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CLASS ACTION REFORM: LESSONS FROM SECURITIES LITIGATION

Jill E. Fisch

I. INTRODUCTION

One of the most damaging accusations made against class action litigation, particularly securities litigation, is the claim that it is “lawyer-driven litigation.” In the parlance of, among others, the proponents of the Republican Contract with America, lawyer-driven litigation is inherently abusive. Recent reform efforts, including the adoption of the Private Securities Litigation Reform Act (the “Reform Act”), have been spurred by the effort to transfer control of litigation away from lawyers and back to clients.

One component of the Reform Act’s attack on abusive litigation was the adoption of a lead plaintiff provision. By vesting control in the hands of substantial shareholders, especially institutional investors, Congress attempted to reduce the ability of plaintiffs’ lawyers to exercise control over securities litigation. This approach typifies more general efforts to reform class action litigation. Criticisms of recent developments in class action litigation have focused on the attorney-client relationship and upon the agency costs created by the substantial control exercised by

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5. Reform Act, supra note 3 (adding Sec. Act § 27(a)(3); Sec. Ex. Act § 21D(a)(3)).
6. See Conference Report, supra note 4, at H13700 (describing the Reform Act as “protect[ing] investors who join class actions against lawyer-driven lawsuits by giving control of the litigation to lead plaintiffs with substantial holdings of the securities of the issuer”).
the lawyer/agent' in class action cases."

This Article will evaluate both the theoretical underpinnings of the lead plaintiff provision and the insights provided by its limited application to date. It will focus upon the efficacy of encouraging institutional investors to participate actively in the litigation process as a means to counteract lawyer-driven litigation. One possible result of the lead plaintiff provision may be to transform securities fraud litigation from prototypical small claimant cases into cases in which the active participants have meaningful stakes in the litigation, but in which the needs and interests of the class representative may diverge from those of the members it represents. By considering securities litigation against the general backdrop of class actions, this Article will explore the relative effects of lawyer control of the litigation process in small claimant cases versus large claimant cases.

This analysis suggests two central insights. First, this Article questions the ability of a lead plaintiff provision or other similar procedural reforms to effect a meaningful change in the control of class action litigation. Second, the Article challenges the purported value of client control. In cases in which the damages suffered by individual class members are small, the value of litigation cannot be judged solely by reference to class member recovery. A defense of the class action structure, in securities cases as well as other class actions, requires a richer conception of the litigation objectives than plaintiff compensation. Unless and until those objectives are clarified, reform initiatives will be limited in their capacity to identify and remedy abusive litigation.

II. THE SECURITIES LITIGATION REFORM ACT

In December 1995, Congress adopted the Reform Act over the veto of President Clinton. The Act was the culmination of several years of reform efforts directed both to abusive litigation practices generally and to private securities fraud

7. Litigation generally is characterized by the fact that disputes are resolved through lawyers as agents for disputing principals. For more general analyses of the effect of this agency structure, see Ronald J. Gilson & Robert H. Mnookin, Disputing Through Agents: Cooperation and Conflict Between Lawyers in Litigation, 94 Colum. L. Rev. 509 (1994) (arguing that, by using agents, principals are better able to commit to cooperation); Rachel Croson & Robert H. Mnookin, Does Disputing Through Agents Enhance Cooperation? Experimental Evidence, 26 J. Legal Stud. (forthcoming 1997) (providing experimental support for Gilson/Mnookin model).


cases in particular." The Reform Act reflected congressional efforts to address a frequently repeated description of abusive litigation." The abuse scenario portrayed plaintiffs' lawyers as responding to corporate announcements of bad news or a drop in stock price with hastily drafted complaints containing poorly supported allegations of fraud." Defendant businesses were frequently pressured to settle even frivolous cases because of the enormous financial burden of litigation." The resulting settlements provided little financial benefit to the claimed victims of the fraud, the class of plaintiff stockholders, but compensated plaintiffs' lawyers with multi-million dollar fee awards."

This scenario, although challenged as inaccurate or atypical by many," conveyed two related concerns: the initiation of meritless claims and the distortion of settlements. The control of litigation decisions by class action lawyers rather than clients was identified as a factor contributing to both problems. Lawyers were accused of filing frivolous cases solely for their settlement value and for targeting defendants because of their financial resources rather than their culpability." The

10. Id. at 717–24 (describing legislative background to adoption of Reform Act).
11. See Conference Report, supra note 4, at H13699–13700 (describing abusive litigation practices to which Reform Act was addressed).
13. See, e.g., In re Philip Morris Sec. Litig., 872 F. Supp. 97, 98–99 (S.D.N.Y. 1995) (describing complaints filed within five hours of announcement by Philip Morris that it was lowering cigarette prices as drafted so hastily that they erroneously described Philip Morris as being in the toy industry), aff'd in part, 75 F.3d 801 (2d Cir. 1996); Common Sense Legal Reform Act, 1995: Hearings Before the Subcomm. on Telecomm. and Finance of the House Comm. on Commerce, 104th Cong., 1st Sess. 222, 223 (1995) (statement of former SEC Chairman Richard C. Breeden) (describing "canned" complaints often filed within a few hours of a stock price drop).
15. Id. (describing argument that most of the millions of dollars paid in securities fraud settlements was paid to plaintiffs' attorneys).
17. See, e.g., Securities Litigation Reform: Hearings Before the Subcomm. on Telecomm. and Finance of the House Comm. on Energy and Commerce, 103d Cong., 2d Sess. 22 (1994) (statement of Sen. Dodd) (claiming that "many cases are filed just to coerce a settlement").
18. See Conference Report, supra note 4, at H13699 (describing targeting of accountants
costs of defense imposed pressure on defendants to settle even weak cases, pressure that was aggravated by the financial incentives created by the third party payment structure of insurance and indemnification. The settlement process also contributed to the problem. Individual shareholder claims tended to be relatively small, so class members had little incentive to monitor the litigation of the case and the settlement decision. Plaintiffs' lawyers, on the other hand, had an incentive to maximize their fee relative to the amount of work they invested in the case, a motivation that bore no necessary correlation to the size of the recovery to class members. The large size of the lawyers' economic interests relative to those of their clients created a structure in which plaintiffs' lawyers had both primary decisionmaking authority and the incentive to make litigation decisions in their own economic interests.

Some lawyers went further in an effort to generate legal fees by developing securities fraud litigation. Witnesses before Congress testified to lawyers maintaining stables of named plaintiffs who were available for use as class representatives at counsel's behest. Lawyers without a ready stock of plaintiffs obtained referrals through payments to brokerage firms. These plaintiffs received bonus payments for their participation but had little actual role in the subsequent cases and were often ignorant of the nature of the claims to which they lent their names.

This then was the scenario described as lawyer-driven litigation to which Congress directed its efforts in the Reform Act. The Reform Act contained a wide range of statutory reforms that have been described in detail elsewhere, but that targeted the class action structure in particular. Concerned about lawyer-driven litigation, Congress sought to limit the class action lawyer's ability to generate litigation through the use of professional plaintiffs. Toward that end, Congress limited the number of lawsuits in which an individual could serve as class representative, and other deep pockets as defendants because of their assets and insurance coverage rather than because of their culpability.

19. According to the Conference Report, “discovery costs account for roughly 80% of the total litigation costs in securities fraud cases.” Id. at H13701 (citations omitted).


21. Macey & Miller, supra note 8, at 19 (stating that class members' stakes are often so small that the litigation is of virtually no importance to them).

22. See, e.g., Janet Cooper Alexander, Rethinking Damages in Securities Class Actions, 48 STAN. L. REV. 1487, 1534 (1996) (describing process by which setting attorneys fee as percentage of recovery creates an incentive for lawyers to obtain a high hourly fee by seeking early settlement without conducting an adequate investigation).

