CNNMoney.com

PRINTTHIS
Powered by Clickability

The fall of America's meanest law firm

Milberg Weiss, the lawsuit factory that took corporations for $45 billion, is in the feds' cross hairs. Fortune's Peter Elkind reports on the saga.

By Peter Elkind, Fortune editor-at-large
November 3 2006: 4:06 PM EST

FORTUNE

(Fortune Magazine) -- For decades, few things have inspired as much fear and loathing in the executive suites of corporate America as the law firm of Milberg Weiss and the two outsized personalities who ruled the place, Mel Weiss and Bill Lerach. Through creativity and ruthlessness, they transformed the humble securities class-action lawsuit into a deadly weapon.

Always, Milberg Weiss cast itself as the champion of the little guy. In media interviews Lerach has spoken evocatively about fighting for the honest, struggling blue-collar worker who, through no fault of his own, had lost his hard-earned savings to corporate perfidy. The firm boasts of having collected $45 billion for cheated investors since its founding in 1965.

But somewhere along the way, the work made its ruling partners a little like the CEOs they sued. In an especially profitable year, both Weiss and Lerach personally made more than $16 million. Weiss, 71, is a high roller at casinos who collects Picassos, owns a five-acre waterfront estate on Oyster Bay, Long Island, and has a vacation condo in Boca Raton.

The Brillo-haired Lerach, 60, who bitterly split with Weiss in 2004, taking Milberg's San Diego-based West Coast operation along with him in a new firm, owns a home in Rancho Santa Fe, Calif., and vacation properties in Steamboat Springs, Colo., and Hawaii. Lerach travels the country in a chartered jet, says his exercise is drinking Scotch, and will be married this month for the fourth time, to a partner at his firm.

Weiss and Lerach have also found themselves in the cross hairs of federal prosecutors. In the most extraordinary federal case now afoot in the land, Milberg Weiss has been indicted for allegedly paying three plaintiffs $11.4 million in illegal kickbacks in about 180 cases spanning 25 years - and then repeatedly lying about it to the courts.

The government says Milberg kept paying kickbacks into 2005, long after the firm knew it was under investigation. Name partners David Bershad, 66, and Steven Schulman, 55, have also been charged. (Both have pleaded not guilty, as has the firm.) The criminal probe has triggered an exodus of lawyers and clients. Once a veritable lawsuit factory - the firm averaged more than one new case a week during 2005 - Milberg has filed just a handful of suits in the five months since the bombshell landed.

And the feds are far from finished: Prosecutors have advised the presiding judge that there is "a significant chance" of a new indictment naming other defendants. Although both Weiss and Lerach insist they have done nothing illegal, the Justice Department has formally notified both that they are targets of the criminal probe. The two appear throughout the 102-page indictment as "Partner A" and "Partner B."

Even as its empire crumbles, Milberg Weiss has fired back, belittling the government's evidence, wrapping itself in legal principle, charging partisan politics by the trial-lawyer-hating Bush administration, and accusing the Justice Department of gross overreaching. But the truth is that Milberg Weiss is hemorrhaging from self-inflicted wounds: greed, hubris, lies, conflicts of interest, and shockingly poor governance - the very sort of venality and dysfunction that make for a juicy class-action lawsuit.

It makes for a wild yarn too - one with important implications for how our companies and courts do business. From a defrocked ophthalmologist with a taste for insurance scams to a retired speculator once known as Seymour the Head, Milberg Weiss's downfall is an improbable saga of deceit and payback. Our story begins, as one law enforcement official puts it, "with a b**** slap."

A domestic disturbance: The Cleveland lawyer confesses

When police showed up at 20563 Beachwood Drive in Rocky River, Ohio, an upscale Cleveland suburb, they were probably expecting to find just another domestic dispute. It was about 4 p.m. on Aug. 22,1996, and a 37-year-old woman named Pamela Davis had reported that her boyfriend had assaulted her, bloodying her mouth.

What the officers were not expecting was the dizzying tale that Davis began telling. She identified her attacker as James "J.J." Little, an attorney with Arter & Hadden, the big Cleveland firm. She said she'd met Little five months earlier at a bar and that although she was still married and had a young son, she and Little planned on tying the knot in December. She explained that Little had a $1,000-a-week crack habit, that it wasn't the first time Little had struck her, that one time she'd ended up in the emergency room, that Little was usually "a very gentle man," that she didn't really want to press charges, and that she was three months' pregnant with his child.

By this point it was clear to the officers that this was no ordinary lovers' quarrel. Davis turned out to be a local socialite on felony probation for buying clothes using stolen credit card numbers. In fact, she wasn't pregnant (and today denies ever telling police that she was). For his part, Little - who really did have a drug problem and who'd been calmly leaning against his Jeep in the driveway when the cops arrived, according to police - denied hitting Davis and claimed that he'd been trying to end the relationship.

Sometime during this dog day afternoon, according to the seven-page police report, Davis dropped another tidbit: Little, who had recently moved to Cleveland from California, was in possession of stolen paintings worth "millions of dollars" from Los Angeles. With that off her chest, Davis went back to complaining about her boyfriend's crack habit.

Within a few months the FBI had linked her story to an unsolved art theft back in L. A. Confronted by a pair of agents in February 1997, Little struck an immunity deal, then led the feds to a storage locker outside Cleveland rented by his mother, using the name of the family gardener. Inside were two cardboard boxes. The first contained Pablo Picasso's "Nude Before a Mirror," painted in 1932 and once owned by Henry Ford. The second held "The Customs Officer's Cabin in Pourville," painted by Claude Monet in 1882.

