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INTRODUCTION

In 1995, my colleague John Beckerman and I had an experience shared by very few legal academics. We mailed the galley proofs of an article that we had written to the staff of a Senate Committee and then saw the Committee, the Senate, and the full Congress enact into law a bill that included all of the recommendations in our article. The article was *Let the Money Do the*

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Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions;[1] the law was the Private Securities Litigation Reform Act of 1995 ("PSLRA").[2] The relevant provisions of the PSLRA, now generally known as "the lead plaintiff provisions," prescribe procedures for the selection of lead plaintiffs and lead counsel in securities class actions.[3]

For years, I have thought about writing something that sets forth the unique history of the lead plaintiff provisions, describes how closely developments pursuant to those provisions have met our expectations and what surprises have occurred, and assesses how well those provisions have worked in a "real world" setting. The invitation to participate in this Symposium, held little more than a decade after the lead plaintiff provisions went into effect, provides me with the opportunity to do just that.

This Essay has six parts. Part I describes the questions that led Professor Beckerman and me to undertake research concerning the dynamics of securities class actions and summarizes our findings and recommendations. Part II sets forth the story of how our recommendations came to be enacted into law. Part III describes post-enactment developments that have been consistent with our expectations, while Part IV describes post-enactment developments that we did not anticipate. Part V contains some thoughts about whether, had Congress followed a more deliberative process before enacting our recommendations into law, it could have come up with a better approach for organizing the process by which lead plaintiffs and lead counsel are appointed in securities class actions. Part VI sets forth a few recommendations for change.

I. OUR RESEARCH

Three things sparked our interest in securities class actions and the role institutional investors play therein. The first was that institutional investors owned a majority of the stock of publicly held corporations and accounted for a larger portion of trading, yet appeared to have played little, if any, role in securities class actions.[4] This struck us as anomalous, especially given institutional investors'

1. Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2053 (1995).

2. Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of 15 U.S.C.).

3. *See* 15 U.S.C. § 78u-4(a)(3) (2000).

4. *See* Weiss & Beckerman, *supra* note 1, at 2056.

steadily increasing participation in other aspects of corporate governance.[5]

The second was the growing controversy over whether securities class actions serve investors' interests. An article by Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, helped fuel this controversy,[6] as did articles by other scholars suggesting that, because lead plaintiffs were often little more than figureheads, agency costs in securities class actions were extremely high.[7] Committees in both houses of the 103rd Congress had held hearings relating to this issue but had recommended no legislation.[8] However, when the Republican Party took control of both houses of Congress after the 1994 elections, legislative action seemed increasingly likely.[9]

The third was my experience representing a shareholder who objected to the settlement of a securities class action against Warner Communications, Inc. ("WCI") on the grounds that the settlement exculpated Steven Ross, Warner's CEO, from liability, despite the fact that his sale of $20 million in WCI stock constituted the strongest evidence that WCI had acted with scienter.[10] Although we succeeded in showing that the factual justification the parties had advanced for

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5. *See id.* at 2056-57.

6. Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 534-48 (1991) (noting that in securities class action suits, litigation decisions typically had been made by the plaintiffs' lawyers, not by the representatives of the class).

7. *See* John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877, 887-88 (1987) (discussing the fee structures for plaintiffs' attorneys, and explaining that under the percentage formula and the lodestar formula, the attorney has an incentive to maximize his own profit); 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, 685-86 (1986) (recognizing the serious principal-agent problem arising from the fact that the plaintiff's attorney, rather than the client, had the discretion over whether to commence a suit); Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 17-18 (1991) (noting the disparity of interest between the principal and the agent, and suggesting means of reducing the agency cost); *see also* Joseph A. Grundfest, *Why Disimply?*, 108 HARV. L. REV. 727, 727-40 (1995) (arguing that diversified investors realized no significant benefits from securities class actions).

8. *See* Weiss & Beckerman, *supra* note 1, at 2055.

9. John Beckerman and I had completed our research prior to the 1994 elections, at a time when Congressional action seemed unlikely. We directed our suggestions for reform to the federal judiciary, which we argued had authority to implement them under Rule 23 of the Federal Rules of Civil Procedure and through the court's inherent authority to control certain aspects of civil litigation. *See id.* at 2105-09.

10. *See id.* at 2067-71 (illustrating "the extremes to which courts go to approve class action settlements").

exculpating Ross was false, the court approved the settlement, arguing that "a bad settlement is almost always better than a good trial."[11] This experience led us to question the wisdom of relying on judicial approval of settlements, the principal procedural mechanism then in place for ensuring that class members' interests are protected.

Professor Beckerman and I reviewed prevailing securities class action practices and procedures, including the process most courts used to appoint lead plaintiffs and lead counsel, and concluded that they effectively precluded institutional investors from becoming actively involved in securities class actions. More specifically, we found that:

- The filing of securities class actions rarely received any publicity;[12]
- Courts tended to appoint as lead plaintiff the first member of the purported class to file a complaint and to appoint as lead counsel a law firm with whom that early filer had a pre-existing relationship. Many of the early filers appeared to be "figurehead plaintiffs" who had purchased (or sold) only a modest amount of stock in the corporation responsible for the alleged fraud and had filed, or authorized their lawyers to file, complaints within hours of the announcement of unanticipated bad (or good) news, and an associated substantial drop (or increase) in the price of that corporation's stock;[13]
- Other class members often did not even know a purported class action was being litigated until they received notice of a proposed settlement, the court's preliminary approval thereof, and defendants' conditional agreement to certification of the proposed plaintiff class;[14]

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11. *In re* Warner Commc'ns Sec. Litig., 618 F. Supp. 735, 740 (S.D.N.Y. 1985), *aff'd*, 798 F.2d 35 (2d Cir. 1986). *But see In re* Chiron Corp. Sec. Litig., No. C-04-4293 VRW, 2007 WL 4249902, at *1 (N.D. Cal. Nov. 30, 2007) (quoting *Warner*, but then rejecting a proposed settlement after noting that "a good epigram could, in this case at least, make for a bad result").

12. *See* Weiss & Beckerman, *supra* note 1, at 2100.

13. *See id.* at 2060-63.

14. *See id.* at 2100 (noting that in some class actions the parties "may attempt first to resolve whether the plaintiff's complaint states a claim on which relief can be granted" before entering into settlement negotiations).

- As evidenced by *Warner Communications*, a court that had given preliminary approval to proposed settlements generally was reluctant to change its mind.[15] A few institutional investors had objected to proposed settlements, but had met with little success.[16]

We also found that institutional investors had demonstrated minimal interest in securities class actions, perhaps because settlements generally were relatively small (rarely exceeding $20 million) and because the prevailing belief (or mythology) was that small investors were the primary beneficiaries of class action settlements. However, when we reviewed data from twenty-two settled cases detailing claims for allowable losses, we found that a relatively small number of investors, mostly institutional, accounted for a majority in dollar value of the claims filed and that the two or three largest claimants, which again were predominantly institutional investors, each accounted for a significant percentage of the dollar value of all claims filed.[17] We also found that, although claims by relatively small investors—those with allowable losses of up to $5,000—accounted for more than seventy percent of all claims filed, they accounted for an average of only about twelve percent of the dollar value of all claims filed.[18]

These data led us to conclude that if class action procedures could be reformed to make it easier for institutional investors with large losses to become lead plaintiffs and to select the attorneys who would represent the class, those institutions would have an economic incentive to retain and to monitor class counsel so as to reduce substantially the agency costs associated with securities class action litigation.[19] We further argued that federal courts, largely through constructive reinterpretation of Rule 23 of the Federal Rules of Civil

15. *Id.* at 2067-71.

16. *See id.* at 2104-05.

17. In all but a few cases, settlement proceeds were distributed pro rata as a percentage of claims for allowable losses. The exceptions were a few cases we found in which settlements were structured in a fashion that was prejudicial to the interests of investors with large losses. *See id.* at 2074-79.

18. *Id.* at 2094. We also noted that if one made the reasonable assumption that allowable losses equaled roughly 10% of the amount investors paid for securities, this category included all who had invested up to $50,000 in a given company's stock. For most individuals, this would amount to a rather large investment. Investors with allowable losses of up to $1,000 accounted for an average of less than 1.5% of valid claims filed. *Id.*

19. *See id.* at 2121-23. We also demonstrated that claims by critics such as Janet Cooper Alexander that the merits did not matter when securities class actions were settled were deeply flawed. *See id.* at 2080-84.

Procedure, had the authority to implement the three reforms we believed were needed. More specifically, we suggested that:

- Whenever a purported securities class action was filed, the court should require the plaintiff to publish a public notice of filing and should give members of the purported class a reasonable period in which to apply to be named lead plaintiff;
- The court should appoint as lead plaintiff the plaintiff or applicant with the largest financial interest in the action, provided that applicant otherwise appeared to be qualified to serve as a class representative, and the court should then allow the lead plaintiff (subject to court approval) to select and retain lead counsel;
- The court should protect applicants—in particular, institutional investors seeking to be appointed lead plaintiff—from harassment by allowing other plaintiffs or applicants to take discovery only where they could show that they had good cause to believe an applicant would not be a typical or adequate class representative.

II. FROM ACADEMIC CONCEPT TO STATUTORY LAW

Just as we were completing editorial work on our article, which the *Yale Law Journal* had accepted for publication, Congress actively was considering legislation to reform various aspects of securities class action litigation. One issue on Congress's agenda was how to end the unseemly "race to the courthouse" that existing case organization practices seemed to encourage.[20]

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20. Unbeknownst to us and to Congress, it appears that in hundreds of cases that had been filed by predecessors to Milberg Weiss LLP (which, before 1996, was by far the most prominent plaintiffs' securities class action firm), the named plaintiffs were individuals to whom those firms had promised to pay kickbacks equal to a percentage of any attorney fees they were awarded. In exchange, the individuals agreed to allow the firms to file class action complaints in their names or the names of cooperating family members and associates. *See* Second Superseding Indictment, United States v. Milberg Weiss LLP, CR 05-587 (D)-JFW (C.D. Cal. Oct. 2006) [hereinafter Milberg Indictment]. Milberg Weiss has pled not guilty to those charges, but several past partners of that firm or its predecessors have pled guilty to charges that they engaged in conduct essentially identical to that alleged in the Milberg Indictment.

We sought to testify about this issue before the relevant subcommittee of the Senate Banking Committee, thinking that our proposal would constitute a more effective solution than the approach included in the bill that the House of Representatives had passed.[21] The subcommittee staff responded that the hearing schedule was fully committed. They suggested that we send them a copy of our article—an invitation that struck us as polite, but unlikely to lead to serious consideration of our proposals. Consequently, we decided to send the galley proofs of our article not only to the subcommittee staff, but also to Robert Giuffra, Chief Counsel of the Senate Banking Committee, with whom I had several conversations when he was an articles editor of the *Yale Law Journal*.

