disconnected from any pecuniary harm to Enron and, in fact, were linked to Enron’s success (at least in the short-term), the Fifth Circuit concluded that the

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386. *Id.* at 438.
387. *Id.* at 442.
388. *Id.*
389. *Id.*
391. The opinion states this proposition more broadly than the facts of the case should merit, insofar as the language seems to prohibit undisclosed profits regardless of whether they ultimately can be traced back to payments made by the victim or profits that would otherwise go to the victim. See *id.* at 956 (“[A]n employee’s undisclosed derivation of profits from business he transacted on his employer’s behalf amount[s] to a deprivation of the employer’s intangible right to honest services in violation of 18 U.S.C. §§ 1341 and 1346.”). This would seem to encompass payments to the fiduciary to which the person owed the fiduciary duty could not assert any kind of claim.
alleged conduct, although a breach of fiduciary duty, was not honest services fraud.  

According to other cases, such as Rybicki II, a kickback or payment to the fiduciary can support a conviction for honest services fraud even though the payment is not clearly related to the victim's injury. In bribery/kickback cases, as opposed to self-dealing cases (which require detriment to the employer-victim), "the undisclosed bribery is sufficient to make out the crime." However, even in this context, the Second Circuit described the prohibited conduct as occurring when a "defendant who has or seeks some sort of business relationship or transaction with the victim secretly pays the victim's employee . . . in exchange for favored treatment." At a minimum, therefore, it seems that honest services fraud requires that a defendant who dispenses the bribe or kickback to the victim's fiduciary receive some kind of "favored treatment" from the victim that he would not otherwise receive. 

My analysis demonstrates that honest services fraud cases involving private parties follow an analytically coherent pattern: (1) the defendant owes the fiduciary duty of loyalty to the victim; (2) the defendant breaches that duty of loyalty; and (3) the breach of duty causes some harm (usually financial) to the victim beyond the disloyalty itself (or, at least, the harm is reasonably foreseeable). In some cases, like Rybicki II's "bribery/kickback" cases, "favored treatment" bestowed on the defendant unwittingly by the victim may serve as a proxy for a victim's loss where the pecuniary loss to the victim is less readily apparent. I will discuss in Part V how the allegations in the Milberg Weiss indictment fall outside the pattern identified by my analysis. Particularly as to the threshold question—the presence of a fiduciary duty—the honest services fraud claim against Milberg Weiss should have failed.

2. Attorneys' Liability for Honest Services Fraud

Before analyzing the honest services fraud charges against Milberg Weiss, it is useful to consider briefly other prosecutions of attorneys for honest services fraud. In the
main, these cases fit within the general pattern that I have identified, although not without some difficulty. The case that deviates furthest from the model (but not as far as the Milberg Weiss prosecution) may be *Rybicki II*.

In most of these cases, the government charged that the defendant attorney owed fiduciary duties of loyalty directly to the *victim* of the scheme.\(^397\) This circumstance has applied, for example, in public corruption cases alleging that lawyers paid kickbacks to judges in exchange for special appointments or treatment.\(^398\) The government successfully prosecuted cases against both lawyers who paid kickbacks and judges who accepted payments. In these cases, however, prosecutors ground the honest services charges on breach of the judges’ fiduciary duties to the public.\(^399\) While the lawyers do not owe fiduciary duties to the public, the law does recognize that judges owe fiduciary obligations to the public to dispense justice even-handedly.\(^400\) Judges accepting kickbacks breach their duties to the public and harm their fiduciary relationship to the public when secret kickbacks affect their decision-making.\(^401\)

In other cases, the lawyers breached their fiduciary duties. In private party cases (*Hausmann* and *Bronston*), for example, the courts assumed that the client-victims were harmed financially by the undisclosed actions of their attorney-fiduciaries. In public corruption cases (*Frega* and *Castro*), kickbacks harmed the public’s right to honest government. Moreover, in all of these cases, the breaching fiduciary received a corresponding benefit, as did the lawyers in the public corruption cases.

The prominent deviation from the model that I have identified is *Rybicki II*.\(^402\) There, the defendant attorneys owed no fiduciary duties to the victim insurance companies. Further, the insurance companies suffered no clear harm from their employees’ duty breaches. And, while the insurance adjusters who received the kickbacks clearly benefited, it is not clear from the opinion how the expedited settlements benefited the attorneys or their clients other than simply by receiving the time value of money (receipt of money earlier is preferred to receipt of money later). However, even in *Rybicki II*, the government could point to a legally-defined fiduciary duty owed by the employee to the employer, a breach of that duty, and at least some pecuniary harm to the employer.

With this analytical model in mind (fiduciary duty to the victim, breach of that duty by the defendant, and injury to the victim or at least reasonably foreseeable pecuniary harm to the victim), I turn now to the Milberg Weiss indictment. The next part examines the nature of the relationship between class representatives, class counsel, and the absent class. More specifically, Part IV examines the government’s assertion that named

\(^397\) See, e.g., United States v. Hausmann, 345 F.3d 952, 957 (7th Cir. 2003) (alleging fiduciary duty in excess of that memorialized in retainer agreement); United States v. Bronston, 658 F.2d 920, 928 (2d Cir. 1981) (finding grounds for the existence of fiduciary duty).

\(^398\) United States v. Frega, 179 F.3d 793, 803 (9th Cir. 1999) (describing that both attorneys and judges were defendants in a scheme involving payment of bribes by lawyers to judges); United States v. Castro, 89 F.3d 1443, 1443 (11th Cir. 1996) (upholding conviction of attorneys and judges in scheme in which attorneys paid kickbacks to state court judges in return for special public defender appointments).

\(^399\) See *Frega*, 179 F.3d at 802–04 (determining the meaning section 1346).

\(^400\) Id.

\(^401\) Id.

\(^402\) See supra Part III.C.1.a (discussing the lack of harm caused by the accused parties’ actions).
plaintiffs owe fiduciary duties to absent class members. Upon closer analysis, the
government relies on a theory of fiduciary duty never defined in the case law nor
enforced by the courts. Indeed, the government's fiduciary theory contradicts commonly-
accepted governance practice in securities class actions, at least prior to enactment of the
PSLRA.

IV. PLAINTIFFS WERE NOT FIDUCIARIES WITH DUTIES TO ABSENTEES

According to Milberg Weiss prosecutors, representative plaintiffs in class actions
are fiduciaries of absent class members and, as fiduciaries, owe absent class members
duties of loyalty, honesty, and trust. The indictment charges that the named plaintiffs
paid by Milberg Weiss breached their fiduciary duties by failing to disclose their fee
sharing agreements to absent class members. The government apparently theorized
that these agreements motivated the paid plaintiffs to maximize Milberg Weiss's fee
award—their "kickbacks" were calculated as a percentage of that award—when their
duty to the class was to maximize the common fund and minimize the fee awarded to
counsel from that fund. Alternatively, prosecutors claimed that the fee sharing
arrangement created conflicts of interest for the paid plaintiffs. As fiduciary of the
absent class members, the representative plaintiff was not permitted to have separate
interests in the outcome of the case. The indictment also alleges that Milberg Weiss
gave preferential treatment to the paid plaintiffs, and harmed the interests of the absent
class members, by agreeing to share attorneys' fees. The government's claim is that
the kickbacks deprived absent class members of the honest services from both the
representative plaintiffs and from class counsel. The representative plaintiffs allegedly
failed to monitor class counsel's fee requests as required to fulfill their duties as
fiduciaries and failed to object to class counsel's allegedly excessive fee requests, as they
should have in order to satisfy their duties.

The government's honest services theory belies the complexity of the agency
problem in class actions generally and in securities class actions in particular. Penetrating
the rhetoric, the indictments reflect fundamental confusion about the
functions and duties of named plaintiffs and class counsel, and the relationship each of
them has (or does not have) with the putative class. The government also confused the
duty of loyalty with the duty of care. This part begins by reviewing the law of fiduciaries and explains its origins in order to understand its governing principles. Applying classic fiduciary doctrine, it is clear that named plaintiffs are not actually fiduciaries of absent class members. The analysis then shifts to examining the law of class actions. This review confirms that named plaintiffs certainly did not function as fiduciaries prior to enactment of the PSLRA, nor did Congress intend for lead plaintiffs appointed after enactment of the PSLRA to assume fiduciary duties on behalf of absent class members. Indeed, courts have not developed a cogent jurisprudence concerning the fiduciary duties of lead counsel, let alone the duties of lead plaintiffs.410

A. Classic Fiduciary Doctrine and Its Applications

Fiduciary law is arguably the most doctrinally complex and indefinite category of legal obligation arising under private law. Among legal academics, "the prevailing view remains that fiduciary law is 'elusive.'"411 For hundreds of years now, fiduciary principles have been characterized mainly by aspirational commands communicated with lofty language412 that continues to evade standardized application. Modern scholars seem to have dissected every aspect of the doctrine, questioning the meaning of fiduciary, how fiduciary relationships differ from other relationships, what obligations fiduciaries owe to their beneficiaries, and the remedies available for breach of fiduciary duty. However, irrefutable pronouncements about application of fiduciary law are few, and the case law remains confused and contradictory.

The concept of a fiduciary has its roots in equity and originated in the law of trusts.413 Literally, the term fiduciary means "faithfulness," and the word denotes one in a position of trust, or a trustee.414 Fiduciary trustees hold title to property owned by the trust’s beneficiaries.415 Beneficiaries may claim the benefits of ownership, but they lack legal title.416 Recognizing that a trustee has undertaken responsibility for the beneficiary’s interests, fiduciary law imposed standards of acceptable conduct on the trustee, proscribing the trustee’s self-interested conduct in order that the trustee may act solely for the advantage of the beneficiary. "The common law imposed on trustees the duty to manage the trust corpus prudently, and fiduciary law strictly prohibited trustees from personally dealing in trust property, regardless of whether the self-dealing harmed the interests of the beneficiary."417

It is, then, the elemental vulnerability of the beneficiary to the fiduciary’s abuse of power and control that justifies the imposition of special duties on the fiduciary necessary to regulate the fiduciary’s conduct. For this reason, fiduciary relationships arise when a person (the fiduciary) receives control over some facet of another person’s (the

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410. Casey, Reforming Securities Class Actions, supra note 14, at 1314–19 (discussing the role of lead plaintiff and lead counsel in class actions).
413. Casey, Reforming Securities Class Actions, supra note 14, at 1316.
414. Id.
415. Id.
416. Id.
417. Id.
beneficiary's) life or property with the expectation that the fiduciary will exercise such control for the benefit of the beneficiary.\textsuperscript{418} "'[At] the heart of the fiduciary relationship' lies 'reliance, and de facto control and dominance.'"\textsuperscript{419} In the main, an owner of assets delegates management power to the fiduciary, and the fiduciary commits, expressly or impliedly, to exercise her discretion to promote the interests of the beneficiary.\textsuperscript{420} Such fiduciary relationships include those between trustees and beneficiaries, agents and principals, and partners one to another.\textsuperscript{421}

Fundamentally, the fiduciary relationship is characterized by "the actual placing of trust and confidence in fact by one party in another and a great disparity of position and influence between the parties to the relation."\textsuperscript{422} Indeed, the element of trust underlies all fiduciary relationships. Because the fiduciary dominates and controls some aspect of the beneficiary's life or property, the beneficiary necessarily must trust the fiduciary to promote the beneficiary's interest. Also for this reason, fiduciaries must act with the utmost loyalty toward their beneficiaries.

During its infancy, the courts limited application of fiduciary doctrine to persons occupying certain positions of trust and confidence, such as trustees, executors, and guardians. Later, as judges applied the trustee-beneficiary construct to other relationships ostensibly characterized by similar trust and confidence, fiduciary case law proliferated. Fiduciary theory expanded "to embrace all those who are placed in any position of trust," and the common law recognized additional categories of fiduciary associations through the courts' "jurisprudence of analogy."\textsuperscript{423}

When examining a particular relationship to determine whether it is fiduciary in character, courts often begin by identifying analogous status relationships where established law already has imposed fiduciary obligations. Then, courts decide whether the relationship under review is sufficiently similar to the paradigm relation to support an extension of fiduciary obligations to that relationship.\textsuperscript{424} Among the facts influencing the courts are the respective positions of the trusted and trusting parties; the trusted party's ability to influence the trusting party; the allocation of functions, if any, to the trusted party; and the potential for opportunistic behavior.\textsuperscript{425} As one example, directors of corporations owe fiduciary duties of loyalty and care to the firm and its shareholders.\textsuperscript{426}

Once the courts establish that a relationship is fiduciary in nature, the inquiry shifts

\textsuperscript{418} Morris v. Resolution Trust Corp., 622 A.2d 708, 712 (Me. 1993).
\textsuperscript{419} United States v. Chestman, 947 F.2d 551, 568 (2d Cir. 1991), cert. denied, 503 U.S. 1004 (1992) (quoting United States v. Marqiotta, 668 F.2d 108, 125 (2d Cir. 1982)).
\textsuperscript{420} Casey, Reforming Securities Class Actions, supra note 14, at 1317-18.
\textsuperscript{421} Id. at 1317.
\textsuperscript{422} Ruebsamen v. Maddocks, 340 A.2d 31, 35 (Me. 1975).
\textsuperscript{423} ERNEST VINTER, A TREATISE ON THE HISTORY AND LAW OF FIDUCIARY RELATIONSHIP AND RESULTING TRUSTS I (3d ed. 1955).
\textsuperscript{424} Casey, Reforming Securities Class Actions, supra note 14, at 1317.
\textsuperscript{425} Id.
\textsuperscript{426} Koehler v. Black River Falls Iron Co., 67 U.S. 715, 720-21 (1862) ("[Directors] hold a place of trust, and by accepting the trust are obliged to execute it with fidelity, not for their own benefit, but for the common benefit of the stockholders of the corporation."); N. Am. Catholic Educ. Programming Found. v. Gheewalla, 930 A.2d 92, 99 (Del. 2007) ("It is well established that the directors owe their fiduciary obligations to the corporation and its shareholders.").
to the obligations of the fiduciary to the beneficiary. Fiduciary doctrine articulates rules of conduct, or duties, that apply to persons recognized as fiduciaries under the law. These duties allow beneficiaries to rely on their fiduciaries and reduce the beneficiary's risk that the fiduciary will behave carelessly. More importantly, imposing duties on the fiduciary reduces the beneficiary's risk that the fiduciary will take the beneficiary's assets or opportunities, or otherwise misuse the beneficiary's property. To address the threat that the fiduciary will exploit her position of dominance and control to serve her own interests, the law imposes on fiduciaries a duty of loyalty and installs a system of accountability for breach of that duty. Classic judicial opinions variously describe the duty of loyalty as mandating that fiduciaries act in "utmost good faith," or with "undivided and unselfish loyalty," or with "the punctilio of an honor the most sensitive."