Little explained that he had brought the artwork to Ohio after having been given it to hold for "safekeeping" several years earlier by his former boss in L.A., James Tierney, an entertainment lawyer whose clients had included actor Timothy Hutton and singer Gloria Estefan. Where had Tierney gotten the paintings? He'd taken them, as part of a cunning insurance scam, at the behest of a friend who owned them: a retired eye surgeon named Steven Cooperman, who would become the feds' first big link to the alleged fraud at Milberg Weiss.

The robbery that wasn't: A bad doctor blows his cover

By July 12,1992, when Dr. Cooperman first reported the theft of the Monet and Picasso from his Brentwood home, he had already served as lead plaintiff in dozens of Milberg Weiss lawsuits. "Lead plaintiff" status made Cooperman the official representative of a class of investors in a company, and required him to convince a judge that his claims of stock market losses were "typical" of the group.

But Cooperman didn't exactly personify the humble defrauded investor evoked by Bill Lerach. He owned multimilliondollar homes in Los Angeles and Connecticut, vacationed in the South of France, drove a Lotus, and collected Impressionist art. His claims of being innocently defrauded, time and again, were also hardly "typical" - or, for that matter, plausible.

In 1993, when Cooperman acknowledged in court papers that he had already served as plaintiff in 38 securities class actions, Dallas federal judge Joe Kendall wryly described him as "one of the unluckiest and most victimized investors in the history of the securities business."

Cooperman had time to spend on Milberg's lawsuits because he no longer worked. He had built a thriving eye-surgery practice in Beverly Hills, drumming up business by airing TV spots featuring Red Skelton and sending limos to pick up patients. In 1987 alone he earned nearly $2.4 million. But then the California medical board accused him of surgical malpractice: forging the signature of a patient on a consent form, and persuading a legally blind woman to sign forms she didn't understand.

When the board moved to revoke his license, Cooperman, then 48 and citing heart problems, settled the case in 1990 by agreeing to quit practicing medicine - and smoothly transitioned into a lucrative new career. He began claiming the proceeds of 18 separate disability-insurance policies, providing more than $600,000 a year in tax-free income. And he had begun serving as a serial plaintiff for Milberg Weiss.

By mid-1992 some of this history had begun to draw attention. A story in the *National Law Journal* discussing "professional plaintiffs" noted Cooperman's recurring role in Milberg cases as well as a court fight with a disability insurer who had sued him for fraud. Lerach fired off a letter to the editor vouching for his prized client: "Dr. Cooperman's reputation and character are impeccable, and any inference to the contrary which may be drawn from your article is unfair and unwarranted."

A bigger problem for Cooperman was that his highflying lifestyle had left him deeply in debt. He was behind on $6 million in loans and facing foreclosure on the house in Brentwood. It was just about this time that the Monet and Picasso paintings disappeared from Cooperman's home. Police were immediately suspicious. Nothing else was missing, there was no sign of forced entry, and the Coopermans' alarm system hadn't made a sound. But the doctor had an alibi: He and his third wife had been vacationing on the New Jersey shore.

The theft, of course, was faked. Cooperman had enlisted his lawyer friend Tierney, who agreed, as Tierney later put it, to "help him bury the body." Cooperman gave him the keys and the alarm code for the house; Tierney made off with the paintings after the doctor left for vacation.

When Cooperman got back, he filed a claim for the full insured value of the paintings: $12.5 million, vastly more than they were worth. Cooperman had bought the Monet in 1986 for $750,000 and the Picasso a year later for $957,000 - and scammed insurers into wildly overvaluing the works.

When the insurance companies refused to pay, Cooperman promptly sued, alleging bad faith and demanding the full $12.5 million, plus punitive damages. In short order, the insurers folded, agreeing to pay Cooperman $17.5 million. The insurers offered a $250,000 reward for recovery of the paintings, but they remained safely missing for almost five years - until J.J. Little slugged Pam Davis.

Little's cooperation with the FBI led to Tierney, who let the lawmen tape phone calls between him and Cooperman, still blissfully unaware that the FBI had recovered his artwork. "Sleeping dogs are best left sleeping," Cooperman declared in one call, when discussing what to do with the paintings. Cooperman had suggested throwing them into a dumpster, but Tierney rejected the idea: "The problem with a dumpster is that the garbage man comes and he picks 'em up, and he might say, 'Hey, this looks like a Monet!'" Cooperman then proposed running them through a shredder or cutting them up with garden shears.

In July 1999, after a ten-day trial in L.A., Cooperman was convicted of insurance fraud. Facing up to ten years in prison, he was released on a $10 million bond and returned to his estate in Connecticut. He hired a new lawyer, New Yorker Russell Gioiella, who raised the idea of cutting a deal with prosecutors to reduce his client's prison time. Did Cooperman know anything - anything big - that might be of interest to the federal government? "They aren't going to trade this case for a peanut," he told Cooperman. As it turned out, Cooperman did know something big: the secrets of Milberg Weiss.

Race to the courthouse: The magic of the serial plaintiff

By the time Steve Cooperman offered to rat out Milberg Weiss, the firm had become the 800-pound gorilla in the shareholder class-action game. Co-founded in 1965 by Mel Weiss, the Bronx-born son of a CPA, Milberg had started out small in a backwater business. But over the decades, Weiss expanded the frontiers of securities suits, bringing ever bigger cases.

Plaintiffs firms are paid on contingency, as much as 30% of whatever they win, and Weiss - unlike most plaintiffs lawyers, who settled fast and cheap - was willing to go into debt to press a case for years in search of a bigger payoff.

Lerach signed on in 1976, opening Milberg's California office in San Diego. He was ferocious and creative, and worked like a madman, building "Milberg West" into an operation that competed with the New York office for influence and profits. His special target was Silicon Valley companies, whose volatile stocks made them juicy prey; he transformed Milberg into a lucrative volume business that churned out scores of class actions a year. This business model allowed him to settle cases when he wanted; if defense lawyers didn't buckle, he'd simply cash in on another lawsuit and continue to torment their clients.

