Northwestern University Law Review

Printed in U.S.A.
Vol. 87, No. 2

AUCTIONING CLASS ACTION AND DERIVATIVE SUITS: A REJOINDER

Jonathan R. Macey & Geoffrey P. Miller***

Randall Thomas and Robert Hansen have made a significant contribution to the literature on the auctioning of litigations in their article *Auctioning Class Action and Derivative Lawsuits: A Critical Analysis.*[1] Utilizing the insights of modern auction theory, they offer a comprehensive analysis of the proposal, first developed in an earlier article of ours,[2] that judges should experiment with auctioning class action and shareholders' derivative litigation in "large-scale, small-claim" cases.[3] Thomas and Hansen offer valuable insights into the strengths and weaknesses of the auction idea and thereby seek to identify more precisely those cases in which litigation auctions would offer significant potential benefits. More generally, their paper demonstrates the utility of modern auction theory for the analysis of important legal issues.

While generally applauding the auction idea, Thomas and Hansen criticize several elements of our initial analysis. In the pages that follow, we respond briefly to these criticisms and offer some additional thoughts

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* Jonathan R. Macey is the J. DuPratt White Professor of Law at Cornell Law School.

** Geoffrey P. Miller is the Kirkland & Ellis Professor of Law at the University of Chicago Law School.

Miller gratefully acknowledges financial support from the Linde and Harry Bradley Foundation and the Sarah Scaife Foundation.

1 Randall S. Thomas & Robert G. Hansen, *Auctioning Class Action and Derivative Lawsuits: A Critical Analysis*, 87 NW. U. L. REV. 423 (1992).

2 *See* Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1 (1991). As we note in that paper, several earlier writers have briefly considered the possibility of class action auctions. John Coffee of Columbia University mentions the possibility of auctioning class claims but then rejects it summarily in John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of the Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 691-93 (1986). Leo Herzel and Robert K. Hagan endorse an auction approach in their article, *Plaintiffs' Attorneys' Fees in Derivative and Class Actions*, 7 No. 2 LITIG. 25, 27 (1981), but do not develop the idea. The auction idea also rests, in part, on earlier literature on marketing tort claims. *See* Robert Cooter, *Toward a Market in Unmatured Tort Claims*, 75 VA. L. REV. 383, 383-411 (1989); Mark Shukaitis, *A Market in Personal Injury Tort Claims*, 16 J. LEGAL STUD. 329, 334-48 (1987). The notion that sale of claims could overcome agency costs is also developed, although not in an auction context, in Geoffrey P. Miller, *Some Agency Problems in Settlement*, 16 J. LEGAL STUD. 189, 196-97 (1987) [hereinafter Miller, *Some Agency Problems*].

3 Thomas & Hansen, *supra* note 1, at 423.

about auctions of class action and derivative lawsuits. Part I of this Article briefly reviews the auction proposal, and Part II considers several of Thomas's and Hansen's observations and criticisms.

I. THE AUCTION PROPOSAL

Our earlier article considered the problems inherent in "large-scale, small-claim" class action and shareholders' derivative suits.[4] In such settings, the plaintiffs' attorney acts essentially as an entrepreneur, exercising virtually plenary control over the conduct of the litigation on behalf of the putative "clients" and seeking, in so doing, to maximize profits from these entrepreneurial activities.[5] The named or representative plaintiff typically exercises little or no influence over the attorney in such cases.[6] Instead, her role is to serve as the attorney's "key to the courthouse door" and little else.

The lack of client monitoring in large-scale, small-claim cases inevitably creates a fruitful setting for agency costs—self-interested behavior by attorneys that may run counter to the best interests of the class or corporation the attorney is purporting to represent. The most serious problems occur in the areas of settlement and attorneys fees. An attorney might be inclined to settle a class action or derivative case early for a lower sum than he could obtain by prosecuting the case further because the attorney may conclude that his economic return from additional effort in the case would not be worth the time involved.[7] The defendant might also induce the plaintiff's attorney to settle the case for an inappropriately low sum in return for a larger fee.[8]

The existing litigation system has developed various mechanisms for regulating these and other agency problems. Certain elements of the authority which attorneys exercise in ordinary litigation settings are instead allocated to others in class and derivative litigation. For instance, the court exercises scrutiny over settlements and attorneys fee awards.[9] The named plaintiff has limited power to challenge the attorney's capacity to

[4] A large-scale, small-claim suit is one in which the aggregate potential liability is large but the average claim or interest of the plaintiffs is small due to the large number of claims (in the case of class actions) or to the large number of shareholders (in the case of derivative suits).