As the law has evolved, the status-based duties imposed on fiduciaries have varied depending upon the circumstances of the relationship. More recent case law eschews elevated rhetoric, and some decisions go so far as to hold that fiduciary responsibilities are not qualitatively different from other contract-based duties. Influenced by law and economics scholars, fiduciary duties increasingly are regarded not as moral imperatives but, rather, as the rules that most parties in a fiduciary category would want to govern their relationships. Although judicial opinions in most fiduciary duty cases omit any hypothetical bargain analysis, scholars have demonstrated that the law increasingly treats fiduciary duties as default rules that the parties may vary by agreement so long as the beneficiary's abrogation is informed and accomplished in a specific, express manner.

Regardless of the operative language, fiduciary law generally prohibits fiduciaries from acting in their own self-interest to the detriment of their beneficiaries. Here, too, courts look to precedent involving analogous relations and situations to determine the specific duties of the fiduciary in the particular circumstances at issue. Those precepts then govern subsequent judicial determinations as to whether a fiduciary has violated its duties and, if so, the monetary and nonmonetary remedies available to the beneficiary to redress that wrongful conduct. Thus, for example, if a director violates her duty of loyalty to the corporation by engaging in self-dealing, the corporation may sue her and seek disgorgement of any gains she received from her wrongful acts. Not surprisingly,

427. Casey, Reforming Securities Class Actions, supra note 14, at 1317.
428. Id.
429. Id. at 1317–18.
430. Id.
431. Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928) (Cardozo, J.) ("A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.").
432. Casey, Reforming Securities Class Actions, supra note 14, at 1318.
433. See Frank H. Easterbrook & Daniel R. Fischel, Contract and Fiduciary Duty, 36 J.L. & Econ. 425, 427 (1993) ("Fiduciary duties are not special duties; they have no moral footing; they are the same sort of obligations, derived and enforced in the same way, as other contractual undertakings.").
434. Id.
436. Casey, Reforming Securities Class Actions, supra note 14, at 1317.
437. Id. at 1317–18 (citing Guth v. Loft, Inc., 5 A.2d 503, 510–11 (Del. 1939)).
however, the law imposes on trustees more stringent restrictions on their use of trust property than corporate directors face in their dealings with the corporation.\textsuperscript{438} Trustees may not use trust property for their personal gain regardless of the profit or potential profit to the trust’s beneficiaries. In contrast, a corporate director may cause the firm to transact business that will benefit her personally so long as the transaction is, nonetheless, intrinsically fair to the corporation and the shareholders.\textsuperscript{439} Indeed, it is the very malleability of these duties and the relationships giving rise to them that pose definitional difficulties for courts and surprise liability for litigants who are found to be fiduciaries in ex post judicial proceedings.

\textit{B. The Relationship Between Class Representatives, Class Counsel, and Absentees Before Reform}

Federal courts have struggled for more than 40 years to identify the legal rights of absent class members and the legal responsibilities of plaintiffs’ counsel or class representatives to absent class members. Rule 23 itself says little about the relationship of class representatives to absent class members.\textsuperscript{440} It does not create any substantive relationship between a class representative and a putative (or even certified) class. Rule 23, like the other Federal Rules of Civil Procedure, is procedural and generally does not create substantive rights or obligations.\textsuperscript{441}

In order for a court to certify the plaintiffs’ class pursuant to Rule 23, the court must find that the class representative has claims typical of the class and will adequately and fairly protect the interests of the class.\textsuperscript{442} However, as interpreted by the Supreme Court, this inquiry primarily “serves to uncover conflicts of interest between named parties and the class they seek to represent” and “factors in competency and conflicts of class counsel.”\textsuperscript{443} Further, although pre-reform class action jurisprudence pays lip service to “the duty of the class representative to ensure that the absent members’ interests are adequately protected,”\textsuperscript{444} review of the case law makes clear that this language has no functional content.

As class action case law has evolved during the decades following adoption of Rule 23, courts have inquired little about the named plaintiffs. Rather, the courts focus their examinations on plaintiffs’ counsel and the ability of counsel to fairly and adequately represent the class.\textsuperscript{445} Here, it becomes clear that the two-party model of individualized

\textsuperscript{438} \textit{Id.} at 1318.

\textsuperscript{439} \textit{See} Weinberger v. UOP, Inc., 457 A.2d 701, 703–04 (Del. 1983) (discussing the corporate director in business transactions). Intrinsic fairness concerns both the substance of the transaction (“fair price”) and the process of negotiation leading to the transaction (“fair dealing”). \textit{Id.} at 711.


\textsuperscript{442} \textit{Fed. R. Civ. P. 23(a)(3)-(4)}.

\textsuperscript{443} Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 625–26 n.20 (1997).

\textsuperscript{444} Nat’l Ass’n of Reg’l Med. Programs, Inc. v. Mathews, 551 F.2d 340, 346 (D.C. Cir. 1976).

client autonomy and its ethical prohibitions against lawyers' control of litigation clash against the reality that, without aggregation of plaintiffs' claims, private enforcement will not serve its laudatory functions. Securities class actions, like other class actions sanctioned by Rule 23, are, in fact, lawyers' vehicles.446 Rather than clients seeking out their services, plaintiffs' attorneys often uncover both the claims and the injured plaintiffs willing and able to bring the claims.447 The law recognizes that plaintiffs' counsel is, in essence, the real party in interest on the plaintiffs' side of the case.448 "Experience teaches that it is counsel for the class representative and not the named parties, who direct and manage these actions. Every experienced federal judge knows that any statements to the contrary [are] sheer sophistry."449

When the "sophistry" is stripped away, the reality is that before the PSLRA, named plaintiffs typically acted as "figureheads" or "puppets" in securities class actions rather than as active advocates for absent class members.450 Courts construing Rule 23 acknowledged—albeit tacitly at times—that the plaintiff representatives in fact did not control or even oversee the litigation in the same way as plaintiffs in the traditional, bipolar lawsuits presumably direct their cases. As the Third Circuit noted in 1985, lawyers for the class carry the "laboring oar" in shaping and presenting the case, while the named plaintiffs usually provide no more than anecdotal testimony in their depositions or at trial.451 Securities class actions were not unique among class actions in this regard. Named plaintiffs generally furnished the factual basis necessary to invoke the court's jurisdiction and put the claims in controversy,452 but they otherwise functioned much like placeholders.453 District courts routinely certified named plaintiffs as adequate class representatives even when their deposition testimony included admissions that they lacked understanding of their claims and involvement in the case and its prosecution.454 This jurisprudence evidences the influence of agency cost theory on both class action advocacy and judicial decision-making. Surveying all class actions filed in the Northern District of California between 1985 and 1993, one study concluded that, "in practice, class representatives serve little beyond a nominal function. They are largely ignored by class counsel and the court and are not assured full participation in the class action

446. Culver v. City of Milwaukee, 277 F.3d 908, 913 (7th Cir. 2002) ("Realistically, functionally, practically, she [the plaintiffs' attorney] is the class representative, not he [the plaintiff]."); Kamen v. Kemper Fin. Servs., 908 F.2d 1338, 1349 (7th Cir. 1990), rev'd on other grounds, 500 U.S. 90 (1991).
448. See, e.g., Sosna v. Iowa, 419 U.S. 393, 412-13 (1975) (White, J., dissenting) (noting that plaintiffs' counsel will continue to litigate as an interested party in a class action suit when the representative plaintiff loses a shared characteristic with the class).
450. Bums, supra note 450, at 179-86 (arguing that plaintiff representatives have no meaningful role in class actions).
Named plaintiffs had no specific responsibilities and no duties to participate, much less to participate actively, in the case. Presiding judges rarely imposed on named plaintiffs any specific responsibilities.456

Courts apparently recognized that, with much smaller stakes in the litigation than the plaintiffs' lawyers, named parties certified as class representatives did not control the lawsuits. In fact, they did not seek to participate in litigation decisions or even consult with the plaintiffs' lawyers.457 “[C]lass representatives often are recruited by class counsel, play no client role whatsoever, and—when deposed . . .—commonly show no understanding of their litigation.”458 Furthermore, “class representatives appointed prior to securities litigation reform seldom reviewed class counsel’s time records, expenses, or work product, much less objected to class counsel’s fee application at the conclusion of the litigation.”459 Judges did not seek the approval or even the opinion of the class representative in evaluating counsel’s fee application, nor did courts usually inquire about or request a copy of the terms of the retention agreement, if any, negotiated between the class representative and plaintiffs’ counsel ex ante.

In fact, courts did not recognize the right or authority of representative plaintiffs to control any class action decisions. Most significantly, class action law made clear that assent of the named plaintiffs was not essential to approval of a settlement that the court found to be fair and reasonable.460 On the rare occasions when judicially-appointed class representatives attempted to exercise meaningful control over key litigation decisions, such as the decision to settle class claims, courts balked.461 Numerous courts have approved settlements advocated by class counsel over the opposition of the named plaintiffs/class representatives purportedly objectsing for the benefit of the class.462

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456. See Koniak & Cohen, supra note 440, at 163 (noting that such responsibilities are “nonexistent”).
457. Macey & Miller, supra note 58, at 20.
459. Casey, Reforming Securities Class Actions, supra note 14, at 1267.
460. See, e.g., Parker v. Anderson, 667 F.2d 1204, 1211 (5th Cir. 1982), cert. denied, 459 U.S. 828 (1982) (noting that the “agreement of the named plaintiff is not essential to approval of a settlement which the trial court finds to be fair and reasonable”); Flinn v. FMC Corp. 528 F.2d 1169 (4th Cir. 1975), cert. denied, 424 U.S. 967 (1976) (holding that class member opposition does not mean a settlement is unfair).
461. Parker, 667 F.2d at 1211 (affirming approval of settlement opposed by all but one of 11 named plaintiffs); see also Officers for Justice v. Civil Serv. Comm’n, 688 F.2d 615, 631 (9th Cir. 1982) (holding that, where named defendants did not differ in relevant respects from other class members, they should not have an undue influence on the settlement process); Maywalt v. Parker & Parsley Petroleum Co. (Maywalt IV), 864 F. Supp. 1422 (S.D.N.Y. 1994), aff’d, 67 F.3d 1072 (2d Cir. 1995) (denying motion to remove class counsel and approving settlement negotiated by counsel over objections by four of five named class representatives); Laskey v. Int’l Union, 638 F.2d 954 (6th Cir. 1981) (upholding settlement over named plaintiffs’ objections); Kincade v. Gen. Tire & Rubber Co., 635 F.2d 501 (5th Cir. 1981) (upholding settlement despite plaintiffs’ objections).
462. Maywalt IV, 864 F. Supp. at 1430 (quoting In re Ivan F. Boesky Sec. Litig., 948 F.2d 1358, 1366 (2d Cir. 1991)).

To empower the Class Representatives with what would amount to an automatic veto over the Proposed Settlement does not appear to serve the best interests of Rule 23 and would merely encourage strategic behavior “designed to maximize the value of the veto rather than the settlement value of their claims.”

Id. In fact, in Maywalt III, the named plaintiffs sought to remove class counsel and class counsel sought to end
The party plaintiff in a class action generally participates less actively than a party plaintiff in traditional bi-polar litigation.\textsuperscript{463} This passivity distinguishes the class action plaintiff from the classical bi-polar model of litigation. The differences are evident even before the filing of the complaints. In the traditional one-party, one-client paradigm, the client recognizes that she may have claims and usually seeks out and retains her attorney to investigate that possibility and sue for damages, if warranted by the facts and law.\textsuperscript{464} Unlike the plaintiff in bi-polar litigation, the securities class action plaintiff may not recognize that she has been the victim of a fraud and seek out counsel herself. Rather, plaintiffs' counsel, having identified the fraud, must find an investor with standing to bring the securities fraud claims who is willing to participate as a plaintiff for the benefit of other investors similarly situated.\textsuperscript{465} Such searches are costly. In the alternative, plaintiffs' counsel might seek out referrals from other attorneys or from securities brokers. Then again, counsel might have formed relationships with investors willing to purchase specific securities for their portfolios in order to position themselves as potential plaintiffs.\textsuperscript{466}

As the lawsuit proceeds, the traditional plaintiff has enough "skin in the game" to want her attorney to keep her informed about the developments in the case and consult with her at critical junctures in the litigation. Most importantly, the attorney cannot settle the individual client's case without the authorization of the client. In the event differences arise between the plaintiff and her counsel, she may fire her attorney at will.

Class actions, however, proceeded differently.\textsuperscript{467} Particularly before Congress enacted the PSLRA, the rationally apathetic named party would delegate control to the attorney, who would prosecute her lawsuit on behalf of similarly situated shareholders.\textsuperscript{468} As the law developed regarding adequacy of representation, courts established that named plaintiffs seeking appointment as class representatives must hire lawyers experienced in class action litigation, authorize them to do what is necessary to prosecute the case successfully, and read the complaint so as to be familiar generally with who has

\textsuperscript{463} See Macey & Miller, supra note 58, at 41 (noting that it is usually not worthwhile for the named plaintiff to follow the lawsuit because she holds only a small stake in the outcome).

\textsuperscript{464} Burns, supra note 450, at 181.

\textsuperscript{465} Id.

\textsuperscript{466} Id.

\textsuperscript{467} Id. at 181–82.

\textsuperscript{468} Macey & Miller, supra note 58, at 41.
been sued and why.\textsuperscript{469} However, representative plaintiffs need not supervise or oversee the lawyers. Courts recognized that the named plaintiffs cannot and will not bear the costs of monitoring the attorneys because they would recover only their small, pro rata share of any (highly unlikely) net gain to the class achieved through their monitoring.\textsuperscript{470} Plaintiffs also need not authorize counsel to settle, and it was almost unheard of for a class representative to attempt to fire class counsel.\textsuperscript{471} In any event, courts almost always rejected named plaintiffs' motions to replace counsel.\textsuperscript{472} The rules of civil procedure accounted for these important differences in plaintiffs' incentives and responsibilities by mandating judicial oversight of class action litigation and court approval of all important decisions in class action proceedings, including the decision to settle, the allocation of settlement proceeds to class members, and the payment of attorneys' fees and costs to plaintiffs' counsel.\textsuperscript{473}

Thus, class action jurisprudence and procedures contradict the rare judicial opinions which refer to class representatives as fiduciaries. And, importantly, courts using such rhetoric do not decide that named plaintiffs owe particular duties to absent class members, nor do their opinions find that plaintiffs have breached their supposed fiduciary duties. Indeed, the judicial decisions containing this language provide no substantive analysis supporting the courts' (mis)characterization of plaintiffs as fiduciaries.\textsuperscript{474}

Instead, courts often simply cite, or rely on some other case that cites, either the Supreme Court's 1949 decision in \textit{Cohen v. Beneficial Indus. Loan Corp.},\textsuperscript{475} or the Supreme Court's 1980 decision in \textit{Deposit Guaranty Nat'l Bank v. Roper}.\textsuperscript{476} Neither case, however, supports the position that class representatives owe fiduciary duties to absent class members.

