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Cutting Class Action Agency Costs: Lessons from the Public Company

Amanda M. Rose

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Cutting Class Action Agency Costs: Lessons from the Public Company

Amanda M. Rose*

The agency relationship between class counsel and class members in Rule 23(b)(3) class actions is similar to that between executives and shareholders in U.S. public companies. This similarity has often been noted in class action literature, but until this Article no attempt has been made to systematically compare the approaches taken in these two settings to reduce agency costs. Class action scholars have downplayed the importance of the public company analogy because public companies are subject to market discipline and class actions are not. But this is precisely why the analogy is useful: because public companies are subject to market discipline, the tools they utilize to reduce agency costs are more likely to be efficient. This Article looks to those tools as inspiration for class action reform, proposing several novel ways to improve current practice.

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INTRODUCTION

Civil procedure scholars routinely explain perceived problems in class action litigation, such as excessive attorneys' fees and settlements that shortchange the class, as "agency costs" — the result of class action attorneys prioritizing their own interests above those of the classes they represent.¹ Volumes have been written analyzing various techniques for aligning the interests of class counsel with those of class members, and this mode of thinking has colored a variety of legislative reform efforts.² The academic approach to corporate law is strikingly similar: corporate law scholars fixate on the divergence of interest between managers and shareholders of public companies, and the corporate law literature evaluating the techniques for aligning those interests could fill its own library. It is odd, then, that class action scholars have paid so little attention to the public company analogy. This is particularly so given the similarity of the agency relationship structure: in both the class action and public company contexts, the principal is not a single individual, but a dispersed collective. This presents special challenges, as collective action problems render ineffective certain monitoring techniques useful for reducing agency costs in simpler relationships.

¹ This approach is traceable to the pioneering work of Professor John Coffee. For some of his earliest contributions, see, for example, John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working*, 42 MD. L. REV. 215 (1983) [hereinafter *Rescuing the Private Attorney General*]; John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877 (1987) [hereinafter *Entrepreneurial Litigation*]; John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 L. & CONTEMP. PROBS. 5 (1985) [hereinafter *Unfaithful Champion*]; 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 (1986) [hereinafter *Understanding the Plaintiff's Attorney*].

² See, e.g., Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C. and 18 U.S.C.); Class Action Fairness Act of 2005 (CAFA), Pub. L. No. 109-2, 119 Stat. 4 (codified in scattered sections of 28 U.S.C.); Fairness in Class Action Litigation Act of 2017, H.R. 985, 115th Cong. (2017). In addition to provisions designed to better align the interests of class counsel with those of class members, these pieces of legislation also contain provisions designed to alleviate the over-deterrence risk aggregate litigation can present — or, more cynically, to handicap the ability of class actions to achieve optimal deterrence. See Bruce Hay & David Rosenberg, "Sweetheart" and "Blackmail" Settlements in Class Actions: Reality and Remedy, 75 NOTRE DAME L. REV. 1377, 1377-78 (2000) (discussing the "two dangers" critics warn class action settlements present: (1) "the problem of 'sweetheart' settlements, in which the class members' interests are compromised by class counsel" and (2) "the problem of 'blackmail' settlements, in which the defendant is bludgeoned into settling cases for more than they are worth").

Indeed, this feature of class actions arguably makes the public company a more natural point of comparison than individual litigation.

I do not mean to suggest that the resemblance between the agency relationship in class actions and public companies has gone unrecognized. To the contrary, commentators often note the similarity,³ sometimes even referring to the agency-cost view of class actions as a “corporate-law model.”⁴ It is no coincidence that John Coffee, the scholar most responsible for developing the agency-cost view of class actions, is also a corporate-law expert.⁵ But the analogy has never been fully explored.⁶ The main reason given for this neglect is the absence of

³ See, e.g., Lucian Arye Bebchuk, *The Questionable Case for Using Auctions to Select Lead Counsel*, 80 WASH. U. L.Q. 889, 898 & n.19 (2002) (analogizing, in passing, the task of setting counsel fees in class actions to that faced by a board of directors deciding a CEO compensation package); Elizabeth J. Cabraser & Samuel Issacharoff, *The Participatory Class Action*, 92 N.Y.U. L. REV. 846, 860 (2017) (observing in passing that class action agency costs, as described in critical commentary, “replicat[e] the classic separation of ownership and control that preoccupied the law of corporate governance”); Charles Silver & Lynn Baker, *I Cut, You Choose: The Role of Plaintiffs’ Counsel in Allocating Settlement Proceeds*, 84 VA. L. REV. 1465, 1465-66 (1998) (drawing but not developing the analogy, except to observe that the rules governing class actions and other litigation groups are akin to default provisions of incorporation statutes); see also Alon Klement, *Who Should Guard the Guardians? A New Approach for Monitoring Class Action Lawyers*, 21 REV. LITIG. 25, 56 n.86 (2002) (noting that the idea that institutional investors would make good monitors in securities class actions resembles “earlier discussion of similar themes in the corporate finance literature”).

⁴ Elizabeth Chamblee Burch, *Optimal Lead Plaintiffs*, 64 VAND. L. REV. 1109, 1129 (2011).

⁵ See, e.g., Coffee, Jr., *Entrepreneurial Litigation*, *supra* note 1; Coffee, Jr., *Rescuing the Private Attorney General*, *supra* note 1; Coffee, Jr., *Understanding the Plaintiff’s Attorney*, *supra* note 1; Coffee, Jr., *Unfaithful Champion* *supra* note 1.