A favorite Lerach tactic was to scream at CEOs, telling one: "I'm going to take away your f***ing condo in Maui! I'm going to take away every penny you own!" Milberg sued several companies repeatedly - 3Com (Charts) nine times. T.J. Rodgers, CEO of Cypress Semiconductor (Charts), called him "lower than pond scum."

Nine out of ten cases did settle. Companies reasoned that paying up was safer and cheaper than going to trial, since insurance companies paid most of the settlement bill. On average, investors recovered only about 15 cents of every lost dollar, while Milberg Weiss routinely pocketed millions. Weiss and Lerach saw their personal takes soar from $3.4 million apiece in 1990 to $16 million in 1995. During the 1990s, both men earned more than $100 million. Bitter executives came to view it all as an extortion racket - they called it getting "Lerached."

But these lawsuits were only that profitable if Milberg Weiss ended up in charge of the case. By gaining the coveted role of lead counsel, the firm commanded the biggest fees and controlled the litigation. Until 1995 that job usually went to whoever filed first, winning the "race to the courthouse." That put a premium on having plaintiffs who lost money on the company's stock available at a moment's notice.

In practice, the plaintiffs were figureheads - the lawyers ran the case. So Milberg Weiss built a stable of plaintiffs with tiny holdings in dozens of companies, ready to lose money and bring suit within hours of a big stock drop. And that's where the likes of Steve Cooperman came in.

The doctor is in: Cooperman sings like a canary

When the retired doctor and his lawyer began trying to negotiate a cooperation agreement, Richard Robinson, the veteran assistant U.S. attorney in L.A. who had won Cooperman's conviction for insurance fraud, knew next to nothing about Milberg Weiss.

There were plenty of reasons not to do a deal. Cooperman's story was that Milberg had paid him to serve as plaintiff - usually about 10% of its fees. If true, the practice was illegal. Lead plaintiffs aren't supposed to receive any special compensation, just their share of the settlement and approved expenses. Indeed, the lead plaintiffs (and their attorneys) are required to swear under oath that they aren't getting special payments; lying about it would be a felony. Yet Robinson knew the charges might strike a jury as a legal nicety, since the money to pay the plaintiffs had come from the pockets of the plaintiffs lawyers, not investors.

Milberg was also a huge, politically charged target - a big supporter of Bill Clinton, then still in office. Plus the man auditioning for the role of government cooperator was a convicted felon. Did it make sense to launch a big investigation on his word?

Robinson, a lifelong Democrat, had no animus toward plaintiffs lawyers. But like most prosecutors, he was eager to chase a bigger case. A deal was soon struck: In return for his cooperation, Cooperman would remain free until 2001, then serve just 21 months. (He is now living in Connecticut.) A sealed July 2001 government sentencing recommendation obtained by *Fortune* cited his "valuable assistance in the initiation and development of a major criminal investigation." The document notes that Cooperman wore a body wire, initiated bugged phone calls, and helped persuade others to cooperate. A lifelong packrat, he produced letters and bank records.

And what a story he had! Cooperman told prosecutors that he, along with relatives and friends, had been paid for serving as plaintiff in about 70 cases over a decade. (The indictment says the total would turn out to be $6.5 million.) He explained that Lerach had introduced him to this new line of work in 1989. After contacting the firm about launching a potential shareholder lawsuit, Cooperman and a Brentwood buddy, Dr. Ronald Fischman, had met with Lerach in San Diego.

Lerach, Cooperman later testified in his divorce trial, "told us that it was very difficult for them to get people to be plaintiffs, and he volunteered that... they compensate the plaintiffs ... by giving them 10% of the fees that they receive." (Lerach declined requests for comment; his lawyer did not return calls.)

According to the indictment, Lerach urged Cooperman and Fischman to buy stock in different companies to position themselves as plaintiffs in future lawsuits. Dozens of cases and payments followed. But because Milberg wasn't supposed to pay plaintiffs, all of this had required certain arrangements.

Following Lerach's instructions, Cooperman testified, he enlisted lawyers to act as intermediaries for the payments. That gave the pretext that Milberg was paying referral fees to the attorneys for originating the case and providing the plaintiff. In most states such fees are legal, as long as the lawyer doesn't share the money with the client. But Cooperman's lawyers did share the money with their client; according to the government, they served as fronts, either passing the money on to Cooperman by personal check or using it to pay bills that Cooperman had run up for other litigation.

Milberg, for example, sent 35 checks totaling $3.5 million to Richard Purtich, an L.A. insurance lawyer who had represented Cooperman in various court battles. (Purtich has pleaded guilty to a felony tax charge in the case.) Cooperman directed another $2 million in Milberg payments to James Tierney. Cooperman's brother-in-law Bruce Bjork served as another conduit; according to the government, Milberg paid him $245,000 for consulting work he never performed, and he passed most of it on to Cooperman. (Bjork declined comment.)

Cooperman reported recruiting others to serve as plaintiffs and share in the windfall - his wife, Nancy; a second brother-in-law; a Beverly Hills pop psychologist named Mel Kinder; and Fischman. (Most of these people are now cooperating with prosecutors.)

Milberg's criminal defense counsel responds that the firm believed it was paying legitimate referral fees and had no idea the money was being passed to plaintiffs.

During his divorce trial, Cooperman said both Weiss and Lerach paid him directly. He testified that one $175,000 check came "from Mr. Weiss himself." (Weiss's lawyer says it was a down payment for a painting he planned to buy from Cooperman.) Cooperman described driving with his wife to San Diego to pick up "a cash payment" from Lerach."... We sat at - at a conference table where he handed us an envelope. And he said, 'Here is $16,000.'" (Nancy Cooperman testified that she never saw any cash change hands.)