\textbf{1. Cohen and Roper}

In \textit{Cohen}, a case which predates Rule 23, the Court wrote, in dicta, that:

\textit{[A] stockholder who brings suit on a cause of action derived from the corporation assumes a position, not technically as a trustee perhaps, but one of a fiduciary character}. He sues, not for himself alone, but as representative of a class comprising all who are similarly situated. The interests of all in the redress of the wrongs are taken into his hands, dependent upon his diligence, wisdom and integrity. And while the stockholders have chosen the corporate director or manager, they have no such election as to a plaintiff who steps forward to represent them. He is a self-chosen representative and a volunteer champion. The Federal Constitution does not oblige the State to place its litigating and adjudicating processes at the disposal of such a representative, at

\textsuperscript{470} Macey & Miller, supra note 58, at 20.
\textsuperscript{471} Id. at 42.
\textsuperscript{473} FED. R. CIV. P. 23(e), (g), and (h).
\textsuperscript{474} See, e.g., Martens v. Thomann, 273 F.3d 159, 173 n.10 (2d Cir. 2001) ("[A]s class representatives, the moving plaintiffs have fiduciary duties towards the other members of the class.").
least without imposing standards of responsibility, liability and accountability which it considers will protect the interests he elects himself to represent.477

The Supreme Court in Cohen not only failed to analyze and articulate its rationale for asserting that the shareholder, by filing suit, had assumed a position of fiduciary “character,” but the plaintiff stockholder in the case was not a class representative in a securities class action. Instead, the stockholder-plaintiff, Mr. Cohen, filed a shareholder’s derivative action.478 He brought a complaint on behalf of Beneficial Industrial Loan under New Jersey law, alleging that the company’s defendant-directors breached their fiduciary duties to the corporation.479 The claims filed by Cohen belonged to the corporation, rather than the shareholders, and any recovery obtained in the derivative action would have gone to the company, rather than shareholders. At issue before the Supreme Court was Cohen’s challenge to a provision of New Jersey’s corporate code intended to curb the filing of derivative suits by nominal shareholders.480 Specifically, the statute in question required derivative suit plaintiffs to post a bond covering the defendants’ litigation expenses unless the plaintiff’s shareholdings exceeded a specified minimum threshold.481 The Supreme Court upheld the constitutionality of the state law482 and determined that the federal district court, exercising diversity jurisdiction to decide the state law claims, erred in not applying New Jersey’s statute under the Rules of Decision Act.483 The Court’s discussion of the relationship between the class representative and the class (more properly, the nominal plaintiff and the nominal defendant corporation) did not affect the outcome of the case in any way. In fact, the passage seems intended simply to create a conscious parallelism (unfortunately, not well-founded) between a director’s or officer’s relationship with the corporation and a shareholder’s relationship with the corporation, insofar as state law regulates both.

Deposit Guaranty v. Roper, a Rule 23 case, concerned a consumer fraud class action challenging certain finance charges imposed by a credit card issuing bank on class member cardholders. The district court refused to certify a class of cardholders. Then, the defendant bank tendered to the two named plaintiffs the entire amount of their individual claim as part of an offer of judgment. Plaintiffs refused the offer because they intended to appeal the denial of class certification, but the district court entered judgment in their favor on their individual claims over their objection. In opposing plaintiffs’ appeal, the bank argued that their claims were mooted by the offer and entry of judgment on behalf of plaintiffs. The question before the Supreme Court was whether plaintiffs had standing to appeal the denial of their motion for class certification if judgment had already been rendered in their favor on the substance of their individual claims.484

The Court concluded that plaintiffs retained the right to challenge the district court’s certification decision even though the amount of their individual claim had been paid into court. In doing so, the Court identified a number of “distinct interests” which were

478. Id. at 543.
479. Id.
480. Id. at 543–45.
481. Id. at 544, n.1.
483. Id. at 557.
potentially impacted by the district court's decision.\textsuperscript{485} The Court identified five such interests. The named plaintiffs had two "private interests": (1) their "personal stake in the substantive controversy" and (2) their right to use Rule 23 when appropriate to vindicate those rights. A "separate" interest, "distinct from their private interests," is the "responsibility of named plaintiffs to represent the collective interests of the putative class." The remaining interests included those of putative class members as intervenors and the district court's interest in monitoring the actions of the litigant "to protect both the absent class and the integrity of the judicial process."\textsuperscript{486}

In reaching its decision, the Court required "consideration only of the private interest of the named plaintiffs."\textsuperscript{487} It explicitly stated that "[d]ifficult questions arise as to what, if any, are the named plaintiffs' responsibilities to the putative class prior to certification; this case does not require us to reach these questions."\textsuperscript{488} The Court then concluded that plaintiffs retained their standing to challenge the denial of their motion for class certification because defendants' offer of judgment did not vindicate the "individual interest" in the litigation; plaintiffs continued to be deprived of their right to use Rule 23—at least in part—in order for them to attempt to shift their attorney’s fees to the defendants.\textsuperscript{489}

The Supreme Court expressly limited its analysis to the named plaintiffs’ own interest and avoided any discussion of what relationship existed (either before or after certification) between the named plaintiff and the putative class. Nor did the Court examine what, if any, duties plaintiffs might owe to absent class members. Instead, the Court's decision turned on the extent of the plaintiffs' own rights and interests, not their obligations to the absent, uncertified class. \textit{Roper} provides no support for the assertion that class representatives are fiduciaries of the absent class.

From time to time, lower courts overseeing class actions have cited either \textit{Cohen} or \textit{Roper} mistakenly for the proposition that class representatives are fiduciaries without further analysis.\textsuperscript{490} However, such decisions do not create positive law by citing to \textit{Cohen} or \textit{Roper} in error, nor has the occasional mischaracterization of named plaintiffs as fiduciaries apparently determined the outcome of any dispute. In fact, no court has imposed fiduciary liability on a named plaintiff, and no legal structures exist to hold plaintiffs accountable as fiduciaries to absent class members. Indeed, I could not locate any reported cases involving allegations that a shareholder named plaintiff breached her purported fiduciary duties to absent class members. Unlike corporate directors and officers, shareholders acting as named plaintiffs are not fiduciaries of the corporation nor its shareholders under state law. Nor does Rule 23 create a fiduciary relationship between the plaintiff class representative and absent class members.

\textbf{C. What the PSLRA Did and Did Not Do}

Despite all the testimony in Congress concerning the purported ills arising from

\begin{itemize}
  \item \textsuperscript{485} \textit{Id.} at 331.
  \item \textsuperscript{486} \textit{Id.}
  \item \textsuperscript{487} \textit{Id.} at 332.
  \item \textsuperscript{488} \textit{Id.} at 340, n.12.
  \item \textsuperscript{489} \textit{Roper,} 445 U.S. at 340.
  \item \textsuperscript{490} \textit{See, e.g.,} Martens v. Thomann, 273 F.3d 159, 173 n.10 (2d Cir. 2001) (citing \textit{Roper,} 445 U.S. at 331).  
\end{itemize}
securities class actions filed by professional plaintiffs and controlled by entrepreneurial plaintiffs' lawyers, the enactment of the PSLRA scarcely changed the law with respect to the duties of named plaintiffs/class representatives. The statute does not enumerate any responsibilities for the named plaintiff other than to provide a sworn certification with her complaint (including the certification that she will not accept any bonus payments for serving as a lead plaintiff) and to publish notice of the pendency of the action in order that other investors may seek appointment as lead plaintiff.\footnote{491} Neither these statutory provisions nor any other sections of the PSLRA refer to the lead plaintiff as a fiduciary, and the statute does not incorporate any state law fiduciary duties. The PSLRA is devoid of any language of trust describing the duties of class representatives. Indeed, nothing in the statute speaks of any duties owed by lead plaintiff to absent class members whatsoever.

Furthermore, while the PSLRA makes clear that the investor with the largest stake in the lawsuit (at least among those seeking the role) becomes the presumptive lead plaintiff, Congress did not mandate that lead plaintiff candidates own or have owned any specific amount of securities in order to receive the judicial appointment. Just as before the PSLRA, then, the lead counsel very well may have a greater financial stake in the outcome of the lawsuit than the lead plaintiff.\footnote{492} Plaintiffs' attorneys still litigate securities class actions on a contingency fee basis and still invest substantial sums of time and money in these lawsuits; counsel likely must make greater investments as a result of the PSLRA's lead plaintiff requirements, heightened pleading standards, and discovery stay provisions. Among other outlays, the lawyers make significant expenditures up front in pre-filing investigations, complaint drafting, and locating potential lead plaintiffs to participate in their lawsuits. After Congress passed the PSLRA, plaintiffs' law firms refocused their efforts on forming relationships with large, preferably institutional, investors who own broad, diversified portfolios of public company securities.\footnote{493} These investors are most likely to have suffered substantial financial losses from the fraud de jour. By marketing their services to public and union pension funds,\footnote{494} plaintiffs' attorneys still compete with one another for the role of lead counsel.\footnote{495}

The PSLRA also is silent with regard to a lead plaintiff's rights and responsibilities, other than to provide that lead plaintiffs may select and retain lead counsel subject to court approval.\footnote{496} Although lawmakers hoped that the larger stakes of institutional

\footnote{492. Pre-PSLRA courts reasoned that such a requirement risked favoritism by the named plaintiff of her own claim over the claims of smaller absent class members. Even after reform, a lead plaintiff's interest in the outcome of the litigation need not be entirely congruent with that of other investors in the putative class. For example, an investor who still owns shares of the issuer may receive appointment as lead plaintiff regardless of how many putative class members sold their shares.}
\footnote{493. See supra Part II.A.4.}
\footnote{494. Largely as a result of commercial conflicts of interest and disqualifying social norms, financial institutions—such as mutual funds, banks, and insurance companies—do not participate as lead plaintiffs in securities class actions. James D. Cox & Randall S. Thomas, Does the Lead Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions, 106 COLUM. L. REV. 1587, 1609–10 (2006).}
\footnote{495. See generally Stephen J. Choi & Robert B. Thompson, Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA, 106 COLUM. L. REV. 1489 (2006) (discussing the role of plaintiff law firms and the effectiveness of PSLRA).}
investors would provide them with the incentive to monitor lead counsel, the statute imposes no oversight requirement whatsoever. Nor did Congress require that the lead plaintiff authorize the settlement of the lawsuit or the payment of lead counsel's fees and costs. In fact, nothing in the language of the statute mandates that lead plaintiffs play any decision-making role whatsoever during the pendency of the case. As prior to enactment of the PSLRA, lead plaintiffs may leave the planning, strategy, and all key decisions to the lead counsel appointed by the court. The statutory language merely permits, but does not require, the lead plaintiff to select and retain lead counsel, and the lead plaintiff's decisions in this regard are, nonetheless, subject to court approval. Some judges have refused to allow the lead plaintiff to select and retain lead counsel, holding an auction to determine that position\[497\] or selecting counsel according to the judge's own criteria.\[498\]

Other than selecting and retaining lead counsel subject to judicial approval, lead plaintiffs have no delineated role to play in the litigation, much less a fiduciary role.

A close reading of the PSLRA's legislative history makes clear that it was no accident that Congress failed to make lead plaintiffs fiduciaries for the class. In fact, Congress did not intend for lead plaintiffs to undertake fiduciary responsibilities to the absent class members. Congress understood that the imposition of fiduciary duties on lead plaintiffs would discourage institutional investors from volunteering for the role. For this reason, federal legislators included in the Conference Report the statement that they expressly did not intend to "confer any new fiduciary duty on institutional investors—and the courts should not impose such a duty [on them as lead plaintiffs]."\[499\]

In the dozen years following enactment of the PSLRA, the courts have not imposed fiduciary duties on investors serving as lead plaintiffs in securities class actions. Courts generally have adhered to the language of the law, following the procedures for the judicial selection of lead plaintiffs and reviewing (but not invariably approving) that lead plaintiff's selection of lead counsel.

### D. Analyzing the Indictment's Theory of Fiduciary Duty

Despite the omission of fiduciary duties from the PSLRA, Rule 23, and class action jurisprudence, the government predicated its honest services fraud claim against Milberg Weiss on fiduciary duties allegedly owed by representative plaintiffs to absent class

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498. See, e.g., In re Quintus Sec. Litig., 201 F.R.D. 475, 492–93 (N.D. Cal. 2001); In re Quintus Sec. Litig., 148 F. Supp. 2d 967 (N.D. Cal. 2001), rev'd on mandamus, In re Cavanaugh, 306 F.3d 726 (9th Cir. 2002) (using questionnaire process to obtain information from lead plaintiff applicants concerning their business acumen, knowledge of the lawsuit, and fee arrangements with their respective attorneys, and using this information to select lead plaintiff best suited to represent class); In re Network Assoc., Inc., Sec. Litig., 76 F. Supp. 2d 1017 (N.D. Cal. 1999) (ordering lead counsel to select lead plaintiff through competitive bidding process).

Prosecutors claimed that payments made by Milberg Weiss to the representative plaintiffs deprived absent class members of the honest services owed to them by the representative plaintiffs as well as by Milberg Weiss. By failing to monitor class counsel’s fee requests and by not voicing their disapproval of class counsel’s fee requests, the named plaintiffs paid by Milberg Weiss allegedly violated their duty of loyalty to the absent investors. According to the government, if the named plaintiffs had not been bought off by Milberg Weiss, they not only would have objected to the law firm’s attorneys’ fees requests, but the presiding judges would have sustained their objections. Thus, the payments to named plaintiffs created conflicts between the named plaintiffs and the putative class insofar as the paid plaintiffs had a “greater interest in maximizing the amount of attorneys’ fees awarded to Milberg Weiss than in maximizing the net recovery to the absent class members.”

The prosecutors’ theory was not only speculative, it was wrong. In addition to grounding the theory on non-existent legal duties, the government assumed that, were it not for the corrupting promise of kickbacks, the representative plaintiffs would have had the motivation (economic incentive) and the ability to monitor counsel effectively. The prosecutors’ theory further assumed that, having monitored counsel, the representative plaintiffs would have objected to Milberg Weiss’s fee requests as excessive. And not only that, but the representative plaintiffs would have convinced the courts of the merits of their objections and the courts, persuaded that Milberg Weiss’s fee requests were, for some reason, excessive, would have reduced the law firm’s fees, thus enlarging the classes’ recoveries.