⁶ Professor Coffee goes furthest to develop the analogy in John C. Coffee, Jr., *Class Action Accountability: Reconciling Exit, Voice, and Loyalty in Representative Litigation*, 100 COLUM. L. REV. 370 (2000) [hereinafter *Class Action Accountability*]. In that article, Professor Coffee points to the importance of the hostile tender offer and proxy contest to public company governance as a way to motivate his proposal to enhance class member opt-out rights and promote solicitations of competing opt-in class actions. *Id.* at 422-23 (noting that solicitation of competing class actions “is the equivalent of a hostile tender offer because it asks class members to ‘vote with their feet’ and leave one class action to join another”). More generally, *Class Action Accountability* utilizes a typology of governance techniques commonly employed in the corporate law literature — exit, voice, and loyalty (often translated to law students as shareholders’ tripartite rights to sell, vote and sue) — to conceptualize the options for reducing agency costs in the class action setting. This typology, which is traceable to Albert Hirschman’s classic book ALBERT O. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES* (1970), has been utilized by other class action scholars, as well. See, e.g., Samuel Issacharoff, *Governance and Legitimacy in the Law of Class Actions*, 1999 SUP. CT. REV. 337, 367-80 [hereinafter *Governance and Legitimacy in the Law of Class Actions*]. None of the prior literature, however, utilizes this or any other

market discipline in the class action context, which is thought to render the comparison unhelpful.⁷ Shareholders of public companies choose whether to invest initially in a firm and are free to resell their shares into a liquid secondary market if they become dissatisfied with the performance of its managers. In contrast, class members are swept into a class action without volition, have no practical ability to sell their claims (except to the defendant in a settlement), and will usually find it economically irrational to opt out to pursue litigation individually — even if they believe class counsel is performing inadequately.

The insulation of class counsel from market pressure relative to the managers of public companies is indeed a critical point of distinction. But far from being a reason for class action scholars to dismiss the public company analogy, it is *why* that analogy has the potential to offer valuable insights. To see this, consider an agency contract entered voluntarily by well-informed, self-interested parties, whereby the first party (the principal) delegates authority to the second party (the agent) to perform some task on its behalf. The parties to this contract would have the incentive to adopt techniques that efficiently constrain agency costs — the costs that arise because, in carrying out the assigned tasks, the agent will be tempted to place his own interests above those of the principal. Agency costs include not just the residual loss that results when an agent acts contrary to the principal's interests, but also the costs incurred in trying to prevent that residual loss (referred to as “monitoring” and “bonding” costs in the literature⁸). Adopting techniques to constrain agency costs would be in the self-interest of the agent, because it would allow the agent to demand greater

typology to undertake the comprehensive comparison of public company and class action governance techniques offered herein.

⁷ See, e.g., Coffee, Jr., *Entrepreneurial Litigation*, *supra* note 1, at 882-85 (arguing that agency problems in class actions are distinguishable from those in public companies because, *inter alia*, “no informed and active market . . . discipline[s] or motivate[s] the agents in the litigation context”); Kenneth W. Dam, *Class Actions: Efficiency, Compensation, Deterrence, and Conflict of Interest*, 4 J. LEGAL STUD. 47, 59-60 (1975) (distinguishing the relationship between shareholders and corporate managers from the relationship between class members and class counsel due to the absence of a market in legal claims); Samuel Issacharoff, *The Governance Problem in Aggregate Litigation*, 81 FORDHAM L. REV. 3165, 3167 (2013) [hereinafter *The Governance Problem in Aggregate Litigation*] (“There is no telling act by class members that would look like the realized buy-in of the capital markets.”); Alexandra Lahav, *Fundamental Principles for Class Action Governance*, 37 IND. L. REV. 65, 115 (2003) [hereinafter *Fundamental Principles*] (observing that the corporate analogy is “not entirely appropriate” because “there is no market — efficient or otherwise — for class action settlements”).

⁸ See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976).

compensation for his services. The parties would not succeed in eliminating agency costs entirely, given that monitoring and bonding costs are positive. But their choice to enter the relationship would allow us to infer that its benefits to them exceed those costs.

We can infer no such thing about the relationship that exists between class counsel and a class. Because class representation occurs by judicial fiat, we have no market-based assurance that it generates benefits in excess of costs.⁹ Nor can we assume that the techniques used to constrain class counsel from elevating its interests above those of the class are efficient. Such techniques are not the result of voluntary bargaining between the parties to be affected, but of choices made by the drafters of Rule 23 and related legislation.

We can, by contrast, have some confidence that the public company persists because the net benefits of dispersed equity ownership exceed those generated by alternative capital structures: when this ceases to be the case, firms can and do go private. More importantly for purposes of this Article, we can also place more faith in the efficiency of the techniques utilized to constrain agency costs in public companies. Like the agent in the simple bilateral contract imagined above, it is in the self-interest of corporate managers to constrain agency costs¹⁰: the inclusion of shareholder-protective measures in a corporate charter allows manager-entrepreneurs to demand a higher share price in the company's initial public offering ("IPO"),¹¹ and capital market discipline incentivizes managers to retain tools to limit agency costs after the firm has gone public.¹² The techniques adopted by public

⁹ While attorneys seeking the class counsel position will have convinced at least one putative class member to retain them, it is the court that decides which attorney will be authorized to represent the class as a whole. See FED. R. CIV. P. 23(g); cf. 15 U.S.C. § 78u-4(a)(3) (2018); *infra* notes 202–203 and accompanying text (discussing the unique approach to the appointment of lead counsel taken in securities class actions).

¹⁰ See FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 17-22 (1991) ("All the terms in corporate governance are contractual in the sense that they are fully priced in transactions among the interested parties."). For other classic works espousing the view of the corporation as a nexus of contracts, see Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 777 (1972); Jensen & Meckling, *supra* note 8, at 311; see also R. H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386, 391 (1937).

¹¹ See, e.g., Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1562-63 (1989) (discussing evidence that differences in charter provisions are priced by investors).

¹² Assuming the company's stock trades in a semi-strong efficient market, managers' public decision to abandon efficient agency-cost-reduction techniques should cause the stock price to drop, making future capital raising efforts more costly and exposing the

companies to constrain agency costs might therefore offer fresh, market-tested ideas for class action reform.