[5] *See* John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877, 896-917 (1987); Coffee, *supra* note 2, at 677-78.

[6] *See* John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter is Not Working*, 42 MD. L. REV. 215, 248-52 (1983); *see also* John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 No. 3 LAW & CONTEMP. PROBS. 5, 23-26 (1985) (arguing that plaintiffs' attorneys should be viewed as risk-taking entrepreneurs essentially outside of their client's control).

[7] Miller, *Some Agency Problems*, *supra* note 2, at 197-209.

[8] Macey & Miller, *supra* note 2, at 26.

[9] *Id.* at 44-61.

represent the class.[10] In derivative litigation, incumbent management may exercise a modicum of control through the director demand requirement[11] and the appointment of special litigation committees.[12] Individual plaintiffs in class action litigation have the right to opt-out of the suit and pursue their own litigation if they desire (although few do).[13] Even the defendant has a share of control through the power to object to the named plaintiff's typicality or adequacy.[14]

Our earlier article criticized the existing regulatory system, because it represents an inadequate approach to the problems presented by the divergence of interests between lawyers and their clients, and because it is based on palpable fictions and untruths (such as the fiction that the named plaintiff takes an active role in monitoring the plaintiffs' attorney or that the defendant can be relied on to represent the interests of the class or corporation when lodging objections to the adequacy or typicality of the named plaintiff). Our paper deals with a substantial number of legal rules, but two of our principal recommendations are important for purposes of this discussion.

First, we recommend that the requirement of a named plaintiff be jettisoned in large-scale, small-claim class and derivative litigation. We contend that the named plaintiff requirement serves little valid purpose in such settings, and that on the contrary, it has detrimental effects in that it interferes with free competition in the market for plaintiffs' attorneys and impairs the private enforcement of the law.[15] We recommend that the courts police the plaintiffs' *attorneys*, rather than their clients, to ensure that they will adequately represent the interests of the class or the corporation.[16]

Our second major policy recommendation is that judges experiment with auctions in large-scale, small-claim cases.[17] To briefly summarize our proposal, we argue that upon the filing of a class action or derivative lawsuit, the judge should make an initial investigation of the case to de-

10 *Id.* at 41-44.

11 The director demand requirement provides, generally, that a shareholder purporting to represent a corporation in a derivative action must first demand that the directors take action on the alleged cause of action or demonstrate that demand on the directors would be futile. *See generally* Kamen v. Kemper Fin. Servs., Inc., 111 S. Ct. 1711, 1715-17 (1991) (director demand requirement as defined by state law must be applied to derivative actions brought under the federal Investment Company Act of 1940, 15 U.S.C. § 80a-20(a) (1988)).

12 Macey & Miller, *supra* note 2, at 34-41.

13 *Id.* at 27-33.

14 *Id.* at 63-66.

15 *Id. passim.*

16 For a recent case commenting on our recommendation, see Wesley v. General Motors Acceptance Corp., No. 91-C3368, 1992 U.S. Dist. LEXIS 3594, at *17-*18 (N.D. Ill. Mar. 20, 1992), a class action in which the court held that "knowledge and sophistication of class counsel, coupled with no more than a moderate understanding of the claim by the plaintiff herself" was sufficient to establish adequacy of representation. *Id.* at *8.

17 Macey & Miller, *supra* note 2, at 105-18.

termine whether it would be appropriate for auction treatment. The judge would investigate the facts by enlisting the aid of plaintiffs' counsel, utilizing a special master, or otherwise. The case would be eligible for auction if (1) it is a large-scale, small-claim litigation, (2) it is one of numerous lawsuits that have been filed on behalf of plaintiffs or the corporation, (3) it appears sufficiently definite in scope to permit an effective auction, and (4) other factors that counsel against auctions (such as important individualized issues not held in common by the class) are not present.