Furthermore, contrary to the prosecution’s theory, and as courts have long recognized, named plaintiffs in class actions serve “largely [as] figurehead[s] who pla[y] little or no part in the initiation and prosecution of the class claim.” They often do not participate actively in the litigation, much less assert control over the claims asserted in the lawsuit, and the law does not instill in them power over the rights or the assets of absent class members. Insofar as investors often have no knowledge that a fraud could have caused their loss, private enforcement lawyers necessarily provide the initiative to commence litigation. As I have written previously, monitoring of counsel by the named plaintiffs is a theoretical mechanism for reducing agency costs in class actions, but it is just that, theoretical. Its empirical effectiveness is unproven. In practice, named plaintiffs rarely object to the settlement agreements negotiated by counsel or the attorneys’ fees requested by class counsel. Moreover, in the rare instances that named plaintiffs have objected, the courts invariably ignore plaintiffs’ protests, opting instead to exercise their judicial oversight powers. Just as before the PSLRA, courts continue to approve settlements of class actions over the objections of the named plaintiffs. As contemplated by both the

500. FSI, supra note 25, ¶21.
501. Id. ¶33(a).
502. Id. ¶29.
503. Bums, supra note 450, at 179.
505. See, e.g., Rodriguez v. West Publ’g Corp., No. CV05-3222R, 2007 U.S. Dist. LEXIS 74767, at *33–35 (C.D. Cal. Sept. 10, 2007) (‘‘The Court rejects the arguments by . . . Objectors that the Settlement should not be approved because the Objecting Plaintiffs object to the terms of the Settlement. To the contrary, ‘agreement of the named plaintiffs is not essential to approval of a settlement which the trial court finds to be fair and
PSLRA and Rule 23, courts make their own independent assessments of the fairness of negotiated settlements and the reasonableness of the fees requested by class counsel.

The Milberg Weiss indictment therefore misstated the legal relationships between representative plaintiffs and absent class members. One of the core tenets of agency law is that a principal has the right to control its agent. Yet, in reality, representative plaintiffs do not control class counsel, and class counsel does not assume the legal role of plaintiffs’ agent. In fact, counsel functions more as an inchoate representative, essentially insulated from control by the named plaintiff but subject to monitoring by the presiding judge.506

1. Named Plaintiffs’ Limited Authority and Functions

As discussed supra Part IV.A, fiduciary duties arise from the structure and substance of the actors’ relationship.507 In securities class action litigation, the named party and the absent class members have no prior relationship (other than owning shares of the same corporation) before plaintiffs’ counsel files the putative class action. Lead plaintiffs are neither selected nor approved by the absent class members. Nor do absent class members select or approve the class representatives. The lawsuit gives form to the contours of whatever “relationship” the investors might have. Application of fiduciary law to this non-contractual relationship between named plaintiffs and absent class members makes no functional sense and is entirely artificial. Furthermore, the “relationship” already is regulated by the courts supervising the litigation and applying the legal rules determined by Congress as appropriate, those rules set forth in the PSLRA and Federal Rule of Civil Procedure 23.

Before Congress enacted the PSLRA, named plaintiffs, in fact and in law, had no powers and rarely participated actively in securities class actions. As discussed before, neither the PSLRA nor the class action law under Rule 23 endows named plaintiffs with the authority to make the most important decisions in the case: they do not have the power to compel plaintiffs’ counsel to go to trial or to settle their claims. Indeed, plaintiffs do not have the legal authority to make settlement demands or to accept or reject settlement offers. Settlements are not contingent on approval by the named plaintiffs, nor do the named plaintiffs have any say in the plan of distribution or the disposition of undistributed settlement funds. Although the PSLRA permits lead plaintiffs to select and retain lead counsel, this function is expressly subject to court approval. Congress also reserved for the courts the power to determine lead counsel’s fees and costs, making no provision for the courts to even consider the views of lead plaintiffs as to the compensation of plaintiffs’ lawyers.

In short, named plaintiffs lack the power to affect litigation outcomes. Because they have no authority over the disposition of claims asserted in the lawsuit, they do not control absent class members’ claims. In fact, unless or until absent class members fail to...

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506. Culver v. City of Milwaukee, 277 F.3d 908, 912 (7th Cir. 2002) ("Realistically, functionally, practically, [class counsel] is the class representative, not [the plaintiff].").

opt-out of the class, the absentees themselves retain ultimate authority over the disposition of their own claims.

Imposing fiduciary responsibilities upon named plaintiffs who have limited functions and no power or authority over absent class members’ claims serves no purpose and would discourage investors from volunteering for the position. Congress recognized that institutions would not volunteer as lead plaintiffs if the role exposed them to liability as fiduciaries to absent class members. That is why, when Congress reformed securities class action practice in 1995, federal lawmakers not only declined to impose fiduciary duties on lead plaintiffs, they also attempted to reassure potential lead plaintiffs that they would not face such liability to absent class members. As mentioned above, Congress took care to underscore that it was not creating new fiduciary duties for named plaintiffs. As specified in the Conference Report: “[T]he most adequate plaintiff provision does not confer any new fiduciary duty on institutional investors—and the courts should not impose such a duty.” Milberg Weiss’s prosecutors attempted to impose alleged duties on lead plaintiffs that Congress simply did not prescribe.

Congress appropriately declined to burden lead plaintiffs with fiduciary responsibilities to absent class members. Without the authority to make fiduciary decisions, it makes little sense for the law to burden lead plaintiffs with fiduciary obligations. Because the key “relationship” is really that between plaintiffs’ counsel and the absent class, and because the law disclaims the named plaintiffs’ power and control, named plaintiffs cannot be fiduciaries of absent class members. Furthermore, even without fiduciary obligations, Congress’s intention to engage institutional investors as lead plaintiffs has met with mixed success at best. Although public pension plans and labor union pension funds have volunteered for the role in certain cases, other institutional investors, such as mutual funds, banks, and insurance companies, have declined the PSLRA’s invitation to participate. If exposed to fiduciary liability, even the institutions that, to date, have acted as lead plaintiffs likely will refuse to take the lead in the future. Since the PSLRA prohibits lead plaintiffs from receiving any rewards for their service as lead plaintiff, they cannot be compensated for undertaking the risk of liability to absent class members.

2. Duties of Plaintiffs’ Counsel in Securities Class Actions

Class action jurisprudence also has not produced any definitive articulation of the relationship between plaintiffs’ counsel and the putative class, except that it differs in significant ways from the relationship of attorney to client in traditional, bi-polar litigation. Under traditional theory, attorneys act as agents for their clients. The

509. Id.
510. Id.
511. See James D. Cox & Randall S. Thomas with Dana Kiku, Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions, 106 COLUM. L. REV. 1587, 1609 (2006) (in study of post-PSLRA cases, authors found no instance “where a bank, mutual fund, or insurance company ha[d] served as a lead plaintiff in a securities class action.”).
attorney-client relationship becomes established through mutual consent; the attorney (the agent) consents to act on behalf of the client (the principal) and subject to the client’s control, and the client also must manifest her assent to the relationship with the attorney. Although consent of both the client and counsel remain relevant considerations throughout the duration of their relationship, the client, nonetheless, incurs agency costs, including the risk that the attorney will not deal with third parties as the client had instructed. Ethics rules attempt to mitigate these agency costs by, inter alia, demanding that the lawyer advocate zealously for the client, keep the client informed, consult the client at all times critical in the litigation, and follow the client’s decisions.\textsuperscript{514}

These tenets do not transfer easily to class action lawsuits filed by attorneys acting to enforce the securities laws, as the courts have recognized.\textsuperscript{515} For one thing, the nature of the relationship of the class action attorney to the absentees is nebulous and ill-defined. The indeterminacy is especially great in the early stages of the lawsuit, before the court has appointed the lead plaintiff or sanctioned the lead plaintiff’s selection of lead counsel. Who is the client of the class action lawyer? The law is unsettled. Agrieved investors retain the services of plaintiffs’ counsel at the inception of the lawsuit and become clients of plaintiffs’ counsel. Almost invariably,\textsuperscript{516} lead plaintiffs then select their own lawyers to serve as lead counsel. Yet, even after the court approves the selection of lead counsel, many months and sometimes years may often pass before the court decides whether to certify a plaintiffs’ class and then appoints counsel to represent the class.\textsuperscript{517} Before that time, there is no class, and there are no class representatives. Counsel presumably owes duties to the lead plaintiff, but what are those duties? How do counsel’s responsibilities differ from those owed to a client in traditional lawsuit? Does counsel also have duties to an entity of sorts, the putative class? Or, by filing the complaint as a putative class action, does the lawyer become a fiduciary to each absent member of the putative class? Some scholars have argued that class counsel represents individual class members,\textsuperscript{518} while others theorize that the class, as an entity, is the client.\textsuperscript{519} Class action jurisprudence could support either conclusion.

Paraphrasing Justice Felix Frankfurter, to say that plaintiffs’ attorneys are fiduciaries only begins the analysis; that statement only gives direction to further inquiry.\textsuperscript{520} To

\textsuperscript{514} See, e.g., MODEL RULES OF PROF'L CONDUCT RULES R. 1.2, 1.4, pmbl. (2008).

\textsuperscript{515} See, e.g., Lazy Oil Co. v. Witco Corp., 166 F.3d 581, 588 (3d Cir. 1999) (noting that since class actions necessarily combine persons with many divergent interests, conflict of interest rules cannot apply precisely).

\textsuperscript{516} After two federal district court judges experimented with lead counsel auctions, the Third Circuit convened a task force to study the approach and issued a report disapproving its use. See SALTZBURG ET AL. supra note 497, at 689.

\textsuperscript{517} The Enron securities class action provides a striking example of this increasingly common experience. See, e.g., Regents of the Univ. of Cal. v. Credit Suisse First Boston (USA), Inc., 482 F.3d 372, 377-78 (5th Cir. 2007) (noting that district court appointed the lead plaintiff in December 2001, denied motions to dismiss in December 2002, and certified the class and appointed Milberg Weiss class counsel in July 2006), cert. denied, 128 S. Ct. 1120(2008).

\textsuperscript{518} John C. Coffee, Jr., Class Action Accountability: Reconciling Exit, Voice, and Loyalty in Representative Litigation, 100 COLUM. L. REV. 370, 380-85 (2000) (noting the failure of “entity theory” proponents to provide clear normative bases to accept the entity as the client over individuals).


\textsuperscript{520} SEC v. Chenery Corp., 318 U.S. 80, 85-86 (1943) (“But to say a man is a fiduciary only begins
whom is counsel a fiduciary? Even if we use the most simplistic assumptions—that class counsel is a fiduciary to both the lead plaintiff and to an entity (investor class certified by the presiding judge)—what are counsel’s duties? Are the duties the same for both beneficiaries? Are the duties the same duties that lawyers representing plaintiffs in bipolar fraud (tort) actions have to their clients? In what respect might counsel fail to discharge those obligations? Specifically, what happens when the interests of investors conflict? And what are the consequences to counsel if she deviates from her duties?

It is not clear then, as a matter of doctrine or practice, whether or how Milberg Weiss violated any fiduciary duties to absent class members. With the case law confused and scholars in disagreement, it seems most accurate to conclude that the duties of plaintiffs’ lawyers to the named party and to absent class members are sui generis. As articulated by Professor Coffee, “it is more accurate to describe the plaintiff’s attorney as an independent entrepreneur than as an agent of the client.”

When Bill Lerach boasted that he had no clients, he was describing the very real effect of this legal indeterminacy.

3. Judicial Supervision of Securities Class Actions

Because class actions are neither initiated nor controlled by the named party plaintiffs and because plaintiffs’ counsel’s role as an “independent entrepreneur” deviates from the traditional attorney-client model, Rule 23 and the PSLRA assign to the courts the responsibility to review and approve decisions made by class counsel for the benefit of absent class members to protect the class from opportunism by plaintiffs’ counsel. Indeed, judicial authorization is required at every important stage of class action lawsuit.

From the outset of the litigation, courts supervise the selection and retention of lead counsel, and lead plaintiffs have no power to dismiss their representatives, much less their claims. First, the court must determine the plaintiff(s) and counsel to lead the prosecution of claims. Before Congress enacted the PSLRA, the courts not only appointed counsel for absent class members, but they also selected plaintiffs’ counsel among the lawyers competing to provide legal services in the case. Since 1996, the PSLRA has allowed the court’s lead plaintiff appointee to select and retain lead counsel, but, again, the selection and retention decision is subject to judicial oversight and approval.

Pursuant to Rule 23, the court next safeguards the interest of absent class members by deciding whether to certify the case as a class action and make specific findings in doing so, including the adequacy of these persons as class representatives as well as the adequacy of class counsel. Nothing in the PSLRA requires that lead plaintiffs select counsel who will act solely for the benefit of absent shareholders, and nothing in the analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?"

522. See Barrett, supra note 9, at 52.
525. FED. R. CIV. P. 23(c)(1)(B).
statute mandates that lead plaintiffs place the interests of the absentees above their own interests.

If the class is certified, it is the court that approves the notice to absent class members.\footnote{Id.} Assuming that the court determines that the class has adequate representation and certifies the case for treatment as a class action, putative members of the class can choose to opt out of the lawsuit.\footnote{FED. R. Civ. P. 23(c)(2)(B)(v).} If they do so, they will not be bound by the outcome of the case (that is, the resolution of the claims as negotiated by class counsel).\footnote{Id.}

Most importantly, the court approves all terms of a class action settlement, including the distribution of settlement funds and the award of attorneys’ fees and costs.\footnote{FED. R. Civ. P. 23(e).} Judicial notice of the pendency of the case and the opt out rights assure absent class members that the court will review and approve any settlement which is fair, adequate, and reasonable and will award as compensation to class counsel only the fees and costs that the court deems to be reasonable.\footnote{FED R. Civ. P. 23(h).} Courts scrutinize class action settlements to safeguard the rights of absent class members.\footnote{See Grunin v. Int’l House of Pancakes, 513 F.2d 114, 123 (8th Cir. 1975) (noting that the court acts as a guardian of absent class members’ rights under Rule 23(e)), cert. denied, 423 U.S. 864 (1975).} The Supreme Court has emphasized that the rights of absent class members must be “the dominant concern” of the courts reviewing proposed settlements, and courts must provide “undiluted, even heightened attention” to the adequacy of representation in the context of certifying a class for settlement purposes.\footnote{Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 593, 620 (1997).} Judicial review under Rule 23(e) safeguards the rights of absent class members. The burden of proving the fairness of a proposed class action settlement is always on its proponents, and no presumption aids them in meeting their burden.\footnote{See 2 HERBERT B. NEWBURG & ALBA CONTE, NEWBURG ON CLASS ACTIONS § 11.42, at 11-94 (3d ed. 1992) (citing, inter alia, In re Gen. Motors Corp. Engine Interchange Litig., 594 F.2d 1106 (7th Cir. 1979), cert. denied, 444 U.S. 870 (1979)); see also Gautreaux v. Pierce, 690 F.2d 616, 630–31 (7th Cir. 1982) (noting that a district court may not assume the fairness of a consent decree).} Courts will not approve such settlements if it appears that the named plaintiff and plaintiffs’ counsel have filed the case as a class action in order “to obtain leverage for one person’s benefit”—the named plaintiff—without providing any benefit or only a “tiny” benefit for absent class members.\footnote{Murray v. GMAC Mortgage Corp., 434 F.3d 948, 952 (7th Cir. 2006).} Fairness demands that absent class members receive fair consideration in exchange for release of their claims, but it is the responsibility of the courts, not the named plaintiffs, to make this determination.