The purpose of this Article is to explore that possibility.¹³ Toward that end, Part I discusses in more depth the important similarities between

management team to the threat of a hostile change in control. It may also affect managers' future prospects in the managerial labor market. See Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 288 (1980).

¹³ Some important caveats are in order. First, public companies do not operate at an agency-cost-minimizing level, and nothing in this Article should be read to suggest that they do. Market imperfections and regulatory interventions surely distort the tools used to align managerial interests with those of shareholders in public companies, a phenomenon well-chronicled in the corporate law literature. See, e.g., Jens Dammann, *The Mandatory Law Puzzle: Redefining American Exceptionalism in Corporate Law*, 65 HASTINGS L.J. 441, 461 (2014) (surveying the empirical literature evaluating how well the IPO market prices charter terms); Gordon, *supra* note 11, at 1573-85 (discussing the possibility that managers can push through opportunistic charter amendments once the company has gone public and ways of addressing it); *id.* at 1571-73 (discussing factors that might lead the legislature to act in ways inimical to shareholder welfare). Second, public companies and class actions possess immutable differences that may cause the optimal mix of governance techniques to vary in each setting. These differences are discussed in Part I and may make some techniques used to constrain agency costs in one setting impossible or inefficient to replicate in the other.

These realities counsel against unreflectively transposing the tools of public company governance onto class actions. They do not, however, warrant completely ignoring the lessons public company governance may have to offer for class action reform. While imperfections undeniably exist, the managers of public companies remain subject to strong market forces, whereas in most cases class counsel are subject to none. And corporate law remains largely enabling, limiting its potential to distort, whereas class action law is mandatory. Even in those instances in which public companies are forced, either by mandatory laws or sticky default rules, to adopt or eschew particular tools to fight agency costs, those laws are likely more efficient (or less inefficient) than those governing class actions: generally speaking, shareholder interests are better represented in the political process than those of potential class members, and because both corporations and the capital they seek are mobile, state and federal corporate lawmakers face forces of regulatory competition that class action lawmakers do not. Finally, the immutable differences that exist between class actions and public companies are readily identifiable and of more limited relevance than might generally be assumed.

A final caveat is in order. The market forces at work in the public company setting do more than lend credibility to the agency-cost reduction techniques public companies employ. Those market forces are *themselves* an agency-cost reduction technique. That is, capital market discipline does not simply encourage managers to adopt tools that minimize agency costs, it also operates to align managerial interests with those of shareholders *directly*. Consider, for example, the threat of a hostile takeover or an activist hedge fund campaign — such threats are thought to do important work to reduce managerial agency costs in public companies, and they are a byproduct of free secondary market trading in public company stock. Even those public company governance tools that are not directly dependent on the existence of a free market in corporate shares may be affected by those that are. As Albert Hirschman observed long ago, when it comes to motivating the leaders of an organization, the right of the

the agency relationship structure in the class action and public company contexts. It also describes the differences that exist between class actions and public companies, explaining how these differences might affect the relative desirability of agency-cost-reduction techniques.

Part II lays the groundwork for the Article's main task. To compare agency-cost-reduction techniques in the class action and public company settings, it is useful to employ a common vocabulary; Part II.A therefore introduces readers to the taxonomy of agency-cost-reduction strategies developed by Reinier Kraakman et al. in their book *ANATOMY OF CORPORATE LAW* ("ACL taxonomy").¹⁴ While developed for the specific purpose of analyzing international approaches to corporate governance, the ACL taxonomy is general enough to transcend subject matter. It groups agency-cost-reduction strategies into three categories: (1) incentive alignment strategies, which aim to align the interests of agents with those of principals through either a "trusteeship" or "rewards" approach, (2) governance strategies, which give principals control over their agents' behavior, and (3) regulatory strategies, which seek to prescribe agent behavior during the course of the agency relationship or to regulate the terms upon which agents and principals enter and exit that relationship.¹⁵

As described in Part II.B, U.S. public companies place important reliance on each strategy, including: incentive alignment strategies in the form of independent boards (an example of the trusteeship approach) and performance-based executive pay (an example of the rewards approach); governance strategies in the form of shareholder voting; and regulatory strategies in the form of judicially-enforced fiduciary duties, mandatory disclosure, appraisal and the free transferability of shares (which in turn facilitates hostile takeovers and hedge fund activism). By using multiple strategies and approaches,

organization's constituents to "exit" may serve as a substitute for "voice"-based governance techniques. Coffee, Jr., *Class Action Accountability*, *supra* note 6, at 437. In the corporate context, then, the existence of a takeover market might justify weaker shareholder voting rights than would be the case if no exit rights existed. While this suggests that the analogy drawn in this Article should be approached cautiously, it remains of value. Notably, class members enjoy *fewer* voice rights than public company shareholders do, while at the same time lacking effective exit rights. Thus, even if the voice-based governance techniques utilized by public companies would be insufficient to minimize agency costs in the class action setting, they might nevertheless represent an improvement over the status quo.

¹⁴ REINIER KRAAKMAN, JOHN ARMOUR, PAUL DAVIES, LUCA ENRIQUES, HENRY HANSMANN, GERARD HERTIG, KLAUS HOPT, HIDEKI KANDA, MARIANA PARGENDLER, WOLFGANG RINGE, & EDWARD ROCK, *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 31-36 (3d ed. 2017).

¹⁵ See *infra* Part II.A.

public companies offer greater protection to shareholders: if one mechanism fails to operate as intended, another stands behind it. The mechanisms, in addition to creating redundancies to help protect shareholders, also offer cross-cutting support to one another. For example, disclosure (a regulatory strategy) assists in shareholder voting (a governance strategy), and shareholder voting in turn legitimizes the board of directors (a trusteeship strategy). In addition, courts' approach to fiduciary duty litigation (a regulatory strategy) is influenced by whether the challenged transaction was negotiated by an independent board (a trusteeship strategy) or approved by a disinterested shareholder vote (a governance strategy).