Having determined that an auction is appropriate, the judge would then define the claim as clearly as possible, with the understanding that it may prove necessary to amend, alter or narrow the definition of the claim as the litigation progresses. The judge would then advertise the availability of the claim—for example by posting notices in suitable newspapers or other periodicals—and would set up the bidding procedures, which probably would be a standard sealed bid protocol. There would be no need for any named plaintiff in this process; it would be enough for the claim to be in the name of unspecified "Jane Doe" or "Richard Roe" plaintiffs.

Anyone with sufficient resources would be allowed to participate under our proposal. Bidders could include the defendant (if the defendant elects to participate) and attorneys. The judge would take bids, open them and award the claim to the highest bidder.

From the winning bidder's payment, the judge would deduct the expenses of the auction, such as the costs of investigating the claim and advertising the auction, and would also have discretion to compensate the attorneys who first brought the case or who assisted in the identification of the claims. The judge would then distribute the remaining amount to the corporation (in derivative litigation) or the class members (in class action litigation).

Meanwhile the winning bidder would succeed to the litigation. If the high bidder is the defendant, the case would settle; the defendant would essentially have purchased a release from liability from the plaintiff class or the corporation. If some party other than the defendant is the high bidder, that party would prosecute the claim more or less as in a standard lawsuit.

The auction need not be one for the claim as a whole, although auction of the entire claim presents the purest procedure for overcoming the agency costs of large-scale, small-claim litigation. Another option is to auction lead counsel rights, with the winning bidder being that responsible attorney willing to take on the litigation for the lowest percentage fee. Federal Judge Vaughn Walker has actually conducted such an auction in a plaintiffs' securities class action in California.[18] A variant on this ap-

[18] Judge Walker's rationale for conducting the auction is spread over a trilogy of opinions. *See*

proach would be for the court to set a percentage fee—say, thirty percent—and then conduct a cash auction for the right to litigate the case with this fee promised at the end if the case is successful. This would tend to align the plaintiffs' attorney better with the interests of the plaintiff class or corporation and would, by forcing the plaintiffs' attorney to ante up some cash at the front end, tend to vouch for the attorney's competence, financial resources, and commitment to the case.[19]

II. THE THOMAS AND HANSEN CRITIQUE

Thomas and Hansen offer a partial critique of this proposal. In discussing this critique, we will start with the points of agreement between Thomas and Hansen and ourselves, and then move on to areas where our views differ (although, as will be seen, the extent of difference is substantially less than might be supposed from a quick reading of the Thomas and Hansen piece).

Thomas and Hansen agree with our analysis of the pervasive existence of agency costs in large-scale, small-claim litigation.[20] They agree that class action and derivative attorneys respond to the incentive effects of the compensation system currently in place, and they agree that no currently used compensation method fully resolves the agency costs.[21] They also concur that the existing procedures for selecting lead counsel are often inefficient and do not serve the interests of the plaintiff class or corporation.[22]

Thomas and Hansen, moreover, agree that an auction approach to class action and derivative litigation would overcome many of these problems by uniting ownership and control in a single party.[23] Thus, winning bidders would have the proper incentive to prosecute their claims in an economically efficient manner.[24] The collective action problems that allow for collusive settlements and require time-consuming and expensive judicial monitoring would be eliminated.[25] The perverse incentives of existing lodestar and percentage-of-recovery attorney com-

In re Oracle Sec. Litig., 136 F.R.D. 639 (N.D. Cal. 1991); *In re* Oracle Sec. Litig., 132 F.R.D. 538 (N.D. Cal. 1990); *In re* Oracle Sec. Litig., 131 F.R.D. 688 (N.D. Cal. 1990). Another distinguished federal district court judge, Milton Shadur, has also expressed interest in auctioning lead counsel rights, observing that "if a like situation were to present itself to this court on another occasion, it would give serious consideration indeed to following Judge Walker's lead." *In re* Telesphere Int'l Sec. Litig., 753 F. Supp. 716, 721 n.12 (N.D. Ill. 1990). *But cf.* Davis v. Coopers & Lybrand, No. 90-C7173, 1991 U.S. Dist. LEXIS 10384, at *12-*13 (N.D. Ill. July 29, 1991) (Shadur, J.) (concluding that this was not an appropriate case for an auction procedure).

19 Macey & Miller, *supra* note 2, at 113-14.

20 Thomas & Hansen, *supra* note 1, at 430-33.

21 *Id.* at 431-33.

22 *Id.* at 431.

23 *Id.* at 435.