Giuffra "felt the article's ideas had potentially broad appeal to the various constituencies [interested in reforming case organization procedures]."[22] He also concluded that the reforms suggested in our article were more likely to lead to constructive changes than those included in the bill the House had passed.[23] Giuffra circulated copies of the article to the members of the Banking Committee, and he directed staff to draft legislation that would implement our three principal recommendations.[24] The Committee thereafter reported out a bill that substantially mirrored our recommendations, providing for early notice of the filing of a purported securities class action and selection as lead plaintiff of the plaintiff or applicant with the largest financial interest, allowing the lead plaintiff to appoint and retain lead counsel, and restricting discovery directed at applicants for appointment as lead plaintiff.[25]

Some Senators—and others—who were critical of class action litigation may have supported enactment of the proposed lead plaintiff

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21. *See* Private Securities Litigation Reform Act, H.R. 1058, 104th Cong. (1995) (enacted).

22. Andrew Longstreth, *Insecurity*, FUTURE LITIG., Fall 2003 (on file with Vanderbilt Law Review).

23. *See* H.R. 1058, 104th Cong. §§ 202-03 (1995) (including provisions that would have required courts hearing class actions to appoint a guardian ad litem or plaintiff steering committee for the class, limited the number of class action complaints that a "professional" plaintiff could file annually, and disqualified as a class action plaintiff an investor with only a trivial amount at stake). Only a modified version of the professional plaintiff provision was included in the PSLRA. *See* 15 U.S.C. § 78u-4(a)(3)(B)(vi) (2000).

24. The staff of the Securities Subcommittee also contacted us, asking each of us to comment on draft legislative language. We both agreed to do so.

25. *See* S. REP. NO. 104-98 (1995) (accompanying S. 240). The Committee generously acknowledged that it based the lead plaintiff provisions on our article. *Id.* at 11 n.32. Moreover, "[a]lthough Congress did not refer to the Weiss/Beckerman article as an 'authoritative' part of the legislative history[,] courts interpreting [those provisions] have nevertheless taken note of Congress's heavy reliance on the Weiss/Beckerman article and given it considerable weight when construing the provision." Johnson v. Elk Lake Sch. Dist., 283 F.3d 138, 154 (3d Cir. 2002).

provisions for reasons that they should have realized were misguided. These critics anticipated that the new legislation would lead to a reduction in "burdensome" class actions by encouraging large institutional investors, many of which they believed were hostile to class action litigation, to seek appointment as lead plaintiffs for the sole purpose of moving to dismiss actions that they believed lacked merit.[26] What these critics should have realized was that the costs to any institutional investor of pursuing such a course of action would far outweigh any potential benefits it might realize. By so proceeding, an institution would become vulnerable to claims by other investors (and their attorneys) that it had breached its fiduciary duties to the members of the purported plaintiff class.[27] An institution could avoid the cost of defending such a claim simply by remaining a passive member of the purported class, collecting nothing if the case was dismissed and receiving its share of any recovery if the plaintiff succeeded in obtaining a monetary recovery.

We have no way of knowing if this miscalculation was a decisive factor in the adoption of the lead plaintiff provisions. What we do know is that the Senate adopted the committee-approved bill without amending those provisions, and the conference committee approved a bill that, with two minor modifications,[28] included the Senate-passed provisions. Both houses of Congress passed the bill and, after President Clinton vetoed it, passed the bill again by supermajority vote.[29]

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26. I base this speculation on several private conversations, including one with a then-sitting SEC Commissioner who told me that this is what he expected would occur. Some plaintiffs' lawyers, as well as Senators sympathetic to their point of view, might have shared this expectation. *Cf.* Weiss & Beckerman, *supra* note 1, at 2111 n.271 (quoting a letter from a plaintiffs' lawyer arguing that institutional investors generally have close relationships with public companies and "do not want to be perceived as hostile to corporate management"). On the Senate floor, several Senators who generally were supportive of the plaintiffs' bar argued against enactment of the proposed new case organization procedures. *See* H.R. REP. NO. 104-369, at 34 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 733 ("Several Senators expressed concern during floor consideration . . . that large investors might conspire with the defendant company's management.").

27. *See* Armour v. Network Assocs., 171 F. Supp. 2d 1044, 1048 (N.D. Cal. 2001) (noting that a lead plaintiff must be capable of carrying out the fiduciary duties a class representative owes to the represented class, and that "[p]rimary among these duties is the obligation of the class representative to select class counsel and monitor the conduct of class counsel throughout the litigation").

28. The Conference Committee added a provision specifying that only the first plaintiff to file a class action is required to publish a notice of requiring, *see* 15 U.S.C. § 78u-4(a)(3)(A)(ii), and a limited restriction on "professional plaintiffs" serving as lead plaintiff in more than five actions during any three-year period, *see id.* § 78u-4(a)(3)(B)(vi).

29. Neil A. Lewis, *Securities Bill Becomes Law as the Senate Overrides Veto*, N.Y. TIMES, Dec. 23, 1995, at 39.

III. DEVELOPMENTS CONSISTENT WITH OUR EXPECTATIONS

In our article, we expressed the hope that if courts decided to implement the reforms we recommended, institutional investors would begin to seek appointment as lead plaintiff in at least some securities class actions and, if appointed, then would act as reasonably diligent litigation monitors, negotiating arm's length fee arrangements with plaintiffs' attorneys and overseeing the prosecution and settlement of the actions in which they were involved. We recognized, though, that institutional investors might choose not to get involved because activism along these lines would have the potential to generate costs as well as benefits for institutions that chose to act.[30]

We did not need to wait to see what the courts would do because, as described above, Congress decided to implement our recommendations legislatively. Institutional investors' reactions, not surprisingly, were somewhat slower in developing.[31] First, they had to process the possibility that they could become lead plaintiffs. As large institutions, often with complex governance structures, they needed to analyze the legal and financial implications of taking on that responsibility. Understandably, too, many institutional investors were reluctant to be the first mover; their preference was to allow other institutions to seek lead plaintiff status and see what they could learn from their experiences.

Over the years, though, institutional investors in steadily increasing numbers have become more comfortable with the idea of serving as lead plaintiff, and have sought and received appointment to

30. *See* Weiss & Beckerman, *supra* note 1, at 2109-26 (explicating potential costs and benefits of institutional activism). That some institutions were unlikely to get involved was presaged by a colloquy between Senators Bennett and Dodd, specifying that the Senate bill did not impose any *obligation* on institutional investors to seek appointments as lead plaintiff. *See* 141 CONG. REC. S9109-05 at 9115 (daily ed. June 19, 1995). A statement to the same effect was subsequently inserted into the Conference Report. *See* H.R. REP NO. 104-369, at 34 (noting that although the "provision does not confer any new fiduciary duty on institutional investors," the provision is intended to "encourage institutional investors to take a more active role in securities class action lawsuits"). Robert Pozen, then-General Counsel to the manager of the Fidelity mutual funds, told me in a private telephone conversation that he drafted the text of the Senate colloquy.

31. *See* Jill Fisch, *Class Action Reform: Lessons from Securities Litigation*, 39 ARIZ. L. REV. 533, 542-44 (1997) (commenting on the small number of institutions that had become involved in the year, or eighteen months, period following passage of the PSLRA). *See generally* Elliott J. Weiss, *Comment: The Impact of the Lead Plaintiff Provisions of the Private Securities Litigation Reform Act*, 39 ARIZ. L. REV. 561 (1997) (discussing reasons why the pace of change was not surprising).

that position.[32] Most of these institutions have been public or union pension funds, but some private sector funds also have been appointed as lead plaintiffs. Moreover, the recent increase in the number of activist hedge funds may well presage a similar increase in the number of private sector funds that seek to increase returns by becoming lead plaintiffs in class actions in which they have substantial financial interests.

Consistent with our expectations, institutional investors that have sought appointment as lead plaintiff generally have negotiated fee arrangements with the law firms they have retained that provide for percentage fees far lower than had been the norm prior to passage

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32. *See, e.g.*, Stephen J. Choi, Jill E. Fisch & A. C. Pritchard, *Do Institutions Matter? The Impact of the Lead Plaintiff Provisions of the Private Securities Litigation Reform Act*, 83 WASH. U. L.Q. 869, 877-78 (2005) (comparing class actions brought in1991-1995 with those brought in 1996-2000, and noting that "recent data suggests that institutional participation is increasing"); James D. Cox, Randall S. Thomas & Lynn Bai, *There Are Plaintiffs and . . . There Are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements*, 61 VAND. L. REV 358 (2008) (presenting an empirical study on the effect of institutional investors on settlement amounts, and noting that there has been increased activity by institutional investors as lead plaintiffs); Michael A. Perino, *Institutional Activism Through Litigation: An Empirical Analysis of Public Pension Fund Participation in Securities Class Actions* (St. John's Univ. Sch. of Law Legal Studies Research, Working Paper No. 06-0055, 2006), *available at* http://ssrn.com/abstract=938722 (examining claims that increased participation by institutional investors yields larger recoveries, better monitoring, and lower attorneys' fees). A related development is that what appear to be increasing numbers of pension funds have begun to opt out of class actions and pursue their claims in separate actions in both federal and state courts. Keith L. Johnson, *Opting Out of Class Actions*, SEC. CLASS ACTION SERVS. ALERT, Jan. 2007. *But see* Peter M. Saparoff & Jennifer K. Alcarez, Opting Out of Securities Class Actions—Is It Worth the Risk? (Jan. 16, 2007) (unpublished manuscript, on file with Vanderbilt Law Review) (created for use at the ALI-ABA Course of Study on Securities Litigation Planning and Strategies in Boston, MA on June 7-8, 2007) (discussing several issues an institution should consider before deciding to opt out).

We attempted to gather data that would allow us to assess comprehensively whether the recoveries institutions have obtained through these efforts are larger or smaller than those obtained by investors who remained in the plaintiff class. Unfortunately, we were unable to obtain sufficient data to reach meaningful conclusions.