Part III turns to the agency-cost-reduction tools used in the class action context, comparing them to those used in the public company context. A very different picture emerges. Class actions rely almost exclusively on just two mechanisms to combat agency costs: (1) the percentage-of-the-recovery method of compensating class counsel (a rewards-based incentive alignment strategy) and (2) judicial control over class counsel's appointment, case settlement and attorneys' fees (a regulatory strategy). Governance strategies play no role in combatting class action agency costs, and while the class representative acts as a trustee in theory, it is in practice no more than a figurehead chosen by class counsel.¹⁶ Exit-based regulatory strategies are also absent: opt-out rights mean nothing in small claims class actions, because it is economically irrational for a class member to pursue individual litigation, and class members cannot freely transfer their class claims to third-party buyers.

Placing such heavy reliance on rewards and court-centered regulatory strategies, to the exclusion of other agency-cost-reduction strategies, is likely unwise. Most scholars believe that judicial oversight of class actions is largely ineffective.¹⁷ Moreover, the percentage-of-the-recovery method of compensating class counsel, while doing important work to align class counsel's interests with those of the class, has significant limitations.¹⁸

Part IV therefore outlines ways that the more varied techniques used by public companies to reduce agency costs might be translated, scaled, and imported into class action practice. Some of the suggestions involve modest changes to current practice. Others are bolder. On the bolder end of the spectrum, I suggest the creation of an independent class

¹⁶ Securities class actions are a notable exception. See 15 U.S.C. § 78u-4(a)(3) (2018); *infra* notes 202-09 and accompanying text.

¹⁷ See *infra* Part III.C.1.

¹⁸ See *infra* Part III.A.2.

overseer position to be staffed, ideally, by a government actor or non-profit (consumer-advocacy groups might, for example, serve this role in consumer class actions).¹⁹ The class overseer would play a trusteeship role more akin to that played by the independent board in public companies, with authority over counsel selection, fees and settlement. Governance rights could be granted to class members for the limited purpose of electing the class overseer, affording it a legitimacy the class representative lacks under current practice.²⁰ In addition, I suggest that the regulatory strategy of free transferability be imported into class action practice by allowing class members to sell their class claims to third parties any time after certification. This would allow larger stakes class members to emerge who might, like institutional investors and hedge funds in the public company setting, take a greater interest in monitoring the enterprise.²¹ These larger stakes class members would also make good class overseer candidates and credible objectors. Moreover, the possibility that they might choose to opt out and pursue litigation separately would help to discipline class counsel. In addition, the level of judicial scrutiny applied to settlement proposals or fee requests might, like the level of judicial scrutiny applied in fiduciary duty suits brought against corporate agents, be reduced if trusteeship and governance strategies like these were utilized.²²

These proposals, which build on important contributions in prior literature, might appear unrealistic at first blush. Class member voting rights, for example, have long been considered a non-starter, as rational apathy and collective action problems render the likelihood of class members casting an informed vote unlikely. Moreover, the transaction costs associated with selling claims in small stakes class actions seem prohibitive. Under current practice, this assessment is likely correct. But another reform has the potential to radically reduce the impediments to successful implementation of these proposals, as well as to revolutionize class action practice in other important respects. This reform also finds inspiration in the public company analogy.

Public company governance does not exist in a vacuum. A variety of external institutions exist that, together, create a capital market infrastructure of sorts. This infrastructure is not captured in the ACL taxonomy, but it operates to greatly reduce the cost, and increase the effectiveness, of public company governance. The EDGAR database

¹⁹ See *infra* Part IV.B.1.a.

²⁰ See *infra* Part IV.C.

²¹ See *infra* Part IV.D.

²² See *infra* Part IV.B.1.b.

operated by the United States Securities and Exchange Commission (“SEC”), for example, provides free and easy access to all public company filings, making mandatory disclosure meaningful.²³ Shareholder voting is aided by the existence of share depository institutions, which maintain ownership records for public company stockholders, as well as by firms specializing in proxy administrative functions. Stock exchanges and clearinghouses facilitate low-cost share transfer, which is critical to hostile takeovers and hedge fund activism. Class action governance lacks any comparable supporting infrastructure. There is no comprehensive database of class action filings.²⁴ Nor is there a central repository that tracks potential class members and provides an efficient way of communicating with them. Finally, no platform exists that would allow class members to easily sell their class claims to third parties.

Given technological advances, a more efficient class action infrastructure is within reach, one that more closely approximates the infrastructure that supports public company governance. Scholars have long advocated for the creation of an official, comprehensive online database of class action filings.²⁵ This would, in effect, replicate for class actions the role played by the SEC’s EDGAR database, allowing researchers and members of the public to search for and obtain class action information freely and easily. This would be a useful step forward, but a centralized, government-run class action website has the potential to accomplish dramatically more. In an essay entitled *Classaction.gov*, I explain how the creation of a federally-run class action website and supporting agency (collectively, *Classaction.gov*) could improve the administration of class actions on a number of dimensions.²⁶

²³ See *Using EDGAR to Research Investments*, U.S. SEC. & EXCH. COMM’N, <https://www.sec.gov/oiea/Article/edgarguide.html> (last updated Sept. 5, 2018) [<https://perma.cc/58UX-E7Z8>] (explaining that the EDGAR database “provides free public access to corporate information, allowing you to research a public company’s financial information and operations by reviewing the filings the company makes with the SEC,” and providing instructions on use and a link to the database).

²⁴ See Deborah R. Hensler, *Happy 50th Anniversary, Rule 23! Shouldn’t We Know You Better After All This Time?*, 165 U. PA. L. REV. 1599, 1615 (2017) (observing that researchers “face a virtual absence of even the most basic information on how class actions operate in federal and state courts”).

²⁵ See *infra* note 281.