23. See, e.g., Macey & Miller, supra note 8, at 22–24 (describing economic incentives for plaintiffs' counsel).


25. See generally Seligman, supra note 9 (describing history and provisions of the Reform Act).

26. See Reform Act, supra note 3 (adding Sec. Act § 27(a)(3)(B)(vi); Sec. Ex. Act §
banned referral fees to brokers,\textsuperscript{7} and prohibited class representatives from receiving special compensation.\textsuperscript{8} Congress further required any plaintiff seeking to serve as class representative to file a statement certifying that he or she has reviewed the complaint and authorized its filing and that he or she has not purchased stock for the purpose of participating in the litigation.\textsuperscript{9}

In a further effort to transfer control of securities litigation away from lawyers and into the hands of class members, Congress adopted the lead plaintiff provision.\textsuperscript{10} The Reform Act requires the court to appoint a lead plaintiff to oversee the conduct of every securities fraud class action. The Act provides that the class member with the largest interest in the litigation is presumptively the most appropriate lead plaintiff\textsuperscript{11} and contains provisions to encourage participation by institutional investors as lead plaintiffs. The lead plaintiff is given the authority to retain class counsel, subject to approval by the court. The Act also seeks to eliminate the traditional "race to the courthouse"\textsuperscript{12} through the lead plaintiff appointment process by requiring any plaintiff who files a securities fraud class action to provide notice of the action and of the opportunity for other shareholders to seek lead plaintiff status in a widely circulated business publication within twenty days of filing the complaint.\textsuperscript{13} Within ninety days of the published notice, the court must consider any motions seeking appointment as lead plaintiff and make the appointment.\textsuperscript{14}

\textbf{III. Evaluating the Lead Plaintiff Provision}

\textbf{A. The Potential of Institutional Activism}

The most comprehensive defense of the lead plaintiff provision is the one provided by its creators, Professors Weiss and Beckerman who, in a 1995 \textit{Yale Law Journal} Article, developed the model Congress adopted in the Reform Act.\textsuperscript{15} Weiss and Beckerman observed that institutional investors account for a large

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\textsuperscript{7} D(a)(3)(B)(vi) (limiting individuals to serving as lead plaintiffs in no more than five securities class actions during a three-year period).
\textsuperscript{8} Id. (adding Sec. Ex. Act § 15(c)(8)).
\textsuperscript{9} Id. (adding Sec. Act § 27(a)(4); Sec. Ex. Act § 21D(a)(4)).
\textsuperscript{10} Id. (adding Sec. Act § 27(a)(2); Sec. Ex. Act § 21D(a)(2)).
\textsuperscript{11} The lead plaintiff provision was adopted in response to a law review article proposal by Professors Weiss and Beckerman. See Elliott J. Weiss & John S. Beckerman, \textit{Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions}, 104 YALE L.J. 2053 (1995) (proposing that investors with the largest stakes serve as lead plaintiffs in securities fraud class actions).
\textsuperscript{12} Reform Act, supra note 3 (adding Sec. Act § 27(a)(3); Sec. Ex. Act § 21D(a)(3)). The presumption is rebuttable. See Greebel v. FTP Software, Inc., 939 F. Supp. 57, 59 (D. Mass. 1996) (holding that presumption can only be rebutted by a member of the plaintiff class).
\textsuperscript{13} Conference Report, supra note 4, at H13700 (stating that "the selection of the lead plaintiff and lead counsel should rest on considerations other than how quickly a plaintiff has filed its complaint").
\textsuperscript{14} Reform Act, supra note 3 (adding Sec. Act § 27(a)(3)(A)(i); Sec. Ex. Act § 21D(3)(A)(i)).
\textsuperscript{15} Id. (adding Sec. Act § 27(a)(3)(B)(i); Sec. Ex. Act § 21D(3)(B)(i)).
\textsuperscript{16} See generally Weiss & Beckerman, supra note 30.
portion of the interests represented by class action lawyers and that their claimed losses are substantial. According to Weiss and Beckerman, these large stakes give institutional investors an incentive to monitor, but procedural impediments predating the Reform Act impeded institutional monitoring. These impediments included the race to the courthouse, that is, the court’s general practice of awarding lead counsel status to the lawyer who files the first complaint, lack of notice that a case had been filed, and discovery relating to the class representative requirements of adequacy and typicality.

As a solution, Weiss and Beckerman proposed the model adopted by the Reform Act, in which the procedures governing notice and the selection of lead plaintiff were designed to favor substantial shareholders, particularly institutional investors, rather than rewarding winners of the race to the courthouse. Under this system, institutions would receive information about proposed litigation and be in a position to monitor. Because the lead plaintiff selects class counsel, institutional investors would also be able to negotiate fee arrangements. Weiss and Beckerman speculated that the process of fee negotiation could be used to reduce agency costs and better tie litigation strategy to class member interests through greater innovations in fee structures than those traditionally employed by judicial fee awards.

The ability of a law firm to file a complaint rapidly was a poor proxy for its competence. Judicial monitoring of the process was minimal however; the acquiescence of courts in the race to the courthouse reflected their unwillingness to determine which firm would provide the best representation at the lowest cost. The lead plaintiff provision thus replaces a process in which plaintiffs’ counsel competed for the financial rewards of the class counsel position through means that impeded rational litigation choices with a system in which a sophisticated investor with a meaningful stake in the litigation and a strong negotiating position makes the selection.

The lead plaintiff provision also vests oversight in a litigant with a substantial stake in the outcome, increasing the incentives to monitor the litigation and settlement processes. A large investor has a financial incentive to prevent plaintiffs’ counsel from selling out legitimate claims too easily; early settlement of strong cases on poor

36. Id. at 2088–94.
37. Id. at 2095–2104.
38. See id. at 2062–63 (describing courts’ general practice of appointing as lead counsel the lawyer who files the first complaint).
39. Id.
40. Id. at 2105.
41. Id. at 2107.
42. Id.
43. Commentators have suggested alternative methods of selecting lead counsel, and a few courts have experimented with alternatives. See id. at 2107–10 (discussing and criticizing several such alternatives).
44. See, e.g., Keith Johnson, Institutional Investor Participation in Class Actions After the Private Securities Litigation Reform Act of 1995, ALI–ABA, Nov. 7, 1996, at 379, 381–82 (describing the interest of the State of Wisconsin Investment Board in securities fraud class action litigation as amounting to as much as 20% of the total damage claim and resulting in recovery of approximately $19 million over the past five years).
terms will not adequately compensate the lead plaintiff for its losses." Institutional investors may also have greater sophistication and resources to devote to the monitoring effort and more familiarity with the legal and factual issues in securities fraud litigation, making them effective as well as motivated monitors. The legislative preference for increased institutional investor involvement in securities litigation, because of these attributes, is thus consistent with calls for greater institutional investor activism generally in corporate governance."

Substantial shareholders may also have litigation incentives that reflect general social welfare. To the extent that much securities litigation results merely in a shift of assets from one shareholder class to another," substantial shareholders who are broadly diversified will rationally reject such cases as producing no social gain." Weak cases that burden business through the imposition of litigation costs will similarly appear undesirable to institutions which benefit from a litigation structure that minimizes the burden on legitimate business activity. At the same time, substantial shareholders are likely to appreciate the deterrence value of securities fraud litigation as well as its capacity to generate a monetary recovery in a particular case and may resist settlements that do not impose adequate accountability on wrongdoers." Thus the lead plaintiff provision offers the possibility of decreasing the control of plaintiffs' counsel over the litigation process and reducing the problems of too much litigation of weak cases and poor settlements in strong cases.

Early experience demonstrates that institutional activism has the potential to alter the decisionmaking process in securities fraud class actions. Even before the adoption of the Reform Act, institutional investors had made some attempts to exercise greater control over securities litigation, attempts that justify Congress' faith in their participation as lead plaintiffs. In litigation over the disclosure of defects in the Intel pentium chip, for example, a group of institutional investors collectively investigated the securities fraud claims and determined that they were without merit." The group

45. Weiss & Beckerman, supra note 30, at 2121 (suggesting that "largest benefit" of institutional monitoring of class actions is likely to be more favorable settlement terms for plaintiff class).


49. See In re California Micro Devices Sec. Litig., 168 F.R.D. 257, 272 (N.D. Cal. 1996) (observing that rational institutional investors will only pursue cases that "generate a genuine deterrent effect" and rejecting proposed settlement in light of objections by institutional investors that the settlement lacked such a deterrent effect).

then drafted a detailed letter to plaintiffs' counsel asking that the suit be dismissed. Although plaintiffs' counsel had voluntarily dismissed the case prior to learning of the letter, the process demonstrated both the institutions' ability to identify a claim meriting dismissal and their willingness to become involved in achieving that result.

In the same vein, the Colorado Public Employees' Retirement Association ("ColPERA") objected to a settlement in In re California Micro Devices Securities Litigation as undervaluing the defendant's cash resources. Upon learning of ColPERA's objection, Judge Walker refused to approve the settlement and to certify the putative class representatives, finding that they had failed to monitor class counsel adequately. Instead, Judge Walker appointed ColPERA as class representative. In choosing an institutional investor as class representative, Judge Walker articulated the same confidence as that expressed by Congress in the Reform Act.

