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## The Hypocrisy of the Milberg Indictment: The Need for a Coherent Framework on Paying for Cooperation in Litigation

### ABSTRACT

The indictment of the Milberg Weiss law firm and two of its named partners for allegedly making illegal payments to lead plaintiffs stands at the intersection of important recent developments in both the expanding criminalization of corporate conduct and the federalization of corporate law. Many have noted the irony and hypocrisy of the Milberg firm's alleged use of illegal tactics to prosecute corporate illegality. However, the more important hypocrisy is that Milberg's prosecutors are essentially paying the same witness—Vogel—that Milberg is being prosecuted for paying. This case illustrates the need to develop coherent standards regarding payments to litigants and witnesses. These standards should be based on the incentive effects of the payments rather than on a desire to discourage or encourage particular types of actions.

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### I. INTRODUCTION

MUCH ATTENTION HAS FOCUSED LATELY ON TWO IMPORTANT developments in corporate and securities laws. First, there has been increasing federalization of the law in this area. The most notable example is the broad new regulation of internal corporate conduct in the Sarbanes-Oxley Act of 2002<sup>1</sup> (SOX). Another example is attempts to control abusive securities class actions by requiring that such actions be brought in federal court.<sup>2</sup> This trend continued recently in the Supreme Court's unanimous decision in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*,<sup>3</sup> which expanded the preemptive effect of the Securities Litigation Uniform Standards Act of 1998.<sup>4</sup>

The second important development is the increased criminalization of corporate law.<sup>5</sup> The recent Enron related criminal trials of Ken Lay and Jeffrey Skilling, and the recent criminal investigations of options backdating and other compensation issues illustrate the potentially enormous impact of criminal fraud prosecutions on issues that have traditionally been part of internal corporate governance controlled by state law and civil enforcement.<sup>6</sup> Indeed, this development intersects with federalization. Commentators have noted that prosecutors' use of the mail fraud and RICO statutes to prosecute individuals for depriving another of the intangible right to honest services "stand[s] federalism on its head" by "turning minor state crimes and violations of non-criminal regulations into 20-year federal felonies."<sup>7</sup> The civil and criminal provisions contained in SOX often closely relate to and have the potential to overshadow areas that were traditionally governed by state corporation law.<sup>8</sup>

The indictment of the Milberg Weiss law firm and two of its named partners for making and concealing alleged illegal payments to lead plaintiffs stands at the intersection of these important developments. First, the indictment of the leading secur-

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1. Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.); see generally HENRY N. BUTLER & LARRY E. RIBSTEIN, *THE SARBANES OXLEY DEBACLE: WHAT WE'VE LEARNED; HOW TO FIX IT* 65-71 (AEI Press 2006).

2. See generally Mark J. Loewenstein, *A Perspective on Federal Corporation Law*, 2 J. BUS. & TECH. L. 425, 425-26 (2007).

3. 547 U.S. 71 (2006). For an analysis of the case and its implications for federalism, see Larry E. Ribstein, *Dabit, Preemption and Choice of Law*, 2006 CATO SUP. CT. REV. 141 (2006).

4. Pub. L. No. 105-353, 112 Stat. 3227 (codified as amended in scattered sections of 15 U.S.C.).

5. For criticisms of this development, see Larry E. Ribstein, *Perils of Criminalizing Agency Costs*, 2 J. BUS. & TECH. L. 59 (2007). See also Howard H. Chang & David S. Evans, *The Optimal Prosecution of Corporate Fraud: An Error Cost Analysis*, (Nov. 1, 2006), available at <http://ssrn.com/abstract=943035>.

6. See, e.g., Jerry W. Markham, *Regulating Excessive Executive Compensation—Why Bother?*, 2 J. BUS. & TECH. L. 277, 296-303 (2007) (discussing criminal investigations of backdating and compensation issues).

7. Albert W. Alschuler, *The Mail Fraud & RICO Racket: Thoughts on the Trial of George Ryan*, 9 GREEN BAG 113, 115 (2006); see also George D. Brown, *Should Federalism Shield Corruption?—Mail Fraud, State Law and Post-Lopez Analysis*, 82 CORNELL L. REV. 225 (1997); Roger J. Miner, *Federal Courts, Federal Crimes, and Federalism*, 10 HARV. J.L. & PUB. POL'Y 117 (1987).

8. See generally BUTLER & RIBSTEIN, *supra* note 1; Jennifer Johnson, *What's Good for the Goose? A Critical Essay on "Best Practices" for Private Firms*, 2 J. BUS. & TECH. L. 251, 253-60 (2007).

ities class action law firm has effects that are analogous to recent federal legislation aimed at controlling securities class actions by reducing the viability of private securities class action lawsuits, at least in the short term.<sup>9</sup> Second, this may, in turn, increase the demand for substitutes, including expanded criminal fraud prosecutions. Third, the federal prosecution of Milberg expands the federal role in this area by turning misdemeanor violations of state law and non-criminal violations of ethics laws into federal felonies.

Even more fundamentally, this Article shows that the prosecution of Milberg shares attributes with the “abusive” class action lawsuits targeted by the Milberg prosecution. While many commentators have focused on Milberg’s hypocrisy in allegedly using concealed kickbacks to sue firms that engaged in similar behavior,<sup>10</sup> the prosecutor’s actions in this case are just as hypocritical. As it has done in many cases, the government used incentive “payments” to induce the cooperation of Howard Vogel in order to prosecute Milberg’s incentive payments to Vogel to be a lead plaintiff. The prosecutors’ activities therefore facially violate the same statute against paying witnesses that Milberg is being prosecuted for violating. Moreover, these parallels are substantive and not cosmetic. That is, to the extent that payments to lead plaintiffs raise concerns over misaligned incentives, the same concerns can apply *a fortiori* when used by prosecutors.

The Milberg prosecution illustrates the need for a general policy framework to evaluate when payments to both witnesses and lead plaintiffs should be enjoined. The payment to lead plaintiffs the Milberg prosecution attacks is a potentially efficient practice because it addresses free-riding and incentive problems that would otherwise plague class actions. Making this conduct illegal creates incentives to engage in costly “arbitrage”—that is, roughly equivalent conduct that is legal, or at least involves less detectable illegality. Moreover, perceived social needs to distinguish among underlying rights and wrongs involved in particular causes of action are best met by crafting the cause of action. Trying to accomplish this result by criminalizing litigation behavior may compromise the legitimacy and moral force of the law by making indefensible distinctions between similar types of conduct.

The Article is organized as follows. Part II describes the Milberg indictment and prosecution. Part III examines the effect of incentive payments to lead plaintiffs. Part IV examines payments to witnesses, and contrasts the payments and other considerations paid to Howard Vogel by Milberg with similar considerations given by prosecutors to Vogel and other cooperating defendants such as Andy Fastow in

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9. See CORNERSTONE RESEARCH, SECURITIES CLASS ACTION CASE FILINGS, 2006 MID-YEAR ASSESSMENT 2 (2006), available at [http://securities.stanford.edu/clearinghouse\\_research/2005\\_YIR/2006FilingsMidYear-Release.pdf#2006](http://securities.stanford.edu/clearinghouse_research/2005_YIR/2006FilingsMidYear-Release.pdf#2006) (noting that class action filings for the first half of 2006 are “the lowest level of filing activity during a six-month period since 1996, the year immediately following the adoption of the [PSLRA]”).

10. See, e.g., 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?postversion=2006103111](http://money.cnn.com/magazines/fortune/fortune_archive/2006/11/13/8393127/index.htm?postversion=2006103111); Walter Olson, *Inside Milberg’s Credenza*, WALL ST. J., May 22, 2006, at A12.

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the Enron case. Part V concludes by suggesting that standards regarding incentive payments to both litigants and witnesses be based on the incentive effects of the payments on the production of information rather than a desire to encourage criminal actions or to discourage civil actions.