²⁶ Amanda M. Rose, *Classaction.gov*, 88 U. CHI. L. REV. (forthcoming 2021) (manuscript at 2-6), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3534317 [<https://perma.cc/MXQ5-T2F6>].

Imagine if, after a broad and effective publicity campaign, individuals who wished to participate in class actions were invited to register on the Classaction.gov website. Registrants would be required to provide basic information about themselves (e.g., name, phone number, email, and physical addresses), which would allow for the creation of a secure database that could be searched to identify potential class members in particular cases. All communications with class members could be sent through Classaction.gov via a trustworthy @classaction.gov email address in a uniform, easy-to-digest format. Settlement funds could be escrowed with the federal government and then deposited electronically into the accounts specified by eligible class members when they registered. Every case would have a dedicated page on the Classaction.gov website where court filings and other important information would be posted in a standardized format, and where opt-outs and claims forms could easily be submitted and objections lodged. Court filings and settlement distribution data would also be fed into a comprehensive, searchable research database that Classaction.gov would make freely available to scholars and the general public.

Classaction.gov holds the potential to dramatically increase the number of class members that actually share in settlement funds, and at the same time could reduce the costs associated with notice and claims administration, leaving more money on the table for victims. It would also render class actions transparent, allowing researchers and the public to intelligently assess their value in our society. In addition to producing these and other important benefits that I describe in my essay,²⁷ Classaction.gov would also render feasible some of the bolder public-company inspired reform ideas advanced in this Article. For example, voting for class overseer online via Classaction.gov may be easy enough that class members would find it worthwhile to participate. Alternatively, and taking further inspiration from the public company analogy, registrants could select a proxy (perhaps a government official, trusted non-profit, or law school clinic) to vote on their behalf in any case in which they find themselves a class member. Classaction.gov could also render practical the free transferability of class claims by operating as an online exchange, providing a platform for the posting of bids and for effecting secure sales transactions. Because all claims sales would occur via the website, it would be easy to redirect communications in the case, as well as settlement payments, to the purchaser.

²⁷ See *id.* (manuscript at 20-23, 26-31).

Clearly, many details would need to be worked out for these reforms to operate as intended. Part IV attempts to address some of the most important of these details. The Article then briefly concludes.

I. AGENCY COSTS IN PUBLIC COMPANIES & CLASS ACTIONS

Public companies and class actions share important characteristics that make the agency-cost-reduction techniques employed in the former relevant to the later. In both contexts, agents are tasked with maximizing the value of claims held by a large collective of persons — investment claims in the form of shares of common stock in the corporate context and legal claims in the class context.²⁸ Shareholders and class members benefit from this arrangement because it allows them to leverage the agent's expertise. Just as typical shareholders know little about how to manage a large corporation, typical class members know

²⁸ It is sometimes argued that compensation is an irrelevant goal in small claims class actions, given that per class member losses are often trivial, and that deterrence should therefore be viewed as the *raison d'être* of this type of litigation. See, e.g., Brian T. Fitzpatrick, *Do Class Action Lawyers Make Too Little?*, 158 U. PA. L. REV. 2043, 2044 (2010) [hereinafter *Do Class Action Lawyers Make Too Little?*] (arguing that “small stakes” class members theoretically should not receive anything at all); Myriam Gilles & Gary B. Friedman, *Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers*, 155 U. PA. L. REV. 103, 104-05 (2006) (“In reality, there is generally no legitimate utilitarian reason to care whether class members with small claims get compensated at all.”). Assuming this is the case, class counsel should still be viewed as tasked with maximizing the value of class member claims, rather than with vindicating some general public interest. In a democracy governed by the rule of law, private parties pursue deterrence through enforcement of the substantive law, and the substantive law gives legal claims to injured class members, not their counsel. See 28 U.S.C. § 2072(b) (2018) (rules of procedure “shall not abridge, enlarge or modify any substantive right”). Of course, class members themselves might rationally care more about deterrence than compensation, and thus may wish to pay a very large chunk of their compensation in attorney fees, if doing so would better motivate class counsel, or may wish to donate their recovery to, say, a consumer advocacy organization through a *cy pres* settlement — the point is merely that class member interests, not class counsel's view of what it is in the “public interest,” should dictate these choices. Notably, a similar debate has long raged among corporate law scholars, with some arguing that public company managers should conceive of their duties as running not exclusively to shareholders, but rather to society more broadly. See, e.g., C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-first Century*, 51 KAN. L. REV. 77, 77-78 (2002). The dominant view, however, is that managers should place shareholder interests first. See Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 441-42 (2001). Viewing class counsel or corporate managers' duties as running to society generally, rather than to class members or shareholders directly, has the practical effect of granting the former wide latitude to place their own interests above those of any other constituency.

little about how to manage a lawsuit. Corporate executives and lawyers, by contrast, are trained for these jobs, and their expertise warrants granting them a great deal of discretion in managing the enterprises. The delegation of substantial discretion to corporate executives and class counsel is also beneficial because the alternative — more direct management by shareholders/class members — would generate significantly higher decision costs, and would be beset by well-known collective action problems, such as rational apathy and free riding.

While this delegation carries important benefits for shareholders and class members, it also creates room for self-serving agent behavior.²⁹ And the room is wide, not just because the discretion delegated is substantial, but also because the same informational deficits and collective action problems that justify that level of delegation make it difficult for shareholders and class members to effectively monitor and discipline their agent's performance.

Agency conflicts manifest in similar ways in the public company and class action contexts. Because neither corporate executives nor class counsel fully internalize the benefits they bestow on the collective they represent, they have an incentive to under-invest in efforts to maximize value on its behalf.³⁰ They also have incentives to act in a more risk-averse manner than the members of the collective would prefer. This is because, even though corporate executives and class counsel have less at stake than the collective on whose behalf they act, they typically have more at stake than individual members of that collective. Both shareholders and class members stand to lose only the value of their

²⁹ See Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 870 (2013) (observing that “[a]gency costs resulting from the divergence of interests between professional managers and diversified shareholders are simply the reciprocal of the benefits of specialization”).