The data we were able to gather suggests that in some cases institutions that opted out recovered appreciably more of their losses than passive members of the plaintiff class, while in others they did not. *See* Kevin M. LaCroix, *Brave New Securities Lawsuit World: Qwest Opt-Out Settlements Exceed Class Settlement*, THE D & O DIARY, Nov. 25, 2007, http://dandodiary.blogspot.com/2007/11/brave-new-securities-lawsuit-world.html (pointing out that "the aggregate amount Qwest has agreed to pay opt-out claimants *exceeds* the [$400 million] it agreed to pay the class" (emphasis in original)). Another impression is that opt-outs generally have had to deal with substantially more in the way of litigation-related costs, both direct and indirect, than have passive members of the plaintiff class. *See* Saparoff & Alcarez, *supra*. Finally, we have concluded tentatively that the factor to which an institution generally should give the greatest weight in deciding whether to opt out (aside from whether its losses are large enough to justify the effort) is whether it believes that the lead plaintiff in the action, and, more importantly, the law firm it has selected, are committed to and capable of obtaining the largest recovery possible for the plaintiff class.

of the PSLRA.[33] Many institutional lead plaintiffs also have actively monitored class actions in which they have served as lead plaintiff and have pushed for larger settlements, recoveries from individual defendants responsible for corporate frauds, and governance reforms directed at preventing corporate wrongdoing from recurring.[34]

A number of law firms that specialize in representing plaintiffs in securities class actions, including several that were formed after the lead plaintiff provisions came into effect, have focused largely or exclusively on securing and representing institutional clients.[35] These firms have found it increasingly important to develop "reputational capital" as effective advocates of investors' interests because they often must compete with other plaintiffs' firms to secure institutional investors as clients. In our view, the dramatic increase in class action recoveries in suits brought after 1995 is due in large part to this dynamic, and also in part to closer client oversight of plaintiffs' attorneys.[36] Other factors that no doubt help explain the increase in what might best be termed "mega-settlements" are the larger size of the corporations involved in frauds disclosed after 1995 and the apparent increase in "aggressive" financial reporting that occurred during the 1990s.

Securities Class Action Services regularly publishes a report on the top one hundred securities class action settlements reached in

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33. *See* Perino, *supra* note 32, at 31 ("These results suggest that public pension fund participation does reduce fees, either because institutions are sophisticated consumers of legal services or because of increased competition for institutional representation."). *But see* Choi, Fisch & Pritchard, *supra* note 32, at 896-900 ("Private institutions are clearly not keeping fees in check."). It should be noted, however, that Choi, Fisch & Pritchard not only adjusted their results to account for the amounts recovered, but also used less current data.

34. This statement is based on numerous conversations with representatives of institutional investors and with plaintiffs' attorneys.

35. Grant & Eisenhofer P.A., organized in 1997, is particularly prominent among the plaintiffs' firms formed after 1995 that primarily represent public pension funds. Grant & Eisenhofer, http://www.gelaw.com (last visited Feb. 18, 2008). Bernstein Litowitz Berger & Grossmann LLP, which was organized before 1995, also specializes in representing public pension funds, and has the largest number of such funds as clients. Bernstein, Litowitz, Berger & Grossmann, http://www.blbglaw.com (last visited Feb. 18, 2008). The firm now named Coughlin Stoia Geller Rudman & Robbins represents many union pension funds and some public funds. Coughlin Stoia Geller Rudman & Robbins, http://www.csgrr.com (last visited Feb. 18, 2008). Choi, Fisch, and Pritchard, in their 2005 paper, reported that in the period they studied (1996-2000), private pension funds tended to avoid the Milberg Weiss firm, *see* Choi, Fisch & Pritchard, *supra* note 32, at 892, which included most of the lawyers who later formed what is now the Coughlin firm.

36. I base this statement in part on my personal experiences as an attorney and an expert witness and in part on conversations with institutional investors and plaintiffs' attorneys. Attorneys who specialize in representing defendants in securities class actions also have told me that the dynamics of class action litigation changed dramatically after 1995, especially in suits in which large institutional investors serve as lead plaintiffs.

cases filed following the passage of the PSLRA. The most recent such report, dated June 30, 2007, shows that all one hundred settlements exceeded $50 million.[37] Eight settlements ranged between $1.032 billion and $7.231 billion, another sixteen ranged between $300 million and $667 million, and an additional thirty-five ranged between $100 million and $374 million.[38] Moreover, institutional investors served as lead plaintiffs in all of the cases that settled for more than $1 billion, in twenty-three of the twenty-four (95.8%) that settled for at least $300 million, in fifty-one of the fifty-nine (86.4%) that settled for more than $100 million, and in seventy-nine of the top one hundred (79%).[39]

As a number of studies have pointed out, the fact that large settlements have become much more common does not necessarily mean that investors have been recovering a larger share of their losses, either in the cases involving mega-settlements or in securities class actions generally.[40] These studies find that recoveries, on average, whether in class actions generally or in cases where institutions have served as lead plaintiffs, represent only a small fraction of the losses investors have incurred and that class members have not fared significantly better in cases with institutional lead plaintiffs.[41]

In our view, the work of these scholars suffers from a serious flaw—the econometric models they use to calculate "investor losses" do not reflect the realities of class action litigation and settlement negotiations.[42] One major weakness is that these models make no

37. Inst. S'holder Servs., *Top 100 Securities Class Action Settlements*, SEC. CLASS ACTION SERVS. ALERT, June 30, 2007. Such settlements have no precedent in cases filed prior to passage of the PSLRA. To my knowledge, not a single such case settled for as much as $50 million.

38. *Id.*

39. *Id.*

40. *See* Choi, Fisch & Pritchard, *supra* note 32, at 894 (finding no indication of a significant increase in recovery); Cox, Thomas & Bai, *supra* note 32, at 383 (indicating that higher settlement amounts likely are caused by higher provable losses); TODD FOSTER ET AL., NAT'L ECON. RESEARCH ASSOCS., RECENT TRENDS IN SHAREHOLDER CLASS ACTION LITIGATION: FILINGS STAY LOW AND AVERAGE SETTLEMENTS STAY HIGH—BUT ARE THESE TRENDS REVERSING? 11 (Sept. 2007), http://www.nera.com/image/PUB_RecentTrends_Sep2007_2color_web-FINAL.pdf ("Higher investor losses for more recently resolved cases explain the rise in settlements.").

41. *See* Cox, Thomas & Bai, *supra* note 32, at 380 (displaying a chart that provides the percentage of losses recovered by the class according to type of plaintiff). NERA calculates that from 2002 through 2006, the annual median ratio of settlement to investor losses ranged from 2.1% to 3.0%. FOSTER ET AL., *supra* note 40, at 12.

42. The scholars that have done such work do not claim that the investors' losses they calculate can be equated with the amounts investors reasonably could expect to recover. They also, in our view, do not emphasize sufficiently how this limitation reduces the significance of their findings. This omission has allowed critics of class actions to cite their work in support of claims that investors realize only trivial benefits from class actions brought on their behalf, and

effort to take account of the allegations in the relevant complaint. Yet, as every practicing securities lawyer knows, investors are entitled to recover only the losses that they can prove were caused by defendants' fraudulent conduct.[43]

A related weakness is that these models take no account of how difficult it will be in each case for plaintiffs to prove deception, materiality, scienter, reliance, and loss causation. All must be shown for plaintiffs to prevail, and all are likely to be major points of contention in settlement negotiations. Indeed, a common practice in securities class actions is for the court, at some point, to order mediation under the supervision of a court-appointed mediator[44] and for the mediator to direct the parties to prepare written submissions addressing each of these issues before settlement negotiations begin.

A final set of problems is that these models take no account of the proportional liability provision of the PSLRA, which greatly reduces the likelihood that any given defendant will be liable for all losses caused by any given fraud[45] or of the fact that, in many cases, at least some defendants who were or may have been responsible for significant shares of investors' losses are bankrupt or otherwise lack sufficient resources (or insurance) to pay all or even a significant portion of the damages for which they arguably are liable.[46]

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that the principal beneficiaries are plaintiffs' attorneys. *See, e.g.*, John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1545 (2006) (citing the 2005 NERA study, and finding that "the conclusion seems inescapable that the securities class action performs poorly"). *In re Omnivision Technologies, Inc.*, No. C-04-2297 SC, 2007 WL 4293467 (N.D. Cal. Dec. 6, 2007), provides an interesting perspective on this issue. The court noted that plaintiffs' damages expert estimated total damages at $151.8 million, while defendants estimated that plaintiff could not recover more than $15.1 to $18.6 million, *and would do so only if they prevailed on all claims. Id.* at *5. The court then concluded that the proposed $13.75 million settlement was reasonable because, after payment of attorneys' fees and costs, plaintiffs would recover "in excess of 6% of the potential[, which] is higher than the median percentage of investor losses recovered in recent shareholder class action settlements." *Id.* A more accurate assessment of the settlement, in our view, would have been that it amounted to between 74% and 91% of the maximum recovery defendants estimated plaintiffs could have achieved.

43. *See* Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 345-46 (2005) (holding that investors must plead and prove loss causation).

44. Often a retired federal district court judge.

45. *See* 15 U.S.C. § 78u-4(f) (2000). A defendant who is proven to have acted with actual intent to defraud can be held jointly and severally liable, *id.* § 78u-4(f)(2)(A), but proving actual intent often can be problematic, and, at a minimum, the difficulty that plaintiffs are likely to face in doing so will be reflected in settlement negotiations.

46. The Worldcom class action, in which settlements totaled $6.156 billion, provides a useful illustration. The corporate defendant and its two senior executives together were responsible for most of the investors' fraud-induced losses. *See generally In re* Worldcom, Inc. Sec. Litig., 346 F. Supp. 2d 628 (S.D.N.Y. 2004). But Worldcom was bankrupt, and the two senior executives, although wealthy, did not have sufficient assets to pay off more than a very small

We recognize that it would be impractical and unrealistic for scholars who study class action settlements to attempt to evaluate plaintiffs' likelihood of success on each critical issue in each case that they review. Among other impediments, much of the evidence produced in such cases is covered by a confidentiality order and therefore could not be evaluated. Moreover, even if scholars were in a position to undertake such evaluations, their results, of necessity, would be highly subjective, and any conclusions that they reached would be vulnerable to criticism on that basis. However, while case-by-case evaluation of the strength of plaintiffs' cases may not be feasible, the absence of such evaluations leads us to discount substantially the significance of the conclusions that these scholars have reached concerning the relative magnitude of investors' recoveries and whether they have been significantly larger in cases in which institutional lead plaintiffs have been involved.[47]

We believe that a far better—if still imperfect—yardstick exists against which the relative "success" of class action settlements could be measured: the total of the recognized and allowable losses submitted to the claims administrator for any given action.[48] This figure has considerable integrity as a measure of the damages investors have incurred, both because the definition of allowable losses is negotiated as part of every monetary settlement, and because class members who believe they will be prejudiced by a proposed measure of

portion of the amounts for which they were potentially liable under the Securities Act of 1933 (which itself was much less than their potential liability under Rule 10b-5). *See* Jonathan Weil, *WorldCom's Ex-Directors Pony Up—Agreement in Principle To Pay Out Personal Funds Creates Liability Precedent*, WALL ST. J., Jan. 6, 2005, at A3 (discussing the charges against Ebbers and Sullivan). Most of the amount paid in settlement came from underwriters, whose greatest potential liability was to bondholders for claims under the 1933 Act. *See id.* (discussing Citigroup Inc.'s $2.58 billion settlement, and plaintiffs' claims for "billions of dollars in damages from 17 other bond underwriters"). Worldcom's outside directors also made contributions, in addition to their D&O insurance coverage, equal to 20% of their assets (not including their principal residences) with respect to 1933 Act claims. Those payments, however, totaled only about $20 million, or 0.3% of the total recovered. *Id.*

47. *Cf.* LAURA E. SIMMONS & ELLEN M. RYAN, CORNERSTONE RESEARCH, SECURITIES CLASS ACTION SETTLEMENTS 2006 REVIEW AND ANALYSIS 4-5 (2006), http://www.cornerstone.com/pdf/practice_securities/2006Settlements.pdf (acknowledging that the damage models on which Cornerstone bases its estimates of potential damages in securities class actions "are not intended to be indicative of actual damages borne by shareholders," and, as a consequence of *Dura Pharmaceuticals, Inc.*, represent "increasingly imprecise proxies for potential damages claimed by plaintiffs").