On another occasion, Lerach was exulting over a big windfall from a lawsuit against Apple Computer (Charts). "Too bad you weren't the plaintiff," Cooperman testified Lerach told him. "You could have made a lot of money in this case."

As Cooperman described it, a major player in the payment scheme was David Bershad, the now indicted partner who served as Weiss's No. 2 and, in effect, chief operating officer of the firm. (Between 1983 and 2005, Bershad earned $160.9 million.) The indictment says Bershad kept a safe in his credenza, from which cash payments to plaintiffs were doled out. Bershad typically signed the checks to Cooperman's intermediaries.

According to the indictment, Cooperman's kickbacks continued until Feb. 25,1999, when his pending trial for insurance fraud brought his career as a paid plaintiff to an end with a final payment of $145,305. But by then, Cooperman testified, it was clear that his was neither the only such arrangement nor the first: "At the time what was going on with Milberg Weiss was a very well-known activity. It was just an activity that Milberg Weiss did with a number of people."

When the prosecutors had digested Cooperman's story, that was precisely what they were wondering about. What Robinson needed was more Coopermans - without the felonious baggage. But finding them wasn't going to be easy. Robinson spent months studying hundreds of Milberg cases, looking for repeat plaintiffs. Once he'd found them, he'd track payments. Subpoenas sent to a law firm required approval from Washington, slowing everything down. Milberg itself wasn't eager to cooperate, of course. And the case generated little enthusiasm or support inside the U.S.

attorney's office in L.A., even after Republicans moved in at the Justice Department. "This case could have died at any moment, and no one in D.C. would have given a s***," says one lawyer.

In January 2002 subpoenas finally went out to a group of repeat Milberg plaintiffs. Among the unhappy recipients was a wealthy retiree from Palm Springs named Seymour Lazar.

American eccentric: How Seymour made his pile

When Lazar appeared in federal court in L.A. earlier this year after being charged with fraud, conspiracy, and obstruction of justice in the Milberg Weiss case, it seemed a miracle he was still alive. A small, wild-haired man, Lazar, now 79, sat in a wheelchair and listened to the proceedings with a hearing aid. Later court filings detailing his medical history - and asking for the charges to be dismissed because the stress of a trial was likely to kill him - reported that Lazar was suffering from congestive heart failure, diabetes, renal failure, high blood pressure, anemia, gout, strokes, a suppressed immune system, and cancer (in remission).

Yet Lazar, who had pleaded not guilty, remained combative and defiant. He'd recently protested his innocence on the front page of the *Wall Street Journal*, declaring, "I swear, they treat me like an absolute thug.... Who did I cheat? Did anybody get screwed?" While Milberg Weiss was insisting that it had no idea its "referral fees" were ending up with plaintiffs, Lazar admitted that Milberg had paid him. He simply argued that no one got harmed because the money came out of the law firm's pockets.

Seymour Lazar is a Great American Eccentric - a wily wheeler-dealer who hates wearing socks. He's retired from highly profitable careers in entertainment law, finance, and real estate. But that doesn't begin to do Lazar's history justice. During the 1950s he dated poet Maya Angelou; during the 1960s he served as manager for comedian Lenny Bruce and hung out with LSD guru Timothy Leary.

In the bestselling book, Supermoney, "Adam Smith" memorialized Lazar as "Seymour the Head" - "formerly a respectable Los Angeles lawyer with a respectable wife and child, who discovered arbitrage, mind-blowing chemicals, and a new life style all at the same time." After years spent overseas, he settled in Palm Springs, where he made tens of millions speculating in desert real estate.

Lazar was litigious too. He sued his wealthy father's estate after being disinherited. He sued Donald Trump and Carl Icahn. In 1980, after Hertz charged him $11.15 for returning a rented Pontiac without filling the tank, he led class actions against rental-car companies. Whatever the motivation, this "feisty little prick," as he was described by one chronicler of the 1960s LSD scene, allegedly received $2.4 million in kickbacks for serving as a plaintiff (with his relatives) in about 70 Milberg cases dating back to 1981.

Lazar first met Mel Weiss after being named a defendant in a 1973 Milberg lawsuit for failing to disclose his stock holdings in a corporate takeover. He assumed the role of Milberg plaintiff three years later, when Lerach - who had just arrived at the firm - sued Gap (Charts) over its IPO.

The indictment suggests that Lazar's relationship with Milberg Weiss established the pattern that Cooperman and other paid plaintiffs would follow: Lazar bought small stakes in companies to position himself as a "defrauded" plaintiff; recruited relatives (a son, a daughter, his wife, and mother-in-law) who also served as Milberg plaintiffs; received 5% to 10% of Milberg's take after the firm was paid; and arranged for Milberg to send the money to attorneys who did unrelated work for him, in the guise of referral fees.

The government says Lazar's arrangement involved six lawyers in three states. On one occasion, Milberg Weiss got its serial plaintiffs mixed up, sending a $25,000 check to a Lazar lawyer for a case where Cooperman had served as plaintiff. Twice it paid two firms for referring Lazar in the same case.

Much of Lazar's Milberg money went through Paul Selzer, a respected real estate attorney who worked in the Palm Springs office of Best Best & Krieger, or BB&K. (Selzer has pleaded not guilty to money laundering.) Beginning in 1984, Selzer received a steady flow of Milberg checks, often with cover letters citing Selzer's involvement in Lazar's class-action lawsuits. After paying Lazar's bill at BB&K, according to the government, Selzer passed on the rest to Lazar and others Lazar wanted paid, such as his accountant or engineers working on Lazar's various real estate projects.

Job Lazar, Seymour's son and a lawyer himself, also got a piece of the action. In March 1995, after Milberg received a $969,000 fee in a United Airlines (Charts) class action (Job's half-brother Adam had served as plaintiff), it sent a $250,000 check to Job, identifying the money as "your participation in our fee" in the United suit. Over his 20 years as a Milberg plaintiff, Seymour Lazar repeatedly denied under oath that he was getting paid.