³⁰ This can lead to generalized shirking — a failure to work as hard at one's tasks as one would if she stood to reap the entire fruits of her labor. It can also distort specific decisions. In the corporate context, for example, executives might refuse to negotiate a profitable merger because it would jeopardize their continued employment, or they might dismiss the possibility of moving corporate headquarters to a more affordable, but less prestigious, address. In the class context, plaintiffs' attorneys might choose to accept an early settlement to avoid the time and expense associated with trial preparation, even though trial would be more profitable for the class.

Corporate executives and class counsel also have an incentive to *over-invest* in efforts that are personally beneficial but costly for the collective. For example, corporate executives may over-invest firm resources in projects that they personally enjoy or in compliance efforts that help shield them from the risk of personal liability; similarly, class action attorneys may invest more time in a case than is efficient if hours spent is a factor in the award of attorneys' fees.

claims if the enterprise fails.³¹ Moreover, the value of their claims tends to be small relative to what their agents have placed on the line.³² Diversified shareholders have only a small percentage of their total assets invested in any individual company. On the other hand, corporate executives have considerable human, reputational, and often financial capital invested in the firm they manage.³³ Similarly, class members often stand to recover only minor losses, whereas class counsel invest substantial time and resources in pursuit of the case. Thus, just as corporate executives might avoid risky but potentially profitable business strategies that shareholders would want them to pursue,³⁴ class counsel might avoid risky but potentially profitable litigation strategies that class members would want them to pursue, like turning down a sure thing settlement offer and threatening to go to trial.³⁵ Finally, both corporate executives and class counsel face the

³¹ Shareholders are insulated from liability corporate debts, see KRAAKMAN ET AL., *supra* note 14, at 8-9, just as class members are insulated from liability for litigation costs and expenses, see Geoffrey P. Miller, *Payment of Expenses in Securities Class Actions: Ethical Dilemmas, Class Counsel, and Congressional Intent*, 22 REV. LITIG. 557, 558-59 (2003).

³² See STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 258 (2004) (explaining that persons are more likely to be risk averse “in situations in which losses would be large in relation to a persons’ assets and thus would impinge substantially on his utility”).

³³ Diversified shareholders are less risk averse than corporate executives not just because they have a smaller percentage of their assets at risk in any particular firm, but also because they have eliminated their exposure to firm-specific risk through the construction of their portfolios. See generally EDWIN J. ELTON, MARTIN J. GRUBER, STEPHEN J. BROWN, WILLIAM N. GOETZMANN, MODERN PORTFOLIO THEORY AND INVESTMENT ANALYSIS (9th ed. 2014) (providing a general overview of portfolio theory). For a variety of reasons, corporate executives cannot similarly diversify, and thus remain significantly exposed to firm-specific risk. See John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 17-20 (1986).

³⁴ See Henry T.C. Hu, *Risk, Time and Fiduciary Principles in Corporate Investment*, 38 UCLA L. REV. 277, 320-25 (1990) (describing the types of “nonshareholder-optimal investment behaviors” corporate managers may engage in due to their greater risk aversion). While corporate managers are typically more risk averse than diversified shareholders, under some circumstances they may be more risk preferring. See *id.* at 325-29 (explaining how poorly designed compensation arrangements can lead to this result); Jonathan R. Macey, *Agency Theory and the Criminal Liability of Organizations*, 71 B.U. L. REV. 315, 326-29 (1991) (explaining that managers of firms on the brink of insolvency may take greater risks than diversified shareholders would desire in order to protect their firm-specific investments).

³⁵ Class action attorneys are paid from the recovery, if any, that they generate for the class. Thus, if they go to trial and lose, they receive nothing. See Coffee, Jr., *Rescuing the Private Attorney General*, *supra* note 1, at 230-31 (providing a numeric example illustrating how divergent risk preferences can affect settlement choices). Risk aversion might also lead class counsel to bring “a high volume of cases, thereby spreading [the]

temptation to siphon value from their principals through self-dealing. For example, both corporate executives and class counsel have incentives to take excessive compensation for their services.³⁶

Given the foregoing similarities, it is logical to inquire whether the techniques used by public companies to constrain agency costs might provide some guidance for class action reform. In undertaking this inquiry, however, one must keep in mind that public companies also differ from class actions in ways that impact the relative desirability of agency-cost-reduction tools. Indeed, these differences, which are surveyed below, likely explain some of the observed differences in public company and class action governance. While this complicates the analogy this Article seeks to develop, the public company remains a rich and largely untapped source of market-tested governance lessons for class action reform.

Duration. The typical lifespans of public companies and class actions differ. The former have no finite end, living several decades on average.³⁷ By contrast, class actions that are not dismissed pretrial terminate when they are tried to judgment or, much more commonly, when they are settled — a process that takes three years on average.³⁸ This means that time-dependent agency-cost-reduction techniques are

risk, but in consequence investing relatively little time or effort in any single case.” *Id.* at 231.

³⁶ Conflicts of interest may also exist amongst shareholders and class members. In the corporate context, for example, a controlling shareholder might extract value from minority shareholders through an interested transaction. In the class action context, a settlement might be structured to advantage one subgroup of class members over others. For example, a mass tort case might be settled on terms that favor current claimants over future claimants. While these conflicts are important and worthy of study, they are not treated here. Instead, this Article focuses on the governance techniques employed to align managerial interests with those of shareholders in non-controlled public companies, and the potential of these techniques to help align the interests of class counsel and class members in non-mass tort damages class actions. It is thus limited to class actions involving legal claims that share a uniformity akin to that of shares of common stock. Consumer class actions, wage and hour employment class actions, securities class actions, and many antitrust class actions fall within this important group.