### II. THE MILBERG INDICTMENT AND THE VOGEL PLEA

On May 18, 2006, a grand jury returned an indictment against Milberg partners David J. Bershada and Steven G. Schulman, two other individuals, and the Milberg Weiss law firm.<sup>11</sup> The 102 page, twenty-count indictment alleges that from about 1981 through at least 2005, Milberg lawyers made concealed payments to named plaintiffs in class actions and shareholder derivative actions in which Milberg served as counsel.<sup>12</sup>

The alleged illegal acts fall into three basic categories.<sup>13</sup> The first category includes the substantive acts, the making of illegal payments to lead plaintiffs allegedly in violation of federal criminal prohibitions against paying witnesses<sup>14</sup> and New York state laws against commercial bribery.<sup>15</sup> The second category includes acts undertaken to conceal the initial acts, including lying to the judge, making

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11. First Superseding Indictment, *United States v. Milberg Weiss Bershada & Schulman LLP, David J. Bershada, Steven G. Schulman, Seymour M. Lazar, & Paul T. Selzer*, No. CR 05-587(A)-DDP (C.D. Cal. May 18, 2006), available at <http://www.abanet.org/journal/ereport/milberg.pdf> [hereinafter *Milberg Indictment*]. The indictment also named Seymour M. Lazar, who served as the lead plaintiff in numerous Milberg class actions, and Paul T. Selzer, who had served as Lazar's attorney.

12. *Id.* Count one alleges that the defendants conspired to commit the following offenses against the United States: (a) to commit obstruction of justice in violation of 18 U.S.C. § 1503(a); (b) to make false material declarations in violation of 18 U.S.C. § 1623(a); to commit commercial bribery, violating New York Penal Law Section 180.00 and 18 U.S.C. § 1952(a)(1), (3); to commit mail and wire fraud in violation of 18 U.S.C. §§ 1341, 1343, and 1346; to make illegal payments to witnesses in violation of 18 U.S.C. § 201(c)(2). *Id.* at 24–79. Count two alleges a racketeering conspiracy in violation of 18 U.S.C. § 1962(d). *Id.* at 79–81. Counts three through eight allege mail fraud, and count nine alleges money laundering. *Id.* at 82–85. The Milberg Weiss law firm is named in counts one, six through eight, and nine. *Id.* at 24, 84, 86. Bershada, Lazar and Schulman are named in counts one, two, and six through eight. *Id.* at 24, 79, 84. Only Bershada and Lazar are named in count nine. *Id.* at 86. Counts three through five simply name Lazar. *Id.* at 83. In addition, counts ten through thirteen name Lazar and Selzer, alleging concealment of money laundering. *Id.* at 90. Counts fourteen through sixteen only name Lazar for filing of a false tax return and for obstruction of justice. *Id.* at 92. Counts eighteen through twenty are criminal forfeiture counts. *Id.* at 94–102.

13. For a detailed discussion of these issues and the Milberg indictment generally, see Theresa A. Gabaldon, *Milberg Weiss: Of Studied Indifference and Dying of Shame*, 2 J. Bus. & Tech. L. 207 (2007).

14. 18 U.S.C. § 201(c)(2) (2000); see *infra* Part IV.

15. N.Y. PENAL LAW § 180.00 (Consol. 1999). This section provides that commercial bribing in the second degree is a class A misdemeanor, and this section states that

[a] person is guilty of commercial bribing in the second degree when he confers, or offers or agrees to confer, any benefit upon any employee, agent or fiduciary without the consent of the latter's employer or principal, with intent to influence his conduct in relation to his employer's or principal's affairs.

The activity can be raised to a class E felony under N.Y. PENAL LAW § 180.03. This section provides that commercial bribing is in the first degree when "the value of the benefit conferred or offered or agreed to be conferred exceeds one thousand dollars and causes economic harm to the employer or principal in an amount exceeding two hundred fifty dollars."

false declarations, falsifying tax documents, obstructing of justice, and laundering money. In the final category are “derivative crimes,” such as conspiracy, RICO, mail and wire fraud, aiding and abetting, and forfeiture counts. We focus on the substantive acts in the first category. This focus does not imply that the derivative acts are inconsequential and of little social harm. Rather, in our view, they illustrate the serious costs that result from attempts to avoid regulations of payments to witnesses and lead plaintiffs. The important issue of entity liability, which is the focus of much of the criticism of the prosecution,<sup>16</sup> is beyond the scope of this Article.

Payments to lead plaintiffs are limited by law and ethics rules. As the Milberg indictment notes,

*The compensation that may be paid to a named plaintiff in a class action or shareholder derivative action is limited to the following: (a) the named plaintiff's pro rata share of the recovery obtained in a lawsuit, calculated on the same basis as the pro rata shares available to all of the absent class members or shareholders; and (b) his or her reasonable costs and expenses incurred in connection with the lawsuit, as approved by the court. Additionally, in some circumstances, the court presiding over such a lawsuit may award a modest bonus payment to the named plaintiff, in recognition of his or her effort in obtaining a beneficial result for the absent class members or shareholders, and only after the absent class members or shareholders have an opportunity to object to the bonus award.*<sup>17</sup>

Moreover, for actions filed after December 22, 1995, payment of bonus awards to lead plaintiffs is precluded under the Private Securities Litigation Reform Act (PSLRA).<sup>18</sup> The indictment states that the

*kickback payments to the Paid Plaintiffs were illegal and improper for the following reasons, among others: (a) under applicable New York law, it is a criminal offense for an attorney to promise or give anything of value to induce a person to bring a lawsuit, or to reward a person for having done so; (b) under applicable New York law, it is a criminal offense to pay a fiduciary, without*

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16. See generally Gabaldon, *supra* note 13.

17. Milberg Indictment, *supra* note 11, ¶ 24, at 9–10.

18. Under the PSLRA, 15 U.S.C. § 78u-4(a)(4),

[t]he share of any final judgment or of any settlement that is awarded to a representative party serving on behalf of a class shall be equal, on a per share basis, to the portion of the final judgment or settlement awarded to all other members of the class. Nothing in this paragraph shall be construed to limit the award of reasonable costs and expenses (including lost wages) directly relating to the representation of the class to any representative party serving on behalf of a class.

Under 15 U.S.C. § 78u-4(a)(2)(A)(vi), lead plaintiffs must file a sworn certification with the complaint that “states that the plaintiff will not accept any payment for serving as a representative party on behalf of a class beyond the plaintiff's pro rata share of any recovery, except as ordered or approved by the court in accordance with paragraph (4).”

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*consent of those to whom he or she owes fiduciary duties, with the intent to influence his or her conduct as a fiduciary; and (c) under applicable New York and California laws, lawyers may not share attorney's fees with persons who are not duly licensed to practice law.*<sup>19</sup>

In addition, both count one (conspiracy) and count two (racketeering conspiracy) of the indictment allege that the payments violate 18 U.S.C. § 201(c)(2), which prohibits payments to witnesses.<sup>20</sup>

The indictments allege that the payments caused a conflict of interest between the lead plaintiff and the other class members to whom they owed fiduciary duties. In economic terms, the indictment alleges that Milberg's paying of a portion of its attorney's fees to the lead plaintiff increased the agency costs between the lead plaintiff, Milberg, and the class.<sup>21</sup> As a result, the share of fees paid to Milberg and the lead plaintiff out of the common recovery funds increased.<sup>22</sup> Moreover, disclosure of the payments could have affected the certification of the class.<sup>23</sup>

Central to the successful indictment was the cooperation of Howard Vogel, who had previously served as a lead plaintiff for Milberg.<sup>24</sup> In late April, 2006, Vogel entered into a plea agreement with the Milberg prosecutors.<sup>25</sup> Pursuant to the plea agreement, Vogel pled guilty to one count of making a false declaration before a court, in violation of 18 U.S.C. § 1623(a), agreed to a United States Sentencing Guidelines offense level of seventeen minus a three level decrease for "acceptance of responsibility,"<sup>26</sup> and agreed to pay a \$2 million dollar fine. The Vogel plea also includes the typical agreement to "cooperate fully . . . with respect to any investigations of criminal, civil, disciplinary, or other proceedings relating to any payment

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19. Milberg Indictment, *supra* note 11, § 29, at 11–12.

20. *Id.* § 41-f, at 26, § 56-e, at 81.

21. Lead plaintiffs were alleged to have been promised "a substantial portion of the attorney's fees MILBERG WEISS obtained in actions in which the individual served, or caused a relative or associate to serve, as named plaintiff for MILBERG WEISS." *Id.* § 27, at 10–11.

22. The paid plaintiffs

had a greater interest in maximizing the amount of attorneys' fees paid to MILBERG WEISS than in maximizing the net recovery to the absent class members and shareholders. . . . Additionally, MILBERG WEISS improperly favored the financial interests of the paid plaintiffs or their spouses or associated entities over the interested class members or shareholders.