From both a functional and a doctrinal perspective, then, named plaintiffs are not fiduciaries of absent class members. Indeed, it is the courts that oversee the litigation and monitor the prosecution of shareholders’ claims at every phase of the lawsuit. Yet, as I have written previously, judges also do not qualify as fiduciaries of absent class members (despite language in scattered court opinions to the contrary), and presiding judges have no enforceable legal duties to absentees as their fiduciaries.\footnote{Casey, Reforming Securities Class Actions, supra note 14, at 1314–23.}
then, who rarely perform the functions associated with fiduciaries and, in any event, are understood to have neither the ability nor the legal obligation to do so (apart from selecting and retaining lead counsel), also are not fiduciaries to absentees. Nevertheless, class action law mandates judicial oversight, and judicial oversight operates to reduce agency costs inherent in representative litigation. Although judges are not perfect monitors, imposing fiduciary duties ex post on named plaintiffs would result in surprise liability while not reducing any residual agency costs significantly, except, perhaps, at great expense to the named plaintiffs. Insofar as the plaintiffs cannot receive compensation for incurring such costs under the PSLRA, the imposition of fiduciary duties on lead plaintiffs likely would discourage investors, and especially institutional investors, from serving in that capacity.

Having determined that representative plaintiffs are not fiduciaries to absent class members, the next part examines the implications of this analysis, first, for the government's honest services fraud charge and then, for the government's case more broadly. The analysis demonstrates not only that prosecutors based their indictment of Milberg Weiss upon fiduciary duties that do not exist, but also that the government charged Milberg Weiss with serious felonies for having engaged in conduct that Congress chose to regulate but not criminalize.

V. WHY CLASS ACTION CRIMINALITY SHOULD FAIL

The foregoing analysis revealed that the government's fiduciary breach theory failed at its foundation. The following discussion explores how this failure would have doomed the prosecution's case against Milberg Weiss.

A. Applying Breach of Fiduciary Duty Analysis to the Indictment

Comparing the allegations in the Milberg Weiss indictment to prior honest services fraud cases involving private parties, one can see that they fall outside the scope of honest services fraud. It goes without saying that no lawyers or law firms have ever been indicted for making undisclosed payments to investors to serve as plaintiffs in class actions, so on that level, the indictment clearly breaks new ground. The triangular relationship between class counsel, the named plaintiff, and the absent class differs from the more conventional breach of fiduciary duty cases or even the *Rybicki II*-type kickback cases in several important respects.

First, the nature of the relationships at issue in the Milberg Weiss indictment diverge from both the conventional type of cases and the *Rybicki II* kickback cases because the named plaintiff does not have a fiduciary relationship with, or owe fiduciary duties to, the absent class. The indictment alleges honest services fraud arising from the breach of either the law firm's fiduciary duty to the absent class or the named plaintiff's fiduciary duty to the absent class. Neither of these scenarios corresponds to the types of cases that generally give rise to honest services fraud convictions. With respect to Milberg Weiss's relationship to the class, it diverges from the traditional attorney-client fiduciary

536. See supra Part IV (discussing that neither classic fiduciary law, nor class action law, imposed on named plaintiffs fiduciary responsibilities toward absent class members).
537. FSI, supra note 25, ¶¶ 20, 21.
relationship. In fact, the very structure of the class action, particularly when dealing with common fund situations, not only permits but even requires that at some point there will be a conflict of interest between the class members and the counsel that represents them.

As for the named plaintiff’s relationship with the class, as discussed previously, it is simply a rhetorical flourish to label that relationship as “fiduciary” in nature or to impose on named plaintiffs fiduciary duties toward absent class members.\textsuperscript{538} The relationship between a class representative and the absent class differs significantly from the trustee, agency, or other similar relationships that traditionally give rise to a duty of loyalty. As discussed above, the named plaintiff not only lacks control over absentees’ claims, it makes no decisions that bind absentees as a typical trustee or agent would, and, particularly pre-PSLRA, the named plaintiff had no actual responsibilities to act on behalf of the absentees. Before Congress enacted the PSLRA, named plaintiffs had little, if any, ability to control the litigation, much less putative class counsel. Congress decided \textit{not} to alter this status quo when it enacted the PSLRA. Federal lawmakers imposed on lead plaintiffs no new fiduciary duties to act for or on behalf of the class.\textsuperscript{539} The principal new obligation imposed by the PSLRA on potential lead plaintiffs is to make the certification required to be filed with the court.\textsuperscript{540}

Second, the relationship between the absent class members, counsel, and the named plaintiff, does not give rise to the type of disclosure obligations owed by an agent to a principal in prior honest services fraud cases. Before the PSLRA, any disclosure of the compensation agreements made between a named plaintiff and the law firm came during discovery taken by defendants seeking to defeat class certification by unearthing facts from which to argue that the putative class representative would be inadequate or atypical.\textsuperscript{541} Since the relationship between a putative class representative and the defendants could not be further from a fiduciary relation, the failure by the deponent to disclose a fee sharing arrangement (while potentially inaccurate or dishonest) does not constitute a breach of fiduciary duty. Moreover, at this point in the litigation, the court likely has not certified a plaintiffs’ class. There cannot be a failure to disclose a fee sharing agreement to a fiduciary principal that does not yet, and may not ever, exist. And while the failure to disclose such an agreement during class discovery might properly be construed as a misrepresentation to the court, there is no breach of a fiduciary relationship implicated. Such a misrepresentation to the court may well violate other criminal statutes, but it does not implicate section 1346. Finally, while competing class counsel may well want to discover the nature of the relationship between the putative class representative and Milberg Weiss (particularly post-PSLRA), no fiduciary relationship gave rise to a duty of disclosure by either Milberg Weiss or its putative class

\textsuperscript{538} See supra Part IV.B (discussing the relationship between class representatives, class counsel, and class members before Congressional reform). Moreover, there is a further serious question as to when a class even comes into being as an entity to which the named plaintiff could owe fiduciary duties. If an agreement is reached with an investor who might become a class representative and the class has not yet been certified, it seems a stretch at best to say that the investor owes any kind of duty to an entity not yet created or recognized by law.

\textsuperscript{539} See supra note 494 and accompanying text (explaining that Congress did not use the PSLRA to impose fiduciary duties on lead plaintiffs).


\textsuperscript{541} See FED. R. CIV. P. 23(a)(3), (4).
representatives. named plaintiffs' failure to disclose their fee sharing agreements did not constitute a breach of fiduciary duty owed by them to anyone.

In addition, even assuming that the paid plaintiff owed a fiduciary duty to the absent class, not every breach of duty constitutes honest services fraud. The breach must damage the purpose of the relationship. Beyond the alleged disloyalty itself, the reasonably foreseeable or actual harm is difficult to discern. The indictment asserted that the classes were deprived of their rights to the services of named plaintiffs and counsel who were free from any conflicts of interest. The indictment also alleged that absentee were deprived of their rights to named plaintiffs and counsel who "would not act in a deceitful, unethical, or unlawful manner toward them or the court." These allegations are circular. The alleged breaches of duty were the alleged conflicts of interest. Moreover, the government cannot state a legally sufficient claim for honest services fraud by simply asserting that the named plaintiff and counsel performed their services dishonestly or deceitfully, without explaining how they performed in ways that differed from faithful fiduciaries. The indictment also alleged that absent class members were deprived of "material economic information that affected their right and ability to influence and control class actions and shareholder derivative actions brought on their behalf."

This allegation, too, seems entirely at odds with a fundamental tenet of the class action: absent class members have no ability to influence or control a class action brought on their behalf.

The last alleged harm is that Milberg Weiss and the named plaintiffs deprived the class of "the amount of any kickback that Milberg Weiss paid using attorneys' fees obtained in the Lawsuit" because attorneys' fees "are paid, directly or indirectly, from proceeds that otherwise would be available to the absent class members or shareholders." However, unlike in Haussman or Jain (or perhaps Rybicki I), this is not a situation in which the class, as putative principal, is paying too much for services because some of those funds secretly went either to the defendant-fiduciary or the defendant-third party who then gave a kickback to the fiduciary agent. Defendants, of course, paid the settlements but can make no claims that they would have been entitled to pay less had the fee sharing arrangement been known. Conversely, it is difficult to imagine that the government could proffer testimony from defendants in securities fraud suits brought by Milberg Weiss who would support the idea that the class had been harmed because defendants would have paid more if some other counsel had represented the plaintiffs. The indictment does not explain how the class otherwise would be entitled to fees that the attorneys shared secretly with the named plaintiff. Federal judges already


542. United States v. deVegter, 198 F.3d 1324, 1328-29 (11th Cir. 1999).
543. FSI, supra note 25, ¶ 33.
544. Id.
545. Id. ¶ 23, 33.
546. The literature suggests that defendants might pay less to settle claims if Milberg Weiss ceases to prosecute securities class actions. See John D. Finnerty & Gautam Goswami, Determinants of the Settlement Amount in Securities Fraud Class Action Litigation, 2 Hastings Bus. L.J. 453, 463-64 (2006) (noting the connection between Milberg Weiss and above-average settlement amounts). If that is correct, the ironic result is that a prosecution based on depriving class members of the honest services of plaintiffs' counsel and the honest services of the named plaintiffs would likely result in diminished future net recoveries to those class members in the aggregate.
determined the reasonableness of the attorneys' fees awarded. Generally, reasonableness is a function of either the hours worked by the firm or a percentage of the total recovery—neither of which changes regardless of whether Milberg Weiss agreed to share its fees or not.

None of these alleged harms alters the purpose of the relationship between plaintiffs' counsel, the named plaintiff, and the absent class members. Their interests, as in Brown, are aligned insofar as each of them seeks to maximize the class's recovery from defendants. Since attorneys' fees (from which the payments were allegedly taken) are almost always a function of the size of the settlement, and, indeed, the attorneys' fees are not awarded until after the settlement has been approved by the court (and, of course, a larger settlement presumably would be viewed as more beneficial to the class and more likely to be approved by the court), the class representative has every incentive, along with plaintiffs' counsel, to support the maximization of the size of the settlement. So, as in Brown, the principal's legitimate interests are sufficiently similar that the criminal defendants need not have recognized, based on the existing case law, that the methods used to achieve those goals constituted a criminal breach of duty to the class.547

Nor is there any "preferred treatment" that the provider of the kickback received from the unwitting victim, as in Rybicki II. Class counsel received no direct gain. Milberg Weiss was the defendant that dispensed, not received, the secret fee payments to its clients. Any gain came from winning the race to the courthouse and being appointed class counsel. However, that benefit came at the expense of other law firms who were not appointed by the courts to serve as lead counsel. Again, appointment of lead counsel requires judicial approval. The putative class does not appoint plaintiffs' counsel or class representatives, so the alleged victims are not doing anything that they would not otherwise have done absent the "kickbacks."

Commentators discussing the indictment have suggested that the harm to the class may have been that the class representative did not strike the most advantageous bargain with plaintiffs' counsel with respect to the contingent fee agreement; relatedly, the named plaintiff failed to scrutinize counsel's fees vigilantly during the pendency of the litigation and, again, at the end of the case when counsel sought judicial approval for the fees and costs incurred.548 This theory suffers from several flaws. First, it is not a theory actively argued by the government or even articulated in the indictment itself. To the contrary, prosecutors represented to the court that they would not attempt to prove that the settlements themselves were unreasonable or that the fee awards were excessive. Second, there is no rule or case law supporting the proposition that class representatives have a duty to maximize recovery for the class. While courts presumably could impose some sanction on a class representative who intentionally helped procure a lowball recovery, there is nothing in the law to suggest that a class representative has any responsibility to absentees for the amount of the recovery. Certainly, absentees cannot sue the named plaintiff if the class representatives obtain merely a reasonable recovery rather than an outstanding recovery.

Even assuming, arguendo, that the class representative bore legal responsibility to try to obtain the maximum possible recovery on behalf of the absent class, it is unlikely

548. Id.
that the duty must be fulfilled by retaining the cheapest attorneys for the class, particularly when the lowest cost service provider may not obtain the maximum net recovery on behalf of the absent class. At a minimum, it would be exceedingly difficult to claim that a class representative could determine ex ante who, among potential class counsel, would recover the most damages or negotiate the largest settlement possible on behalf of the class. Moreover, it is ultimately the court that approves both the retention of class counsel in the beginning of the litigation and the reasonableness of the attorneys' fee award at the conclusion of the litigation.549

In almost every respect, the indictment as pleaded represents an unprecedented extension of the honest services statute. *Rybicki II* is the closest analog; however, beyond the fact that *Rybicki II* seems to be the most overreaching private honest services fraud case in its own right, even that indictment stood on firmer doctrinal ground. The *Rybicki II* prosecutors charged honest services fraud based on a legally recognized fiduciary relationship between the recipient of the kickback and the putative victim, as well as the apparent "preferred treatment" that the victim unwittingly bestowed on the defendant lawyers dispensing the kickback.550 Government prosecutors indicted Milberg Weiss despite the absence of a legally-recognized duty, much less a logical harm to the alleged victims.

**B. Lenity**

The principle of lenity:

is founded on two policies that have long been part of our tradition. First, a fair warning should be given to the world in language that the common world will understand, of what the law intends to do if a certain line is passed. To make the warning fair, so far as possible the line should be clear. Second, because of the seriousness of criminal penalties, and because criminal punishment usually represents the moral condemnation of the community, legislatures and not courts should define criminal activity.551

In cases where criminal statutes create such ambiguity, "the tie must go to the defendant. The rule of lenity requires ambiguous criminal laws to be interpreted in favor of the defendants subjected to them."552

As in *Brown* or *Cleveland*, the haziness of the boundaries of honest services fraud and the interpretive difficulties arising from section 1346 strongly suggest that the doctrine of lenity should have counseled against convicting Milberg Weiss and its partners.553 Honest services fraud turns on the "soft-edged and aspirational" doctrines of fiduciary duty and breach of fiduciary duty.554 Because these conceptions are not easily

550. See supra Part III.C.1.a (discussing *Rybicki*).
553. In *Brown*, the Fifth Circuit applied the rule of lenity and adopted the narrower, reasonable interpretation of section 1346 to exclude such conduct rather than incrementally expand a statute that the court deemed "vague and amorphous on its face [and which] depends for its constitutionality on the clarity divined from a jumble of disparate cases." United States v. Brown, 459 F.3d 509, 523 (5th Cir. 2006).
defined, much less attained, criminal liability should not attach to them absent some extraordinary, exacerbating circumstances. 555 Problems evaluating an alleged breach of fiduciary duty are particularly acute if—as in this context—the courts have not delineated the duties claimed. Yet, even where the legal duties are articulated clearly in the law, determining whether a claimed fiduciary breached its duties is fraught with potential error. In the main, such decisions involve review of prudential judgments made by persons who, usually with imperfect information, decided in good faith among alternatives presented, a number of which were plausible. Unfortunately, given the uncertainties associated with prosecuting complex class action claims, careful choices made among plausible alternatives may, with hindsight, prove erroneous.