³⁷ Public companies used to have a much longer average lifespan. See Martin Reeves & Lisanne Püschel, *Die Another Day: What Leaders Can Do About the Shrinking Life Expectancy of Corporations*, BCG HENDERSON INSTIT. (Dec. 2, 2015), <https://www.bcg.com/publications/2015/strategy-die-another-day-what-leaders-can-do-about-the-shrinking-life-expectancy-of-corporations> [https://perma.cc/S3LB-XHEY].

³⁸ Brian T. Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. EMPIRICAL LEGAL STUD. 811, 820-21 (2010) [hereinafter *An Empirical Study of Class Action Settlements and Their Fee Awards*].

less likely to be effective in the class action context than in the public company context.³⁹

Size. It is also the case that some governance techniques that are efficacious for public companies might simply be too expensive to be worthwhile in the class action context.⁴⁰ This is because the aggregate value of shareholder claims in a typical public company greatly exceeds the aggregate value of class member claims in a typical class action.⁴¹ As a result, the magnitude of potential residual losses from agency costs is greater in the public company context, warranting a larger expenditure on preventative measures.⁴²

Judicial Involvement. Another difference, which again relates to the costs of preventative measures, concerns the pervasive role of the judiciary in the class action context, as compared to the sporadic role the judiciary plays in the life of a public company. Since the court is inevitably involved in overseeing a class action, the marginal cost of conscripting the court to play a role in policing agency conflicts is fairly small. This is not to say that judicial oversight is effective,⁴³ just that it is a cheaper approach in the class action setting than it is in the public company setting. It is also the case that judges are better equipped to

³⁹ Consider, for example, a technique that required a monitor to periodically make a decision to retain or replace the agent based on their track record of performance. In the class action context, this may not work because there may be an insufficient track record upon which to base the determination until the end of the litigation.

⁴⁰ It is also the case that governance techniques that are efficacious for large public companies may be too expensive to be worthwhile for smaller public companies. See Michal Barzuza, *Inefficient Tailoring: The Private Ordering Paradox in Corporate Law*, 8 HARV. BUS. L. REV. 131, 175-76 (2018).

⁴¹ The average market capitalization of a company in the Russell 3000 Index, a benchmark for the entire U.S. stock market, exceeds \$8 billion (median \$1.6 billion). See George S. Georgiev, *Too Big to Disclose: Firm Size and Materiality Blindspots in Securities Regulation*, 64 UCLA L. REV. 602, 664 n.287 (2017). One study calculates the average class action settlement at \$55 million (median \$5.1 million). See Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, *supra* note 38, at 827-28. Settlement values may, of course, understate the true value of class member claims. See *supra* note 35 and accompanying text (discussing how risk averse class counsel might accept suboptimal settlements).

⁴² Assume, for example, that agents will appropriate 1% of the enterprise's value if left unmonitored. Whereas it would make sense for shareholders in a public company worth \$1 billion to spend up to just under \$10 million to avoid this loss, class members in a class action worth \$100 million should spend less than \$1 million to do so.

⁴³ To the contrary, many scholars think that it is not. See *infra* note 262 and accompanying text.

evaluate the performance of an attorney than they are a corporate executive, given that they train in law and not in business.⁴⁴

Complexity. The tasks corporate executives are delegated responsibility to perform are relatively more complex than those assigned to class counsel. This is not to minimize the challenge of prosecuting a class action, but simply to recognize that managing a public company is a much larger and more multifaceted endeavor. This means that, all else equal, the performance of class counsel should be relatively less difficult to monitor, measure and evaluate than the performance of corporate executives. As discussed below, however, all else is not equal.

Information Costs. For one thing, class members lack the low-cost source of information about agent performance that shareholders enjoy in the form of stock prices. As explained in the introduction, the presence of free secondary market trading in public company stock, along with a competitive IPO market, gives a credibility to public company governance tools that class action governance tools do not possess.⁴⁵ It also organically produces its own governance tools (think hostile takeovers and hedge fund activism). Free secondary market trading carries a third benefit, as well: it offers a free and easily accessible source of information about managerial performance, in the form of stock prices, which can help facilitate the use of other governance tools. For example, stock price performance can help shareholders decide whether to vote for or against incumbent directors, and it can be used as a basis for setting executive compensation. Of course, relying on stock prices too heavily might also cause distortion,⁴⁶ and other sources of information may be as good or better indicators of

⁴⁴ Those who sit on the Delaware Chancery Court are better equipped than most judges to understand complex business matters, given the prevalence of such matters on their docket and, in many cases, their prior experience practicing corporate law. But even these judges acknowledge their limitations. See, e.g., *In re J.P. Stevens & Co. Shareholders Litigation*, 542 A.2d 770, 780 (Del. Ch. 1988) (“[B]usinessmen and women are correctly perceived as possessing skills, information and judgment not possessed by reviewing courts.”).

⁴⁵ *Supra* notes 10–12 and accompanying text.

⁴⁶ Some argue that an excessive focus on stock prices leads corporate executives to adopt a destructive short-term mindset. See Lynne L. Dallas & Jordan M. Barry, *Long-Term Shareholders and Time-Phased Voting*, 40 DEL. J. CORP. L. 541, 544–46 nn.3–7 (2015) (citing the literature both in support of and against this argument); see also Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1084–85 & nn.268–71 (2007) (discussing the argument that the stock market is myopic and surveying relevant literature). It might also create incentives for executives to manipulate financial results. See Alfred Rappaport, *The Economics of Short-Term Performance Obsession*, 61 FIN. ANALYSTS J. 65, 69 (2005).

managers' contribution to firm value. The point is merely that stock prices play an important informational role in the public company context with no clear analogue in the class action setting.