24 *Id.*

25 *Id.*

pensation systems would be overcome.[26]

Thomas and Hansen also agree that the auction approach, by utilizing a price system, offers the added advantage of allocating valuable economic goods (here, litigation rights) to the highest value user. The consequence would presumably be that the quality of litigation will improve on the plaintiffs' side, thus benefiting members of the plaintiff class or the corporation and assisting in the private enforcement of the law.[27] Finally, although Thomas and Hansen are skeptical about the general feasibility of an auction approach as a practical matter, they agree that in some cases auctions would be valuable methods for overcoming agency costs and conclude that an auction approach in such cases is "worthy of judicial experimentation."[28]

There are other advantages of the auction approach which Hansen and Thomas do not mention but with which they might agree. For example, the auction approach would allow the judicial system to dispense with the embarrassing fictions which pervade current practice (such as the fiction that plaintiffs' attorneys do not solicit their clients) and which in our view bring unnecessary discredit on the process in general and on plaintiffs' attorneys in particular. The auction approach would tend to break down the existing, anticompetitive structure of plaintiffs' class action securities litigation, in which a small number of firms appear in nearly every case and effectively dominate the litigation. It would reduce transactions costs by vesting the prosecution of the case in a single entity rather than in the unwieldy coalitions of plaintiffs' firms that currently characterize large-scale, small-claim litigation. And, by facilitating the private enforcement of the law, the auction procedure we propose would tend to deter wrongful conduct in the first place because potential defendants would know that the chance of their being sued and required to pay substantial damages is higher in an auction regime than under the existing system.

Thomas and Hansen also recognize that we did not advocate the auction approach as a panacea. We acknowledged that the auction approach carries significant costs.[29] In particular, defining the scope of the claim would be problematic in many cases; bidders might engage in collusion to keep prices low; bidders might find it difficult to obtain financing for large claims; ensuring the cooperation of plaintiff class members might prove troublesome; compensating the party that first identified the claim could be problematic; and suits brought in multiple jurisdictions might be difficult to consolidate. Moreover, we recognized that the auction approach might not work in civil rights litigation or other cases in which the only pecuniary award from the litigation expected by counsel

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26 *Id.* at 436.
27 *Id.* at 435.
28 *Id.* at 457.
29 Macey & Miller, *supra* note 2, at 110-16.

is an award of attorneys fees under a fee-shifting statute if the suit is successful.[30] Thomas and Hansen agree with our identification of many of these problems, and concur also that these problems, while serious, can sometimes be overcome.[31]

Thus, there is actually a broad area of agreement between Thomas and Hansen and ourselves on the pros and cons of an auction approach to class action and derivative litigation. However, despite this agreement, Thomas and Hansen style their article as a critique of our auction approach. They do so because of flaws which they identify in the auction procedure, and which they believe we did not sufficiently consider in our earlier article. They address three main issues: first, who should be the auctioneer, second, should defendants be allowed to participate in the auction, and third, how can bidders be informed about the value of the claim being auctioned?

On the first question, Thomas and Hansen, following other work of theirs on auction theory,[32] undertake an interesting and persuasive analysis of the costs and benefits of judicial auctions as opposed to auctions by others. They observe that judges do not obtain financial or reputational benefits from conducting an auction well, and note that because of absolute judicial immunity, judges need not fear liability for performing poorly in their role as auctioneers. Thomas and Hansen conclude, nonetheless, that on balance judges would make good auctioneers for lawsuits.[33] This is a sensible conclusion, and in no way inconsistent with the points made in our earlier paper.

What, then, is the gravamen of the Thomas and Hansen critique? Concerning the second question listed above, they object to our recommendation that courts allow defendants to bid at the auction. They theorize that since the defendant knows much more about the value of the lawsuit than the outside bidders, outside bidders will tend to reduce their bids on the theory that if they win the auction they will probably be paying too much—they will have outbid the defendant who possesses superior information about the value of the claim. Thus, according to Thomas and Hansen, "defendants should be prohibited from bidding."[34]

While Thomas and Hansen are correct that the presence of an informed bidder affects the auction process, their conclusion that the defendant should not be allowed to bid is questionable. It is certainly true, as Thomas and Hansen argue, that in a common value auction outside bidders will reduce their bids if they know that an informed bidder is in the auction. In fact, if outside bidders knew that the informed bidder

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30 *Id.*

31 Thomas & Hansen, *supra* note 1, at 453-56.

32 *See* Randall S. Thomas & Robert G. Hansen, *A Theoretic Analysis of Corporate Auctioneer Liability Regimes*, 1992 WIS. L. REV. 1147.