Institutional investors have financial interests in the outcome of securities class actions which dwarf the interests of individual plaintiffs, and with this increased financial interest comes an increased incentive to monitor class counsel's conduct of the action. Institutional investors, moreover, are much better situated to conduct such monitoring, both because they have greater resources and because, as repeat players in securities class actions, they are experienced in the issues which these actions inevitably raise.

Following ColPERA's appointment as class representative, the settlement was favorably renegotiated.

In a related context, the California Public Employees' Retirement System ("CalPERS") recently sought and obtained permission to intervene in a state derivative suit. CalPERS, which owned 1.3 million shares, had retained its own counsel to monitor the proceedings in Weiser v. Grace, a case involving allegations of breaches of fiduciary duty by the directors of W.R. Grace. When plaintiffs' counsel proposed to settle the case on terms that did not involve any monetary payment to the company, CalPERS objected to the settlement. In addition to permitting CalPERS to intervene, the court appointed CalPERS' counsel to serve as co-lead counsel for the

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51. See id. at 608-26 (containing a copy of the letter as Exhibit A).
52. Id. at 595.
54. Judge Walker later appointed the California State Teachers' Retirement System as an additional class representative. Id. at 277.
55. Id. at 275.
56. Johnson, supra note 44, at 384. Because the renegotiated settlement involves a greater proportion of cash, and because of fluctuations in the value of the stock portion of the settlement, there is currently some debate before the court regarding whether the new settlement is more favorable to class members.
59. Kasner & Musoff, supra note 57.
plaintiffs, thereby allowing CalPERS full participation in the settlement negotiations.  

The first widely reported effort by an institutional investor to gain lead plaintiff status under the Reform Act was also successful. In *Gluck v. Cellstar,* the experienced plaintiffs' firm of Milberg Weiss Bershad Hynes & Lerach filed a class action suit on behalf of individual investors. After plaintiffs complied with the notice requirements of the new statute, the State of Wisconsin Investment Board filed a request for appointment as lead plaintiff. In an October 1st ruling, the court granted that request over Milberg Weiss' objection. Significantly, the court denied Milberg Weiss' request that the court designate its plaintiff group and SWIB as co-lead plaintiffs, rejecting the invitation to institute litigation management by committee.  

SWIB considered a proposal from Milberg Weiss to serve as lead counsel as well as proposals from several other firms. The proposals included descriptions of anticipated litigation plans and fee schedules. Subsequently, SWIB selected its lawyers, the Philadelphia firm of Blank, Rome, Comisky & McCauley, as lead counsel. The agreed fee arrangement provided for counsel to receive a sliding scale percentage of the recovery, with the percentage increasing both with the size of the recovery and the progress of the matter through various stages of litigation. This structure, unlike traditional judicial fee awards, was designed to give plaintiffs' counsel an incentive to pursue a sizeable recovery even if that recovery required additional litigation effort. The fee structure thus aligned the interests of the law firm more closely with those of SWIB, its client.

**B. The Possible Dark Side of Institutional Activism**

Institutional activism enjoys broad support. Many commentators believe institutional investors are well situated to improve monitoring and reduce agency costs through greater participation in corporate governance. Institutional participation in securities fraud litigation, through the lead plaintiff provision, offers a classic example of institutional activism as a means to reduce agency problems. Yet there are reasons to question both the willingness of institutional investors to participate and the value of their participation. In evaluating the lead plaintiff provision, it is important to consider the possible dark side of institutional activism in

60. *Id.* This was not the first case in which CalPERS had intervened in an effort to oppose the settlement of a derivative suit. In *Kahn v. Sullivan,* 594 A.2d 48 (Del. 1991), for example, CalPERS intervened and opposed the settlement of a suit challenging a decision of Occidental Petroleum's Board of Directors to make a charitable donation to construct a museum to house the Armand Hammer Art Collection. The court in *Kahn* approved the settlement over CalPERS' objections. *Id.* at 58 (describing lower court's approval of settlement); *id.* at 63 (finding lower court's approval of settlement did not constitute an abuse of discretion).


63. *See Johnson, supra note 44, at 386–87 (describing SWIB's process of selecting Blank, Rome to serve as lead counsel).*

64. *Id.* (describing fee arrangement).

65. *See, e.g., Weiss & Beckerman, supra note 30, at 2056.*
addition to its merits."

1. The Risk of Passivity

One pending question about the power of the lead plaintiff provision is the extent to which institutional investors will participate under the Reform Act as lead plaintiffs. Weiss and Beckerman themselves recognized that institutions may be wary of the costs and burdens associated with lead plaintiff status. In addition to institutional fear of liability associated with lead plaintiff status—a fear which the Conference Report attempted to dissipate with a statement that the lead plaintiff provision does not create any new fiduciary duty on the part of institutional investors—lead plaintiffs have reason to fear the practical burdens of activism. Lead plaintiff participation requires institutions to bear costs such as investigating a securities fraud claim, reviewing a complaint, submitting to discovery, selecting lead counsel, and monitoring the litigation and settlement process. These costs create free rider problems, because institutions, particularly those concerned about minimizing administrative costs generally, are rationally apt to prefer that another investor take the initiative to become involved.

Institutions may also fear that the benefits of greater activism will be outweighed by adverse consequences. Active participation in litigation may provide an institution with inside information that limits its ability to trade in the stock that is the subject of the litigation. Institutions may sacrifice their relationships with issuers by litigating securities fraud claims, reducing the superior access and influence that some institutional investors have come to enjoy. Some institutional investors may also be


67. See Dominic Bencivenga, Litigation Re-Formed: Lawyers Report on ‘Year 1’ Under Securities Act, N.Y.L.J., Jan. 16, 1997, at 5 (observing that “large investors and institutional investors have not been stepping forward in significant numbers to become the most adequate plaintiff”).


69. Conference Report, supra note 4, at H13700 (stating that “the most adequate plaintiff provision does not confer any new fiduciary duty on institutional investors and the courts should not impose such a duty”).

70. See, e.g., Johnson, supra note 44, at 386–87 (describing uncertain costs and risks associated with institutional participation as lead plaintiffs).

71. See, e.g., Fisch, supra note 46, at 1020–23 (describing how free rider problems create particular disincentives for activism among institutions for which performance is judged relative to the performance of their peers).

72. See Bencivenga, supra note 67 (quoting defense attorney Bruce G. Vanyo as attributing lack of institutional participation to the fact that lead plaintiff status offers “too much risk and too little to gain”).

73. See, e.g., Johnson, supra note 44, at 5 (questioning whether institution serving as lead plaintiff will be precluded from trading in the company’s stock during the course of the litigation).

74. See John C. Coffee, Jr., Class Wars: The Dilemma of the Mass Tort Class Action, 95 COLUM. L. REV. 1343, 1352 n.25 (1995) (predicting that most institutions will prefer to avoid active participation in class actions in order to preserve their relationships with corporate
subject to political pressure or other constraints on their freedom to make litigation decisions.

If institutions do not affirmatively decide to participate, despite the Reform Act’s invitation, securities litigation may proceed in substantially the same manner as before. Although post-Reform Act litigation demonstrates some effort by institutions to become involved in securities fraud litigation, individuals rather than institutions have secured lead plaintiff status in most cases to date. Indeed, plaintiffs appear to be responding to Congress’ direction that the appropriate lead plaintiff is the plaintiff with the largest stake by forming groups of individuals to serve as co-lead plaintiffs. Recent examples include Weikel v. Tower Semiconductor Ltd., in which a group of ten individual plaintiffs was appointed; In re Health Management Inc. Securities Litigation, in which eleven individual plaintiffs were appointed co-lead counsel; and In re Vista 2000, Inc. Securities Litigation, in which thirteen individual plaintiffs were appointed. The plaintiffs, and more importantly the plaintiffs’ counsel, responsible for initially filing the complaints, frequently retain their role in the litigation despite the lead plaintiff provisions. Thus, for example, in Greebel v. FTP Software, Inc., the plaintiffs filing the complaint were appointed as lead plaintiffs and their lawyers, the firm of Milberg Weiss, were appointed class counsel, a result mirroring the standard practice pre-dating the adoption of the Reform Act.

Similarly, it appears that lead counsel positions are being secured, in most cases, by the traditional plaintiffs’ securities firms. Milberg Weiss, the leader in pre-Reform Act filings, has already secured a number of lead counsel appointments, including appointment as sole lead counsel in Greebel and Tower Semiconductor and as co-lead counsel in Vista 2000 and Wellcare. Similarly, the three firms jointly appointed class counsel in In re Cephalon Securities Litigation were all traditional plaintiffs’ securities firms. Even where institutional investors are among the lead

management and the superior access to information resulting from those relationships).