The sui generis and ill-defined duties arising from the relationship between class counsel, named plaintiffs, and the putative class, as well as reservations concerning criminal liability for entities more generally, make the arguments favoring lenity in this case even more compelling. As the Supreme Court decided in Santos, applying the rule of lenity is appropriate because it "places the weight of inertia upon the party that can best induce Congress to speak more clearly and keeps courts from making criminal law in Congress's stead." 556 A court should not, indeed must not, "play the part of a mind reader" and "speculate regarding a dubious congressional intent." 557 Especially insofar as the government failed to articulate any coherent theory as to how fee sharing harmed absent class members, applying the principle of lenity in Milberg Weiss's case is most appropriate. 558

C. Other Considerations Weighing Against Class Action Criminality

A number of policy considerations also should have pointed prosecutors away from charging Milberg Weiss or its attorneys for honest services fraud. First, the prosecution contradicts the existing evidence regarding Congress's intent and understanding with regard to incentive payments. Although federal lawmakers heard accusations that Milberg Weiss and other firms paid investors to serve as named plaintiffs, 559 Congress did not prohibit such payments outright, much less legislate criminal sanctions for

555. Id. (referring to Cardozo's "punctilio of honor" language to support the argument that the vagueness of its application and definition means that the violation of a trustee's fiduciary duty should not be criminalized because this duty is vague and aspirational).

556. Santos, 128 S. Ct. at 2025.

557. Id. at 2026 (relying on United States v. Wiltberger, 18 U.S. 76, 105 (1820) (Marshall, C.J.)) ("[P]robability is not a guide which a court, in construing a penal statute, can safely take."); Bell v. United States, 349 U.S. 81, 83 (1955) (Frankfurter, J.) ("When Congress leaves to the Judiciary the task of imputing to Congress an undeclared will, the ambiguity should be resolved in favor of lenity.").

558. The difficulty proving a single interpretation of the ambiguous money-laundering statute was one reason the government in Santos argued for a broader definition of "receipts" from money-laundering. In essence, the government contended that its interpretation of "receipts" made the statute "easier to prosecute" and would further "Congress's presumptive intent to facilitate money-laundering prosecutions." Santos, 128 S. Ct. at 2028. In rejecting this argument, Justice Scalia stated that this would "turn[] the rule of lenity upside-down. We interpret ambiguous criminal statutes in favor of defendants, not prosecutors." Id. Honest services fraud prosecutions in general, and the Milberg Weiss prosecution in particular, seem to arise also from the government's reliance on an ambiguous criminal statute, a law that facilitates prosecutions that otherwise are more difficult to prove.

559. Private Litigation Hearings, supra note 6, at 16–18.
attorneys who engage in those practices. Instead, lawmakers wrote into the PSLRA the requirement that plaintiffs file certifications attesting, inter alia, that they would not accept payments for serving as a representative party beyond their pro rata share of any class recovery, except as approved by the supervising court. The statute also directed courts to award to representative parties an equal portion, on a per share basis, of the final judgment or settlement recovered for the class. Congress could have criminalized incentive payments by plaintiffs' counsel to lead plaintiffs, but it did not.

Furthermore, the inclusion of a plaintiff certification requirement in the reform statute strongly suggests that before Congress enacted the PSLRA, no other federal law, civil or criminal, prohibited such voluntary arrangements; that is, no law prohibited class counsel from agreeing to compensate the client for her service as named plaintiff by sharing counsel's fee award or otherwise. Indeed, nearly all of the payments alleged in the indictment were made by Milberg Weiss to plaintiffs before the PSLRA became effective at the end of 1995. Viewed in context, then, the government's decision to charge Milberg Weiss criminally for pre-reform conduct a decade after legislators enacted the PSLRA seems to countermand Congressional intent regarding this practice.

Actually, Congress twice legislated to combat abusive practices by lawyers filing private securities class actions; yet, neither the PSLRA nor SLUSA criminalizes the act of compensating representative plaintiffs. The mail fraud statute, as Chief Justice Burger explained, is a "stopgap device to deal on a temporary basis with the new phenomenon until particularized legislation can be developed and passed to deal directly with the evil," and a "first line of defense" against novel fraudulent schemes. But Milberg Weiss's prosecutors did not use the mail fraud statute to charge the law firm for some "novel fraudulent scheme." The PSLRA's legislative history demonstrates that paying plaintiffs was not a "new phenomenon" in 2006 that prosecutors had to address by invoking the mail fraud statute. Rather, Congress considered that precise wrongdoing and chose to regulate it, though not to criminalize it. Criminalizing fee sharing alters the balance in the now heavily regulated areas of private securities litigation and securities fraud enforcement generally. The current Supreme Court is unlikely to imply new crimes and impose criminal penalties that Congress did not legislate expressly. To paraphrase the

561. Id. § 78u-4(a)(4).
562. Courts have deemed breaches of other lead plaintiff certification requirements to be sufficiently minor that investors may continue to serve as lead plaintiffs. A fortiori, the failure to make accurate disclosures in other contexts have not led to Justice Department investigations, much less felony indictments. See, e.g., In re Scientific-Atlanta, Inc. Sec. Litig., No. 1:01-CV-1950-RWS, 2007 U.S. Dist. LEXIS 66282, at *43 (N.D. Ga. Sept. 7, 2007) (finding that a failure to disclose all stock transactions on PSLRA certification was not sufficient to render the plaintiff an inadequate representative).
564. In a similar vein, the Supreme Court recently concluded that the extensive regulatory framework created by the securities laws, including the PSLRA, meant that applying private litigation under the antitrust statutes was impliedly repealed or preempted with respect to various IPO offerings which were heavily regulated by the securities laws. See Credit Suisse Sec. (USA), LLC v. Billing, 127 S. Ct. 2383, 2392 (2007) (finding a private antitrust action precluded by securities laws because there was: (1) regulatory authority under the securities laws to supervise the activities in question; (2) evidence that the responsible regulatory entities exercise that authority; (3) a risk that applying both the securities and antitrust laws would produce conflicting requirements, duties, privileges, or standards of conduct; and (4) evidence that the possible conflict affected practices in a financial market activity that the securities laws regulated). Each of these factors seems to exist
Fifth Circuit's recent admonition, the "ever-expanding and ever-evolving federal common-law crime" of honest services fraud cannot "reach all manner of accounting fraud and securities fraud, which have not generally been prosecuted as honest-services fraud and are heavily regulated under other statutes." This proscription applies equally to prosecutors' attempts to expand the scope of honest services fraud in order to reach all manner of misconduct in private securities fraud enforcement.

Professor Coffee has suggested that the criminal law should not be used in situations where society believes that a defendant's behavior has some social utility. Instead, tort law and administrative regulation are better equipped to combat the inappropriate behavior while preserving the positive value of the conduct for society. The benefits and costs of securities law enforcement continue to be debated. Although the corporate and Wall Street interests disputing its benefits seem, at this point, to have the louder voices, Congress, the SEC, and the Supreme Court all continue to maintain that private securities enforcement is an "essential supplement to criminal prosecutions and civil enforcement actions."

Milberg Weiss and its attorneys were more effective at deterring fraud than many private enforcers. As such, sanctioning the law firm for unethical conduct through applicable tort law or the professional code of responsibility, rather than criminal law, would have been more consistent with the view that investors' enforcement of the securities antifraud laws contributes to social welfare.

Indicting Milberg Weiss for honest services fraud was by no means the only charge available to prosecutors for the wrongful conduct alleged. The government had (or has) the opportunity to prosecute the clear violation of the law: to the extent that any paid plaintiff misrepresented that he would receive nothing other than his pro rata share of any recovery, prosecutors could have charged that plaintiff with violating 18 U.S.C. § 1623(a), the federal perjury statute. The attorneys, and perhaps the firm, also could be

with respect to the application of criminal law to the conduct at issue here. The SEC has the regulatory authority to supervise securities class actions and their prosecution, and the agency has exercised its authority, even participating in such lawsuits as amicus from time to time. Applying both the securities laws, like the PSLRA, and section 1346 seems to produce conflicting duties and standards of conduct. These conflicting mores affect one of the fundamental activities—the litigation of private securities lawsuits—that the PSLRA, SLUSA, and other securities law already regulates. Imposing an additional layer of criminal regulation could create a clash in regulatory schemes under the Court's analytical framework.

568. Finnerty & Goswami, supra note 546, at 463–64 (noting the connection between Milberg Weiss and above-average settlement amounts).
569. Section 1623 states:

Whoever under oath (or in any declaration, certificate, verification, or statement under penalty of perjury as permitted under section 1746 of title 28, United States Code) in any proceeding before . . . any court . . . of the United States knowingly makes any false material declaration or makes or uses any other information, including any book, paper, document, record, recording, or other material, knowing the same to contain any false material declaration, shall be fined under this title or imprisoned not more than five years, or both.

18 U.S.C. § 1623(a) (2000). Plaintiffs likely could not be convicted for violating 18 U.S.C. § 1001, the prohibition on making false statements to judicial officers, because section 1001(b) specifically "does not apply to a party to a judicial proceeding, or that party's counsel, for statements, representations, writings or documents submitted by such party or counsel to a judge or magistrate in that proceeding." 18 U.S.C. § 1001(b).
charged with suborning perjury or perhaps violating 18 U.S.C. § 1512(b), or its counterpart 18 U.S.C. § 1503.\textsuperscript{570} Proceeding under these statutes would neither break new ground in the criminal law nor assault the plaintiffs’ bar in reliance on untested, ill-defined, and perhaps non-existent, fiduciary relationships.

Why might the government have chosen instead to “overcharge” Milberg Weiss rather than indicting the firm or its partners for perjury, suborning perjury, or obstructing justice? Prosecuting Milberg Weiss for these violations would have reduced substantially the potential penalties that could be imposed by a court. Violations of the federal perjury statue are not RICO predicate acts.\textsuperscript{571} Although violation of the statute criminalizing obstruction of justice, 18 U.S.C. § 1512, does qualify as a RICO predicate act, that provision has important limits that would have impeded prosecutors from using the charge effectively against Milberg Weiss. First, section 1512 only applies to proceedings in the federal court system. Milberg Weiss’s payments to clients acting as named plaintiffs in state court derivative actions could not serve as the basis for charging obstruction of justice.\textsuperscript{572} Second, conviction under section 1512 requires proof of a significant nexus between the alleged obstruction and the proceeding obstructed. An obstruction charge against Milberg Weiss would be susceptible to dismissal. Arguably, the firm’s failure to disclose the fee sharing agreement is too peripheral to the merits of any securities fraud case to support a conviction under section 1512.\textsuperscript{573} The difficulty of pleading and proving the significant nexus may explain why government usually does not rely on section 1512 as the sole predicate for a RICO indictment. Finally, because the indictment described a number of temporally distant overt acts—some dating back as much as two and a half decades—the conspiracy and racketeering charges were crucial to the prosecution; they allowed the government to append stale conduct for which the statute of limitations otherwise had expired.\textsuperscript{574} For all of these reasons, it appears that prosecutors indicted Milberg Weiss for honest services fraud in order to charge the law firm with conspiracy and racketeering, thereby threatening the firm with forfeiture and

\textsuperscript{570} Section 1512 states:

\begin{quote}
Whoever knowingly . . . corruptly persuades another person, or attempts to do so, or engages in misleading conduct toward another person, with intent to: (1) influence, delay or prevent the testimony of any person in an official proceeding; [or] (2) cause or induce any person to (A) withhold testimony, or withhold a record, document, or other object, from an official proceeding . . .
\end{quote}


\textsuperscript{571} Midwest Grinding Co. v. Spitz, 976 F.2d 1016, 1021 (7th Cir. 1992) (“[W]e know that telling a lie or committing perjury is not per se a RICO predicate act for one simple reason: it is not included among the list of predicate acts in 18 U.S.C. § 1961(1).”); see also Pyramid Sec., Ltd. v. IB Resolution, Inc., 924 F.2d 1114, 1117 (D.C. Cir. 1991); United States v. Williams, 874 F.2d 968, 973 (5th Cir. 1989).


\textsuperscript{574} See 18 U.S.C. § 3282(a) (five year statute of limitations for non-capital criminal offenses).
related firm-ending consequences.\textsuperscript{575}

The effects of this choice are discussed next in Part VI. Not only did the government injure Milberg Weiss, but the effects of the indictment rippled outward. The prosecution’s decision may lead to further regulation limiting private securities enforcement, impeding defrauded investors from pursuing their claims in the court going forward.

VI. CONSEQUENCES AND CRITICISMS

A. Consequences for the Firm

Although the government eventually dismissed all charges against Milberg Weiss, the indictment seriously damaged the law firm, and the government’s decision to charge the partnership imposed severe extralegal sanctions on the law firm.\textsuperscript{576} Conviction or no conviction, the Justice Department’s choice to indict the entity—and not just the culpable partners—hurt innocent employees who had no knowledge of, much less participation in, the alleged illegal activities. The exodus of hundreds of attorneys, support staff, and clients from Milberg Weiss began as soon as prosecutors filed their felony complaint.\textsuperscript{577} Milberg Weiss's important institutional clients also began defecting immediately following the indictment, taking with them many pending lawsuits, the day after prosecutors announced the grand jury’s charges.\textsuperscript{578} Not surprisingly, the law firm initiated many fewer new lawsuits. In 2006, for example, Milberg Weiss filed only 59 cases.\textsuperscript{579} Scores of partners and employees with no involvement in the alleged wrongdoing (as later stated by the government itself) left Milberg Weiss.\textsuperscript{580} Partners joined competing practices or formed their own firms. Associates shopped their resumes and accepted offers with other law firms. The indictment spoiled the attractiveness of Milberg Weiss as a place for professionals to practice law. As a result, the “best and most ‘marketable’ attorneys . . . yield[ed] to other offers from firms with . . . more certain future[s].”\textsuperscript{581} As of July, 2007, Milberg Weiss had shrunk to less than 70 lawyers.\textsuperscript{582}
While the indictment did not cause Milberg Weiss to collapse, as some pundits had predicted, the firm did have to shutter some offices, including its Florida branch that had employed 120 lawyers in 2005. Indeed, Milberg Weiss had expanded its business in the year preceding the indictment and had leased larger office spaces in both Florida and in New York, its headquarters. Under its nonprosecution agreement with the government, Milberg LLP has five years to satisfy the $75 million penalty assessed. However, even if the firm recovers some of the penalty amounts from its four former partners who pleaded guilty to wrongdoing, the firm’s survival still depends upon its ability to attract clients and litigate cases successfully despite the reputational harm caused by the indictment.