48. Every securities class action settlement that involves a monetary recovery includes a definition of class members' allowable losses, which then serves as the basis on which the claims administrator allocates and distributes the settlement proceeds, net of attorney fees and expenses, after class members' claims have been submitted and reviewed.

allowable losses have standing to contest this figure if they believe it to be unfair.[49]

The most significant conceptual problem in using total recognized and allowable losses as a yardstick may be that, as Professors Cox and Thomas have demonstrated, many institutional investors apparently do not submit proof of claim forms in cases in which they are entitled to do so.[50] Thus, if the percentage of the recognized and allowable losses that class members receive is used to measure the extent to which investors have recovered their losses in securities class actions, total recoverable losses will be understated, and, concomitantly, recovery percentages will be overstated.[51] Nonetheless, we believe that using the percentage of total recognized and allowable losses received by class members as the yardstick of success—and as a measure of the impact institutional lead plaintiffs have on investors' recoveries—would represent a far superior approach to that used in previous academic studies.[52]

The real problem with using total recognized and allowable losses to measure relative success is practical, not conceptual. In every settled case, the settlement administrator must compute the total recognized and allowable losses for the plaintiff class or each subclass in order to determine what percentage of allowable losses it should pay out with respect to each valid claim. Moreover, although there may be good reasons to treat as confidential the amount of each claimant's losses, we can think of no good reason why the total losses

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49. Class members also can contest a claims administrator's rejection of their claim.

50. James D. Cox & Randall S. Thomas, *Leaving Money on the Table: Do Institutional Investors Fail to File Claims in Securities Class Actions?*, 80 WASH. U. L.Q. 855, 871 (2002). It seems almost certain that an even higher percentage of individual investors do not submit claims, especially because, for many of them, the cost involved in completing a proof of claim form may exceed whatever amount they estimate they will recover. On the other hand, the losses such investors have incurred may well represent only a relatively trivial portion of class members' total losses.

Another potentially significant conceptual problem is that calculations of allowable losses generally are not adjusted to take account for the fact that one or more of the principal defendants are insolvent or would become so if required to make good for all losses class members have incurred. However, as noted above, current studies also are subject to this limitation.

51. A second conceptual problem is whether attorneys' fees should be counted as part of the recovery. Because the plaintiff in any almost successful lawsuit must pay her attorneys' fees, either out of pocket or in the form of a contingent fee, there is a strong argument for counting any fees awarded as part of the recovery. However, because public debate about class actions focuses largely on whether they benefit class members or plaintiffs' attorneys primarily, in the table that follows, *infra* p. 16, we count as investor recoveries only the amounts actually distributed to class members.

52. There is little reason to believe that the proportion of class members, institutional and individual, who fail to submit proof of claim forms varies much from case to case.

claimed by the class (or each subclass) should not be made public, perhaps in a post-distribution filing (or a series of filings) with the court.[53]

Yet that is not the current practice. In order to test our hypothesis, and to see what results it would produce, we sought to obtain, for almost all settlements of more than $50 million included on the Securities Class Action Services' Top 100 list, dated December 31, 2006,[54] data on the recognized and allowable losses in each case and the amount distributed to each class (or subclass) of claimants.[55] We had very limited success.

Some plaintiffs' attorneys and claims administrators agreed to provide us with the data we requested, but others—including Gilardi and Co., which administered the largest number of the top 100 settlements, and the law firms that regularly used Gilardi's services—declined to do so. Nonetheless, we did get allowable loss and distribution data for eleven cases in which distributions had been completed. They showed that, in most of these eleven cases, investors who filed claims recovered significant percentages of their allowable losses. More specifically, class (or subclass) members recovered:[56]

- 65.5% of their recognized losses in *Charter Communications*;[57]

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53. *See infra* at p. 575 (recommending that courts begin to require that such information be filed). In most cases, when the court authorizes distribution of the bulk of the settlement proceeds, it will agree that some small percentage be held back to deal with contingencies. *See, e.g.*, Order Granting Lead Plaintiffs' Motion For Initial Distribution of the Net Settlement Fund to Authorized Claimants, *In re* Royal Ahold N.V. Sec. & ERISA Litig., 2007 WL 3128594, at *3 (D. Md. Sept. 26, 2007) (approving hold back of 5% of settlement fund to deal with possible contingencies). Requiring that a report be filed following the initial large distribution would ensure that data is available on a timely basis, especially if the report states what percentage of the fund remains to be distributed.

54. *See* Inst. S'holder Servs., *Top 100 Securities Class Action Settlements*, SEC. CLASS ACTION SERVS. ALERT, Dec. 31, 2006. That was the most recent list available when we undertook this portion of our research. We knew that data would not be available for the most recent settlements, because it often takes a year or more for all claims to be processed. It also follows that none of the data we were requesting is now available for settlements approved after December 31, 2006.

55. In some cases we sought this information from the claims administrators; in others, from counsel for the lead plaintiff or plaintiffs.

56. The percentages in the chart that follows are based on data provided by lead attorneys for plaintiffs in each of these cases. The percentage recoveries reflect the amounts actually paid to claimants. There is a strong argument that investors' recoveries also should include class members' share of the fees paid to plaintiffs' attorneys, because class members pay no out-of-pocket attorney fees. We have chosen to use the more conservative measure of success in this essay.

57. *See In re* Charter Commc'ns, Inc. Sec. Litig., 443 F.3d 987 (8th Cir. 2006). This reflects plaintiffs' settlement with the primary defendants. Their claims against two secondary

- 48% of their recognized losses in *Service Corporation International*;[58]

- 47% and 37% of their recognized losses in *Waste Management I*;[59]

- 35.1% of their recognized losses in *Cendant*;[60]

- 31% of their recognized losses in *Raytheon*;[61]

- 28.6% of their recognized losses in *Dollar General*;[62]

- 26.6% of their recognized losses in *Xcel Energy*;[63]

- 27% of their recognized losses in *Bristol-Myers Squibb*;[64]

- 18.9% of their recognized losses in *Waste Management II*;[65]

- 17.6% of their recognized losses in *Elan*;[66]

- 3.1% of their recognized losses in *Lucent*.[67]

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defendants were dismissed. *Id.* at 992 (affirming the district court's dismissal of the plaintiffs' claims against secondary defendants); *see also* Stoneridge Inv. Partners, LLC. v. Scientific-Atlanta, Inc., No. 06-43, 2008 U.S. LEXIS 1091 (Jan. 15, 2008) (affirming the 8th Circuit's dismissal).

58. *See* Sines v. Serv. Corp. Int'l, 2006 U.S. Dist. LEXIS 25072 (S.D.N.Y. Nov. 8, 2006).

59. *See* Mowbray v. Waste Mgmt. Holdings, Inc., 45 F. Supp. 2d 132 (D. Mass. 1999), *aff'd*, Mowbray v. Waste Mgmt. Holdings, Inc., 208 F.3d 288 (1st Cir. 2000).

60. *See In re* Cendant Corp. Litig., 264 F.3d 201 (3d Cir. 2001).

61. *See* LaFata v. Raytheon Co., 147 F. App'x 258 (3d Cir. 2005).

62. This recovery includes a Fair Fund distribution from the SEC.

63. *See In re* Xcel Energy, Inc. Sec., Derivative, & ERISA Litig., 364 F. Supp. 2d 980 (D. Minn. 2005).

64. *See* Stipulation and Agreement of Settlement, *In re* Bristol-Myers Squibb Sec. Litig., 2006 WL 516229 (D.N.J. Jan. 31, 2006). This recovery includes a Fair Fund distribution from the SEC. The private action for damages was settled during the pendency of plaintiffs' appeal of the district court decision dismissing their complaint.

65. *See* Mowbray v. Waste Mgmt. Holdings, Inc., 189 F.R.D. 194 (D. Mass. 1999), *aff'd*, Mowbray v. Waste Mgmt. Holdings, Inc., 208 F.3d 288 (1st Cir. 2000).

66. *See In re* Elan Sec. Litig., 385 F. Supp. 2d 363 (S.D.N.Y. 2005).

67. *See In re* Lucent Techs., Inc. Sec. Litig., 307 F. Supp. 2d 633 (D.N.J. 2004). Lucent provides a good illustration of the point made above regarding defendants' solvency. Lucent is the most widely-held public company, and potential damages were in the tens of millions. It was bankrupt at the time the case was settled.

IV. DEVELOPMENTS WE DID NOT ANTICIPATE

There have been six major developments since the Reform Act was passed that we did not anticipate. Some have been external, others not.

A. The Emergence of the Internet

The most significant unanticipated development probably has been the emergence of the Internet as a low-cost mechanism for plaintiffs' attorneys to communicate with investors. When we proposed that plaintiffs' attorneys be required to distribute early notice that a securities class action has been filed,[68] legal notices customarily were published in a few leading newspapers. We had no reason to believe that this would not remain the practice. Our thought was that plaintiffs' attorneys would spend more time analyzing potential claims before filing and that, either before or after filing, they would discuss with potential (or existing) client institutions the pendency of actions in which those institutions appeared to have significant amounts at stake.

Shortly after the Act was passed, though, a plaintiffs' firm posted notice of the filing of a class action on the Business Wire website, and a court thereafter held that such publication satisfied the statute's notice requirement.[69] Moreover, by this time many investors had begun to use web-based services that allowed them to post lists of all public companies in which they held stock or otherwise had an interest and to receive both relatively current pricing information and notification whenever anything was posted on the web that related to any of those companies.[70]

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68. The proposal in our article envisioned a somewhat different process than the process Congress ultimately decided to mandate. We suggested that a defendant corporation be required to compile a list of the one hundred largest purchasers of its securities during a purported class period, and that the attorneys for the first-filing plaintiff then be required to mail a notice to those investors. Weiss & Beckerman, *supra* note 1, at 2108-09. Congress elected to require only that notice be published no later than twenty days after an action is filed. 15 U.S.C. § 78u-4(a)(3)(A) (2000).

69. Greebel v. FTP Software, Inc., 939 F. Supp. 57, 63-64 (D. Mass. 1996) (noting that "publication on *Business Wire* is reasonably calculated to reach, at the least, sophisticated and institutional investors," and holding that the "press release on *Business Wire* satisfied the [statutory] requirements").