33 Thomas & Hansen, *supra* note 1, at 436-45.

34 *Id.* at 448-49.

would bid in at exactly the objective expected value of the item being sold, they would never bid at all since in such a case they would either lose the auction and get nothing or win the auction and overpay.

If a fully informed bidder is in the auction, the auction would proceed only if outside bidders predicted that the informed bidder would bid below the objective value of the object—a reasonable assumption since the informed bidder would be aware of the deterrent effect that its presence in the auction will have on the outside bidders. Thus the informed bidder may also bid below the objective price, and outside bidders will not be completely deterred from bidding because they know that the informed bidder may do so. However, the presence of an informed bidder will, as Thomas and Hansen observe, probably reduce the expected sale price in the auction.

One should not necessarily conclude, however, that defendants should be excluded from bidding at an auction of litigation rights. First, Thomas and Hansen's assumption that defendants inevitably know more about the value of the lawsuit than other parties is dubious. While defendants generally will have more information than the plaintiffs about the nature of their own conduct, this is often not of critical importance. Over a wide range of situations, the defendants will have no meaningful information advantage over other bidders. For example, where plaintiffs' attorneys bring a derivative suit claiming that the directors breached their fiduciary duties to shareholders by approving a sweetheart contract or by failing to redeem a poison pill in the face of a hostile tender offer, the defendants may not have a significant information advantage over outside bidders.

Moreover, litigation outcomes are often sufficiently uncertain that defendants often will have only a marginal advantage over outside bidders with respect to the expected value of the claim. Further, any information advantage a defendant may have with respect to the facts of the case may be reduced because of the defendant's involvement in the case. For example, a corporate president who views a suit as a personal attack may well refuse to recognize the possibility that the case might be successful if taken to the jury.

In other cases where defendants might have an information advantage, the best solution would be to reduce the advantage, not to eliminate the bidder. Consider a derivative suit against corporate directors for failing to establish appropriate mechanisms for monitoring and controlling employees, or where the directors are charged with failing to make appropriate disclosures of information. Defendants in such cases may know more than outsiders. But many of the problems for auctions posed by this information advantage can be mitigated by providing potential bidders with suitable information about the claims being sold.

Yet another reason to doubt the Thomas and Hansen conclusion that defendants should be barred from bidding is that it is based on the erroneous foundation that all auctions for litigation rights will be common value auctions. As suggested above, auctions for litigation rights may not be common value auctions because of the emotional stakes involved. Pride, attachment to the issues involved, hubris, and other human factors may lead parties to place disproportionate values on litigation rights. Sometimes these factors will cause plaintiffs to add value to litigation rights; other times these factors will cause defendants to add value to such rights.

The costs of the litigation process itself further suggest that an auction for litigation rights is not ordinarily a common value auction. An outside bidder in a litigation auction would be willing to pay an amount up to the bidder's assessment of the value of the expected judgment or settlement *less* the litigation costs which the bidder expects to incur in prosecuting the case to judgment or settlement. The defendant in such an auction, on the other hand, would be willing to pay an amount up to the defendant's assessment of the value of the expected judgment *plus* the litigation costs the defendant expects to incur in taking the case to judgment or settlement. Thus, if the defendant and the other bidders have similar views on the expected judgment, the defendant's reservation price at the auction would be higher than that of the other bidders by the sum of the two litigation costs.

If we introduce the fact that strategic considerations inevitably play a role in the litigation process, the consequences of having the defendant bidding at the auction can be seen to be somewhat ambiguous. Thomas and Hansen rightly point to the fact that, other things being equal, the knowledge that an informed bidder is in the auction will result in outside bidders lowering their bids. On the other hand, if the outside bidders also know that the informed bidder places a higher value on the good being auctioned off than the other bidders, this tendency to lower bids will be countered by the expectation that the informed bidder will not underbid the suit being auctioned. If the informed bidder places a bid that is too low, it risks losing the auction to an outside bidder, thus forfeiting not only the difference between the objective value of the claim and the winning bid, but also the special value which the defendant can gain from the auction because of the reduction of its litigation costs.