Predictably, the damage to Milberg Weiss’s reputation resulting from the criminal indictment of its former senior partners may jeopardize its continuation. Although the government mitigated some damage by stating publicly that no current members of the Milberg firm participated in the alleged scheme, obtaining this concession may prove to be a Pyrrhic victory for Milberg’s remaining attorneys. Courts have shunned the firm and refused to appoint Milberg Weiss as lead counsel in class actions. Even judges who allowed Milberg Weiss to retain its appointment as lead counsel nonetheless slashed the firm’s requests for attorneys’ fees. Most significantly, the federal district court overseeing the Nortel Networks mega securities litigation awarded Milberg Weiss just three percent of the $1.26 billion settlement fund recovered for shareholders, despite the firm’s successful representation of the class and ex ante agreement with the lead plaintiff (a public pension fund) for a fee totaling 8.5% of the class’s recovery. On appeal, the Second Circuit conceded that the district court’s award was “toward the lower end of reasonable fee awards” and stated that it was “troubled” by the trial judge’s failure to explain why he did not award Milberg Weiss at least the eight percent fee awarded to a different law firm in a separate Nortel class action involving mirror claims. However, the Second Circuit refused to reverse the lower court’s decision, a ruling that cost Milberg Weiss some $63 million. Other courts have also appeared to punish Milberg Weiss in cases having no relation to the alleged wrongdoing or the indicted partners, even though, by all accounts, investors were well-represented by the firm. Those decisions, in turn,

584. Id.
585. See, e.g., Posting of Nathan Koppel to the Wall Street Journal Law Blog, http://blogs.wsj.com/law/2006/06/07/milberg-weiss-watch-firm-removed-from-medtronic-steering-committee (June 7, 2006, 12:10 EST) (reporting that federal judge removed Milberg Weiss from plaintiffs’ steering committee in multi-district litigation; although no plaintiffs had complained about the firm continuing in supervisory role, the court reportedly asserted, “Amongst many highly competent lawyers, the Court suggests few [plaintiffs] would select an indicted, as opposed to an unindicted, law firm.”).
586. See, e.g., Nowak, 240 F.R.D. at 363–66 (denying Milberg Weiss’s motion to serve as lead counsel).
588. *In re Nortel Networks Corp. Sec. Litig.*, Civil Action No. 01-CV-1855 (RMJ), Order and Final Judgment (D. N.J. Jan. 29, 2007), available at http://online.wsj.com/public/resources/documents/WSJ-070130-Nortel.pdf (finding Milberg Weiss “qualified and experienced in these matters” and noting that the firm successfully defended against a motion to dismiss the complaint and obtained certification of the class).
589. *In re Nortel Networks Corp. Sec. Litig.*, 539 F.3d 129 (2d Cir. 2008).
590. See, e.g., *In re New Motor Vehicles Canadian Export Antitrust Litig.*, MDL Docket No. 1532,
may influence potential shareholder clients—especially state and local pension funds operated by politically sensitive public officials—that they cannot retain Milberg Weiss as lead counsel. For all these reasons, clients, attorneys, and employees who remained loyal to the firm still face repercussions from the government’s decision to indict the entity. Only time will tell whether Milberg LLP will stay in business, or whether the law firm’s innocent stakeholders will suffer yet more financial harm in the future.

If history is any guide, the reputational harm caused to the firm may be irreparable. Before Milberg Weiss, the last nationally known professional services firm (indeed, the last entity) indicted as a felon by the Justice Department was Arthur Andersen, Enron’s auditor. The government did not charge Arthur Andersen with fraud or crimes relating to accounting irregularities at Enron. Rather, federal prosecutors chose instead to indict Arthur Andersen for corruptlypersuading and attempting to persuade its employees to alter and destroy documents related to an SEC investigation of Enron’s special purpose entities.591 Convicting Arthur Andersen of obstruction of justice required the government to prove only that at least one person in the company attempted to persuade others to alter or destroy a document that might be sought in connection with a federal agency investigation. At the time he announced the indictment, then-Deputy Attorney General Larry Thompson stated that “Arthur Andersen is charged with a crime that attacks the justice system itself.”592

Commentators generally agreed that Arthur Andersen’s prosecutors not only stretched applicable criminal law, but that they failed to anticipate the economic consequences of their decision. By indicting the accounting giant, government lawyers effectively demolished a going concern that had employed more than 30,000 people in

Memorandum Decision on Defendants’ Motion to Disqualify Milberg Weiss from Continuing as Counsel in this Litigation and Cross Motion of Counsel Michael M. Buchman and J. Douglas Richards to be Appointed Vice-Chair of the Plaintiffs’ Executive Committee (D. Me. Dec. 18, 2006), available at http://online.wsj.com/public/resources/documents/law.milberg.pdf (After three years of successful leadership, the court disqualified Milberg Weiss as vice-chair of the plaintiffs’ steering committee in certified nationwide antitrust class action, finding that the indictment jeopardized Milberg Weiss’s financial, legal and administrative capacity to pursue massive litigation); see also Julie Friedman, Damage Control, AM. LAW., Mar. 1, 2008 (reporting on various pending cases in which competitors and defense counsel challenge Milberg Weiss as “a poor choice to lead litigation”).

These decisions to cut the firm’s attorneys’ fees based on conduct by other Milberg Weiss attorneys in other cases seems particularly at odds with the Supreme Court’s recent opinions holding that it is a constitutional violation of due process to impose punitive damages on a defendant for conduct that defendant may have committed that is not before the court. See, e.g., Phillip Morris USA v. Williams, 127 S. Ct. 1057, 1063 (2007) (“We can find no authority supporting the use of punitive damages awards for the purpose of punishing a defendant for harming others.”); State Farm Mut. Automobile Ins. Co. v. Campbell, 538 U.S. 408, 424 (2003) (finding an unconstitutional deprivation of property when the punitive damages award was grossly disproportionate to the actual harm suffered by the insured).


the United States. Arthur Andersen disintegrated months in advance of its trial for obstruction of justice and years before the Supreme Court unanimously ruled in its favor and against the government. Because Arthur Andersen was responsible for the actions of its employees taken within the scope of their employment, the firm’s indictment was the equivalent of its conviction, destroying the business and harming its many innocent partners, former partners, and employees. Furthermore, the indictment of Arthur Andersen significantly affected competition in the already concentrated auditing industry. The presumably unintended economic and regulatory impacts associated with increased concentration are beyond the scope of this Article. Suffice it to say that the ancillary effects extended far beyond the firm and its then-current employees and current and former owners.

The Arthur Andersen prosecution confirmed for the Justice Department that its choice to indict a business entity—especially a professional services firm—is likely tantamount to sentencing the entity to death. Even companies that survive the indictment to defend themselves at trial face potentially ruinous penalties and business-ending collateral costs if convicted, regardless of the ultimate outcome. The DOJ presumably did not intend to repeat the embarrassing Arthur Andersen scenario by putting Milberg Weiss out of business only to have the firm exculpated at trial or on appeal. Nonetheless, after Milberg Weiss refused prosecutors’ demands that it waive the attorney-client privilege, government lawyers still made good on their threat to charge the entity. Employing an untested and dubious theory of criminal liability, the DOJ imposed great costs on scores of non-culpable Milberg Weiss employees and partners, persons who—prosecutors ultimately conceded—had no involvement in and no knowledge of the fee sharing.

The government’s indictment of Milberg Weiss also produced significant consequences outside the firm and beyond its current and former partners and employees. The next sections examine the ripple effects of the Milberg Weiss prosecution.

B. Consequences for Private Securities Litigation Generally

Reduced private enforcement of the securities laws in 2006 and 2007 is one consequence that commentators have associated with criminalizing class actions. In the year after the Justice Department indicted Milberg Weiss, securities class actions fell to

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595. For a more recent example, see the district court’s decision in the KPMG case, United States v. Stein, 495 F. Supp. 2d 390 (S.D.N.Y. 2007) (“The government threatened to indict, and thus to destroy, the giant accounting firm, KPMG LLP.”).


their lowest level in more than a decade,\textsuperscript{598} a "fantasy-come-true for corporate America."\textsuperscript{599} Milberg Weiss, previously one of the country’s largest, best funded, and most experienced plaintiffs’ law firms as well as one of the most productive among private securities enforcers, filed fewer lawsuits. At the same time, the number of new securities class actions filed by all plaintiffs’ firms declined significantly. Although the reported statistics vary somewhat (from 106, according to PricewaterhouseCoopers, to 135, according to National Economic Research Associates (NERA)), all researchers agree that plaintiffs’ lawyers filed many fewer lawsuits in 2006.\textsuperscript{600} The downward trend in filings persisted in the first half of 2007, as plaintiffs’ counsel initiated only 59 new securities class actions on behalf of shareholders, well below the historical averages for the fourth consecutive six-month period.\textsuperscript{601} Finally, after two years of decline, the number of securities class actions rebounded in the last six months of 2007, as bad news in the housing market led to enormous losses for investors holding mortgage-backed securities.\textsuperscript{602} With the addition of more than 100 complaints initiated from July until the year end, investors filed a total of 166 new class actions in 2007, an increase of nearly 50\% from the previous year.\textsuperscript{603} Yet, despite this increase, the 2007 total still was 14\% below the average number of new cases filed (194) annually in the preceding decade since Congress enacted the PSLRA.\textsuperscript{604}

What caused the downturn in new case filings? No consensus exists. However, many observers pointed to the Milberg Weiss indictment as one reason for the decline.\textsuperscript{605} Not only did the plaintiffs’ bar lose several of its most experienced, successful advocates,\textsuperscript{606} but the government’s actions posed threats to other attorneys who represent

\begin{thebibliography}{9}
\bibitem{599} Andrew Longstreth, Starving for (Class) Action, AM. LAW., Aug. 1, 2007, at 13, 14.
\bibitem{601} Cornerstone Research, Mid-Year Assessment, supra note 600, at 2.
\bibitem{602} It is perhaps an interesting coincidence that much of the most egregious behavior associated with subprime lending and securitization of subprime mortgages concerns mortgage loans made and debt securities sold in 2006 and 2007, after prosecutors indicted Milberg Weiss.
\bibitem{603} Cornerstone Research, 2007 Year in Review, supra note 600, at 4.
\bibitem{604} \textit{Id.} at 2.
\bibitem{606} Corporate lawyers who had defended clients against Weiss and Lerach have acknowledged that investors have lost two highly skilled, powerful, and effective advocates. \textit{See} John Ryan, \textit{Kill Bill Volume 2}, LAWDRAGON MAG., Fall 2005, available at
\end{thebibliography}
investors in class litigation. Plaintiffs’ lawyers may not have filed putative securities fraud cases that, but for the new risk of criminal sanctions, they would have initiated otherwise. Perhaps the expected sanction became so high as to chill private enforcement, arguably over-detering investors and their counsel from initiating meritorious claims for some period of time. Observers called this controversial impact the “Milberg Effect.” Other commentators believed that the timing was coincidental with the prosecution of Milberg Weiss. They contended that the declines in new filings resulted from the strong stock market performance and historically low stock price volatility. Still other observers hypothesized that there was simply less fraud, or that class action lawyers were too busy with other types of cases.

Plaintiffs’ class action lawyers themselves acknowledged that they felt threatened by the Milberg Weiss prosecution. The government not only forced four of the most experienced, successful private enforcers out of the profession, but the Department of Justice indicted the entire firm as well. The decision to indict Milberg Weiss stood out against the government’s contemporaneous decisions not to charge Bristol Myers, KPMG, and other companies for other potentially felonious conduct. After the Supreme Court overturned Arthur Andersen’s conviction 9–0, the Justice Department became more conservative about charging corporations and other entities. Rather than indicting these business organizations, government lawyers charged the individual employees involved in the alleged wrongdoing and entered into deferred-prosecution agreements with the firms. Yet, government lawyers did not similarly spare Milberg Weiss from indictment. The effect of charging Milberg Weiss with honest services fraud is, in a very

http://www.lawdragon.biz/index.php/lawdragon/fullstory/milberg_weiss/ (“The fact is, . . . a firm with the skills of Lerach and Weiss can turn a David v. Goliath case into an evenly matched heavyweight battle, credibly holding out for more money for class members.”).


608. Id.

609. CORNERSTONE RESEARCH, MID-YEAR ASSESSMENT, supra note 600, at 3 (explaining the strong stock market hypothesis endorsed by John Gould of Cornerstone Research); see also U.S. Litigation, FIN. TIMES, Jan. 4, 2007, at 12 (“Investors cut company managers more slack when share prices are going up. That partly explains a sharp decline in the number of US securities class action lawsuits in 2006 compared with 2005. This is not just psychological. If a company’s valuation is rising, its shareholders have no financial loss on which to hang litigation, whatever managers might be up to.”).

610. Professor Joseph Grundfest stated that aggressive enforcement actions by the SEC and the Department of Justice effectively deterred misrepresentations by executives of public companies, who most likely eliminated fraudulent accounting practices and improved financial reporting. CORNERSTONE RESEARCH, MID-YEAR ASSESSMENT, supra note 600, at 3 (opining that the “decline in class action securities litigation may be the result of less fraud” and “the size of class action securities fraud litigation activity may have experienced a permanent shift”). Unlike other commentators, Professor Grundfest rejected the contention that the government’s indictment had any chilling effect on private enforcement. Id.

611. For example, Pricewaterhouse presumed that plaintiffs’ counsel in 2006 busied themselves litigating breach of fiduciary duty cases relating to the options backdating scandals, attributing the decline in class action filings to “the distraction of the options backdating cases brought during the year, which were mostly filed as derivative actions in state courts.” PRICERWATERSHOUSECOOPERS, supra note 598, at 5. Pricewaterhouse also surmised that the Sarbanes-Oxley Act (specifically the section 404 requirements and the substantial increases in sentences for convicted fraudsters) deterred securities fraud, as did the prospect of companies paying mega settlements to resolve shareholder claims. Id.
real way, intimidating to the plaintiffs' securities bar.

Even if the government never pursues criminal charges against another plaintiffs' lawyer or law firm, the Milberg Weiss prosecution tainted the plaintiffs' securities bar and the private enforcement system. As class action lawyers feared,612 "the Trial Lawyers' Enron" not only deflected the public's attention from the arrant financial frauds perpetrated by corporate executives, but also hurt the credibility of plaintiffs' lawyers as they attempted to recover losses on behalf of defrauded shareholders. The reputation of the entire securities class action bar has suffered, according to attorneys practicing in the area.613 As one plaintiffs' lawyer from another firm told the New York Times, "Any judge you come before expects that you're a crook, too . . . . There are judges that I've appeared before for many years who [became] frosty all of a sudden."614

Looking forward, perhaps the most concerning result of prosecution will be its impact on justified efforts to recover damages for defrauded shareholders and deter future wrongdoing. Because the potential for attracting a criminal investigation and suffering criminal sanctions now must be part of the equation for both plaintiffs' attorneys and investors volunteering to serve as lead plaintiffs, the costs of private enforcement actions have increased. Possible forfeiture of attorneys' fees earned in cases closed for more than a decade also has become a real risk for established plaintiffs' law firms. More chilling yet, the liberty of individual lawyers and their investor clients is at stake.

To the extent that the indictment has discouraged and will discourage in the future the filing of meritorious lawsuits by and on behalf of defrauded investors, prosecutors may have damaged social welfare.615 Insofar as private securities litigation functions not only to compensate fraud victims but also to deter corporate wrongdoing, private enforcement enhances social welfare. In any event, deterring class actions should not be confused with deterring wrongdoing by representative plaintiffs and plaintiffs' counsel. Insofar as Congress already enacted the PSLRA to regulate the selection and compensation of lead plaintiffs, the deterrence benefits obtained from charging crimes other than perjury or obstruction of justice are marginal at best.