By 1994, BB&K partner Daniel Olivier, a Selzer protégé, began to entertain doubts about the propriety of the ongoing arrangement, and put those doubts in a memo. Lazar wanted to have it both ways - to have his California lawyers claim the payments were legitimate referral fees that belonged to the firm, yet apply the money toward his bills.

"Mr. Lazar does not wish to have this relationship documented," Olivier noted. Lazar was proposing that the firm spend "excess" funds on personal items for him, such as making lease payments on cars and charitable contributions, Olivier added. "Mr. Lazar argues that these things would simply be 'business favors' for a very profitable firm client." But Olivier was doubtful. Lazar's "business favors" cover story wouldn't stand up to outside scrutiny. "To us," Olivier wrote, "it just smells bad and probably would to an investigator."

Yet Lazar continued sending work to the firm, and a year later, when Selzer left BB&K to open his own law office, Olivier took over Selzer's role with Milberg and Lazar. Olivier, who remained at the firm until 2004, when investigators started asking questions, is now expected to be a government witness. Selzer's attorney claims the arrangement was approved by BB&K management - as does Lazar. "Everything was declared and everyone knew about it," Lazar said in a May interview with the Riverside Press. BB&K vehemently denies this, saying Selzer and Olivier were acting on their own, without the knowledge of anyone else at the firm.

After Lazar's subpoena from the U.S. attorney's office arrived in January 2002, according to the government, Lazar instructed his accountant to destroy records concerning his relationship with Milberg Weiss. His career as a serial plaintiff was over. (Lazar could not be reached for comment.)

The divorce: Weiss and Lerach part ways

By 2002, Mel Weiss was flying high. His firm was thriving, despite a move by Congress to rein in class actions. It had survived a coup attempt by a partner who had unsuccessfully urged Weiss to oust Lerach before his recklessness destroyed the firm. In 1999 it had endured an embarrassing trial in Chicago on an abuse-of-process suit filed by Daniel Fischel, a star damages expert for the defense bar. There was testimony about how Weiss had told Fischel, "I'm going to destroy you" - and how Lerach had vowed "to put the little f***er out of business." After a jury awarded Fischel $45 million and prepared to consider punitive damages, Milberg settled for $50 million.

Despite that, Weiss's firm had grown to more than 200 lawyers - four times as many as any of its rivals. And it had won appointment as lead counsel in Enron, the mother of all class actions. There was, of course, the small matter of the criminal investigation in L.A., but no one at Milberg seemed worried. Cooperman was easily branded a miscreant - never mind that he had been their miscreant. And if the feds seemed to be zeroing in on Lazar, that didn't bother them either. Seymour had long proved a wily prey.

There were other distractions too. In 2004, Weiss was being sued by one Labib Labib, a waiter at the New York Palace Hotel. In legal papers, Labib, a 34-year-old Egyptian immigrant, claimed he had arrived to provide room service to Weiss on June 25,2003, when an "unruly and wild" dog made him trip and break his foot. Labib says he was taken to the hospital and missed three months of work.

The dog, a Maltese, actually belonged to Paris Gordon, a 46-year-old Manhattan fashion designer who was in Weiss's room at the time, according to Labib's complaint. The waiter asked for $1 million in damages. There was a rich irony in Mel Weiss getting sued by an aggressive plaintiffs lawyer demanding a princely sum on behalf of a humble man. Gordon, who told Fortune she was visiting Weiss to discuss a legal matter, accuses Labib of engaging in a shakedown, seeking "a relief program for his life" because "Mr. Weiss is so rich."

But Labib and his lawyer, Howard Ross, say Weiss strung the case along through repeated court postponements; Ross says Weiss finally settled the case for "close to 50 grand" in 2005 on the eve of his scheduled deposition. In a written statement, Weiss lawyer Benjamin Brafman states, "Mr. Weiss was represented by counsel assigned by his insurance company, and the case was settled for nuisance value. Paris Gordon Inc. was both a client and a company in which Mr. Weiss invested." Nuisance value, of course, is precisely what corporate America says it settles Milberg class-action suits for.

Amid all these issues, Milberg Weiss itself split in two.

Weiss and Lerach had long been on a slow-moving collision course over money, power, and credit. Where Lerach seemed to relish being loathed, Weiss craved respect and reveled in his role as dean of the plaintiffs bar. The final straw came in June 2003, after Lerach - frustrated in repeated attempts to control yet another big class action - threatened to sue two Milberg rivals who had been named co-lead counsel in the WorldCom case, firing off a letter demanding to know how much malpractice insurance they carried.

In fact, the rival firms were representing a key client in other cases for Milberg's New York office. Weiss wrote the rival firms, advising that they should consider Lerach's demand for the insurance information "withdrawn" and apologizing "for any inconvenience that it may have caused."

The divorce became official in May 2004. Lerach got the California offices for his San Diego-based firm, now called Lerach Coughlin Stoia Geller Rudman & Robbins. Weiss got everything else, in what was renamed Milberg Weiss Bershad & Schulman. Ongoing cases would be split up, with the ultimate recovery to be apportioned between the two firms.

Inside Milberg Weiss, many felt that the departure of Lerach offered an opportunity to establish a modicum of democracy within the partnership, which had always been run as an autocracy. Weiss agreed to establish a new management committee, but real power remained in the hands of the name partners - Weiss and Bershad had veto power over any decision.

There was also relief in New York that with Lerach gone, the firm had gained some distance from the criminal investigation. Cooperman and Lazar both had been in California; whatever crazy stuff had gone on was surely under Lerach's watch. In any case, it looked as if the prosecutors were coming up dry. As best anyone could tell, they'd done little more than issue wave after wave of subpoenas since 1999. Says a former Milberg partner: "They took years to get their d*** out of their pants."