85. See Bohn & Choi, supra note 16, at 909 n.27 (listing major traditional plaintiffs’ firms).
plaintiffs, traditional plaintiffs' firms are obtaining lead counsel appointments."

The structure of the lead plaintiff provision requires institutions to act affirmatively to change the existing litigation procedure." In the absence of an institution’s motion to participate, the first filer and his or her law firm will continue to control the litigation. This scenario was exemplified in Greebel, in which the court concluded that the statutory language of the Reform Act limits the right to challenge the qualifications of the lead plaintiff and to conduct discovery on that issue to other members of the plaintiff class." Over the objection of the defendant, the Greebel court therefore appointed as lead plaintiffs the plaintiffs who had filed the initial complaint." The court’s holding was constrained by a statutory structure that leaves the decision to seek appointment in the hands of the large shareholder. Because no other class members had sought appointment as lead plaintiff, the shareholders who filed the complaint therefore had the largest financial interest and were otherwise most appropriate.""

If, because of their generally small stakes, class members are rationally apathetic on the issue of who serves as lead plaintiff, many cases are likely to be litigated along the lines of the Greebel model, in which no substantial shareholder attempts to interfere with the appointment of the initial filer and his or her counsel. Moreover, institutions that do not seek lead plaintiff status themselves have little reason to object to such an appointment. In terms of the expected effect on the institution’s welfare, the appointment of lead plaintiff is far less significant than the terms of settlement, yet pre-Reform Act cases demonstrated relatively little involvement by institutions even at the settlement stage. California Micro Devices was the exception, not the norm.

2. The Risk of Activism

The risk of institutional passivity should not be overstated. Although the lead plaintiff proposal has been criticized as offering institutional investors insufficient incentive to incur the costs associated with taking a more active role in securities litigation, the apparent willingness of institutional investors to become involved even without express legislative support offers the possibility that some institutions will accept Congress’ invitation. Given the degree of institutional investment in the stock market, a relatively small percentage of institutional involvement could change the control structure in securities fraud litigation.

The wisdom of inviting institutional involvement is another matter. First, the adoption of the lead plaintiff provision creates some tension between its procedures and the pre-existing requirements of Federal Rule of Civil Procedure 23." If

87. Cf Alexander, supra note 22 (proposing regulatory reform that requires institutions to take an active role in securities litigation in order to participate in the class action).
89. Id.
90. Id.
91. See generally Vincent R. Cappucci, Conflicts Between Rule 23 and Securities
Institutions decide to participate actively, their participation may threaten the process by which Rule 23 protects the interests of all class members. The text of the Reform Act does not address the manner in which this tension is to be reconciled. Second, and more importantly, there are reasons to question the ability of institutional involvement to address the general goal of the Reform Act: the concerns associated with lawyer-driven litigation.

Initially, participation by institutions as lead plaintiffs must be consistent with the protection that Rule 23 and due process provide for absent class members through the use of the class representative. To insure that the interests of class members are treated fairly, Rule 23 requires the court to identify a class representative. The court must determine that the class representative fairly and adequately represents the interests of the class, that the class representative's claims are typical of those of the class, and that the class representative is not subject to unique or personal defenses. Institutional investors may not meet these criteria.

Weiss and Beckerman's article and Congress' response applaud the value of institutional investors as lead plaintiffs precisely because they are atypical in terms of their larger stake, greater sophistication and better access to information. These qualities may be held against them, however, as defendants challenge their reliance on public disclosures or assert a failure to exercise due diligence. Moreover some institutions like CalPERS enjoy a degree of informal access to corporate management not shared by individual investors. Some courts have found that these qualities may subject a sophisticated investor to unique defenses in securities fraud litigation. An investor who faces the prospect of the sophisticated investor defense may not meet the typicality requirement of Rule 23.

Similarly, an institution may have traded in

Reform Act, N.Y.L.J., Apr. 2, 1996, at 1 (describing potential inconsistencies between requirements of Rule 23 and participation of institutional investors as lead plaintiffs).
94. See, e.g., In re General Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig., 55 F.3d 768, 796 (3d Cir.), cert. denied, 116 S. Ct. 88 (1995) ("The Rule 23(a) class inquiries (numerosity, commonality, typicality, and adequacy of representation) constitute a multipart attempt to safeguard the due process rights of absentees.").
95. See Brodsky, supra note 62 (describing plaintiffs' arguments in Gluck v. CellStar that SWIB did not meet the typicality requirement of Rule 23).
97. The plaintiff group challenging SWIB's effort to be appointed lead plaintiff argued that SWIB was atypical because it was a sophisticated investor and because it used investment methods that were not typical of smaller investors in the plaintiff class. Johnson, supra note 44, at 388.
98. See, e.g., Judith H. Dobrzynski, Small Companies, Big Problems, N.Y. TIMES, Feb. 6, 1996, at D1 (describing CalPERS' superior access to corporate boards).
99. See Macey & Miller, supra note 8, at 72-73 (describing judicial acceptance of sophisticated investor defense); Cappucci, supra note 93 (same).
100. See, e.g., Zandman v. Joseph, 102 F.R.D. 924, 932 (N.D. Ind. 1984) (finding that
and out of the relevant stock throughout the class period. This trading is, of course, relevant to the extent of the institution's damage claims, but it is also relevant to issues such as the manner in which the class is defined and the institution's reliance.100

The litigation objectives of institutional investors may also differ from those of the individual investors in the class.101 Obviously an institution that continues to own stock is poorly suited to represent investors who are no longer invested in the company.102 Most institutions hold a broad share of the market in a diversified portfolio. Securities litigation that transfers money from present stockholders to past stockholders is of little value to these investors. Elimination of this type of litigation, however, may prejudice individual investors.103 Similarly, an institution may have diversified away the risks associated with being on the losing end of a securities fraud, and recognizing that over time, it is likely to gain an equal amount from being an innocent beneficiary of improper disclosure, it may be unwilling to incur the costs associated with litigating the redistribution of damage claims within its own pocket. Although rational from the institution's perspective, that litigation posture need not produce the optimal level of securities enforcement from the perspective of all investors.

Given that Congress chose the lead plaintiff provision instead of alternatives such as a requirement that filing plaintiffs own a designated minimum quantity of stock, it is reasonable to infer that Congress intended institutions to represent the interests of small as well as large shareholders. A statutory provision imposing a minimum shareholding requirement would achieve Congress' objective of insuring that claims were filed by those plaintiffs with a substantial financial stake in the litigation.104 A minimum shareholding requirement was objectionable, however, on the grounds that investor who invested $3 million in defendant corporation's stock and had substantial contacts with officers of the company and financial analysis failed to meet typicality requirement); Grace v. Perception Tech. Corp., 128 F.R.D. 165, 169 (D. Mass. 1989) (holding that "contact with corporate officers and special meetings at the company will render a plaintiff atypical to represent the class").

101. See, e.g., Fleming Co. Inc. Litig., Nos. 96-CV-869, 96-CV-853, 96-CV-830 (W.D. Okla. filed April 4, 1996) (first-filing plaintiffs claiming that causation defense renders an institutional investor unsuitable as class representative); J.H. Cohn & Co. v. American Appraisal Assocs., Inc., 628 F.2d 994, 998 (7th Cir. 1980) (finding institutional investor's sophistication might prevent it from establishing reliance and that the presence of this potential defense destroys its typicality).

102. See Vandergriff, supra note 48 (suggesting that public or political pressure faced by some institutional investors may make them less willing to settle litigation).

103. The interests of continuing shareholders will conflict with those of class members who have sold on the issue of whether to seek a large compensatory damage award. See Alexander, supra note 22, at 1505 (arguing that pursuing meritorious litigation may not be in the best interests of continuing shareholders).

104. See, e.g., id. at 1504 (observing that, because institutions are diversified and frequent investors, they may prefer deterrence to compensation as a litigation objective).

it would eliminate the small shareholders' recourse to the courts, rendering small shareholders dependent on a large shareholder's decision to pursue litigation.