70. My Yahoo! is one of the most popular such services. It provides subscribers with an indication of whether an issuer has been mentioned in a web filing posted within the past twenty-four hours, and provides ready access to a link that allows them to view that filing. *See* My Yahoo! Home Page, http://cm.my.yahoo.com (last visited Feb. 18, 2008).

As a consequence of these developments, the dynamics of communications between plaintiffs' attorneys and members of the purported class developed in a manner far different from what we had anticipated. Plaintiffs' attorneys realized that they could use an Internet notice that they had filed a class action to "troll" for potential clients by including in the notice an invitation to investors to contact the firm for additional information about the pending suit.[71] Attorneys then could attempt to recruit investors who contacted them—especially those who appeared to have incurred substantial losses due to the alleged fraud—to become part of a lead plaintiff "group" that would be represented by the firm that had filed the notice.[72]

B. The "Race to the Courthouse" Continues and Other Unintended Consequences

The prospect that a law firm could use this tactic to assemble a "group" of investors large enough to enhance the likelihood that the law firm would be appointed lead counsel led to a continuation of the "race to the courthouse" that Congress (and we) hoped the lead plaintiff provisions would eliminate. Many plaintiffs' attorneys concluded that members of a purported class were more likely to contact the first law firm to post a notice that it had filed a class action against some given defendant.[73] As a result, law firms have continued to file class action complaints only days or even hours after an announcement of some unanticipated news triggering a sharp decline or increase in the price of a public company's stock.[74]

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71. *See* MICHAEL A. PERINO, SECURITIES LITIGATION AFTER THE REFORM ACT 2028-29 (2007) [hereinafter PERINO, SECURITIES LITIGATION].

72. The statute provides that the presumptive lead plaintiff is the "investor or group of investors" with the largest financial interest. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I)(bb). Developments relating to this provision are discussed below.

Published decisions include reports of instances in which plaintiffs' attorneys sought to appoint individuals as class representatives based on information the counsel had received from online forms that simply requested information about the individuals' purchases of the defendant company's securities. *See, e.g.*, Newby v. Enron Corp., No. H-01-3624, 2006 U.S. Dist. LEXIS 43146, at *242-43 (D. Tex. June 5, 2006) (noting that the individual for whom class representative status was sought "learned of the class action on the Internet and filled out a form online").

73. Sherrie R. Savett, *The Merits Matter Most and Observations on a Changing Landscape Under the Private Securities Litigation Reform Act of 1995*, 39 ARIZ. L. REV. 525, 528-29 (1997) (claiming that the race to the courthouse has ended, but then noting that plaintiffs' attorneys commonly use early filing of notice for just the purpose described in the text).

74. To be clear, we are *not* saying that, as some critics of class actions alleged before the Private Securities Litigation Reform Act was passed, a class action is almost always filed whenever the price of a public company's stock drops or increases by more than 10%. *See* Joel Seligman, *The Merits Do Matter: A Comment on Professor Grundfest's "Disimplying Private*

The continuation of early filing also was encouraged inadvertently by the statute's provision that the "person *or group of persons*" with the largest financial interest in an action should become the presumptive lead plaintiff.[75] Congress based this decision in large part on our article, in which we reported that affiliated institutional investors—for example, several mutual funds under the same management—often filed claims in an action.[76] We recommended that unrelated institutional investors that had substantial stakes in a pending action should be allowed to act together, rather than being forced to compete to be named lead plaintiff.[77]

Both we and Congress should have realized that the term "group of persons" has no precise meaning. Plaintiffs' law firms that posted notices on the Internet and were then contacted by hundreds or thousands of investors began to argue that all those investors constituted a "group," and that this "group" should be appointed lead plaintiff if its members' losses, when aggregated, were larger than those of any other applicant or "group" of applicants. These arguments initially were successful in several cases where courts agreed that the meaning of the word "group" was open ended and could include large groups of investors that plaintiffs' attorneys had assembled.[78] But courts soon began to recognize that appointing large groups as lead plaintiffs was inconsistent with Congress's rationale for enacting the lead plaintiff provisions because those groups were incapable of acting

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Rights of Action Under the Federal Securities Laws: The Commission's Authority," 108 HARV. L. REV 438, 442 (1995) ("One witness at the 1993 Senate Subcommittee hearings . . . testified that 'companies can be exposed to potential litigation whenever the stock price falls by approximately 10%, even if there's absolutely no violation of securities laws . . . .' "). *But see id.* at 444 ("[E]ven a cursory review of litigation in this field reveals that the federal courts regularly dismiss before trial complaints whose sole substance is a description of a stock drop."). Our claim is only that in situations where class action complaints are filed, the first complaint often is filed very shortly after unexpected news becomes public.

75. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I)(bb) (emphasis added).

76. *See* Weiss & Beckerman, *supra* note 1, at 2090-91 n.200.

77. *See id.* at 2108 (suggesting that providing notice to the investors involved in the largest transactions in the issuer's securities "would give institutional and other investors with substantial stakes in pending class actions an opportunity to decide whether they were interested in participating in those actions, alone or with other investors, as lead plaintiffs"). In private conversations with staff of the Senate Banking Committee, I urged them to include a reference to "groups" in the Committee bill.

78. *See, e.g., In re* Microstrategy, Inc., Sec. Litig., 110 F. Supp. 2d 427, 434 (E.D. Va. 2000) (noting that it has become a "common phenomenon" to see " 'groups' of class members who form to be named as lead plaintiffs jointly, and who seek to aggregate their losses to enhance their chances of winning selection as lead plaintiff"); *In re* Oxford Health Plans, Inc. Sec. Litig., 182 F.R.D. 42, 49 (S.D.N.Y. 1998) ("Because the PSLRA does not recommend or delimit a specific number of lead plaintiffs, the lead plaintiff decision must be made on a case-by-case basis . . . ."); *see also* PERINO, SECURITIES LITIGATION, *supra* note 71, at 2047-48 (noting various reasons why some courts have found for allowing the aggregation of plaintiff "groups").

as effective litigation monitors.[79] Consequently, most began to reject lead plaintiff applications from large groups.[80] Some courts continue to appoint groups made up of a small number of unrelated investors, but generally only do so if the group makes a showing that it has the potential to oversee the attorneys it purportedly has retained.[81] Others decline to appoint groups of unrelated individuals unless members can show that they entered into some relationship with each other before the lawsuit was filed.[82]

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79. The Securities and Exchange Commission, through amicus briefs filed in several district courts, played a major role in heightening courts' awareness of this problem. *See, e.g.*, *In re* Baan Co. Sec. Litig., 186 F.R.D. 214, 218-35 (D.D.C. 1999) (reprinting the SEC's amicus brief as an appendix to court's memorandum opinion).

80. *See, e.g.*, *In re* Cendant Corp. Litig., 264 F.3d 201, 267 (3d Cir. 2001) (noting that "groups with more than five members are too large to work effectively"); Takeda v. Turbodyne Techs. Inc., 67 F. Supp. 2d 1129, 1135 (C.D. Cal. 1999) (holding that a "group of persons" under the PSLRA means "a small group of manageable size that is capable of joint decisionmaking regarding the litigation"); *see also* PERINO, SECURITIES LITIGATION, *supra* note 71, at 2047 (noting that "there is a clear trend against permitting aggregation").

81. *See, e.g.*, *In re* Gemstar-TV Guide Int'l, Inc. Sec. Litig., 209 F.R.D. 447, 452-55 (C.D. Cal. 2002) (appointing a group of two pension funds as lead plaintiff, noting that the two funds "would supervise a single law firm"); *In re* Sprint Corp. Sec. Litig., 164 F. Supp. 2d 1240, 1244 (D. Kan. 2001) (appointing a group including five pension funds as lead plaintiff); *In re* Bank One S'holders Class Actions, 96 F. Supp. 2d 780, 783 (N.D. Ill. 2000) (appointing a group of six pension funds as lead plaintiff after noting the court's desire to avoid the suit being "run by the lawyers and not by the client class members"); Switzenbaum v. Orbital Scis. Corp., 187 F.R.D. 246, 251 (E.D. Va. 1999) (appointing five pension funds as co-lead plaintiffs after recognizing the group's "ability to manage class action securities fraud cases").

The Ninth Circuit's decision in *In re Cavanaugh*, 306 F.3d 726 (9th Cir. 2002), complicates this process by restricting considerably a district court's power, at least in the Ninth Circuit, to inquire into the *bona fides* of a lawyer-assembled group where no other class member has questioned the adequacy of the applicant. I had the honor of arguing that case, which involved a writ of mandamus, on behalf of Judge Vaughan Walker in the Northern District of California. The appellate decision, in my view, misrepresents the basis for Judge Walker's decision, which was that the individuals who comprised the group with the largest financial interest had failed to demonstrate that they would be adequate class representatives, not that another applicant had negotiated a more reasonable fee arrangement. *See also In re* Copper Mountain Sec. Litig., 305 F. Supp. 2d 1124, 1128-29 (N.D. Cal. 2004) (commenting on the lead plaintiff group's subsequent decision to dismiss voluntarily the complaint seeking appointment as lead plaintiff).

82. *See, e.g.*, *In re* eSpeed, Inc. Sec. Litig., 232 F.R.D. 95, 100-02 (S.D.N.Y. 2005) (counting only the losses of investors who had a familial relationship to determine which applicant had the largest financial interest, but also allowing an unrelated individual to be a part of the lead plaintiff group because his losses did not affect which applicant would be appointed). Courts, in general, are willing to appoint as co-lead plaintiffs institutional investors that have agreed to cooperate with each other in prosecuting a class action and to appoint as lead or co-lead counsel one or more law firms that those institutions recommend. *See, e.g.*, Barnet v. Elan Corp., PLC, 236 F.R.D. 158, 162 (S.D.N.Y. 2005) ("Recognizing that the question is one of degree, several courts have adopted a 'rule of reason' test, pursuant to which the acceptability of the proposed 'group' is tested against its ability to represent the interests of the class, and only allowed to proceed as a group if the court determines that 'lawyer-driven' litigation is not likely to result."). Such appointments, in our view, are consistent with the rationale underlying the lead plaintiff provisions.

Nonetheless, the race to be the first to file—and to post a notice of filing on the internet—continues.[83] From this, we infer that at least some plaintiffs' attorneys continue to find it advantageous to file complaints, and then Internet notices, as soon as possible.