But by 2004 the investigation was taking a surprising turn. Robinson, the methodical assistant U.S. attorney who had launched the case, had been joined by an aggressive colleague, Bob McGahan, whom one government witness describes as "your typical mad-dog Irish prosecutor." A third prosecutor would soon come aboard.

In June 2005 the first big blow fell: Lazar and Selzer were indicted, baring the framework of the alleged paid-plaintiff scheme by a "New York law firm." A former Milberg partner named Bob Sugarman, granted immunity from prosecution, soon found himself in front of the grand jury. The former head of the case-starting department in New York, he would prove a jaw-dropping witness, pointing the prosecutors to a third serial Milberg plaintiff.

The Goldilocks plaintiff : Not too sleazy, not too cranky

It seems improbable that the criminal prosecution of Milberg Weiss should rest so heavily on the slight, 61-year-old shoulders of Howard Vogel, a retired mortgage broker living in Florida. He's a bent, bookish-looking man who survived a childhood bout with polio and suffers from severe arthritis, leaving his hands permanently curled.

But to prosecutors, he was the Goldilocks plaintiff: not too sleazy, like Cooperman; not too cantankerous, like Lazar. Vogel seemed just right, with a clean past and a healthy dose of remorse. After Sugarman sent prosecutors his way, Vogel, who had failed to pay taxes on the money he had received, quickly cooperated. He'd offer damning accounts of dealings with Bershad, Steve Schulman, and even Weiss.

Most remarkable, Vogel had told prosecutors he'd received payments from Milberg as late as 2005. If true, this meant the firm was continuing its dubious practices years after it knew a criminal investigation was underway. (Vogel and his Washington attorney, Mark Rochon, declined to comment.)

Vogel's involvement with Milberg Weiss dated back to 1991. Then living with his wife, Eugenia, in Englewood, N. J., Vogel liked to play the market, and he was furious when his stake in Valero (Charts), a Texas energy company, plunged. He called Milberg's office and was soon talking to Sugarman about serving as plaintiff for a class action. *Howard J. Vogel v. Valero Energy* was filed in San Antonio on Aug. 20,1991 - but only after Vogel had received Sugarman's assurance that he would get a piece of Milberg's fee.

According to the statement of facts accompanying Vogel's plea, he met with Bershad and Schulman months later to negotiate the amount: 14% of the firm's take, plus $10,000 to cover his loss on Valero. Vogel says the two men also instructed him to find a lawyer to serve as an intermediary because Milberg could not pay him directly.

Vogel recruited Gary Lozow, his fraternity brother at Indiana University. Lozow was a criminal lawyer in Denver - he had represented the family of Columbine killer Dylan Klebold - but had nothing to do with securities litigation. He'd also done nothing to refer Vogel to Milberg Weiss; the case had already been filed. No matter. In October 1992, Milberg sent Lozow a retainer agreement, promising to pay him 14% of its Valero fee "on the basis of your efforts in this matter and your having shared in the work and responsibility." Two months later, after Milberg collected $4.75 million for the case, it sent Lozow a check for $637,223. Lozow sent the money to Vogel.

Vogel - along with his wife and stepson - went on to serve as plaintiff in about 40 Milberg cases, receiving $2.49 million, according to the government. Usually the money went through Lozow or a New York real estate lawyer Vogel knew; on one occasion, he says, Sugarman gave him an envelope stuffed with cash.

Vogel's biggest windfall came in the giant Oxford Health Plans case. Viewing the health insurer as a juicy target for yet another Milberg lawsuit, Vogel had spent $3,918 to buy 50 shares for his retirement plan in 1997. Sure enough, the stock plummeted, and Milberg filed a class action in Connecticut, with the Howard Vogel Retirement Plan as plaintiff. Vogel signed a sworn declaration that he hadn't purchased the Oxford shares to participate in litigation and would not accept any special payment for serving as plaintiff. In 2003, when Milberg received $40 million in attorneys' fees from Oxford, Vogel was told by Schulman that his payment would have to be negotiated with Weiss. After Vogel sent a memo on the subject to Weiss's office, Schulman told him Weiss wouldn't discuss the matter on the phone; Lozow would need to come to New York to talk with Weiss. The two men met for about 30 minutes on Nov. 10, 2003. The allegations of paying plaintiffs were apparently much on Weiss's mind. "We're under investigation," Weiss volunteered at one point, according to a source.

But that didn't alter Milberg's arrangements. In mid-December, the firm sent Lozow a check for $1.1 million, citing their "joint representation" of Vogel in Oxford. A second $120,000 check, for a case where Vogel's stepson had served as plaintiff, went out the same day. In January, Lozow wired $1,205,932 to a bank account Vogel had set up. (Brafman, Weiss's lawyer, says Weiss believed he was merely negotiating a "lawful referral fee" for Lozow. Lozow's attorney says his client is "working closely" with prosecutors.)

Milberg kept filing lawsuits - and paying Vogel - for two more years. Vogel bought shares of companies that might be buyout targets, opening them up to shareholder derivative suits in Delaware, a specialty of Milberg partner Steve Schulman. Schulman even had some of the lawsuits drafted ahead of time, so that they'd be ready to file at a moment's notice - "shelf complaints," they called them.

Vogel eagerly offered ideas, as in 2000, when he bought 100 shares of Infinity Broadcasting in anticipation of Viacom making a takeover bid, and wrote Schulman, "As we just discussed, [Eugenia] owns shares of Infinity Broadcasting.... I feel that a complaint should be drafted and ready to go." Sure enough, Viacom announced the acquisition, and Milberg filed its lawsuit seeking a higher buyout price that very day, with Vogel's wife as plaintiff. When Milberg banked $2.5 million in attorneys' fees, it sent $86,923 to Vogel's New York lawyer, who forwarded most of the money to Vogel.