This observation suggests a weakness in the lead plaintiff provision. To the extent that the Reform Act allows small shareholders to file suit but permits institutional investors to take control of the litigation away from the filing plaintiff, it preserves for the small investor only the opportunity to incur the costs associated with drafting and filing a complaint and eliminates meaningful access to the judicial system. The anticipation that individual plaintiffs and their lawyers may lose control of filed cases through the appointment of others as lead plaintiffs also diminishes the incentive for smaller investors to investigate instances of fraud and initiate legal action. To the extent that one value of private litigation is to supplement public enforcement efforts in an area in which detection of wrongdoing is difficult, the potential reduction in investigation effort imposes a public cost on market integrity.

Concerns about typicality and the ability of institutions to represent small investors could be partially mitigated through the use of co-lead plaintiff appointments. Courts have appointed multiple class representatives in pre-Reform Act cases and, as indicated above, a number of courts have appointed groups of investors as co-lead plaintiffs under the Reform Act. If co-lead plaintiff appointments reflect the diversity that exists within the plaintiff class, they permit the lead plaintiff to represent a broader range of investor interests as well as reducing the potential for opportunistic self-dealing by the lead plaintiff.

The downside of appointing multiple litigants to serve as co-lead plaintiffs is frustration of the Reform Act's effort to increase the efficiency of the litigation process and to reduce agency costs. Indeed, prior reform proposals such as the Common Sense Legal Reforms Act would, through the use of plaintiff steering committees, have implemented an approach analogous to the use of multiple co-lead plaintiffs. The proposed steering committees had the drawback of generating administrative costs that threatened to overwhelm any additional value created through the committee's oversight. The perception that multiple co-lead plaintiffs would render the administration of class actions unwieldy may have influenced the Gluck court's decision to deny the filing plaintiff's request to share co-lead plaintiff


107. See supra notes 75–78 and accompanying text.

108. H.R. 1058, 104th Cong., 1st Sess. § 2 (1995) (proposing steering committees of at least five members which would have primary responsibility for directing counsel on behalf of the class as well as reviewing offers of settlement).

109. See, e.g., Richard A. Nagareda, Turning from Tort to Administration, 94 MICH. L. REV. 399, 955–66 (1996) (describing holdout problem and other failures created by the steering committee's negotiations in the federal asbestos litigation and explaining that a broadly representative steering committee will encounter difficulty in satisfying all its constituents).
Among other things, joint appointment could create conflicts over the choice of class counsel. Alternatively, if courts follow the pattern emerging from cases like IVAX,\textsuperscript{111} Medaphis,\textsuperscript{112} and Vista 2000,\textsuperscript{113} and appoint multiple lead counsel as well multiple lead plaintiffs, such appointments could further multiply the already substantial legal fees associated with class actions.\textsuperscript{114}

A still darker side of institutional participation in securities litigation is the potential for collusion. To the extent that institutions exercise control of litigation decisions, their control need not be exercised for the general benefit of the shareholder class but could instead be used for the creation and appropriation of private gains. Other commentators and I have identified the ability of institutions to use their bargaining power to obtain private gains as a general risk of institutional activism.\textsuperscript{115} This risk is similarly present in securities litigation. Institutions may seek to obtain favorable investment opportunities, better access to corporate information, or influence over corporate governance decisions, in exchange for cooperation in addressing the concerns of securities fraud defendants. These exchanges can result in institutions exercising their decisionmaking authority in ways that are inconsistent with the needs of the shareholder class.

The risk of collusion is enhanced by the fact that institutions have traditionally maintained the ability to act through informal contacts with issuers in ways not subject to public view. The Reform Act operates to reduce this prospect by mandating increased disclosure of settlement terms. Section 101 of the Act requires settlement notices to include an explanation of the reasons for the settlement, the amount sought in attorneys fees, and a statement from each settling party describing the amount of recoverable damages.\textsuperscript{116} The extent to which this disclosure will limit collusive settlement is unclear, however. As some commentators have observed, courts have evidenced limited ability to scrutinize inadequate or collusive settlements,\textsuperscript{117} and there is little reason to believe that disclosure under the Reform Act will substantially increase judicial monitoring of settlements.\textsuperscript{118} Indeed, the adoption of the lead plaintiff

\textsuperscript{110} See Harvey L. Pitt & Karl A. Groskaufmanis, Business Watch, NAT’L L.J., Oct. 28, 1996 at B5 (claiming that “management by committee” would also reduce the attraction of the lead plaintiff role for many institutional investors).


\textsuperscript{114} See Alexander, supra note 22, at 1532 (observing that appointment of multiple lead counsel can lead to performance of duplicative or unnecessary legal work in an effort to justify fee awards).

\textsuperscript{115} See, e.g., Rock, supra note 66; Fisch, supra note 46.

\textsuperscript{116} Reform Act, supra note 3 (adding Sec. Act § 27(a)(3)(B)(7); Sec. Ex. Act § 21D(a)(3)(B)(7)).

\textsuperscript{117} See, e.g., Macey & Miller, supra note 8, at 45–46 (describing judicial approval of settlements as a “highly imperfect” means of protecting plaintiffs’ interests).

\textsuperscript{118} Note, Investor Empowerment Strategies in the Congressional Reform of Securities
provision is arguably a recognition of the ineffectiveness of judicial monitoring. Moreover, litigants retain ample opportunities through the discovery process to control the record upon which settlement review is based. This enables litigants to convince a reviewing court that the settlement terms are reasonable.

The lead plaintiff’s control over the selection of class counsel may also create an opportunity for collusion. The Reform Act provides that lead plaintiffs will be responsible for the choice of class counsel, subject to approval by the court. The Act provides no standards for judicial review, and the circumstances under which courts should defer to the lead plaintiff’s choice are therefore unclear. Historically, courts in most cases have been unwilling or unable carefully to scrutinize the qualifications of class counsel. Indeed, judicial reluctance to impose meaningful selection criteria directly contributed to the “race to the courthouse” scenario, by placing a premium on being first to file rather than rewarding the counsel that files the best complaint or offers the most cost-effective litigation strategy. The Reform Act offers little indication as to why institutional investors are better equipped than courts to select lead counsel, and even less guidance as to the manner in which courts can effectively review lead counsel’s decision.

On the one hand, it is unclear that institutions will exercise this selection power differently than traditional plaintiffs. The existing plaintiffs’ bar in securities fraud litigation is highly specialized. A small number of firms are responsible for the filing of most cases, and most other firms have little experience litigating securities claims, at least on the plaintiffs’ side. If institutions choose among the traditional plaintiffs’ counsel, as initial practice under the Reform Act suggests most are doing, substituting institutions for individual class representatives may have limited impact on the conduct of securities fraud litigation. Indeed, the choice of a traditional plaintiffs’ firm may signal an acceptance of the firm’s expertise and litigation strategy as appropriate.

If, on the other hand, institutions choose other lawyers, their choice may be criticized for sacrificing the developed expertise of existing plaintiffs’ firms. Among Milberg Weiss’ objections to SWIB’s selection of Blank Rome in Gluck v. CellStar was the argument that Blank Rome had no experience representing securities fraud plaintiffs. The Reform Act offers courts no guidance for weighing this argument or for evaluating the qualifications of the chosen firm. Nor does the Act indicate whether it is appropriate for institutions to prefer law firms with which they have ongoing

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120. See Rutter, supra note 79 (describing majority of filings as made by top five plaintiffs’ firms).
business relationships to the exclusion of firms more experienced in securities litigation.

The Reform Act creates an incentive for lawyers seeking the lucrative class counsel appointment to develop relationships with institutional investors. Pre-Reform Act litigation was criticized for allowing lawyers to recruit class action plaintiffs rather than the other way around. Institutional investors, however, are readily identifiable as potential lead plaintiffs; it is rational for existing plaintiffs' firms to cultivate institutions as clients. The Act thus offers the opportunity to create a lucrative new position, that of class action counsel for an institution such as CalPERS, a position that offers a lawyer more secure access to the counsel fees associated with securities fraud litigation than the pre-Act litigation structure. By creating these incentives, the Reform Act may alter the litigation of securities class actions, but it need not lessen the degree to which they are controlled by lawyer rather than client.122

Institutions may also utilize their increased power to select class counsel by extracting private gains in exchange for lead counsel appointments.123 These gains might involve favorable treatment in the subject litigation or instead involve unrelated legal services. Although the Reform Act bars lead plaintiffs from receiving bonuses or preferential treatment in a settlement, courts are likely to have difficulty discovering if a lawyer has, for example, agreed to provide unrelated legal services to an institutional investor at below market rates in exchange for selection as class counsel.