C. Timing Problems Caused by the Act's Pleading Requirements

The rise of the internet and the continuation of early filing have given rise to an additional development that is inconsistent with our expectations. We hypothesized that if our proposals were adopted, plaintiffs' attorneys would have an incentive to do substantial research about potential claims before filing complaints, because they would then be in a better position to seek to be retained by institutional investors that had a substantial stake in lawsuits that they decided had merit.[84] The continued prevalence of quickly filed complaints makes clear that, in the vast majority of cases, relatively little pre-filing research occurs.[85] In addition, the competition to be the first to file (and to post notice) frequently creates a timing problem for institutional investors that may have an interest in seeking to be appointed lead plaintiff. The relevant provisions of the Act provide institutional investors with a relatively brief period in which to assess whether a filed claim has sufficient merit to justify the investment that an institution is likely to have to make if it chooses to seek to be appointed lead plaintiff.[86] For an institution committed to acting responsibly, this assessment will focus on whether that institution, through its attorneys, is likely to be able to acquire sufficient information to allow it to file a post-appointment amended complaint

83. For example, on Sunday, November 4, 2007, Citigroup announced that it might have to write off as much as $11 billion in value of securities that largely were secured by sub-prime loans. The price of Citigroup stock declined sharply on November 5. On November 8, the first class action complaint was filed. Press Release, Coughlin Stoia Geller Rudman & Robbins, Coughlin Stoia Geller Rudman & Robbins LLP Files Class Action Suit Against Citigroup Inc. (Nov. 8, 2007), http://www.csgrr.com/csgrr-cgi-bin/mil?case=citigroup.

84. *See* Weiss & Beckerman, *supra* note 1, at 2108-09 (hypothesizing that such proposals would "provide [the plaintiffs'] attorney an incentive—an increased chance of employment—designed to counter any hesitation she might have about doing the prefiling investigation and other work necessary to prepare a complaint").

85. The combination of the PSLRA's stringent pleading requirements and Federal Rule of Civil Procedure 11 somewhat constrain the quick filing of a complaint after unexpected news is followed by a sharp move in the price of a company's stock. An experienced plaintiffs' attorney, however, can cobble together a complaint sufficient to satisfy Rule 11 within hours or days. Moreover, in almost all cases the first filed complaint is superseded by a consolidated amended complaint that lead counsel files after all actions involving similar allegations have been consolidated and a lead plaintiff and lead counsel have been appointed.

86. The allowed period is generally no more than 60 days. *See* 15 U.S.C. § 78u-4(a)(3)(A)(i)(II) (2000).

that will satisfy the Act's stringent pleading requirements.[87] The difficulty of making this assessment within the relatively brief period that the Act allows is likely to be exacerbated by many institutions' need to follow an organized, but somewhat cumbersome, decisionmaking process before they can decide to proceed.

We do not have sufficient information to assess with any accuracy the extent to which such time pressures impede active institutional investor participation in securities class actions. But the only reasonable assumption, we believe, is that their impact to some degree is negative.

D. Judicial Resistance to the Act's Requirements

The lead plaintiff provisions not only revolutionized class action procedures but also constituted a congressional intrusion into an arena that courts traditionally had controlled. Congress had the authority to take this action,[88] but some courts nonetheless chose to resist the statute's mandate.

The most striking instance of resistance, in our view, occurred in *In re Oxford Health Plans, Inc. Securities Litigation*, one of the earliest cases in which a large institutional investor sought appointment as lead plaintiff.[89] The losses incurred by that institution, the Colorado Public Employees Retirement Association ("ColPERA"), were approximately twice as much as those of any other applicant.[90] The law firm that the institution proposed to name to represent the class, Grant & Eisenhofer ("G&E"), organized shortly after passage of the PSLRA to represent institutional investors in securities class actions; accordingly, it had a limited track record.[91]

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87. A responsible institution, we believe, would not want to be appointed lead plaintiff in an action in which any amended complaint that it was able to file after being appointed was likely to be dismissed.

88. *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499, 2512 (2007) ("No decision of [the Supreme Court] . . . suggests . . . that the Seventh Amendment inhibits Congress from establishing whatever pleading requirements it finds appropriate for federal statutory claims.").

89. 182 F.R.D. 42 (S.D.N.Y. 1998). The State of Wisconsin Investment Board had previously succeeded in securing appointment as lead plaintiff. *See* Gluck v. CellStar Corp., 976 F. Supp. 542, 543 (N.D. Tex. 1997).

90. *In re Oxford Health Plans*, 182 F.R.D. at 44-45. ColPERA's alleged losses amounted to nearly $20 million, as compared to alleged losses in excess of $10 million by one "group" comprised of thirty-five individuals and entities (which the court reduced to three individuals with aggregate claimed losses of about $8.5 million), and to alleged losses amounting to nearly $3 million by the remaining applicant. *Id.*

91. *See supra* note 35.

Judge Brieant, to whom the case was assigned, expressed concern about what he saw as G&E's limited financial resources, and he refused to appoint ColPERA the sole lead plaintiff and G&E the sole lead counsel.[92] Instead, he held that the class would be better served by having representatives of individual investors and mutual funds, as well as a public pension fund, serve as co-lead plaintiffs and by having their counsel serve as co-lead counsel.[93] Perhaps not coincidentally, Milberg Weiss, which for many years had been the most prominent firm in the plaintiffs' class action bar and was a firm with which Judge Brieant was familiar, represented the individuals he appointed as co-lead plaintiffs. He then appointed Milberg Weiss as co-lead counsel.[94]

District court judges similarly disregarded the statute's mandate in a few other cases.[95] More recently, though, courts generally have become comfortable with appointing institutional investors to serve as lead plaintiff and, in fact, have tended to favor them over individual applicants. In *eSpeed*, for example, Judge Scheindlin held that she would not aggregate the losses of the members of a group of unrelated individuals where a consequence of doing so would be to "displace the institutional investors preferred by the PSLRA."[96]

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92. *In re Oxford Health Plans*, 182 F.R.D. at 45-47, 50-51. The Court worried in particular about the possibility of ColPERA's dropping out as lead plaintiff if the costs of litigation began to exceed the reasonable prospects of recovery, and also about the extent to which ColPERA's fiduciary obligations to its pensioners might ultimately influence that decision. The court declined to give any weight to G&E's representation that it and the four other firms that it had suggested should be appointed the Executive Committee had committed to fund any costs not funded by ColPERA. *Id.* at 46-47.

93. *Id.* at 45, 50.

94. Ironically, the Milberg Indictment alleges that Milberg Weiss had a kickback arrangement with one of the plaintiffs it represented in the *Oxford* case, and eventually paid him more than $1 million. Milberg Indictment, *supra* note 20, at 43.

95. In one case, the court appointed a lead plaintiff committee comprising the manager of a state pension fund, which was also represented by G&E, and a number of individual investors represented by a local law firm. Burke v. Ruttenberg, 102 F. Supp. 2d 1280, 1344-45 (N.D. Ala. 2000). In another action in the same district, a different judge, rather than decide which applicant had the largest losses, ordered that the issue of whom to appoint as lead plaintiff be resolved through a coin toss. Laperriere v. Vesta Ins. Group, Inc., No. 98-AR-1407-S, 1998 U.S. Dist. LEXIS 23619, at *8-10 (N.D. Ala. Oct. 19, 1998). Before the appointed hour, though, the applicants agreed to serve as co-lead plaintiffs and to have their attorneys serve as co-lead counsel, which may well have been the result the court intended to bring about. Stipulated [Proposed] Order Appointing Lead Plaintiff and Approving Co-Lead Counsel at 1-2, *Laperriere*, 1998 U.S. Dist. LEXIS 23619 (filed Nov. 10, 1998).

96. *In re* eSpeed, Inc. Sec. Litig., 232 F.R.D. 95, 100 (S.D.N.Y. 2005).

E. Lead Plaintiffs Who Withdraw

Another development that we did not anticipate was that investors would apply to be named lead plaintiff but, once appointed, would withdraw prior to certification of the plaintiff class.[97] This, too, occurred in *Oxford*, where defendants' discovery efforts turned up evidence that called into question the magnitude of some of the individual co-lead plaintiffs' claimed losses, as well as their adequacy and typicality.[98]

The limits on discovery directed at applicants for appointment as lead plaintiff, which we recommended and Congress adopted, may have made it more likely that this development would occur. When we made that recommendation, we never considered the possibility that investors whose backgrounds were suspect would seek appointment or that investors would misrepresent (or allow their attorneys to misrepresent) their losses when they did so.[99] We therefore also did not anticipate that if either of these events were to occur, and if the designated lead plaintiff then withdrew, the court might allow lead counsel to remain in place, even though the client that had "selected" the firm was no longer in a position to monitor its prosecution of the case. Yet, that is exactly what the court did in *Oxford*,[100] and what courts have done in a few other cases.[101]

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97. *See* Perino, *supra* note 71, at 2074-75.

98. *See* Karen Donovan, *A Case of Ill-Fitting Oxfords? Milberg's Leading Role in Big Class Action is Under Attack*, NAT'L L.J., Oct. 9, 2000, at A1 (citing allegations in defendants' brief that a co-lead plaintiff "filed 'misleading' affidavits to 'create the appearance that they had suffered substantial losses' " from trading in defendants' stock).

99. In at least some instances, investors reportedly sought appointment in exchange for promises of financial rewards from the law firm that represented them. *See* Peter Elkind, *The Law Firm of Hubris Hypocrisy & Greed*, FORTUNE, Nov. 13, 2006, at 154, 163, 166, 170 (citing one individual who allegedly received $6.5 million for serving as a plaintiff in about seventy Milberg Weiss cases spanning a decade, another who received $2.4 million for also serving as a plaintiff in about seventy cases, and another who allegedly received $2.49 million for serving as plaintiff in about forty cases).

100. *See In re* Oxford Health Plans, Inc. Sec. Litig., 199 F.R.D. 119, 124-25 (S.D.N.Y. 2001) (declining to re-open the lead plaintiff selection process).

101. *See, e.g.*, *In re* Ins. Mgmt. Solutions Group, Inc., Sec. Litig., 206 F.R.D. 514, 515 (M.D. Fla. 2002) (noting the withdrawal of one of two court-appointed lead plaintiffs); *In re* Bank One Sec. Litig./First Chi. S'holder Claims, 2002 Fed. Sec. L. Rep. (CCH) ¶ 91,913, at *3 (N.D. Ill. May 19, 2002) (granting the withdrawal of Evergreen Fund as lead plaintiff).

F. The Difficulty of Determining Who Has the Largest Financial Interest

A final problem we did not anticipate—and this is one that we probably should have anticipated—is that determining which lead plaintiff applicant has the largest financial interest in a case can pose dauntingly complex problems. We based our proposals on claims-filed data, where each investor's recognized and allowable loss could be determined precisely, but we failed to focus on the fact that, at the time an action is filed, precise calculation—or even reasonably precise estimation—of investors' allowable losses simply is not feasible.[102] Thus, no generally accepted approach was available to the courts to make the key determination that the statute requires: how large is each applicant's "financial interest in the relief sought by the class"?[103]

Courts now generally approach this problem by using the four factor test first set forth in *Lax v. First Merchants Acceptance Corp.*: "(1) the number of shares purchased [during the class period]; (2) the number of net shares purchased [during the class period]; (3) the total net funds expended by the plaintiffs during the class period; and (4) the approximate losses suffered by the plaintiffs."[104] Where these computations point in different directions, courts tend to emphasize the fourth factor, viewing "the approximate losses suffered" as the best proxy for an applicant's "financial interest in the relief sought by the class." However, this does not get them very far because, as noted above, no consensus exists on how best to determine the "approximate losses" an investor has incurred.