The last payment from Milberg Weiss, for $10,800, was sent to Lozow, as a "referral fee" for Eugenia Vogel's role as plaintiff in a Delaware case against BarnesandNoble.com on May 19, 2005 - five years after the criminal investigation began.

Indictments: The Feds get angry

By late 2005, prosecutors were furious at Milberg's response to the investigation. When a company finds itself under criminal scrutiny, it is expected to halt the suspect behavior, cooperate with investigators, launch its own inquiry, and bar anyone under investigation from dealing with the problem, to make sure he doesn't jeopardize the business by trying to save his own neck. These are among the Justice Department's specific criteria for deciding whether to indict a corporate entity.

As prosecutors saw it, Milberg flunked on every score. It was refusing to turn over key materials, citing attorney-client privilege. Weiss, Bershad, and Schulman were still calling the shots. Worst of all, the firm had kept paying kickbacks. "When they know we're looking at them, and you still have activity all the way into 2005, it's extremely problematic," says Debra Wong Yang, U.S. attorney for the district that includes Los Angeles.

In mid-2005, the government had issued target letters to Weiss, Lerach, Bershad, Schulman - and Milberg Weiss. On Dec. 29, prosecutors wrote Milberg's outside legal team - led by Bill Taylor, a partner with Washington's Zuckerman

Spaeder - that the firm would be indicted unless it pleaded guilty. Taylor protested. No law firm Milberg's size had ever been charged with a crime. Indicting the firm would surely be devastating, and as even the government acknowledged, only a handful of Milberg's 365 employees played a part in the alleged kickbacks. But as the feds saw it, the dirty players at Milberg were the ones who ran the place - and they were still showing no sign of contrition.

Weiss repeatedly reassured the partnership that it faced no danger. After Lazar's indictment, Edith Kallas, who served on the firm's management committee, had pressed Weiss to bring in an outside firm to investigate Milberg. He refused. Management committee members urged Weiss to turn over all decisions about the investigation to the nontargeted partners on their committee - that meant excluding Weiss, Bershad, and Schulman. But Weiss wouldn't do that either. (Taylor insists that many key decisions were turned over to nontargeted partners.)

Weiss and Taylor began presiding over a string of partnership meetings, each less comforting than the last. Nothing terrible was on the horizon, Taylor insisted in early 2006. The investigation was to be carried out in "phases," and the firm couldn't be charged unless the prosecutors in L.A. first sent a proposed indictment to the Justice Department for review - and that hadn't been done.

At the next meeting, Taylor seemed less sanguine. A partner named Elaine Kusel asked him directly: Had the investigation reached the next "phase"? Had a draft indictment of the firm been sent to Washington? Taylor acknowledged that it had. "At that point, there was a shock wave in the room," recalls a former partner. As the crisis deepened, a few lawyers talked about rallying the partnership's rank and file to challenge Weiss themselves. But ultimately, no one had the stomach to rush the cockpit. Says one former partner: "It was Mel's world, and everyone else just lived in it." (Taylor says he cannot discuss his legal advice to the firm.)

In February the California prosecutors had officially informed lawyers for Bershad and Schulman to expect their indictments; Weiss and Lerach had been told they wouldn't face charges - for now. The scene shifted to Washington, where, the partners were told, Milberg was making the moves needed to save the firm. There were weeks of back-and-forth negotiations, aimed at hammering out a deferred-prosecution agreement that would allow the firm to escape indictment.

But Milberg, controlled by the people in the crosshairs, refused to meet prosecutors' demands, which included a public statement acknowledging that the government had "substantial evidence" of misconduct by individual partners; limited waivers of attorney-client privilege to give the government access to specific documents; and removing Bershad and Schulman. There was talk of a $100 million fine, but money was never the stumbling block. Giving the prosecutors whatever evidence they wanted would, of course, make it easier to bring a case against Weiss - as would angering Bershad or Schulman, which might prompt them to seek a deal. "These guys had each other over a barrel," says a former Milberg partner. "And nobody was going to pull the trigger on the other."

Some frustrated partners concluded that Weiss was playing a game of chicken, risking the firm to save himself. "All of us were just in the dark," says one. "We had no ability to make choices, and have our choices control the firm's destiny." Weiss, it seemed, also simply didn't believe that the feds would indict. He was acting like a plaintiffs lawyer - expecting to extract a better deal by refusing to give an inch. Instead, it antagonized the prosecutors. With the Bershad and Schulman indictments looming, the issue of their removal came to a head at an angry four-hour all-hands meeting on April 24.

Weiss, who'd viewed the issue as a bargaining chip with prosecutors, vowed he wouldn't make them go. After the meeting, still clinging to hope of avoiding the firm's indictment, some partners began collecting petition signatures to forcibly remove Bershad and Schulman under a never-used provision of the partnership agreement that allowed two-thirds of those holding an equity stake to oust a partner. But before the rebellious partners got the necessary signatures, Bershad announced he was taking a leave of absence on May 16. Schulman would soon follow.

Not everyone was happy to see Bershad go. Despite the government's allegations, he was widely respected as a skilled deal closer and a man who kept his word. Far fewer tears were shed for the gifted but volatile Schulman. Former colleagues recount horror stories of his volcanic temper - on one occasion, he sprayed a mouthful of scrambled eggs while berating one of his partners. As one lawyer who counts himself as a Schulman friend says, "He has the world's worst people skills."

That reputation had been cemented a few years ago, when a woman showed up in the lobby of Milberg's New York offices near Penn Station and began handing out fliers. The woman was a former exotic dancer and the mother of Schulman's infant daughter; the fliers displayed a snapshot of Schulman in a bathrobe, and complained about the big-shot partner at Milberg Weiss who wouldn't support his child. After causing a stir in the lobby, the woman was persuaded to leave. (Schulman's spokesmen say he later reached a generous settlement with her.)