Even assuming that the presence of defendants in the auction significantly lowers the amounts that outside bidders are willing to risk, it still does not necessarily follow that defendants should be excluded. One of the advantages of allowing the defendant to bid is that settlement can occur quickly, giving the defendant a powerful incentive to make a bona fide settlement offer (in the form of a bid at the auction).[35] Quick settlement saves litigation costs for both parties, conserves the social resource

[35] We would add to our scheme the rule that the court would not disclose the defendant's bid if it is not the high bid. This way, defendants will not be deterred from making bids at or near their reservation price for fear that if they do not win the auction they will have disclosed their reservation

of judicial time, and ensures rapid payment to members of the plaintiff class. These advantages would be lost if defendants were excluded from the auction.

Thomas and Hansen observe that the winning bidder could initiate settlement discussions with the defendant immediately after the auction even if the defendant were excluded,[36] but this is unpersuasive. Parties often do not initiate settlement discussions for strategic reasons, and there is no assurance that settlement discussions would commence quickly if a party other than the defendant purchases the claim.

Thus, Thomas and Hansen's case against allowing the defendant to bid in a litigation auction is not established.[37]

Concerning the third question—how can bidders be informed about the value of the claim being auctioned—Thomas and Hansen observe that litigation auctions are characterized by a high degree of uncertainty about the value of the claim being sold. Auction theory predicts that the price paid in an auction characterized by uncertainty as to the value of the item being auctioned will tend to be below the objective value of the object for two reasons: the winner's curse problem[38] and bidders' strategic incentive to shave bids when the bids are likely to be widely dispersed.[39] Thus, the bidders' lack of information about the value of the claim would be an impediment to an efficient auction.

We recognized this problem in our earlier article, and suggested mechanisms by which bidders could make themselves better informed about the value of the claim.[40] In particular, we suggested that the judge conduct an initial limited discovery, either on her own or by utilizing the services of one of the plaintiffs' attorneys or a special master.[41] Thomas and Hansen observe that this procedure would involve costs of administration and analysis, and that these costs will reduce the number of bidders in the auction and, further, will result in the analysis costs of all bidders being imposed on the seller (the plaintiffs in a class action case).

We do not understand why the costs of initial limited discovery that

price to the winning bidder. There appears to be little reason why the winning bidder should be informed of the defendant's bid.

36 Thomas & Hansen, *supra* note 1, at 449.

37 Moreover, as a practical matter it may be impossible to prevent the defendant from bidding in the auction, since the defendant might be able to act as an undisclosed principal by bidding through an ostensibly unaffiliated party.

38 Under conditions of imperfect information regarding the value of the asset being sold, the winning bidder in a common value auction will tend to be the bidder who places the highest value on the item—and thus the bidder who overvalues the item relative to its actual value. But because participants in the auction know of this winner's curse problem, they will systematically lower their bids so as not to overpay for the item in case they win the auction. The result is that the winning bid in a common value auction will tend to be below the actual expected value of the item.

39 Thomas & Hansen, *supra* note 1, at 447.

40 Macey & Miller, *supra* note 2, at 110-11.

41 *Id.* at 106-07.

we discussed in our initial article will significantly raise litigation costs since discovery and similar costly information-gathering techniques must be employed in any event.

Moreover, auction theory, like economic theory generally, is based on the fundamental premise that market processes are not costless. Identifying costs associated with auctions is not sufficient to resolve the issues, because the relevant inquiry is not whether such costs exist, but whether there are countervailing benefits that justify the costs. Thus the problems identified by Thomas and Hansen occur in all auctions of goods where bidder uncertainty exists—antiques, horses, houses, and corporations, for starters. Yet these problems do not prevent auctions from occurring with these items. Given the potential for reducing bidder search costs by preliminary discovery and the significant benefits of litigation auctions already discussed, Thomas and Hansen have not demonstrated the futility of an auction approach merely by pointing out that, like many other auctions, litigation auctions would face problems associated with bidder uncertainty.