*Id.* § 45, at 27–28.

23. Specifically, if the secret payments alter the paid plaintiffs' incentives, the payments may make the paid plaintiff's claims atypical and in conflict with the interests of absent class members. *See id.* § 17, at 6–7; *see also* FED. R. CIV. P. 23(a) (setting out prerequisites to a class action).

24. *See* Elkind, *supra* note 10.

25. Plea Agreement for Defendant Howard J. Vogel, *United States v. Howard J. Vogel*, No. CR 06-00320 (C.D. Cal. Apr. 28, 2006), available at <http://www.abanet.org/journal/creport/plea.pdf> [hereinafter Vogel Plea Agreement].

26. *Id.* § 14, at 5–6. The base offense level is twelve, with enhancements for substantial interference with the administration of justice (three levels) and abuse of a position of trust (two levels). *See* U.S. SENTENCING GUIDELINES MANUAL § 2J1.3 (2005). A level fourteen offense level yields a guidelines sentence of fourteen to twenty-one months for a defendant with the lowest criminal history category. *Id.* § 5A1.1 sent. table (1995).

made directly or indirectly to any named plaintiff in any class action or shareholder derivative lawsuit brought by the law firm of Milberg Weiss Bershad & Schulman LLP.<sup>27</sup> Cooperation requires the defendant to, among other things, “respond truthfully and completely to all questions that may be put to defendant, whether in interviews, before a grand jury, or at any trial or other court proceeding.”<sup>28</sup>

The prosecutor agreed not to prosecute certain related offenses, to conditionally notify the court of Vogel’s cooperation and substantial assistance, and to move for various sentence reductions. Among other things, the prosecutor agrees “[n]ot to further prosecute defendant for violations of federal law arising out of defendant’s conduct [described in the plea agreement]”; to provide written confirmation that the defendant will not be prosecuted for any related criminal tax violations; “if requested by defendant, to bring to the court’s attention the nature and extent of defendant’s cooperation, in connection with his sentencing”; “[i]f the USAO determines, in its exclusive judgment, that the defendant has both complied with his obligations under [the plea agreement] and provided substantial assistance to law enforcement in the prosecution or investigation of another (“substantial assistance”), to move the Court pursuant to United States Sentencing Guidelines § 5K1.1”; “to fix an offense level and corresponding guideline range below that otherwise advised by the sentencing guidelines”; “to recommend a sentence within this reduced range”; “to recommend that defendant be sentenced to the low-end of defendant’s applicable sentencing guidelines range”; and to recommend that “the defendant not be ordered to pay a fine amount higher than the low end of defendant’s applicable guideline fine range.”<sup>29</sup>

### III. INCENTIVE PAYMENTS TO LEAD PLAINTIFFS

This Part briefly examines the economic function of payments to lead plaintiffs. While the indictment highlights the potential increased agency costs generated by payments to lead plaintiffs, Subpart A shows that any such effect is likely to be *de minimus*, and thus an implausible explanation for the practice. Subpart B examines alternative explanations for the practices. The point is not to defend Milberg’s alleged behavior. For example, even if Milberg did not commit theft, it may have breached fiduciary duties and deprived absent class members of the intangible right to honest services by concealing the payments.<sup>30</sup> However, this only reinforces our point that making the underlying conduct illegal creates incentives to conceal. It then becomes more important to find some rationale for barring the underlying conduct.

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27. Vogel Plea Agreement, *supra* note 25, ¶ 19, at 7–9.

28. *Id.* ¶ 23, at 12–14.

29. *Id.*

30. See Posting of Peter J. Henning, *Is It Fraud or Dishonesty in the Milberg Weiss Prosecution*, to White Collar Crime Profs Blog, [http://lawprofessors.typepad.com/whitecollarcrime\\_blog/2006/05/is\\_it\\_fraud\\_or\\_.html](http://lawprofessors.typepad.com/whitecollarcrime_blog/2006/05/is_it_fraud_or_.html) (May 20, 2006).



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### A. *Did the Payments Harm Absent Class Members?*

It is far from clear that paying lead plaintiffs harms class members or serves to transfer the proceeds of the common fund to Milberg and the paid lead plaintiff. To see this, consider the division of fees in a common fund class action. Assume that the size of the common fund  $CF$  is determined by negotiations between the class counsel and the defendant, and that the defendant is only concerned about the total payout, and not how it is distributed between the members of the class and its counsel. Under these assumptions, whether or not the Milberg payments to the lead plaintiff are disclosed should not affect the outcome of the negotiations to determine  $CF$  if the payments do not affect the underlying merits of the case.<sup>31</sup>

This can be seen by developing a simple model of payments to plaintiffs. Any common fund would be apportioned between the pro-rata class recovery,  $R$ , additional recovery for the lead plaintiff,  $B$ , and the attorney's fee,  $F$ :

$$CF = R + (B + F).$$

In the absence of any expectation of a bonus payment or kickback, the lead plaintiff expects a pro-rata share of the recovery  $R$  net of his costs of being the lead plaintiff minus reimbursable reasonable costs and expenses ( $c - e$ ). Thus,

$$LP^0 = k/N * R - (c - e)$$

where  $N$  is the number of outstanding affected shares, and  $k$  is the number of affected shares owned by the plaintiff. In the absence of the kickbacks, the lead plaintiff's payoff increases as  $R$  increases.

Now suppose that the lead plaintiff is promised or otherwise expects a bonus,  $B$ , equal to a percentage,  $a$ , of the fee award  $F$ . The lead plaintiff's expected payoff is now

$$LP^1 = k/N * R + aF - (c - e) = (k/N - a)R + a(CF) - (c - e).$$

The lead plaintiff's marginal incentives to increase  $R$  are now equal to  $k/N - a < k/N$ . Moreover, if the plaintiff's pro rata share  $k/N$  is small, then the lead plaintiff's payoff will be decreasing in  $R$  and increasing in  $F$ . Thus, this analysis suggests that a compensated lead plaintiff will sacrifice  $R$  in favor of  $F$ .

It is unlikely, however, that any such effect is the reason for the payments. The prosecutor's theory assumes that the class representative effectively constrains the fee award given to the lead counsel. In that case, the payments might persuade the plaintiff to consent to higher fees. But as long as  $k$  is a small proportion of  $N$ , the lead plaintiff has little incentive to increase  $R$ . Indeed, one of the reasons for the lead plaintiff provisions of the PSLRA was to attempt to replace such ineffective non-institutional lead plaintiffs with larger institutional lead plaintiffs.<sup>32</sup> Thus, it is

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31. This assumption would not hold if disclosure of the payments to the lead plaintiff lowered the probability that the class would be certified, which should reduce  $CF$ . Thus, with respect to the size of the common fund, non-disclosure of the payments should not harm absent class members.

32. See, e.g., Bruce H. Kobayashi & Larry E. Ribstein, *Class Action Lawyers as Lawmakers*, 46 ARIZ. L. REV. 733, 771-75 (2004) (discussing lead plaintiff provisions of PSLRA).

not clear that the payments to non-institutional lead plaintiffs such as Vogel effectively increased agency costs or caused any economic harm to the absent class members.

Moreover, the prosecutor's theory does not take into account the fact that the size of the attorney's fee must be approved by the judge presiding over the case, and that the size of the attorney's fee award in such cases depends mainly on the client's recovery.<sup>33</sup> Eisenberg & Miller found that the "dominance of the client's recovery as a determinant of the fee is nearly complete," and that the "relation between fees and recovery is remarkably linear on a log scale."<sup>34</sup> The size of the award dominates effort or cost-based measures such as the lodestar in explaining fee awards. They also do not find that the presence of objectors to the fee award has any discernable effect on the size of the award, or any decrease in fees in securities class actions after the PSLRA was enacted.<sup>35</sup>

These findings suggest that judges mainly base attorneys' fee awards on a percentage of the recovery, with the percentage  $p$  determined by a standard sliding scale. Under the assumption that the judge fixes  $p$  based on the characteristics of the recovery, a non-compensated lead plaintiff will expect to recover

$$LP^2 = k/N*(1-p)R - (c-e).$$

By contrast, a lead plaintiff that expects to be paid an additional bonus equal to  $aF$  would expect to recover

$$LP^3 = k/N*(1-p)R + paR = R(k/N + p(a - k/N)) - (c-e).$$

Comparing  $LP^3$  and  $LP^2$ , compensating the lead plaintiff increases the lead plaintiff's incentive to raise  $R$  because a higher  $R$  produces a higher  $F$  and therefore a higher bonus. Thus, under these assumptions, paying the lead plaintiffs a portion of the attorney's fees would not result in lower recoveries by absent class members. Rather, the class attorney would internalize the cost of the payment to the lead plaintiff.