Whether institutional investors will exercise their new power under the Reform Act to control securities litigation remains unclear. Even more uncertain is the extent to which Congress' decision to vest this power in the hands of institutional investors has created a new opportunity for exploitation of small investors. What is perhaps most unclear, however, is the extent to which the procedural reforms of the Act, including the lead plaintiff provision, will transfer control of securities class actions from lawyer to client.

IV. PROCEDURAL REFORM BEYOND SECURITIES LITIGATION

Outside the securities area, critics have offered many proposals for general class action reform,124 some of which have been discussed in this symposium.125

122. Nor will the procedural changes adopted by the Reform Act prevent this process. Although elimination of bonuses and broker-referral fees reduces the ability of lawyers to recruit individual plaintiffs, these reforms are not meaningful checks against collusion between plaintiffs firms and institutional investors. Firms do not need brokers, for example, to refer them to institutional putative lead plaintiffs; the investment holdings of many institutional investors are in the public domain.

123. See Fisch, supra note 46, at 1038-47 (discussing potential for institutional investors to use their influence to generate private gains).

Analyzing reform proposals is complicated by the fact that the class action structure is used in a range of situations. As the experience with securities litigation reform demonstrates, a particular substantive area may have characteristics that generate special opportunities for abuse or, alternatively, create unique opportunities for experimentation and reform. A more general problem is that class actions divide into two distinct economic models: “small claimant” cases and “large claimant” cases.

A. Small Claimant Class Actions

Traditionally, the class action format was used to aggregate small claims that were not worth litigating separately. Because the claims were small, concerns over individualized justice were limited. Even though small claimant cases presented problems of agency costs and inadequate monitoring by class members, class actions were viewed as an effective means by which to hold defendants accountable for widespread harm. Securities fraud class actions are generally characterized as small claimant cases, as are many cases involving antitrust and consumer fraud claims.

Although the class action model permits and even encourages litigation in situations in which the damages suffered by individual class members are quite small, the public value of supporting litigation in which individual class members have very small stakes is subject to question. The Draft Minutes of the Civil Rules Advisory Committee cite the example of a two cents per month overcharge affecting two million customers as a case in which class certification might not be proper. The filing of such cases is one of the abuses typically attributed to lawyer-driven litigation. Absent the class action vehicle and, more significantly, the potential of small claim cases to generate substantial attorneys fees, most small claimant class actions would...


126. The presence of large institutions as securities fraud class members offers a potential mechanism for reducing the agency costs typically associated with the small dispersed claimholders in a class action. Similar lead plaintiffs may not be available, for example, in consumer fraud cases.

127. Coffee, supra note 74, at 1351–52. Class actions are also used in noneconomic cases and have had substantial impact in areas such as civil rights law. See, e.g., Jack Greenberg, Civil Rights Class Actions: Procedural Means of Obtaining Substance, 39 ARIZ. L. REV. 575 (1997) (describing role of class action device in civil rights litigation).

128. See, e.g., Samuel M. Hill, Small Claimant Class Actions: Deterrence and Due Process Examined, 19 AM. J. TRIAL ADVOC. 147, 150 (1995) (defending class action format as enabling small claimants to litigate claims which would otherwise be economically unfeasible).

129. See Coffee, supra note 74, at 1351–52 (describing securities and antitrust class actions as small claimant cases).

130. Federal law provides one check on the use of federal court class actions to redress claims of trivial damage by barring the aggregation of damages suffered by individual class members to meet the amount in controversy requirement of diversity jurisdiction, but no such barrier applies to claims arising under federal statutes such as the federal securities laws.

not be brought. Indeed, small claimant class actions are structured to provide far more substantial rewards to plaintiffs' counsel than to individual class members.\footnote{132. See generally John C. Coffee, Jr., Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions, 86 COLUM. L. REV. 669, 701-24 (1986) (developing an economic model of plaintiffs' attorneys' incentives to litigate).}

Small claimant class actions also present a clear example of rational class member apathy. Because of the small stakes involved, individual class members have little incentive either to monitor litigation decisions or to opt out to pursue individual claims. This creates litigation in which plaintiffs' counsel has both the largest economic stake and the greatest freedom from client oversight. This structure leads to additional concern about lawyer-driven litigation.\footnote{133. See Macey & Miller, supra note 8, at 19-21 (explaining why plaintiffs in small claimant cases are incapable of adequate monitoring).}

The Reform Act addresses these concerns by attempting to transfer litigation control away from class counsel and back to class members through the lead plaintiff appointment and related provisions. The goal is to have substantial shareholders make the decision whether proposed litigation is worthwhile or whether, apart from attorneys fees, it will produce only trivial benefits.

The proposed amendments to Rule 23 take another approach. Presumably evidencing concern about the absence of analogues to institutional investors in other small claimant class action settings, the amendments place responsibility for determining the value of a proposed class action with the court. The amendments add subparagraph F to subdivision (b)(3) in order to reduce the use of class actions to aggregate trivial claims.\footnote{134. Proposed Rules, supra note 124, at 559.}

Subparagraph F allows a court to make a preliminary determination of the merits of the litigation and, as the Advisory Committee notes explain, to deny certification of class actions in which the probable individual relief is too small to justify the cost of litigation.\footnote{135. See Advisory Committee Minutes, supra note 131, at 542.}

Both the reform to Rule 23 and the lead plaintiff provision thus have a common goal of reducing the incidence of trivial cases, cases that are viewed as the product of lawyer-driven litigation. The extent to which trivial cases characterize federal court class action litigation is unclear, however.\footnote{136. Id. at 544.}

Critics of the reform effort claim that trivial cases are rare. Neither high settlement rates nor small individual recoveries demonstrate trivial or meritless litigation; settlement is the standard procedure for resolving civil claims and small individual recoveries are characteristic of class action litigation.\footnote{137. Id. (describing Federal Judicial Center Study finding that relatively few class actions are filed on claims that, as pleaded, would yield trivial relief); see also Bohn & Choi, supra note 16, at 903 (describing empirical study attempting to evaluate extent to which securities fraud litigation in new issues market serves as a deterrent effect or is frivolous).}

The focus of these concerns on economic recovery to individual class members

138. Indeed, in Phillips Petroleum Co. v. Schutts, 472 U.S. 797 (1985), the plaintiff class consisted of 33,000 members with claims averaging one hundred dollars each. Id. at 801.
is also misleading." A central value of the class action vehicle is its capacity to deter wrongdoing." The private attorney general nature of class actions has been widely defended and is of increasing importance in an era in which the size of government and hence its enforcement resources are being reduced." The SEC itself has defended the deterrent effect of private securities fraud litigation as a valuable component in maintaining the integrity of the U.S. securities markets." The ability of small claimant cases to provide deterrence value requires that they be lawyer driven. The costs of litigation provide an insurmountable barrier to the use of individual claims to redress problems of small scale widespread wrongdoing.

Even if lawyer-driven litigation is defensible in terms of the deterrent effect of litigation, the economics of small claimant class actions generate concern. The relationship of attorneys fees to individual class member recoveries is particularly problematic in that litigation costs, including attorneys fees, threaten to overwhelm litigant recovery. Newspaper articles describe the multimillion dollar fees awarded to successful plaintiffs' firms." Courts appear unable carefully to scrutinize proposed attorneys fees, awarding the amounts requested without adjustment in most cases." In