The problem becomes even more complex because some applicants will not have made all their purchases of the issuer's securities during the purported class period or will not have held all securities they purchased until the period's end. Some will have held securities at the time the class period began and then sold some or all of them during the class period at allegedly inflated prices (arguably

102. The problems here are similar to the problems discussed above, *see supra* notes 40-51 and accompanying text, relating to studies that rely on econometric models to estimate investors' losses.

103. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I)(bb) (2000). The applicant that the court determines has the largest such interest becomes the presumptive "most adequate plaintiff." *Id.* § 78u-4(a)(3)(B)(iii)(I). Fortunately, based on reported decisions, it appears that this determination takes on critical importance in only a distinct minority of cases. In most cases in which more than one investor or group applies to be named lead plaintiff, it is obvious which applicant has the largest financial interest.

104. Lax v. First Merchs. Acceptance Corp., No. 97 C 2715, 1997 WL 461036, at *5 (N.D. Ill. Aug. 11, 1997). As of January 4, 2008, Westlaw listed seventy-two cases that had cited *Lax*, only one of which had declined to follow it.

realizing some benefit from the alleged fraud).[105] Others will have made all of their securities purchases during the class period but sold some of those securities before that period's end.[106] Some may have done both. Moreover, two common occurrences can make the computation of applicants' losses even more complex. First, a major portion of an applicant's losses (at least arguably) may be due to adverse business developments, not the alleged fraud.[107] Second, corrective disclosures often enter the market piecemeal, rather than all at once, and one or more applicants may have purchased or sold securities after the first partial corrective disclosure, but before the last.

We outline these problems not to criticize the approach that courts have taken, but to acknowledge our own failure—and that of Congress—to anticipate these issues and to provide courts with better guidance as how best to grapple with the difficult task that the statute directs them to carry out. Whether we could have come up with a better approach to this problem than that the courts have developed, had we given more thought to it in advance, is not something that we attempt to address in this Article.

V. COULD WE (OR CONGRESS) HAVE DONE BETTER?

These unanticipated problems and developments, together with the fact that Congress embraced the recommendations in our article and then adopted the lead plaintiff provisions without any hearings whatsoever on those provisions, have led us to wonder whether we or Congress could have come up with a better approach to organizing the prosecution of securities class actions. Likewise, the court's complaints in *In re Molson Coors Brewing Co. Securities Litigation*—that deciding which applicant to appoint as lead plaintiff "consume[s] judicial resources," and that, "from a public policy perspective, one might

105. The examples in this section assume a situation in which disclosure of unanticipated bad news is followed by a drop in the price of the subject company's stock.

106. One court recently held that the Supreme Court's decision in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), required it to reduce an applicant's claimed losses by the amount of losses it incurred on in-and-out trades during the class period. *See In re* Comverse Tech., Inc., Sec. Litig., No. 06-CV-1825 (NGG)(RER), 2007 WL 680779, at *4-5 (E.D.N.Y. Mar. 2, 2007).

107. For example, although a number of telecommunications companies, including WorldCom, Qwest, and Global Crossing, clearly misrepresented material facts relating to their businesses, it also seems clear that the losses incurred by investors in those companies, to some significant extent, were due to imprudent investments in new capacity made by those and other telecommunications companies.

question whether the right incentives are yet in place"[108]—also led us to this question.

The court in *Molson Coors* suggested no alternative approach to appointing either lead plaintiff or lead counsel and also ignored another reality: although federal judges may resent having to devote "judicial resources"—*i.e.*, their own time—in deciding whom to appoint as lead plaintiff and lead counsel, some significant expenditure of judicial resources may always be required unless courts revert to the first-to-file rule that prevailed before the lead plaintiff provisions were enacted. This, however, does not necessarily mean that the lead plaintiff provisions represent the best possible solution to the problem of how to organize the prosecution of securities class actions. Two other recent decisions, both of which involved different kinds of representative litigation, suggest different approaches that courts might use.

In *Nowak v. Ford Motor Co.*, which involved a class action brought under ERISA, the court based its decision to appoint one of the four competing applicants for lead plaintiff on its view that the law firm that the applicant retained had significantly more experience and expertise in ERISA litigation.[109] Meanwhile, in *In re Comverse Technology, Inc. Derivative Litigation*, decided only a week earlier, the court declined to appoint any lead plaintiff, even though one of the two applicants had a far larger financial interest in the action than the other, but did appoint the law firm retained by the second applicant as lead counsel based on its conclusion that that firm had been more diligent in investigating the relevant facts and had drafted a superior complaint.[110]

Although the approaches followed in *Nowak* and *Comverse* both have some appeal, each would generate its own set of costs and benefits. Let us start with *Nowak*, where the court focused on the experience and expertise of each applicant's counsel. On the plus side, if these factors governed the court's choice, the plaintiff class would be assured of representation by experienced and qualified counsel. On the other hand, courts already scrutinize the qualifications of proposed

108. 233 F.R.D. 147, 149 n.4 (D. Del. 2005). No sophisticated observer doubts that contests between class members to be appointed lead plaintiff often are driven in part by plaintiffs' attorneys who aspire to be named lead counsel. But, based on private conversations with representatives of institutional investors, we are convinced that many institutions act out of a sincere desire, based on their sense of fiduciary responsibility, to ensure that they are named lead plaintiff in actions in which they have a substantial amount at stake, and that a law firm in which they have confidence is named lead counsel.

109. No. 06-11718, 2006 WL 3870399, at *356-57 (E.D. Mich. Dec. 22, 2006).

110. No. 06-CV-1849 (NGG)(RER), 2006 WL 3511375, at *4-5 (E.D.N.Y. Dec. 15, 2006). *Comverse* actually involved a district court affirming a magistrate judge's decision.

lead counsel before appointing them to represent a plaintiff class. Moreover, basing the choice on law firms' relative experience and expertise could give rise to a cartel-like system in which newly organized firms and experienced firms that had not previously represented plaintiffs in securities class actions would be precluded from competing with the firms that comprise the established plaintiffs' bar. In addition, many of those law firms have a great deal of experience and expertise litigating securities class actions. Consequently, judicial decisions about which of those firms to appoint likely would become, or at least would appear to be, highly subjective. For example, a judge who believed that "a bad settlement is almost always better than a good trial" might be inclined to select law firms that shared that point of view.[111]

The approach followed in *Comverse*, which emphasizes the relative quality of the investigations competing law firms have carried out and of the complaints they have drafted, would give rise to a different set of problems. Under current rules, law firms that specialize in representing plaintiffs in securities class actions, viewed collectively, already engage in duplicative research because each must decide, on its own, whether it is worthwhile to pursue a case on a contingent fee basis. If courts began to select lead counsel on the basis of which firm had conducted the most thorough pre-filing investigation and had drafted the most detailed complaint, plaintiffs' attorneys would have a strong incentive to engage in even more competitive, but largely duplicative, research. This, in turn, would drive up their costs, which probably would lead them to seek higher fees than they currently receive. Investors, however, probably would not realize significant benefits from this research, because once a firm is named lead counsel, under current rules, it has a strong incentive to investigate thoroughly all the claims it is charged with pursuing.[112]

One could argue that despite these drawbacks, the approaches followed in *Nowak* or *Comverse* nonetheless are superior to that mandated by the PSLRA, because each gives a court considerable discretion to decide which applicant law firm is likely to be the most effective advocate of the interests of the plaintiff class. It is true that some courts have interpreted the lead plaintiff provisions of the

111. *In re* Warner Commc'ns Sec. Litig., 618 F. Supp. 735, 740 (S.D.N.Y. 1985), *aff'd*, 798 F.2d 35 (2d Cir. 1986); *see supra* text accompanying note 11.

112. This process also could unfairly prejudice defendants. Once a court decided that one of several complaints was the most persuasive, it might become reluctant to grant a motion to dismiss that same complaint. Alternatively, if a court decided that none of the complaints filed in an action were satisfactory, it would make little sense for the court, then, to appoint as lead counsel the firm that had prepared the best of a group of inadequate complaints.

PSLRA in a relatively rigid fashion,[113] but one should keep in mind that the provisions actually provide courts with enough "play in the joints" to exercise a degree of discretion where they find it appropriate and important to do so.

In re Enron Corp. Securities Litigation provides a striking example of a case in which, in our view, the court did exactly that.[114] Several groups of institutional investors, all represented by highly qualified and experienced plaintiffs' attorneys, applied to be named lead plaintiff.[115] One group then decided to disband, leaving one of its members, the Regents of the University of California ("Regents"), as the applicant with the largest single financial interest in the action. The Regents were represented by William Lerach, a sometimes flamboyant plaintiffs' attorney who publicized his firm's commitment to investigating the Enron fraud by walking into court, in front of a bevy of television cameras, carrying a "large" carton that he claimed was filled with the shredded remains of documents that the Enron defendants had attempted to destroy.[116]

We cannot be sure how much influence Mr. Lerach's antics had on the court, but its opinion appointing the Regents as lead plaintiff leads us to believe that their influence may have been considerable.[117] Other courts had appointed groups of institutional investors as co-lead plaintiffs in several cases,[118] and the aggregate losses of some of the applicant groups in *Enron* exceeded the losses claimed by the Regents.[119] But Judge Harmon refused to allow any of the groups to aggregate their members' losses, which allowed her to find that the Regents had the largest financial interest of any of the applicants.[120]

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113. *See supra* note 81 (discussing *In re Cavanaugh*).

114. 206 F.R.D. 427 (S.D. Tex. 2002).

115. *See generally id.* (discussing various plaintiffs' motions to be named lead plaintiff). Some of them may have decided to join together at the urging of the attorneys who represented them. We have no reason to believe, however, that any of them did so simply to advance their attorneys' interest in being named lead counsel.

116. Leslie Wayne, *Enron's Collapse: The Lawyer; Seeking Top Berth in Pursuit of Enron*, N.Y. TIMES, Jan. 23, 2002, at C6.

117. The court did mention them in the decision appointing the Regents lead plaintiff and Mr. Lerach's firm lead counsel. *In re Enron Corp. Sec. Litig.*, 206 F.R.D. at 458.

118. *See, e.g.*, *In re Cendant Corp. Litigation*, 182 F.R.D. 144, 147-48 (D.N.J. 1998), in which a group comprised of the California Public Employees Retirement System, the New York State Common Retirement Fund, and the New York City Pension Funds was appointed lead plaintiff.