### B. Why Lead Plaintiffs?

If payments of a portion of the attorney's legal fees are not being used to transfer a larger portion of a fixed common fund to the lawyer and lead plaintiff, why would the lawyer and lead plaintiff agree to such payments? In this section, we show that such payments can serve to reduce agency costs, solve collective action problems, and increase the recovery of class members. Rather than viewing the payments as a way to enact wealth transfers in a zero-sum game, we show that such payments can be used to increase the payoff to class members by increasing the probability that

33. See FED. R. CIV. P. 23(h) (setting out procedures for court approval of fees).

34. Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees in Class Action Settlements: An Empirical Study*, 1 J. EMPIRICAL LEGAL STUD. 27, 28 (2004).

35. *Id.* at 66-68.

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viable actions are filed in the first place.<sup>36</sup> Thus, in contrast to the theory contained in the Milberg indictment that these payments facilitate self-interested behavior by class counsel, payments to lead plaintiffs can be used to reduce, rather than increase, agency costs. If so, these payments can increase the expected recovery by absent class members.

There are several reasons why incentive awards to class plaintiffs may be efficient.<sup>37</sup> First, bonus payments can solve free-rider and collective action problems. Class members rationally will refuse to serve as lead plaintiffs if they are limited to a pro-rata share of the net recovery. Their non-reimbursable costs can outweigh any expected pro-rata recovery, so that  $LP^0 < 0$ . More importantly, even if  $LP^0 > 0$ , the class member will be better off by  $(c - e)$  as long as someone else serves as the lead plaintiff. This free-rider problem and the resulting difficulty in finding a suitable lead plaintiff can prevent the filing of some class action lawsuits.

Payments to lead plaintiffs can mitigate these free-riding and collective action problems by, for example, reimbursing lead plaintiffs for non-pecuniary litigation costs. Even if these payments cause increased agency costs between the lead plaintiff and absent class members, class members are better off if solving the free-rider problem leads to more actions being filed.<sup>38</sup> Bonus payments can also reduce agency costs by rewarding class representatives for superior service, thus inducing the lead plaintiff to take actions that increase the probability and size of the class recovery. Payments can also achieve proportionality between awards and other outcomes, such as costs or attorney's fees.

Eisenberg & Miller's empirical study of court-granted bonus awards to lead plaintiffs in class actions finds little support for the attorney self-interest explanation of payments to lead plaintiffs. In contrast, they find evidence consistent with using these payments to solve the collective action and free-rider problems, by reimbursing lead plaintiffs for non-pecuniary costs.<sup>39</sup> Eisenberg & Miller also find a strong association between lead plaintiff bonus awards and the size of the class

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36. Moreover, payments that induce the filing of class action lawsuits can be socially productive even if the payments redistribute a portion of the recovery from absent class members to the lead plaintiff and class counsel. See, e.g., Myriam Gilles & Gary B. Friedman, *Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers*, 155 U. Pa. L. Rev. 103, 105-06 (2006) (noting deterrence function of lawsuits can be separated from compensation function).

37. See Theodore Eisenberg & Geoffrey P. Miller, *Incentive Awards to Class Action Plaintiffs: An Empirical Study*, 53 UCLA L. Rev. 1303, 1307 (2006) (discussing these reasons).

38. Consistent with this hypothesis, one of the lawsuit deterring features of the PSLRA is to prevent the payment of bonuses to lead plaintiffs. See 15 U.S.C. § 78v-4(a)(2)(a)(vi) (2006).

39. For example, Eisenberg & Miller find frequent use of bonus awards in cases where average recoveries are low (e.g., consumer credit cases), which is consistent with a desire to ensure that the lead plaintiff does not incur a net loss as a result of his service to the class. In addition, the large incentive awards observed in employment discrimination cases, which exhibit high average recoveries, are consistent with compensating such plaintiffs for the risk of retaliation from their employers. See Eisenberg & Miller, *supra* note 37, at 1308, 1324-25.

recovery, attorney's fee and expenses awarded in settlement.<sup>40</sup> Thus, court-awarded bonus payments have a structure similar to those used by Milberg to pay Vogel and the other paid plaintiffs.

The prior analysis shows how payments to class plaintiffs can benefit class plaintiffs by reducing agency costs. However, court-awarded bonus payments are not allowed in post-PSLRA securities cases. Milberg allegedly used direct payments even in pre-PSLRA cases, perhaps because court awards in securities cases were insufficient or too uncertain to solve the free-riding and collective action problems.<sup>41</sup> In any event, legislative or judicial rules preventing sufficient awards clearly increase lawyers' incentives to engage in illegal behavior in order to solve the free-rider problem with lead plaintiffs. The illegality of this behavior, in turn, triggers efforts to conceal the payments and the demand for more remedies, including federal criminal sanctions, to prevent such arbitrage.<sup>42</sup>

#### IV. PAYING WITNESSES

The analysis in the prior section shows that the prosecutor's theory of harm to absent class action members is implausible. Moreover, there are plausible efficiency reasons for making payments to lead plaintiffs. However, there may be other costs to allowing payments to litigants. For example, allowing the payments may create an appearance of impropriety by compromising the integrity of the participants and thereby reduce the normative force of law.

Indeed, the indictment alleges that Milberg violated a federal bribery statute that does not require that the payments were made for corrupt purposes. In counts one and two of the indictment, the defendants are alleged to have agreed

*to make illegal payments to a witness by giving, offering, and promising money to the Paid Plaintiffs, for and because of the testimony under oath of affirmation given and to be given by the Paid Plaintiffs as a witness upon a trial, hearing, or other proceeding before a court authorized by the laws of the United States to hear evidence or take testimony in the Lawsuits, filed or liti-*

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40. *Id.* at 1334–35; Richard A. Nagareda, *Restitution, Rent Extraction, and Class Representatives: Implications of Incentive Awards*, 53 UCLA L. REV. 1483, 1494–96 (2006).

41. Eisenberg & Miller found bonus payments in pre-PSLRA cases were relatively infrequent (used in 24 percent of cases) and of modest amounts. Eisenberg & Miller, *supra* note 37, at 1308. Another potential reason for such payments is to bond the lead plaintiff to the lawyer in order to prevent client free-riding on efforts of the lawyer. See Kobayashi & Ribstein, *supra* note 32, at 768–71.

42. *But see* Richard A. Booth, *Why Pay a Fraud Plaintiff to Sue?*, WASHINGTONPOST.COM, June 26, 2006, <http://www.washingtonpost.com/wp-dyn/content/article/2006/06/25/AR2006062500527.html>. The problem of inefficient lawsuits is a real and serious one. However, it is not clear that the solution to such problem lies in procedural rules that raise the cost of all lawsuits. Rather, the solution is substantive reform which lowers the gain from bringing inefficient actions.

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gated in federal courts, in violation of Title 18, United States Code, Section 201(c)(2).<sup>43</sup>

The bribery statute, 18 U.S.C. § 201(c)(2) states that

*[w]hoever . . . directly or indirectly, gives, offers or promises anything of value to any person, for or because of the testimony under oath or affirmation given or to be given by such person as a witness upon a trial, hearing, or other proceeding, before any court . . . authorized by the laws of the United States to hear evidence or take testimony, or for or because of such person's absence therefrom . . . shall be fined under this title or imprisoned for not more than two years, or both.*

Clearly, the law requires only the appearance of corruption, and not that such payments were made corruptly or with intent to influence the testimony.<sup>44</sup>

This statute is of interest for two main reasons. First, it is the only federal criminal statute cited in the Milberg indictment that directly regulates the substantive conduct involved in the Milberg case. Moreover, since application of the statute does not require that the payments were made with bad intent or were concealed, if the statute applies to the Milberg case it would also preclude disclosed payments to lead plaintiffs even in the absence of other criminal, civil or ethical prohibitions against such payment.