139. See Kenneth E. Scott, Two Models of the Civil Process, 27 STAN. L. REV. 937, 940 (1975) (arguing that small claimant class action model has "nothing to do with judicial economy" because it enables litigation of cases that would otherwise not be brought); Alexander, supra note 22, at 1508 (proposing regulatory remedy as alternative to compensation model of damages).
140. See Stephen Berry, Ending Substance's Indenture to Procedure: The Imperative for Comprehensive Revision of the Class Damage Action, 80 COLUM. L. REV. 299, 299–300 (1980) (observing that small claimant class actions serve deterrence rather than compensation goals). The ability to provide deterrence through the imposition of compensatory damages is a general tenet of tort law. See, e.g., WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF TORT LAW (1987); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW (4th ed. 1992); STEVEN SHAVELL, ECONOMIC ANALYSIS OF ACCIDENT LAW 5–31 (1987). The extent to which private litigation results in an optimal level of deterrence depends on a variety of factors, including the manner in which damages are determined. See, e.g., E. Donald Elliott, Why Punitive Damages Don't Deter Corporate Misconduct Effectively, 40 ALA. L. REV. 1053, 1057 (1989) (arguing that punitive damages fail to provide optimal deterrence because they are unpredictable).
141. See, e.g., Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 315 (1985) (observing that "the securities markets have grown dramatically in size and complexity, while Commission enforcement resources have declined") (quoting H.R. REP. NO. 355, 98th Cong., 1st Sess. 6 (1983)); see also Woolf v. S.D. Cohn & Co., 521 F.2d 225, 227 (5th Cir. 1975) ("The scarce enforcement resources of the S.E.C. are adequate only to police the most flagrant and widespread abuses in the private placement area.").
142. See Aiding and Abetting Liability Under the Federal Securities Laws: Hearings on the Impact of the Supreme Court's Decision in Central Bank Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs, 103d Cong., 2d Sess. (1994) (statement of Arthur Levitt, Chairman, SEC), available in 1994 WL 233142, at *10 (defending the role of private securities fraud actions as complementing SEC enforcement efforts); see also Bateman Eichler, 472 U.S. at 315 (recognizing the SEC's concern that it "does not have the resources to police the securities industry sufficiently").
143. See, e.g., Rutter, supra note 79 (describing attorneys fees awards totaling $227 million for securities suits brought against high tech companies and settled during the period from 1991 through 1994).
144. See Macey & Miller, supra note 8, at 48 (claiming that "judges rarely reject fee petitions presented as part of a settlement").
this regard, the Reform Act’s requirement that legal fees be limited to a reasonable percentage of the class recovery, a direction that fails to provide a meaningful substantive change from existing legal standards, appears to be, at best aspirational."

Defenders of class action litigation challenge the claim that attorney fee awards are too high. Plaintiffs’ lawyers argue that they bear substantial risks in pursuing class action litigation and expend substantial resources investigating and prosecuting cases. To the extent that large attorneys fees compensate plaintiffs’ lawyers for these costs, a large fee award is not a windfall. More telling, perhaps, is the fact that, because litigation costs are a function of risk and litigation effort, they are high relative to litigant recovery in many cases in which litigation is appropriate.

An example is provided by the Apple Computer case, one of the rare securities fraud cases to proceed to trial on the merits. The case, which involved allegations that Apple and its officers failed properly to disclose information concerning problems in the development of a new computer, resulted in an initial jury verdict of $100 million against the individual defendants—presumably an indication that the case was not frivolous. The jury found in favor of the corporate defendant, however, and following the trial court’s decision to grant judgment notwithstanding the verdict on the ground that the jury verdicts were inconsistent, the case was settled for $19 million. Of the settlement proceeds, plaintiffs’ lawyers received $9 million, defense lawyers got $6 million and the Apple shareholders got approximately $2 million. Although this recovery to Apple shareholders was small both in absolute terms and relative to the costs of the litigation, it is difficult to attack the decision to file a complaint that resulted in a jury award of $100 million in damages. Nor does a $9 million attorneys fee appear unreasonable in light of the litigation efforts provided by plaintiffs’ counsel.

Defending small claimant class actions in terms of their deterrence value rather than in terms of compensation raises a second concern: whether private litigation is superior in achieving deterrence to enforcement efforts by government agencies. State and federal law enforcement organizations have the ability to investigate and punish cases involving widespread small scale fraud and offer an alternative means by which to address wrongful conduct.

145. See id. at 46–61 (describing difficulties associated with judicial review of attorneys fee requests).
146. See, e.g., Coffee, supra note 132, at 703 (describing risks and opportunity costs for plaintiffs’ lawyers); Bohn & Choi, supra note 16, at 925–26 (describing plaintiffs’ lawyers’ arguments that fee awards should compensate them for the risks associated with class action litigation).
147. See In re Apple Computer Sec. Litig., 886 F.2d 1109 (9th Cir. 1989) (describing plaintiffs’ allegations).
148. See Rutter, supra note 79 (describing initial verdict).
149. Id. (describing terms of settlement and attorney fee awards).
150. See generally Thomas E. Kauper & Edward A. Snyder, An Inquiry into the Efficiency of Private Antitrust Enforcement: Follow-on and Independently Initiated Cases Compared, 74 Geo. L.J. 1163, 1220–21 (1986) (analyzing relationship of private actions to government enforcement in antitrust area and finding that most private cases are not follow-ons to government actions).
151. See, e.g., Michigan Attorney General Kelley Slams Telephone Slammers, PR
the private attorney general structure versus government enforcement, a question that is beyond the scope of this Article."11

Efficiency may not be the only relevant question, however. The tradeoff between public and private enforcement requires society to address a number of issues that have received little attention in the debate over class action reform. Concerns about limiting the size of government and political pressure to reduce expenditures on public enforcement support increased reliance on private enforcement."12 In contrast, private enforcement reduces the accountability of the law enforcement effort and delegates to plaintiffs' counsel, rather than to the political process, the control over enforcement priorities."13 Although a system in which enforcement decisions are a function of the profitability of litigation appears to provide a poor fit with social benefit, the legal system can influence plaintiffs' litigation decisions by modifying substantive law to disfavor particular types of claims."14 If, for example, litigation over forward-looking statements is socially wasteful or producing overdeterrence, the frequency of such litigation can be reduced through the adoption of legislative reform such as the Reform Act's safe harbor."15 Conversely, legislation can increase litigation incentives in areas in which private enforcement is considered particularly valuable—an example is the availability of treble damages in private antitrust litigation."16

In sum, although plaintiffs' lawyers may exercise substantial control over the small claimant class action, the causal connection between this control and the shortcomings associated with class action litigation is far from obvious. More importantly, the problems with the existing structure are unlikely to be remedied by institutional controls, whether those controls are supplied by class members, as with the lead plaintiff provision, or by the courts under the proposed amendment to Rule


154. See Coffee, supra note 132, at 684–91 (analyzing disparity between private and social incentives to litigate and concluding that existing legal structure is likely to produce underfunding of private enforcement efforts).

155. See Kauper & Snyder, supra note 150, at 1067 (describing “equilibrating tendency” of procedural aspects to balance for substantive provisions of the law).

156. Reform Act, supra note 3 (adding Sec. Act § 27A; Sec. Ex. Act § 21E). Cf. Bohn & Choi, supra note 16, at 980 (suggesting that most suits directed at initial public offerings are frivolous and recommending lawmakers consider desirability of allowing such suits).

157. See Kauper & Snyder, supra note 150, at 1051 (predicting that a decrease in the treble damage multiple would decrease deterrence of antitrust violations).
B. Large Claimant Class Actions

Class action reform efforts do not focus exclusively on small claimant cases. Rather, small claimant cases are a shrinking sector of the class action landscape. They have been largely superseded, as has much else in the law, by the mass tort case, the prototypical large claimant case. In spite of the explicit instructions of the drafters of Rule 23 that it was not intended for use in mass tort cases, the class action has become the vehicle of choice to deal with the issues of competing claimants, technical complexities in legal and factual analysis, defendants with limited funds, and the temporal inequalities posed by cases in which both class and discovery periods span decades.

The problems affecting the large claimant case are quite different from those of the small claimant class action. Large claimant cases have raised concerns about the capacity of the class action format to provide individualized justice, the degree to which class counsel can effectively represent differing needs of class members, and the relative importance of common issues in the certification decision. Recent cases in areas such as asbestos litigation also present the problem of addressing the needs of potential or future class members who do not, as of the time of the litigation, have a ripe claim.

A number of these issues are especially troubling in the context of settlement. Courts in mass tort and other large claimant cases have embraced the general judicial policy of favoring settlement, based in part on concerns about congestion of judicial dockets and the perceived efficiency of centralizing the resolution of complex legal and factual issues. Because of the peculiar incentive structure of large claimant class

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158. See Coffee, supra note 74, at 1344–45 (describing recent evolution of class action to focus on mass tort cases).
159. Advisory Committee Note to Rule 23 (1966) (stating that a ‘mass accident’ resulting in injuries to numerous persons is ordinarily not appropriate for a class action); for further historical research, see Judith Resnik, From "Cases" to "Litigation," LAW & CONTEMP. PROBS., Summer 1991 at 5, 9–14.
160. See William W. Schwarzer, Settlement of Mass Tort Class Actions: Order Out of Chaos, 80 CORNELL L. REV. 837 (1995) (describing obstacles in litigation of mass torts that have motivated efforts to use class action format as a resolution).
161. See, e.g., Koniak, supra note 8, at 1048 (describing flaws in class action mechanism for addressing large mass tort cases).
162. See Georgine v. Amchem Prods., Inc., 83 F.3d 610, 626, 630 (3d Cir.), cert. granted, 117 S. Ct. 379 (1996) (denying request for certification of settlement class, in part, because of difficulty in addressing the interests of future claimants and observing substantial conflict between the interests of presently injured and “futures” class members); see also Note, And Justiciability for All?: Future Injury Plaintiffs and the Separation of Powers, 109 HARV. L. REV. 1066 (1996) (addressing the justiciability of futures claims).
163. See, e.g., Macey & Miller, supra note 8, at 45–46 (describing judicial incentive to approve settlements); In re Warner Communications Sec. Litig., 618 F. Supp. 735, 740 (S.D.N.Y. 1985), aff’d, 798 F.2d 35 (2d Cir. 1986) (stating that “a bad settlement is almost always better than a good trial”).
164. See Coffee, supra note 74, at 1462–53 (describing pressure faced by courts in mass tort cases to approve settlements notwithstanding “suspicious signs of collusion”).
action settlements, an incentive structure that only partially resembles the model applicable in securities fraud cases, defendants in these cases have begun to encourage use of the class action vehicle as a way of limiting their liability. Commentators have identified this opportunity for collusion. In particular, defendants in mass tort cases have an incentive to search for and negotiate with the plaintiffs' counsel willing to agree to the lowest settlement amount.