With respect to Thomas and Hansen's point about bidder uncertainty, we also wish to emphasize the implications of plaintiffs' attorneys ability to reduce risk by diversification. Plaintiffs' attorneys maintain a portfolio of lawsuits at any given time. Applying elementary principles of corporate finance in this context, we can divide the risks faced by lawyers bringing class action and derivative lawsuits into two categories: market risks, which influence the probability of success for all lawsuits in the portfolio, and lawsuit-specific risks, which influence only the probability of recovery in particular suits. The risks that a particular jurisdiction will change substantive legal rules in a particular area retroactively, or impose caps on jury awards, are examples of market risks that will have portfolio-wide implications. By contrast, the risk that a particular witness will be unusually convincing at trial, or that a damaging fact will emerge late in the litigation, are examples of lawsuit-specific risks. Plaintiffs' attorneys cannot diversify away (and thereby avoid) market risks for the simple reason that these are the general risks associated with any litigation process. By contrast, bidding attorneys can diversify away lawsuit-specific risks. Indeed, an important advantage to the auction mechanism we propose is that it enables plaintiffs' attorneys to diversify their portfolios of cases better by giving them more control over which cases they get to handle at a particular time.

Thomas and Hansen recognize that the social utility of litigation auctions depends on cost-benefit analysis. In the final section of their article, they offer several valuable suggestions about how to improve the auction process.[42] For example, they offer the sensible recommendation that information about the value of the claim be placed in a public dis-

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[42] Thomas & Hansen, *supra* note 1, at 453-56.

covery record which is both relatively complete and equally available to all bidders.[43] They also propose that the court bar bidders from pursuing discovery on their own, a suggestion that may have a sound theoretical basis but that would be difficult to implement in practice.[44]

Thomas and Hansen see particular merit in auctioning lawsuits where the level of uncertainty about the value of the lawsuit is low.[45] This is obviously a sensible insight, although a countervailing consideration is the fact that when the value of the lawsuit is very easy to appraise, the problem of agency costs that litigation auctions are designed to overcome is less problematic as well. A plaintiffs' attorney would have a more difficult time justifying an inadequate settlement if the amount of damages is easy to calculate from the face of the complaint and the defendant's liability is undisputed. Thus, while the costs of auctions are lower because of reduced uncertainty about the value of the claim, the benefits of the auction at reducing agency costs are likely to be lower as well compared with other types of cases.

At the same time, in identifying cases where auction treatment is particularly appropriate, Thomas and Hansen do not establish that an auction procedure is necessarily inappropriate in other settings. Where the uncertainty is greater, the costs of the auction may be greater in that the plaintiffs receive a lower return from the sale, but the benefits from the auction may be greater as well. We have noted that agency costs are in part a function of the uncertainty of the claim, so that if the claim is relatively uncertain, agency costs are likely to be high, indicating that an auction can offer significant benefits by overcoming them. Further, where the claim has an uncertain value, the litigation is likely to take a substantial amount of time to conclude, and may even result in a trial. Auctions in such cases result in prompt payment to the plaintiffs, rather than delayed payment. In addition, where the claim is uncertain, the litigation will tend to be riskier for the plaintiffs. If plaintiffs are risk-averse, an auction provides the benefit of rendering an uncertain claim certain, a benefit that increases in value as the uncertainty of the claim rises. And where the claim is uncertain, settlement is likely to be difficult[46] which will most likely lead to litigation costs being higher than for cases where the claim is relatively easy to appraise. If, as we have suggested, an auction approach with defendant bidding facilitates settlement, the use of litigation auctions is likely to reduce litigation costs more when the claim is uncertain than when it is relatively easy to evaluate.

Ultimately the question is one of cost-benefit analysis. We do not

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43 *Id.* at 454.

44 *Id.*

45 *Id.* at 455-56.

46 George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1, 9-17 (1984) (arguing uncertainty makes settlement more difficult).

advocate a wholesale adoption of the auction approach, but rather a more limited experiment in situations where the auction approach offers significant benefits and the difficulties with the approach are not overly severe.[47]

III. CONCLUSION

Thomas and Hansen have made a significant contribution to the literature on litigation auctions in their article, and as should now be apparent, we agree with the great majority of their observations. We remain more optimistic than Thomas and Hansen about the potential utility of litigation auctions in cases where the value of the claim is quite uncertain, but the difference is one of degree. In any event, it might be sensible for courts to experiment first with litigation auctions in cases where the benefit of such auctions appear most clear-cut. The types of cases identified by Thomas and Hansen are among this category, although we think other types of cases might well be appropriate as well.

[47] Macey & Miller, *supra* note 2, at 105-16.