Second, the statute facially applies to the U.S. Attorney's promises contained in the Vogel plea agreement. Thus, this suggests that if 18 U.S.C. § 201(c)(2) applies to Milberg's payments to Vogel, it might also apply to the federal prosecutor's plea agreement with Vogel.<sup>45</sup>

The issue of whether 18 U.S.C. § 201(c)(2) applies to the standard practice of giving leniency in exchange for testimony was addressed in *United States v. Single-*

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43. See Milberg Indictment, *supra* note 11, ¶ 41, at 25–26.

44. Such corrupt payments to witnesses could be charged under similarly structured 18 U.S.C. § 201(b)(3), which subjects the violator to greater punishment. This section reads as

*[w]hoever . . . directly or indirectly, corruptly gives, offers, or promises anything of value to any person, or offers or promises such person to give anything of value to any other person or entity, with intent to influence the testimony under oath or affirmation of such first-mentioned person as a witness upon a trial, hearing, or other proceeding, before any court . . . authorized by the laws of the United States to hear evidence or take testimony, or with intent to influence such person to absent himself therefrom . . . shall be fined under this title for not more than three times the monetary equivalent of the thing of value, whichever is greater, or imprisoned for not more than fifteen years, or both, and may be disqualified from holding any office of honor, trust, or profit under the United States.*

Violations of 18 U.S.C. § 201(b)(3) would be punished under United States Sentencing Guidelines section 2J1.3, which has a base offense level of fourteen. In contrast, violations of 18 U.S.C. § 201(c)(2) would be punished under United States Sentencing Guidelines section 2J1.9, which has a base offense level of six.

45. J. Richard Johnston, *Paying the Witness, Why is it OK for the Prosecution, but not the Defense?*, 11 CRIM. JUST. 20 (1997).

ton (*Singleton I*).<sup>46</sup> In this case, the defendant, Sonya Singleton, was convicted at trial for one count of conspiracy to distribute cocaine and seven counts of money laundering. Central to the prosecution's case was the testimony of Napoleon Douglas, who testified against Singleton at trial. Like Vogel in *Milberg*, Douglas had entered into a plea agreement in which he agreed to cooperate with the prosecution in exchange for leniency. Specifically, in "consideration" of his promise to testify truthfully in federal and/or state court, the prosecutor promised that Douglas would not be prosecuted "for any other violations of the Drug Abuse Prevention and Control Act stemming from his activities currently under investigation, except perjury or related offenses," and that he would advise both the Mississippi parole board and the sentencing court, prior to sentencing, of the nature and extent of the cooperation provided by Mr. Douglas.<sup>47</sup> Singleton's attorney argued on appeal that the conviction should be overturned because of the district court's refusal to exclude the testimony of Douglas, which was obtained in violation of 18 U.S.C. § 201(c)(2) and the Kansas Rule of Professional Conduct 3.4(b).<sup>48</sup>

In a decision that was described as a "bombshell" and the "new *Miranda*,"<sup>49</sup> the panel in *Singleton I* reversed the conviction, and remanded the case for a new trial, ordering the exclusion of Douglas' testimony. The panel found that the term "whoever," and thus the statute, applied to U.S. Attorneys, holding that the prosecutor's actions did not fall within the limited set of circumstances recognized by the Supreme Court where statutes do not apply to the government or affect governmental rights unless the text expressly includes the government.<sup>50</sup> Specifically, the panel noted that while statutes "which would deprive the sovereign of a recognized or established prerogative title or interest" would imply a government exception, the exception did not apply "where the operation of the law is upon the agents or servants of the government rather than on the sovereign itself" or when the "statute's purpose is to prevent fraud, injury, or wrong."<sup>51</sup> Thus, the term "whoever" included prosecutors because prosecutors were agents of the government, and because the purpose of 18 U.S.C. § 201(c)(2) was to prevent the "wrong" of bribery.

The court also rejected a second reason for a government exception—that the statute would create an absurdity if applied to the government. The court found that "the statute's application to government officials, far from being absurd, is at

46. 144 F.3d 1343 (10th Cir. 1998), *rev'd en banc*, 165 F.3d 1297 (10th Cir. 1999).

47. *Id.* at 1344.

48. Kansas uses Model Rule 3.4, which simply states that an attorney "shall not . . . offer an inducement to a witness that is prohibited by law." MODEL RULES OF PROF'L CONDUCT R. 3.4 (2006). Federal law subjects U.S. Attorneys to state ethics rules. See McDade Amendment to the Omnibus Consolidated and Energy Supplemental Appropriations Act of 1999, Pub. L. No. 105-277, div. A, Sec. 101(b), tit. VIII, § 801(a), 112 Stat. 2681 (codified as amended at 28 U.S.C. § 530B (2000)).

49. Jeffrey M. Schumm, *Courts Rush to Extinguish Singleton, But are the Embers of the Panel's Decision Still Glowing?*, 27 FLA. ST. U. L. REV. 325 (1999).

50. See *Nardone v. United States*, 302 U.S. 379, 383 (1937) (holding that the term "anyone" in a wiretap statute applied to federal law enforcement agents).

51. *Singleton I*, 144 F.3d at 1346.

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the center of our legal tradition.” The court noted the payments for testimony were not necessary because “[e]very citizen has the legal duty to testify to facts within his knowledge, and any witness may be compelled to do so by subpoena and civil contempt proceedings.”<sup>52</sup> The court also noted that the “judicial process is tainted and justice cheapened when factual testimony is purchased, whether with leniency or money. Because prosecutors bear a weighty responsibility to do justice and observe the law in the course of a prosecution, it is particularly appropriate to apply the strictures of § 201(c)(2) to their activities.”<sup>53</sup>

The reaction to the *Singleton I* decision was swift. The decision led to a flood of similar challenges and appeals. But these challenges were met with a near unanimous rejection of *Singleton I*'s holding.<sup>54</sup> Moreover, because the decision threatened to jeopardize numerous previous convictions and ongoing prosecutions, the Tenth Circuit agreed to vacate the panel's decision ten days after the opinion was issued, and agreed to hear the case en banc. In a 9–3 decision, the en banc court in *Singleton II* affirmed the convictions, with seven judges holding that the word “whoever” does not include the United States acting in its sovereign capacity, and thus does not include an Assistant United States Attorney acting as the alter ego of the United States in offering leniency to a criminal accomplice in exchange for truthful testimony.<sup>55</sup> Further, because the “ingrained practice of granting leniency in exchange for testimony has created a vested sovereign prerogative in the government,” applying the statute to the government would deprive the sovereign of a recognized or established prerogative, title, or interest.<sup>56</sup>

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52. *Id.* at 1347.

53. *Id.*

54. See *United States v. Lara*, 181 F.3d 183, 197 (1st Cir. 1999); *United States v. Stephenson*, 183 F.3d 110, 118–119 (2d Cir. 1999); *United States v. Hunte*, 193 F.3d 173 (3d Cir. 1999); *United States v. Richardson*, 195 F.3d 192 (4th Cir. 1999); *United States v. Condon*, 170 F.3d 687, 689 (7th Cir. 1999); *United States v. Boyd*, 168 F.3d 1077, 1078 (8th Cir. 1999); *United States v. Johnson*, 169 F.3d 1092, 1097–98 (8th Cir. 1999); *United States v. Lowery*, 166 F.3d 1119, 1124 (11th Cir. 1999); *United States v. Ramsey*, 165 F.3d 980, 987 (D.C. Cir. 1999); *United States v. Haese*, 162 F.3d 359 (5th Cir. 1998); *United States v. Ware*, 161 F.3d 414 (6th Cir. 1998). The only reported exceptions are *United States v. Fraguera*, 1998 WL 560352 (E.D. La. Aug. 27, 1998), vacated, No. Crim. A. 96-0339, 1998 WL 910219, at \*2 (E.D. La. Oct. 7, 1998) and *United States v. Lowery*, 15 F. Supp. 2d 1348 (S.D. Fla. 1998), *rev'd*, 166 F.3d 1119 (11th Cir. 1999). In addition, an unreported decision favorable to *Singleton I*, *United States v. Mays*, No. 97-CR-127 (E.D. Tenn. Sept. 18, 1998), is cited in *Ramsey*, 165 F.3d at 987.

55. *United States v. Singleton (Singleton II)*, 165 F.3d 1297, 1302 (10th Cir. 1999).