119. *In re Enron Corp. Sec. Litig.*, 206 F.R.D. at 454 n.31.

120. *See id.* at 455 (holding that the parties "have not shown that their grouping is not a manipulated effort to aggregate larger losses than other proposed Lead Plaintiffs or to cure certain deficiencies of [one of the applicants]").

She appointed the Regents lead plaintiff and, per their request, appointed Mr. Lerach's firm lead counsel.[121]

Goldberger v. PXRE Group, Ltd. represents a more typical example of the kinds of situations in which courts have exercised discretion to appoint a lead plaintiff that the court thought would be the most effective litigation monitor.[122] In *Goldberger*, an individual investor was competing with a group comprised of two married couples and three other individuals to be appointed lead plaintiff.[123] All of the prospective lead plaintiffs agreed that the individual applicant's losses were larger than those of any member of the group and that the group's aggregate losses exceeded those of the individual.[124] The court acknowledged that the statute authorized it to appoint a "group."[125] It held, however, that appointing the group before it would be inconsistent with Congress's desire to encourage client-directed, as opposed to lawyer-directed, lawsuits: "To allow lawyers to designate unrelated plaintiffs as a 'group' and aggregate their financial stakes would allow and encourage lawyers to direct the litigation."[126] Consequently, the court appointed the individual investor to be lead plaintiff and appointed the attorneys he had retained to be lead counsel.[127]

It remains clear, though, that the lead plaintiff provisions do constrain considerably courts' discretion to decide whom to appoint as lead plaintiff and lead counsel. That limitation is a necessary byproduct of the market-based rationale underlying those provisions of the Act. And, in those cases in which at least one applicant has a

121. *Id.* at 459. Her decision appears to have worked out well for members of the plaintiff class. To date, it has secured settlements totaling more than $7 billion, mostly from secondary defendants that allegedly were participants in a number of Enron's fraudulent schemes. A recent Fifth Circuit decision, for which cert was denied, indicates that had Judge Harmon allowed an interlocutory appeal of her decision refusing to dismiss the claims against those secondary defendants, the Fifth Circuit would have ordered that those claims be dismissed. *See* Regents of the Univ. of Cal. v. Credit Suisse First Boston, 482 F.3d 372, 394 (5th Cir. 2007) (ruling on standards for securities fraud), *cert. denied*, No. 06-1341, 2008 WL 169504 (U.S. Jan. 22, 2008).

122. No. 06-CV-3410 (KMK), 2007 WL 980417 (S.D.N.Y. Mar. 30, 2007). In *Goldberger*, the court expressly stated that it believed the attorneys representing both competing applicants were "capable of serving as lead counsel." *Id.* at *2. In making this comment, we do not intend to suggest that the Regents have not exercised effective oversight in *Enron*. In fact, based on private conversations, we believe that they have monitored actively the manner in which their attorneys have prosecuted that case.

123. *Id.* at *1.

124. *Id.* at *3.

125. *Id.*

126. *Id.* at *4.

127. *Id.* at *5. Several other courts have followed the same approach. *See id.* at *4 (citing cases agreeing that "group" must be construed in context).

substantial financial stake in the action, we believe that rationale retains considerable validity.

We argued in our article that a class member with a considerable sum at stake was likely to be more committed than a court to ensuring that all claims asserted on behalf of the plaintiff class were prosecuted vigorously.[128] As discussed above, the unprecedented large settlements that plaintiffs have obtained in numerous post-1995 cases strike us as persuasive evidence that, in many cases, the litigation dynamic we hypothesized would develop has come to pass.[129] In our view, the lead plaintiff provisions of the PSLRA and the Act's pleading standards have been important forces that have changed the landscape of securities litigation from one in which claims that "the merits do not matter" appeared to have some plausibility to one in which critics now spend much of their time decrying the size of the settlements that plaintiff classes, often led by institutional lead plaintiffs, have been able to secure.

VI. OUR BOTTOM LINE

We believe that the lead plaintiff provisions have worked reasonably well, but we do not claim that they constitute a perfect solution to the problem of how best to organize the prosecution of securities class actions. We are aware of no suggestion by any court or commentator that some alternative approach would be superior.[130] Thus, were we to start over—or were Congress, the courts, or the SEC to be inclined to reconsider these issues—we would again recommend essentially the same approach. However, we also would suggest three refinements.

Only the first requires legislative action. We believe the statute should be amended to clarify that, whether or not one lead plaintiff applicant seeks to demonstrate that another is inadequate or atypical,

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128. *See* Weiss & Beckerman, *supra* note 1, at 2089.

129. We are less confident that the same dynamic is present in cases in which lead plaintiffs' losses are relatively small.

130. A group of six law professors has suggested that the SEC undertake a comprehensive review of key issues relating to securities class actions. Notably, the extensive list of issues they suggest the Commission consider does not include reconsidering the lead plaintiff provisions of the PSLRA. *See* Letter from Donald C. Langevoort, Thomas Aquinas Reynolds Professor of Law, Georgetown Univ. Law Ctr., to Christopher Cox, Chairman, SEC (Aug. 7, 2007), *available at* http://law.du.edu/jbrown/corporateGovernance/secGovernance/documents/SECAug7.pdf; *see also* Langevoort Letter on the Role of Litigation to SEC Chairman Cox, Attachment (Aug. 7, 2007), *available at* http://law.du.edu/jbrown/corporateGovernance/secGovernance/documents/SECAug2.pdf. The SEC reportedly is planning to convene a roundtable early in 2008 to discuss these issues. Kara Scannell, *SEC to Study Revamp on Shareholder Suits*, WALL ST. J., Sept. 24, 2007, at C2.

a court has the authority, *sua sponte*, to inquire into any applicant's qualifications and to disqualify any applicant that it finds to be inadequate or atypical.[131] Competing applicants may not ask the right questions, and defendants, who can inquire into these issues at the class certification stage, generally are more concerned with defeating class certification than with ensuring that class members' interests are represented effectively.[132] The court is far more likely to be concerned with whether any given applicant is qualified to represent the plaintiff class. Moreover, it makes sense to allow the court to focus on that issue early in the litigation process, rather than leaving the issue to be resolved much later in the process.

Our second suggestion relates to the first, but it is directed to the courts. We believe that whenever either an individual or a member of a group that has been appointed lead plaintiff withdraws or is found to have misrepresented facts material to the selection of lead plaintiff, the court, *sua sponte*, should reconsider its order appointing lead plaintiff *and lead counsel*. If other class members applied to be appointed lead plaintiff, the court should appoint the applicant that had the second largest financial interest in the action, provided that she appears to be an adequate and typical class representative. If no other class member applied, or if none who previously applied agrees to serve, then the court should require that a new notice be posted and should then, following the procedures set forth in the Act, select a new lead plaintiff from those who apply.[133]

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131. In our view, it was on the basis of such inquiries, not the fact that one applicant had negotiated lower attorneys' fees than another, that Judge Walker appointed a lead plaintiff in the *Copper Mountain* litigation. Admittedly, the opinion explaining that decision is somewhat ambiguous. *See In re* Copper Mountain Sec. Litig., 305 F. Supp. 2d 1124 (N.D. Cal. 2004). However, when I represented Judge Walker before the Ninth Circuit, *see supra* note 81, I examined the full record and concluded that concerns about adequacy, not who had negotiated the lowest fees, provided the basis for his decision to disqualify the applicants with the largest financial interest, all of whom were members of an attorney-organized lead plaintiff group. The Court of Appeals, however, did not so read his decision; it held that he had chosen a lead plaintiff improperly based on his view of which applicant had negotiated the most advantageous fee arrangement. *In re* Cavanagh, 306 F.3d 726, 731-34 (9th Cir. 2002). Unfortunately, the appellate court also went on to state that the statute effectively denies a district court *any* authority to initiate inquiries into the adequacy or typicality of an applicant for appointment as lead plaintiff. *Id.* Judge Wallace disagreed with this portion of the court's opinion. *See id.* at 741-42 (Wallace, J., concurring). Relying on *In re Cendant Corp. Litig.*, 264 F.3d 201, 263 (3d Cir. 2001), courts in the Third Circuit, in contrast, continue to view whether a prospective lead plaintiff has negotiated a reasonable fee arrangement as one indicator of an applicant's adequacy. *See, e.g., In re* Sterling Fin. Corp. Sec. Class Action, No. 07-2171, 2007 WL 4570729, at *4 (E.D. Pa. Dec. 21, 2007).

132. Weiss & Beckerman, *supra* note 1, at 2101.

133. The applicant with the largest financial interest, again, should be selected as the presumptive "most adequate plaintiff."

Unless the court concludes that to do so would seriously prejudice the interests of the plaintiff class, the court should also allow a successor lead plaintiff (subject to court approval) to decide whether to retain as lead counsel the law firm initially appointed or to retain a different firm. If courts made clear that they intended to so proceed, the integrity of the lead plaintiff selection process would be enhanced considerably. The threat that a firm would be removed as lead counsel if its client either misrepresented facts material to its selection as lead plaintiff or was not committed to remaining involved throughout the course of the litigation would provide plaintiffs' attorneys with a strong incentive to ensure both (i) that all the information provided to a court by any lead plaintiff applicant that they represented was accurate in all material respects and (ii) that all such applicants understood that they had a fiduciary obligation to oversee the litigation, not merely to facilitate selection of their attorneys as lead counsel.[134]

Our final suggestion also is directed to the courts. We argued above that the best feasible approach to measuring the relative success of securities class actions is to compare the funds distributed to class members in any given case to the recognized and allowable losses that class members have claimed.[135] We also noted that, in every settled case, the settlement administrator has to compute both the total allowable losses of the class or each subclass and the amount to be distributed to that class or subclass. Settlement administrators, however, do not routinely file that information with the court or otherwise make it public.[136] Moreover, we found that, in most of the cases in which we sought that information, the settlement administrators and the attorneys who retained them are unwilling to make it available.

We can think of no good reason why this information should not be available to the public. Every time a court approves a monetary settlement of a securities class action, it should order the settlement administrator to file with the court, promptly after it has finished distributing the bulk of the settlement proceeds and again after the final distribution, reports setting forth total recognized and allowable losses and the total sum distributed to the class members who claimed

134. Judge Scheindlin's thoughtful comments at the conference where I first presented these ideas led me to revise this recommendation substantially.

135. *See supra* text accompanying notes 48-52. We would include, for this purpose, distributions from SEC Fair Funds accounts and amounts derived from settlements of private actions. Our understanding is that settlement negotiations in private actions generally reflect defendants' agreements to make Fair Funds payments to the SEC.

136. Weiss & Beckerman, *supra* note 1, at 2104 n.250.

those losses. Such disclosure would serve a public purpose by increasing the transparency of the class action litigation process and thus facilitating a more informed discussion of issues relating to the costs and benefits of private actions for damages.

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