As it turned out, the departures of the two name partners didn't change anything. On Thursday, May 18, the Justice Department announced the criminal indictment of Bershad, Schulman, and the law firm Milberg Weiss.

Exit the clients... and half the partners too

The reaction to Milberg Weiss's indictment was devastating. Key institutional clients, including the state public pension funds of New York and Ohio, fired the firm. A federal judge in Minnesota summarily tossed a Milberg lawyer off the plaintiffs' steering committee in litigation against Medtronic, noting, "Few would select an indicted, as opposed to an unindicted, law firm." Eliot Spitzer, running for governor of New York, returned political contributions from Milberg Weiss and its partners. Though there were plenty of old cases to manage, by October half the partnership had melted away.

Weiss battled back, hiring a PR consultant retained by Michael Milken and Jack Abramoff and setting up a special website, milbergweissjustice.com. In statements, the firm complained that the government had insisted on "impossible concessions" - including waiving attorney-client privilege - "as a condition to avoiding indictment," and had acted recklessly in moving against the firm. There were the inevitable accusations that the Justice Department was motivated by politics - the firm took out an ad in the *New York Times* to publish a letter from four Democratic Congressmen calling the indictment "a very thinly veiled attempt by the Bush administration to accomplish by bullying and intimidation what it has not been able to do by law - to end class-action lawsuits...."

Momentarily clear of the storm, Bill Lerach voiced his public sympathy for his former partners' plight, even while moving quickly to exploit Milberg's weakness. With 180 lawyers, Lerach's San Diego firm was by far the biggest left standing. He immediately made an audacious grab for the legal fees in a case where Milberg and another firm were co-lead counsel.

Prosecutors are still gunning for Lerach and Weiss, their original prey. If Schulman or Bershad were to cut a deal, they could well end up on trial. And there's at least one other shoe to drop that could also prove devastating.

One last flip? What if Torkelsen turns?

A silver-tongued graduate of Princeton and Harvard Business School, John Torkelsen served for years as Milberg Weiss's favorite "damages expert." He made tens of millions by delivering reports in securities cases that justified huge awards. Prosecutors came to focus on Torkelsen because of suspicions that Milberg paid him on a contingency basis (experts aren't supposed to have a financial stake in the outcome of litigation) - and gave him extra in cases with big recoveries to make up for giving him nothing in cases that came up dry.

As prosecutors saw it, this would amount to theft: stealing money from one class of investors to pay Torkelsen for his work on behalf of another. Torkelsen thus offers the prospect of opening a powerful new front in the Milberg prosecution - as well as a direct line to Lerach, with whom he'd long been close. "Stealing from investors" sounds worse to a jury than "deprivation of honest services," which is what the existing indictment claims.

Torkelsen would seem an ideal prospect to cut a cooperation deal. A famously extravagant spender - his Christmas parties for lawyers were legendary - Torkelsen and his wife, Pam, had spiraled into financial and legal trouble. In 2003 the U.S. Small Business Administration, citing shady dealings, seized a venture capital firm that Torkelsen had launched with the help of $32 million in SBA loans - and millions more from plaintiffs lawyers, including Lerach. That mess led to a criminal investigation, in which both Torkelsens, accused of embezzlement, pleaded guilty to felony charges.

In the throes of a bitter divorce from her husband, Pam struck a deal to help prosecutors in the Milberg case; she remains free, awaiting her sentence. According to one former Milberg partner, prosecutors have documents from Torkelsen's files that bear handwritten notations directing his bookkeepers to shift a six-figure sum from the bill for one class action to another. To bring charges against Lerach, they would, of course, have to prove he knew Torkelsen actually was doing this. Pam, who helped with the books, testified before the Milberg grand jury in June.

But Torkelsen, now 61, has thus far refused to cooperate. In a divorce filing, he said Pam was engaged in a "crusade" to destroy him, and cooperating in the Milberg investigation to reduce her sentence "regardless of the lies that she has to tell." In March 2006 he was sentenced to 70 months in prison. He entered federal prison in

Morgantown, W.Va., on June 22.

In August, Torkelsen was transferred to a detention center in downtown L.A., near the federal courthouse where the Milberg grand jury was meeting. This triggered speculation that he had cut a deal. Attorneys in the case say he was officially moved only to provide handwriting samples; noting that this could have been done in West Virginia, they suggest that the unofficial reason was to pressure him to flip.

Torkelsen's refusal thus far to do so may come from a belief that Milberg did nothing wrong, or maybe it's loyalty to Weiss and Lerach. While Weiss officially issued a firmwide ban on using Torkelsen as an expert after bailing him out of a previous financial mess during the 1990s, records seized from Torkelsen's office by the FBI show him listing Milberg Weiss as one of his "major clients" in November 2001, with work "in progress" on six cases. The firm continued using his services even after he came under criminal scrutiny.

Prosecutors have prepared other evidence, in what promises to be a brutal fight, should it go to trial. In a recent court hearing they projected calling 80 government witnesses, a group that will likely include several repeat Milberg plaintiffs, as well as three sitting federal judges, who will testify that knowing Milberg was paying kickbacks would have influenced whom they appointed to run class actions. "How much longer can you possibly investigate?" asked Judge John Walter during a September hearing. Prosecutors said they were still considering adding to the indictment - either fresh names to existing charges or a whole new set of crimes. In any event, a trial would not start until late 2007.

In the meantime, that will probably leave Mel Weiss to watch the law firm he built - once a unique assemblage of legal talent, money, and power, gathered in the name of the public good - slowly slip away. "Until the very end, it was always Mel's firm," says one former partner. "He's welcome to it."

REPORTER ASSOCIATE Doris Burke

From the November 13, 2006 issue