56. *Id.* at 1301. For a discussion of the costs and benefits of exchanges of leniency for testimony, see generally Bruce H. Kobayashi, *Deterrence with Multiple Defendants: An Explanation for 'Unfair' Plea Bargains*, 23 RAND J. ECON. 507 (1992); Daniel C. Richman, *Cooperating Clients*, 56 OHIO ST. L.J. 69 (1995); Daniel C. Richman, *Cooperating Defendants: The Costs and Benefits of Purchasing Information from Scoundrels*, 8 FED. SENT'G REP. 292 (1996); Ian Weinstein, *Regulating the Market for Snitches*, 47 BUFF. L. REV. 563 (1999). The federal government also has set up specific reward and punishment systems to encourage reporting of wrongdoing and, in some cases, the filing of lawsuits. See, e.g., Bruce H. Kobayashi, *Antitrust, Agency, and Amnesty: An Economic Analysis of the Criminal Enforcement of the Antitrust Laws Against Corporations*, 69 GEO. WASH. L. REV. 715 (2001) (discussing Antitrust Amnesty Program); Bruce H. Kobayashi & Larry E. Ribstein, *Outside Trading as an Incentive Device*, 40 U.C. DAVIS L. REV. 21, 66–70 (2006) (discussing whistleblower laws); Richard E. Moberly, *Sarbanes-Oxley's Structural Model to Encourage Corporate Whistleblowers*, 2006 BYU L. REV.

Critics have described *Singleton II* as “very result oriented” and noted the court’s “strained” interpretation of the term “whoever.”<sup>57</sup> Even those who might agree with the outcome note that any such modification should have been left to the legislature.<sup>58</sup> Indeed, many of the post-*Singleton II* analyses find merit in Judge Lucero’s concurrence.<sup>59</sup> Judge Lucero rejected the majority’s strained interpretation of the term “whoever” and agreed with the panel that the term included the U.S. Attorney.<sup>60</sup> Lucero noted that the majority’s definitions would imply the obvious absurdity that the prosecutor could pay cash, or even violate the identically structured 18 U.S.C. § 201(b)(3).<sup>61</sup> Lucero emphasized instead that application of 18 U.S.C. § 201(c)(2) to the prosecutor’s exchange of leniency for testimony would conflict with several federal statutes and rules, including portions of the Sentencing Reform Act and Sentencing Guidelines,<sup>62</sup> U.S. Sentencing Guidelines Manual § 5K1.1(a)(2), the Federal Immunity Statute,<sup>63</sup> and Federal Rule of Criminal Procedure 11(e).<sup>64</sup>

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1107; Elizabeth Tippet, *The Promise of Compelled Whistleblowing: What the Corporate Governance Provisions of Sarbanes Oxley Mean for Employment Law*, EMP. RTS. & EMP. POL’Y J. (forthcoming), available at <http://srn.com/abstract=930226> (discussing punitive approaches to whistleblowing contained in SOX).

57. Chad Baruch, *Through the Looking Glass: A Brief Comment on the Short Life and Unhappy Demise of the Singleton Rule*, 27 N. KY. L. REV. 841 (2000); Camille Knight, *The Federal Bribery Statute and the Ethics of Purchasing Testimony*, 33 J. MARSHALL L. REV. 209 (1999); A. Jack Finklea, Note, *Leniency in Exchange for Testimony: Bribery or Effective Prosecution?*, 33 IND. L. REV. 957 (2000); Melissa W. Rawlinson, Note, *United States v. Singleton and the Witness Gratiuity Statute: What is the Best Approach for the Criminal Justice System?*, 14 BYU J. PUB. L. 227, 244 (2000). *But see* Eric S. Lasky, Note, *Perplexing Problems with Plain Meaning*, 27 HOFSTRA L. REV. 891 (1999) (criticizing plain meaning analysis of *Singleton I* panel).

58. See, e.g., Schumm, *supra* note 49, at 329, 347. Indeed, in the wake of the *Singleton I* decision, legislation was introduced in Congress on July 15, 2006 that would have amended 18 U.S.C. § 201 to include the following clause:

- (a) IN GENERAL—Notwithstanding any other provision of law, nothing in section 201 of title 18, United States Code, or any other provision of law, shall be construed to prohibit any otherwise lawful giving, promising, or offering by a prosecutor of leniency, witness protection, or any other thing of value within the reasonable exercise of prosecutorial discretion, in exchange for the testimony of any person, including any—
- (1) offer or grant of immunity for prosecution;
  - (2) offer to advise a court or parole board of the extent of the cooperation by the person with the prosecutor, or any advice so given; or
  - (3) plea bargain agreement.

Effective Prosecution and Public Safety Act, S. 2311, 105th Cong. (1998). See James P. Dowden, Note, *United States v. Singleton: A Warning Shot Heard ‘Round the Circuits?*, 40 B.C. L. REV. 897, 924–26 (1999) (discussing introduction of the Effective Prosecution and Public Safety Act); see also James M. Lungstrum, Note, *United States v. Singleton: Bad Law Made in the Name of a Good Cause*, 47 U. KAN. L. REV. 749 (1999). The legislation was not passed, as the subsequent and unanimous action of the circuit courts eliminated the pressing need for the amendment.

59. *Singleton II*, 165 F.3d at 1303 (Lucero, J., concurring).

60. *Id.* at 1303–05.

61. *Id.* at 1305.

62. 18 U.S.C. § 3553(e) (2000).

63. 18 U.S.C. §§ 6001–05.

64. *Singleton II*, 165 F.3d at 1306–07 (Lucero, J., concurring).



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Where specific statutes conflicted with the general prohibitions of § 201(c)(2), Judge Lucero reasoned that the specific statutes should control.<sup>65</sup>

A more serious examination of § 201(c)(2) and conflicting statutes suggests some principles for discerning the scope and limits of such a statute. For example, exceptions to the prohibition of witness payments under § 201(c)(2) could be allowed where the testimony could not otherwise be compelled. For example, the immunity statute allows removal of a witness's Fifth Amendment privilege, restoring the prosecutor's ability to compel the testimony. Similarly, the exception contained in 18 U.S.C. § 201(d) that allows the payment of a reasonable fee paid in exchange for expert testimony<sup>66</sup> also applies to a setting where admissible testimony could not otherwise be compelled.<sup>67</sup> This would distinguish the immunity statute and payments to experts from payments to witnesses that could be legally compelled to testify. Moreover, the apparent conflicts with the provisions of the sentencing guidelines provisions for downward departures under U.S. Sentencing Guidelines Manual § 5K1.1, and the plea provision of Federal Rule of Criminal Procedure 11(e), suggest the need for court supervision of any deals, and may differentiate leniency in sentencing from promises not to prosecute.<sup>68</sup>

The major problem with *Singleton II*'s alter ego analysis is the absence of any type of substantive analysis of the practice and possible conflicts.<sup>69</sup> This is especially problematic given that the court's alter ego analysis is only a judicially created and ad hoc public policy exception to § 201(c)(2). For example, the *Singleton II* majority suggests that payment of cash for testimony would bring the prosecutor under § 201(c)(2) because the prosecutor "who offers something other than a concession normally granted by the government," such as paying cash or bribing a witness to

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65. See *id.* at 1303 ("Whereas the majority considers these statutes to be unnecessary to its result, see Maj. Op. at 1302, I find them dispositive.").

66. 18 U.S.C. § 201(d) provides:

{p}aragraph . . . (2) . . . of subsection (c) shall not be construed to prohibit the payment or receipt of witness fees provided by law, or the payment, by the party upon whose behalf a witness is called and receipt by a witness, of the reasonable cost of travel and subsistence incurred and the reasonable value of time lost in attendance at any such trial, hearing, or proceeding, or in the case of expert witnesses, a reasonable fee for time spent in the preparation of such opinion, and in appearing and testifying.

67. In the normal case, an expert witness's opinion testimony will require the expert to undertake effort in order to meet the admissibility standards set out for such testimony under Federal Rule of Evidence 702. Thus, an expert's admissible opinion testimony differs from an ordinary witness's lay testimony as to facts within his knowledge. Moreover, the ability of such testimony is highly regulated by the trial court. See *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993) (expanding the trial judge's gatekeeping role in determining whether such expert testimony meets the standards for admissibility under Federal Rules of Evidence 403, 702, and 703).