Indeed, class action criminality imperils not only the plaintiffs' bar but also potential representative investors.616 The expected cost for prosecuting securities fraud claims may be so high as to chill private enforcement of meritorious fraud claims. Deceived investors may decline to serve as lead plaintiffs and class representatives if they perceive that they are vulnerable to charges of honest services fraud. The concerns of institutional lead

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614. Id. (quoting prominent shareholders' lawyer Richard Schiffrin, who commented that the "field has gotten a black eye").

615. Professors Bruce Kobayashi and Larry Ribstein also have shown that the plaintiffs' securities bar makes valuable contributions to the production of law. Bruce H. Kobayashi & Larry E. Ribstein, Class Action Lawyers as Lawmakers, 46 ARIZ. L. REV. 733 (2004).

616. Investors' inability to receive compensation, much less a bonus, for serving as representative plaintiffs discourages their participation in class action litigation. Geoffrey P. Miller, Payment of Expenses in Securities Class Actions: Ethical Dilemma, Class Counsel, and Congressional Intent, 22 REV. LITIG. 557, 558–59 (2003). In truth, the PSLRA "makes it economically irrational for class members to volunteer as lead plaintiffs, absent special motivations." Charles Silver & Sam Dinkin, Incentivizing Institutional Investors to Serve as Lead Plaintiffs in Securities Fraud Class Actions, 57 DEPAUL L. REV. 471, 472 (2008).
plaintiffs, whom Congress attempted to attract to private enforcement, are especially important. Public pension plans had become more active as lead plaintiffs in certain cases from 2001 to 2004. Their participation as lead plaintiffs correlated with higher net settlement awards to investors, much to the chagrin of defendants. Not surprisingly, then, the prosecution of Milberg Weiss has instigated a concerted and coordinated effort by Corporate America to reduce the participation of public pension funds in private securities litigation. Businesses already are lobbying Congress to enact proposed legislation that would require these institutional investors to make detailed disclosures of fee arrangements and political contributions received by plan officials from plaintiffs' lawyers. Special interests also cite to the Milberg Weiss indictment as justification for proposals that Congress strip lead plaintiffs of their authority to select lead counsel, as provided in the PSLRA. If the position of lead counsel were determined by auction, as recommended by the U.S. Chamber of Commerce, these institutional investors would be less likely to participate as lead plaintiffs in securities class actions. The PSLRA's restrictions on judicial awards for lead plaintiffs already make it unprofitable for investors to participate as representative plaintiffs. Why would institutional investors take the lead in prosecuting fraud claims when they would have no say in the selection and retention of the lawyers for the putative class? One prominent national law firm specializing in the defense of large corporations has characterized "Mr. Lerach's demise" as "the latest step in a gradual reining-in of lawyers whose business model exploits business controversies."

C. Consequences for Class Actions Generally

Beyond the impact on private securities enforcement, the Justice Department's decision to prosecute Milberg Weiss also may have important consequences for class action litigation generally. First, the prosecution's theory challenges the fundamental structure of common fund class actions. In such cases, there inevitably comes a time

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618. See INST. FOR LEGAL REFORM, SECURITIES CLASS ACTION LITIGATION: THE PROBLEM, ITS IMPACT, AND THE PATH TO REFORM, at iii, 2 (2008), available at http://www.instituteforlegalreform.com/issues/docload.cfm?docId=1213 (discussing that lead plaintiffs' law firms made political contributions to public officials who control their pensions to ensure their status as lead counsel). The U.S. Chamber of Commerce's litigation reform group touted the indictment and conviction of Bill Lerach as evidence that much more needs to be done to limit—if not eliminate—private enforcement of the securities laws. The group also has pointed to the prosecution as evidence that "the system is plagued with abuse" and asserts that private enforcement "is not needed to monitor and punish securities fraud." Id. at iii, 2.

619. Id.

620. See id. at 33. One of the ILR's proposals is that Congress immediately enact the Securities Litigation Attorney Accountability and Transparency Act, a bill introduced by Sen. John Cornyn (R. Tex.) that would "address abusive payment practices and excessive fees" and "enhance transparency in the selection of lead counsel by requiring disclosure of payments, fee arrangements, and political contributions by attorneys." Id. at iii.

621. See SALTZBURG ET AL., supra note 497, at 689.

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the interests of class counsel and the class representative diverge from the interests of the absent class members. That conflict of interest arises when plaintiffs' counsel seek a court order awarding them attorneys' fees and other monies, including a bonus for the lead plaintiff, from the common fund. The government's attempt to criminalize a conflict of interest—a conflict inherent in all successful common fund class actions—has penalized class actions as a tool of enforcement. Is the government's indictment of Milberg Weiss exceptional? That remains to be seen. What is certain is that the indictment created disincentives for plaintiffs' counsel and institutional investors to file class action lawsuits.

It also is clear that the government's theory of criminality could be used to police conflicts of interest in any class action litigation. Because conflicts of interest in class actions and other forms of aggregate litigation are ubiquitous, the government could assert its honest services theory to indict other law firms representing plaintiffs in non-securities class actions as well as group actions. Indeed, a host of conflicts of interest arise in traditional attorney-client relations. Most at risk, however, are attorneys who represent plaintiffs in class actions. Trial lawyers who sue corporations must consider this additional risk, whether they represent consumer borrowers misled by unscrupulous lenders, minority employees harmed by discriminatory employment practices, or even persons injured by defective products. By criminalizing conflicts of interest in class actions, the Department of Justice has increased the expected cost of suing Corporate America on behalf of persons who might not otherwise pursue their claims. The indictment of Milberg Weiss put the entire plaintiffs' class action bar on notice that the Department of Justice might investigate long-closed files, probe decades-old representations, and utilize an array of strongly persuasive measures against class action counsel.

Some commentators have criticized some of the tactics employed by the Justice Department against Milberg Weiss. Perhaps the most publicized of these tactics is federal prosecutors' "request" that entities targeted by the government waive their attorney-client privilege in order to avoid indictment, or as a condition of a plea agreement, or to obtain credit at sentencing. Because many entities—especially corporations in regulated industries and professional services firms—cannot continue in business if indicted, they will cooperate in order to save the company from certain death. With increasing regularity in the past decade, the government not only has demanded that companies turn over contemporaneous legal advice provided about the subject of the case, but prosecutors also have required that firms produce to them attorney work product, the "factual internal investigation" created by lawyers after the government began its

inquiry.\textsuperscript{624} Although forcing companies to waive the attorney-client privilege has proven effective for the government in many of its investigations, practitioners, lawmakers, and scholars have voiced mounting concern about the effect of the federal government’s “culture of waiver” on the willingness of companies to seek legal advice. The American Bar Association opposed federal prosecutors’ waiver and cooperation policies in 2005, before prosecutors demanded that Milberg Weiss waive the privilege. Yet, the government’s use of these tactics to police attorney ethics could portend an even wider attack by the Justice Department on the profession. For this reason, federal lawmakers have introduced legislation in both chambers of Congress that would prohibit federal agents from pressuring an entity to waive its attorney-client privilege or work product protection in order to indicate its cooperation with the government.\textsuperscript{625}

\textbf{D. Other Criticisms of the Prosecution}

Some commentators have also questioned whether the Justice Department pursued Bill Lerach and Milberg Weiss for political ends. The fact that federal officials expended extraordinary resources conducting an eight-year investigation to convict four Milberg Weiss lawyers and several representative plaintiffs for allegedly lying in court proceedings concluded 10, 15, or 20 years ago begs the question whether it was appropriate or necessary to indict the law firm itself; that is, how did the prosecution of a thriving plaintiffs’ law firm for pre-Reform Act breaches of state ethics rules (prohibiting client solicitation) relate to the nation’s current criminal enforcement priorities? As one commentator noted, “the focus of the indictment is on long ago behavior . . . . The feds may be attacking behavior that . . . has [been] already modified substantially.”\textsuperscript{626}

Even assuming politics has played no role in the Justice Department’s decisions to indict Milberg Weiss, the timing of the case created the \textit{appearance} that such motivations existed. Indeed, Justice Department officials repeatedly felt the need to disclaim any political motivations for the prosecution. These impressions risk undermining the public’s perception of government prosecutions and Americans’ confidence in the criminal justice system.

Policing the ethics of class action lawyers by expanding the reach of the mail and wire fraud statutes also calls into question democratic accountability and, because of grand jury secrecy, democratic transparency. Congress is accountable for its class action reforms, but the federal prosecutors in Los Angeles are not. The plaintiffs’ class action bar surely has studied the indictment carefully, and the charging document—particularly the government’s statements concerning counsel’s legal duties and client responsibilities—clearly will influence attorneys’ behavior going forward. However, plaintiffs’ attorneys may have difficulty determining what rules the Department of Justice, acting through the grand jury, seems to have created or endorsed. Class action criminality therefore raises the concern that prosecutors could criminalize ethical standards for the plaintiffs’ class action bar on an ad hoc basis under the cloak of grand jury secrecy, potentially with a judicial imprimatur and no democratic accountability.

\textsuperscript{624} See Am. Coll. of Trial Lawyers, \textit{supra} note 623, at 319–20.


Finally, class action criminality threatens to expand federal power at the expense of the state’s existing regulatory structure and its autonomy. State law already provides an extensive system—including a host of potential sanctions—regulating attorney conduct and disciplining lawyers found to have breached the rules of ethics. Milberg Weiss’s employment of professional plaintiffs was no secret to defendants, their counsel, and the firm’s competitors in the plaintiffs’ bar, as I have discussed. Had the firm’s adversaries perceived Milberg Weiss’s practices to be sanctionable, its partners presumably would have been grieved years ago.\textsuperscript{627} Courts could have disqualified Milberg Weiss attorneys from representing investors and ordered the law firm to return any fees awarded. Other possible sanctions include reprimand, suspension, or even disbarment of individual lawyers, along with imposition of fines. The mere institution of ethics proceedings leads to loss of reputation, if not potential liability for malpractice.

\textbf{E. The Call for Further Private Securities Litigation Reform}

Whether intended or not, the Milberg Weiss prosecution has certainly put securities litigation reform back in the headlines and back on the regulatory and legislative agendas. The indictment has inspired calls for further restrictions on shareholder litigation. Despite the marked decline in the number of new cases filed after the indictment, corporate interest groups argue that the Milberg Weiss prosecution demonstrates the need for even greater regulation of securities class actions. Seeking to reduce their potential exposure to securities litigation, lobbyists for corporations, public accounting firms, and the securities industry have stepped up their efforts to obtain new reforms before voters elect a new president and a new Congress. In May, 2008, on the same day that Bill Lerach reported to federal prison to begin serving his sentence, Senator John Cornyn (R-Tex.) introduced the Securities Litigation Attorney Accountability and Transparency Act.\textsuperscript{628} Among other things, the proposed law would require plaintiffs’ lawyers and their firms to disclose payments and promises of payments made to investors seeking appointment as lead plaintiffs in securities class actions. No new law would be necessary, of course, if legislators felt comfortable with the government’s reliance on honest services fraud to criminalize fee sharing. Introduction of the bill by Senator Comyn follows the call by several senior Republican congressmen for the House Judiciary Committee to conduct hearings on the same subject.\textsuperscript{629} Specifically, these representatives want to determine whether the plaintiffs’ securities bar shares its attorney’s fees with investor class representatives as a matter of “industry practice.”\textsuperscript{630}

The business community, led by the U.S. Chamber of Commerce, is expending significant resources in an attempt to put securities litigation reform back on the legislative agenda. In a report published in July, 2008, the Chamber used the prosecution

\textsuperscript{627} Such sanctions could include disqualification as lead counsel in particular class action lawsuits, disgorgement or refund of attorneys’ fees, damages for professional malpractice, referral to state ethics authorities, and suspension or even forfeiture of attorneys’ licenses to practice law.


\textsuperscript{630} \textit{Id.}
of Milberg Weiss to argue that “some of the most powerful and wealthy plaintiffs’ firms in America” engage in the “systemic” extortion of U.S. public companies.  

In language reminiscent of the legislative debates preceding enactment of the PSLRA, the report argued that trial lawyers still “abuse the class action mechanism for profit.”  

According to the report, the plaintiffs’ bar has adopted “a ‘pay to play’ culture” whereby plaintiffs’ law firms “ensure their status as lead counsel by contributing to the political campaigns of officials who control the large public pension funds that bring these lawsuits.”  

The Chamber of Commerce not only called on Congress to “investigate the fraud and abuse endemic in the securities plaintiffs’ bar,” but the report also suggested a new reform agenda ostensibly designed “to help to keep our nation on a prosperous and competitive course.”

Defining Milberg Weiss’s conduct—recruiting representative plaintiffs by promising to share its fees—as criminal implies that the conduct had little, if any, social utility. Yet, insofar as any lawsuits brought by Milberg Weiss compensated investors for some losses and deterred corporate wrongdoing, that implication is misleading. Indeed, as discussed previously, it is the prohibition of any possible rewards to investors serving as lead plaintiffs that may expose the investing public to greater risks; that is, the risks of under-deterring securities fraud. Of course, the costs and benefits of private litigation ultimately are empirical questions. A key obstacle to answering them is that, while the “costs” of private securities litigation are fairly apparent and quantifiable, the deterrence benefits of private securities litigation are difficult to observe, much less measure. Reform advocates interpret this difficulty in measuring the benefit to mean that no benefit actually exists. However, corporations do not report when the threat of civil liability causes them to reveal material information to investors that executives and their advisors otherwise would choose to conceal from investors. Although the public does not observe most occasions in which potential liability deters executives from committing securities fraud, there is a good deal of anecdotal evidence supporting the deterrence value of private enforcement. In order to measure the benefits of private enforcement beyond the compensation achieved for investors, we would need somehow to quantify the effects of securities fraud deterred on social welfare, including investor confidence in the securities markets.

VII. CONCLUSION

This Article tested for the first time the legally complex mail and wire fraud charges leveled by the Department of Justice against Milberg Weiss. By developing an original model of analysis, I deconstructed prosecutors’ theory of honest services fraud, the foundation of the government’s unprecedented and controversial case against the law firm. My examination revealed not only fundamental weaknesses in the indictment but also significant misunderstanding of the doctrinally complicated relationships among
named plaintiffs, absent class members, and the attorneys who represent them. Evaluating
the basis, or lack thereof, for burdening lead plaintiffs with fiduciary duties, the Article
also exposed the disconnect between the actual functions and duties of lead plaintiffs, on
the one hand, and the dubious legal duties sought to be imposed by federal prosecutors on
the other.

Justice William O. Douglas, an author of the original federal securities statutes and
commissioner of the SEC, once wrote, "The class action is one of the few legal remedies
the small claimant has against those who command the status quo."635 By studying the
government's effort to criminalize class actions, this Article advances the important and
continuing dialogue about the merits and problems of private securities enforcement.
Going forward, this debate appropriately should take place in Congress. Democratically
accountable lawmakers, not federal prosecutors, should decide the future of securities
class actions.