This has led to the presentation, in some recent cases, of proposed settlements before a complaint has even been filed. Litigants have argued that, consistent with the policy of encouraging settlement, courts should apply certification standards more liberally in these cases and should certify cases for settlement that might not meet the normal prerequisites of Rule 23. Indeed, the proposed revisions to Rule 23 expressly endorse the use of settlement classes by permitting certification of a subdivision (b)(3) class for settlement purposes in circumstances in which the class would not otherwise be certifiable.

Interestingly, this reform threatens to move large claimant class actions closer to lawyer-driven litigation, by making them more similar to small claimant cases. The proposed broader certification procedure, coupled with the practice of pre-negotiated settlements, enhances lawyer control by providing the opportunity to structure a settlement outside the normal litigation process. This reduces the ability of courts and class members to monitor the settlement decision. The cost of investigating and objecting to a proposed settlement may be high and, even for an individual litigant with a substantial stake, the cost of monitoring may outweigh the benefits. This is particularly true because, for a large claimant, the option of opting out and pursuing an individual claim provides a realistic alternative to objecting to an unsatisfactory settlement.

The nature of the stakes of some putative class members in large claimant mass tort cases can also reduce the incentive to monitor. Cases like Georgine propose settlements that would adjudicate the rights of future claimants, those who have suffered exposure, for example, but are not yet sick. These plaintiffs are particularly ill-equipped to monitor plaintiffs' counsel and determine if they are being adequately represented as a group—their expected damages even if high must be discounted by the possibility that they will never suffer an injury. At the time a court is deciding

165. Id. at 1350 (explaining how class action can serve as a “shield for defendants”).
166. See, e.g., id. at 1367-84 (describing possible forms of collusion in class action settlements).
167. Professor Coffee terms this problem “structural collusion.” Id. at 1354.
169. Proposed Rules, supra note 124, at 559 (adding Rule 23(b)(4)).
170. See Coffee, supra note 74, at 1450 (describing opt-out as a checking mechanism on the value of settlements).
171. Georgine v. Amchem Prods., Inc., 83 F.3d at 610.
172. See id. at 617-18 (describing fairness concerns created by inclusion of future claimants within putative plaintiff class).
whether to approve a settlement, some of these futures plaintiffs may not even realize that they are members of the plaintiff class. Thus the concern about lawyer-driven litigation might appropriately be focused on the proposal that Rule 23 be amended to allow certification of settlement classes."

The concerns about abuse and collusion in large claimant class actions can similarly provide additional insight into the operation of the lead plaintiff provision. Although securities fraud cases have traditionally been viewed as small claimant cases, the increasing representation of institutional investors as class members casts some doubt upon the accuracy of this characterization. Institutional investors have large stakes in securities fraud class actions, both in absolute terms and relative to the interests of the rest of the class. Weiss and Beckerman report that losses of large claimants in securities fraud cases averaged over $1 million. If the lead plaintiff provision succeeds in increasing institutional participation, these large stakes may cause securities fraud litigation to take on some of the litigation characteristics generally associated with large claimant class actions. Although predicting the evolution of securities fraud litigation under this scenario is necessarily tentative, the experience of large claimant mass tort cases suggests two possible changes in the conduct of securities litigation.

First, motivating institutional investors to take securities fraud litigation more seriously creates an enhanced risk that institutions may choose to opt out of class actions in the same way that individual large claimants may opt out of other types of class actions, rather than seeking to exert greater control within the class action format. An institution’s participation as lead plaintiff in a class action may subject the institution to the traditional disadvantages associated with opting out and litigating separately, including identifiability, submitting to discovery, and incurring monitoring costs. If the institution is willing to incur these costs by active participation, it may be more advantageous for it to go all the way and pursue an individual action, in which the problems of free riding and administrative expense are reduced.

Second, the large claimant class action offers securities fraud defendants a model for opportunistic or even collusive negotiations with institutional plaintiffs. Securities defendants may follow the lead of defendants in recent mass tort cases and approach institutional investors in hopes of negotiating favorable settlement terms. Defendants’ incentive to negotiate may be increased by uncertainty about the manner in which courts will apply substantive provisions of the Reform Act. Institutions may be particularly receptive to these offers of negotiated settlement because participation in a friendly or negotiated context will not jeopardize an institution’s reputation with issuers or require the institution to submit to burdensome discovery."

Negotiated settlements thus offer a better prospect of institutional participation

173. See Advisory Committee Minutes, supra note 131, at 551–55 (discussing debate over proposed amendment allowing certification of settlement classes).

174. See, e.g., Macey & Miller, supra note 8, at 63–66 (describing process by which defendants may prefer atypical plaintiffs as class representatives because their participation may facilitate easy settlements).
than hostile litigation. Institutions that would not have sought lead plaintiff status because of a desire to protect ongoing business relationships with issuers or because of political constraints may be willing to participate for the limited purpose of implementing a negotiated settlement. This participation itself may be problematic, however, in that institutions subject to these concerns may not be capable of exercising independent judgment in connection with the settlement process. An institutional investor concerned about remaining on friendly terms may not adequately defend the interests of the plaintiff class. Thus, although the settlement decision may reflect client rather than lawyer control, it need not improve the degree to which settlement reflects the merits of the cases.\textsuperscript{175} This failure would seriously undermine the purported value of the lead plaintiff provision.

\textbf{V. CONCLUSION}

Despite widespread disagreement about the extent to which reform of the securities fraud class action was necessary, Congress enacted sweeping changes through its adoption of the Reform Act. A similar movement is afoot in the proposals to reform Rule 23. The proposals for reform share a common ground: the desire to address concerns about lawyer control over litigation and settlement decisions in the class action context. In both cases, critics attribute the filing of frivolous litigation and the resolution of cases on terms that have insufficient relationship to the merits to the fact that lawyers, rather than clients, are the primary decisionmakers.

Upon reflection, it appears that critics have been allowing lawyer-driven litigation to serve as a scapegoat and to bear too much of the responsibility for deficiencies in the litigation process. As a result, the capacity of the reform proposals to return litigation control to class members is unclear, and the impact of reform on litigation decisions is uncertain.

The transsubstantive nature of this symposium provides a rare opportunity for a fuller evaluation of the merits of the reform proposals. The observed developments in class action litigation outside the securities area, particularly in the context of mass tort cases, offer new insights into the likely consequences of the procedural changes adopted by the Reform Act, particularly the lead plaintiff provision. Similarly, the recently enacted reforms to the federal securities laws and the initial experience with the lead plaintiff provision suggest additional factors to consider in connection with reform of Rule 23. It is far too early to judge the impact of the Reform Act upon securities fraud class actions. The questions raised by the lead plaintiff provision, however, suggest a need for greater attention to the purposes of class action litigation and the extent to which reform proposals are tailored to those purposes than the attention reflected in the legislative history of the Reform Act.

\textsuperscript{175} Alternatively, the new procedures may simply transfer control of the litigation from the plaintiffs' bar to the defense bar. See Douglas M. Branson, \textit{Chasing the Rogue Professional After the Private Securities Litigation Reform Act of 1995}, 50 S.M.U. L. Rev. 91, 115 (1996) (describing further possibility for collusion in that the defense bar can now create stables of "sweetheart plaintiffs" with substantial shareholdings who are both able to displace filing plaintiffs and willing to agree to easy settlements).