68. See *United States v. Arana*, 18 F. Supp. 2d 715, 718 (E.D. Mich. 1998) (noting the importance of judge intermediation); see also *Singleton II*, 165 F.3d at 1303 (noting promises not to prosecute are not in exchange for testimony, but rather in consideration for a plea of guilty (and the avoidance of trial and other costs) to the six counts).

69. See *Singleton II*, 165 F.3d at 1302 (noting that "[w]e simply believe the general principles we have set forth so completely undercut defendant's reading that further exposition would be redundant").

provide false testimony, would no longer be “the alter ego of the sovereign and is divested of the protective mantle of the government.”<sup>70</sup> But, *Singleton II* provides no guidance to determine when these normal conditions exist, or what, if any, limits are placed on prosecutors’ behavior.<sup>71</sup> Indeed, some federal appeals courts have allowed prosecutors and law enforcement officers to pay witnesses cash in exchange for testimony.<sup>72</sup>

A serious analysis also would facilitate a more general discussion of the consequences of a rule barring prosecutors from buying testimony, and thus help in analyzing what limits should be placed on prosecutors offering inducements in exchange for testimony. Many of the post-*Singleton II* analyses focus on the imbalance in favor of the prosecutor. Commentators have suggested legislative reforms that would address this imbalance, including the mutual application or repeal of § 201(c)(2),<sup>73</sup> limiting the prosecutor’s ability to make contingent plea agreements,<sup>74</sup> or increasing judicial oversight of prosecutors.

There has also been criticism of *Singleton I*.<sup>75</sup> In its concern over the costs of false convictions, that opinion may not have properly balanced the costs of letting guilty defendants go free. Witnesses may face significant disincentives, including social stigma or fear of extralegal punishment or retribution, which justifies paying them for testimony.<sup>76</sup> But as noted in the many commentaries following the *Singleton* decisions, any considerations that apply to the prosecutor would also apply to use

70. *Id.* at 1307.

71. From a policy standpoint, the primary issue is not about the power of government but about the need to discipline agency costs within the government, just as those between class lawyers and the class. Recent actions and controversies illustrate that government agency costs may be as serious as agency costs between class counsel and the class. A notable example is the government’s use of discretion in charging an accounting firm to effectively coerce cooperation by its employees by denying them the funds necessary for their defense. See *United States v. Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006); Larry E. Ribstein, *The Primacy of Contract*, TECH CENTRAL STATION DAILY, July 6, 2006, <http://www.tcsdaily.com/article.aspx?id=070606E> (discussing *Stein*).

72. *United States v. Anty*, 203 F.3d 305, 311 (4th Cir. 2000); *United States v. Barnett*, 197 F.3d 138, 144–45 (5th Cir. 1999); *United States v. Albanese*, 195 F.3d 389, 394–95 (8th Cir. 1999); *United States v. Harris*, 193 F.3d 957 (8th Cir. 1999).

73. See, e.g., H. Richard Uviller, *No Sauce for the Gander: Valuable Consideration for Helpful Testimony from Tainted Witnesses in Criminal Cases*, 23 CARDOZO L. REV. 771, 790–92 (2002) (arguing for mutual application or the repeal of the statute); Korin K. Ewing, Note, *Establishing an Equal Playing Field for Criminal Defendants in the Aftermath of United States v. Singleton*, 49 DUKE L.J. 1371, 1373–74 (2000) (noting flaws in both *Singleton I* and *Singleton II* approaches, and arguing that the same rules should apply to defendants and prosecutors); James W. Haldin, Note, *Toward a Level Playing Field: Challenges to Accomplice Testimony in the Wake of United States v. Singleton*, 57 WASH. & LEE L. REV. 515 (2000) (suggesting that Federal Rule of Evidence 403 be used to exclude unreliable purchased testimony in the absence of legislation).

74. Timothy Hollis, Note, *An Offer You Can’t Refuse? United States v. Singleton and the Effects of Witness/ Prosecution Agreements*, 9 B.U. PUB. INT. L.J. 433 (2000).

75. See generally Frank O. Bowman, III, *Departing is Such Sweet Sorrow: A Year of Judicial Revolt on “Substantial Assistance” Departures Follows a Decade of Prosecutorial Indiscipline*, 29 STETSON L. REV. 7 (1999).

76. Thus, on public policy grounds, payments or things of value could be given when there is a de facto as well as a de jure impediment to the ordinary ability to compel a witness to testify. These considerations would allow 18 U.S.C. § 201(c)(2) to be reconciled with the Witness Relocation and Protection Act, which allows the government to give benefits for the protection of government witnesses. See 18 U.S.C. §§ 3521–28 (2000).

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of payments by the defense. Most importantly for present purposes, these considerations would also apply to the use of witness payments by Milberg. Indeed, as discussed in Part III, for this reason it is far from clear that such payments would be prohibited.<sup>77</sup>

On the other hand, despite the “doomsday” rhetoric, it is far from clear that *Singleton I* would have resulted in much prospective harm to prosecutors. One possibility is that the court’s approach may not stop the practice of leniency for testimony, but rather make such promises implicit rather than explicit.<sup>78</sup> Indeed, under this system, the prosecutors or even defense attorneys could simply inform defendants of the probable outcomes of their actions, including leniency by the judge at sentencing.<sup>79</sup> Such an outcome would reduce both judicial oversight and the fairness of the process to defendants. For example, the accomplice witness, when asked in court, could truthfully respond that he was not given consideration in exchange for testimony, even when all parties expect this to be the case *ex post*.<sup>80</sup>

Such concerns are not speculative. For example, during the Enron trial, the star witness for the prosecution was Andrew Fastow, who previously pled guilty to two counts of wire fraud and agreed that his “guidelines sentence would include 120 months in the custody of the Bureau of Prisons.”<sup>81</sup> At trial, Fastow testified that he

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77. Indeed, one appellate court held that cash payments for testimony by a private litigant did not violate 18 U.S.C. § 201(c)(2) because it requires that payments constitute a bribe for false testimony. See *Golden Door Jewelry Creations, Inc. v. Lloyds Underwriters Non-Marine Ass’n*, 117 F.3d 1328, 1335 n.2 (11th Cir. 1997). The court seems to misapply its earlier holding in *United States v. Moody*, which held that 18 U.S.C. § 201(c)(2) is not unconstitutionally vague, and that any person could reasonably conclude that the defendant’s actions, giving a bribe for false testimony, would be proscribed by the statute. 977 F.2d 1420, 1425 (11th Cir. 1992). The court did not hold that the statute required the payment to be for false testimony. See, e.g., *United States v. Lowery*, 15 F. Supp. 2d 1348, 1356 (S.D. Fla. 1998), *rev’d on other grounds*, 166 F.3d 1119 (11th Cir. 1999).

78. See *Bowman*, *supra* note 75, at 37–39.

79. *Id.*

80. See R. Michael Cassidy, “Soft Words of Hope:” Giglio, *Accomplice Witnesses, and the Problem of Implied Inducements*, 98 Nw. U. L. Rev. 1129 (2004) (noting that implicit terms in plea agreements cause the same concerns as explicit ones, but afford defendants fewer opportunities to challenge them); Eli Paul Mazur, Note, *Rational Expectations of Leniency: Implicit Plea Agreements and the Prosecutor’s Role as a Minister of Justice*, 51 DUKE L.J. 1333, 1355–60 (2002).

81. See Plea Agreement, *United States v. Andrew S. Fastow*, Cr. No. H-02-0665 (S.D. Tex. Jan. 14, 2004), available at <http://fl1.findlaw.com/news.findlaw.com/cnn/docs/enron/usafastow11404plea.pdf> [hereinafter *Fastow Plea Agreement*]. Fastow agreed to plead guilty to one count of wire fraud, and one count of mail and securities wire fraud, each having a statutory prison term of zero to five years, which “will be imposed consecutively.” *Id.* The agreement states that

the parties agree that Defendant’s sentence under the Sentencing Guidelines shall include 120 months in the custody of the Bureau of Prisons. Defendant agrees that he will not move for a downward departure from the offense level of guideline range calculated by the Court and that no grounds for downward departure exist.

*Id.* at 2–3. Moreover, the agreement states that the DOJ is not obligated to and will not at any time in the future file any motion for a reduction in Defendant’s sentence under U.S. Sentencing Guidelines Manual § 5K1.1, 18 U.S.C. § 3553 or Federal Rule of Criminal Procedure 35, based on information provided by Defendant related directly or indirectly

had no chance of a better deal for his testimony.<sup>82</sup> Fastow's claim that he was testifying as a non-contingent witness certainly would be a key factor in the jury's credibility assessment of him as a witness.<sup>83</sup> However, at sentencing, Fastow, in

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to Enron, any entity related to Enron, or any transaction involving Enron or any entity related to Enron.

*Id.* at 6.

82. In the following exchange between the Enron Task Force prosecutor John Hueston and Fastow, the prosecutor represents to the Lay-Skilling jury that Fastow had agreed to a floor of ten years of prison time:

Hueston: And was there a minimum sentence that you pleaded guilty to?

Fastow: My plea agreement states that I agree to a sentence of 10 years. [ . . . ]

During cross-examination, Skilling counsel Daniel Petrocelli followed up with the following:

Petrocelli: Okay. And you said you have to go to jail for 10 years; right?

Fastow: Well, my sentence is for 10 years. I could potentially have time off for good behavior. . . .

Petrocelli: Okay. And the reason why you just answered my question in the way you did is because you want to communicate to the jury that Mr. Skilling is a criminal along with you, correct?

Fastow: No, Mr. Petrocelli. I'm just trying to answer the questions honestly. My outcome is already determined. [ . . . ] I'll be sentenced to ten years as far as I understand. It doesn't matter — my [sic] sentence isn't affected by whether Mr. Skilling is convicted or not.

Finally, on re-direct examination by Hueston, Fastow testified as follows:

Hueston: And as a result of your pledge to cooperate, did you agree to plead guilty to a 10-year minimum sentence of imprisonment?

Fastow: A 10-year maximum imprisonment.

Hueston: And what is the minimum amount of time that that plea agreement calls for?

Fastow: It calls for a 10-year sentence.

Hueston: So after January 14th, can your cooperation lower that 10 years?

Fastow: My understanding is that I will be sentenced to 10 years. The Judge ultimately has a [sic] discretion; but in my plea agreement, I agreed to the 10-year sentence.

See More on the Fastow Sentence, <http://blog.kir.com/archives/003476.asp> (Sept. 26, 2006 13:35 EST).

83. The following exchange also took place between Hueston and Fastow in response to questions during cross examination regarding whether Fastow forged a key document:

Hueston: And after all this time, you found and turned over the document to the FBI, you remembered, late May or June; is that right?

Fastow: I believe that's correct, yes.

Hueston: And you turned it over because you were cooperating?

Fastow: Yes, sir.

Hueston: And this is months after, six months after, you enter your plea of guilty; is that right?

Fastow: Approximately, yes, sir.

Hueston: And can this document lower your sentence now, under your understanding?

Fastow: My understanding is, no.

Hueston: And if, as the defense was suggesting, you were just falsely creating this document, wouldn't it have been better to do so before you entered a plea of guilty, when you were bargaining with the government?

Fastow: A. Well, one could argue that. [ . . . ]

Hueston: Mr. Fastow, if as the defense suggests, you're on some sort of mission to say or do anything to convict Jeff Skilling, might you have been tempted to just add a couple more initials to that Global Galactic document?

Fastow: Sir, I have no incentive to add any initials. My incentive is to be truthful. If I'm not truthful, I could go to prison for life. By making a document more compelling, I can't lower my sentence.

Hueston: By trying to do that, there's only one thing you're sentence would do; right? . . . If you tried to alter a document or tell a lie, there's only one direction that sentence can go?

Fastow: That's correct. That would be a lie. That means my sentence would go up, potentially, to a life sentence.

*Id.*

## THE HYPOCRISY OF THE MILBERG INDICTMENT

consideration of his cooperation, received a six-year sentence. No one, including Prosecutor Hueston, brought up his earlier trial testimony to the contrary in the sentencing hearing.<sup>84</sup> Nor did the prosecutor bring up the fact that the sentence facially violated the plea agreement. Rather, Hueston was reported to have said that Fastow's help had been "critical" in unraveling the Enron fraud and that without Mr. Fastow "we would not have convicted Mr. Lay."<sup>85</sup> The prosecutor also was reported to have said that Fastow "appeared truly repentant," and despite the terms of the plea agreement, did not object when a Fastow lawyer recommended a five-year prison term.<sup>86</sup>

This example further illustrates the potentially negative consequences of laws that would prohibit payment to witnesses. The Enron prosecutor legally could have agreed to recommend a four-year reduction for testimony. Instead, he explicitly agreed not to do so. Yet he nevertheless chose not to disclose this at sentencing, perhaps to avoid public criticism of the deal. The enforcement of laws against paying witnesses would significantly increase incentives for secret deals, thereby making them the norm rather than the exception. The absence of full disclosure is problematic for the same reasons non-disclosure of Milberg's payments to Vogel is problematic—it prevents the court or jury from making a fully informed decision. Moreover, the lack of disclosure by a prosecutor is more problematic given the high value placed on avoiding false convictions of innocent defendants.

In light of the analysis in Part III that showed that incentive payments to lead plaintiffs can improve efficiency, the lack of disclosure was the primary substantive distinction between the secret Milberg payments to Vogel and the prosecutor's open payments to Vogel through his plea agreement. The Fastow example raises the question of how well the court can supervise these plea deals—a problem that

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84. Indeed, Skilling's lawyer, Daniel M. Petrocelli, called Fastow's reduced sentence "disturbing," and attacked Fastow and other government witnesses for misrepresenting at trial the sentence reductions they would receive in exchange for their cooperation. See Carrie Johnson, *Feeling 'Slap in the Face' After Fastow's Sentence*, WASH. POST, Oct. 3, 2006, at D1.

85. See John R. Emshwiller, *Enron: The Tale of Two Sentencings*, WALL ST. J., Oct. 19, 2006, at C3.

86. *Id.* In contrast, Jeff Skilling received a 292 month guidelines sentence (the lower end of guidelines offense level forty sentence). The guidelines level calculation for Fastow would likely have been similar, and the associated guidelines sentence would easily exceed the statutory maximum of ten years associated with two counts of wire fraud. Under the U.S. Sentencing Guidelines Manual, section 2B1.1 would be applied to Fastow for his violations of wire fraud convictions under 18 U.S.C. § 371. The base offense level would be six, under section 2B1.1(a)(2). There would be another eight level increase under sections 2B1.1(b)(2) and (b)(12)(B) (more than 250 victims and the endangerment of a publicly traded company with 1,000 or more employees) and an additional two level increase under section 2B1.1(b)(9) (for use of a "sophisticated means"). In the Skilling sentencing, Judge Lake set investor loss at 80 million dollars, resulting in a twenty-four level increase in the offense level under section 2B1.1(b)(1). See Posting of Peter Lattman to WSJ Law Blog, <http://blogs.wsj.com/law/2006/10/23/skillings-sentence-24-years-4-months/> (Oct. 23, 2006, 15:44 EST). The resulting offense level would be forty, which would result in guidelines range of 292 to 365 months. Thus, Fastow, though precluded from asking for a downward departure in his plea agreement, almost certainly received a below-guidelines sentence from Judge Hoyt.

would be exacerbated by a rule that prohibited paying witnesses.<sup>87</sup> If the court can not effectively supervise the giving of implicit deals, then there is not much difference between the prosecutor's actions and Milberg's payments to witnesses based on disclosure.

#### V. CONCLUSION

Commentators on the Milberg case have noted the irony and hypocrisy involved in the case. However, the primary hypocrisy in this case is not the fact that Milberg "prosecuted" many firms for engaging in "kickbacks" and concealing information. Rather, the important hypocrisy is the fact that the prosecution seeks to prosecute Milberg for paying witnesses while simultaneously using the same conduct, indeed to the same person, to prosecute Milberg. This case illustrates the need to reconsider standards regarding incentive payments to litigants and witnesses. Any such standard should be based upon analysis of the incentive effects of the payments, and not based on a desire to encourage criminal actions or to discourage civil actions. Indeed, it may be rational not to apply 18 U.S.C. § 201(c)(2) to prosecutors. But the same considerations would apply to the application of this statute to defendants and their lawyers, as well as to evaluating restrictions on payments to lead plaintiffs.

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87. In the alternative, one could argue that the sentencing court in the Fastow case was the one who exhibited "mercy" by giving him a six year sentence. Of course, one could also say that the federal court in a class action controlled the attorney's fees.