Level of Rational Apathy. Another factor helps compensate for the greater relative complexity of the corporate executive job, and hence the greater difficulty shareholders face in monitoring and disciplining their agents: on average, shareholders have stronger incentives to monitor and discipline agent performance than do small-claims class members, as well as a better capacity to do so. While the median level of incentive and capacity should be low across both groups, there is greater variation amongst public company shareholders than amongst class members in small-claims class actions. Public company shareholders include small-stakes, individual investors. These shareholders are very similar to class members in small-claims class actions: both tend to be rationally apathetic and unsophisticated. But some public company shareholders represent "smart money."⁴⁷

Smart money shareholders include not just sophisticated investors who fuel stock price discovery by trading on information, but also professionally managed institutional investors, like mutual funds and public pension funds, who take buy-and-hold positions. The rise of institutional investors is a relatively recent phenomenon in the United States,⁴⁸ one attributable to changes in the way that Americans channel their retirement savings.⁴⁹ Institutional investors hold greater stakes in the public companies they invest in than do individual shareholders, and a handful collectively represent effective control of many large U.S. corporations.⁵⁰ Given their sophistication, the size of their holdings,

⁴⁷ See Caroline Banton, *Smart Money*, INVESTOPEDIA, <http://www.investopedia.com/terms/s/smart-money.asp> (last updated Mar. 19, 2020) [<https://perma.cc/FY75-2QDF>] (defining "smart money" as "the capital that is being controlled by institutional investors, market mavens, central banks, funds, and other financial professionals").

⁴⁸ In 1950, public equity was held predominantly by households, with institutional investors holding just over 6%; by 2009, institutional ownership had risen to over 50% of all public equity and 73% of the equity of the thousand largest U.S. public companies. See Gilson & Gordon, *supra* note 29, at 874. This does not mean that households are less exposed to public equities than they were in 1950; to the contrary, the number of households so exposed has risen dramatically. See Gerald F. Davis, *A New Finance Capitalism? Mutual Funds and Ownership Re-concentration in the United States*, 5 EUR. MGMT. REV. 11, 15 (2008) (finding that the level of household exposure jumped 30% from 1977 to 2004). Rather, it reflects the fact that households are more likely today to be invested through an institutional intermediary, such as a mutual fund or pension fund. See *id.*

⁴⁹ For an overview of these changes, see Gilson & Gordon, *supra* note 29, at 878-84.

⁵⁰ See Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 879-80 (1991) ("As a result of

and their concentration, apathy is less rational for institutional investors than it is for individual investors, and the incentive to free-ride is less compelling.⁵¹ Certain agency-cost-reduction tools used in the public company context, such as voting, should therefore prove more effective than in the past, and — more relevant for our purposes — more effective than would be the case in the class action context.

The actual impact of institutional investors on corporate governance should not be overstated, however. Even though institutional investors are better equipped to vote intelligently than most individual investors, public company managers still largely dictate the voting agenda.⁵² As will be discussed in Part II.B.2.a, it can be expensive for a shareholder to nominate board candidates or propose other issues for a shareholder vote. Costs and lingering collective action problems dissuade institutional investors from doing so,⁵³ and these problems are exacerbated by agency costs within the institutions themselves.⁵⁴ Perhaps most importantly, those who manage mutual funds and pension funds are typically evaluated based on relative performance.⁵⁵ This makes investing in the improvement of particular portfolio companies unappealing to fund managers, even if doing so would be in the best interests of the funds' beneficial owners. This is because, unless a fund is significantly over-weighted in the company's stock relative to the fund's peers (something that is unlikely for a variety of reasons⁵⁶),

the growth of institutional holdings during the 1980s, manageable numbers of institutions now command what would be, if it were voted in a coordinated fashion, a controlling block of stock in many public companies.”).

⁵¹ See Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 524 (1990) [hereinafter *Shareholder Passivity Reexamined*].

⁵² See *id.* (“For the most part, managers control what shareholders vote on, how proposals are packaged, when the shareholders vote, and when the shareholders find out what they’re voting on.”).

⁵³ See John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1352 (1991); Gilson & Gordon, *supra* note 29, at 891-92.

⁵⁴ See Coffee, Jr., *supra* note 53, at 1326 (observing that “agency problems at the institutional level can frustrate efforts to correct agency cost problems at the corporate level, even if institutional shareholders own sufficiently large blocks to be able to resolve their collective action problems”). Legal restrictions also discourage mutual fund activism. See Kahan & Rock, *supra* note 46, at 1048-50.

⁵⁵ Gilson & Gordon, *supra* note 29, at 889-90.

⁵⁶ See, e.g., Black, *Shareholder Passivity Reexamined*, *supra* note 51, at 530-66 (surveying a host of legal rules and other factors that make it difficult for shareholders to amass a large stake in a single company in the U.S.); Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 19-22 (1991) (discussing provisions in the Investment Company Act of 1940 and in the Internal Revenue Code

any effort to improve the company's performance will not improve the fund's performance relative to its peers.⁵⁷

Perhaps as a consequence, mutual and pension funds have done little to initiate shareholder votes on company-specific matters, like the composition of the board of directors, or to otherwise push for strategic corporate changes.⁵⁸ By contrast, these funds have sometimes taken initiative with respect to general issues of corporate governance — issues related to companies' governance structure and processes, as opposed to corporate strategy.⁵⁹ This is in line with what theory would predict, given that “many process and structural issues arise in similar form at many companies,” such that a shareholder can enjoy economies of scale by offering the same proposal at multiple portfolio companies.⁶⁰ For example, public pension funds have advanced shareholder proposals to eliminate certain governance practices thought inimical to shareholder interests — such as the use of staggered boards — and in some cases have succeeded in effecting change on a broad scale.⁶¹ In

that discourage mutual funds from taking large positions in individual portfolio companies).

⁵⁷ See Kahan & Rock, *supra* note 46, at 1052-53.

⁵⁸ See Gilson & Gordon, *supra* note 29, at 867 (explaining that institutional investors, while not rationally apathetic, are “rationally reticent”: they “will respond to proposals but are unlikely themselves to create them”); Kahan & Rock, *supra* note 46, at 1061-62 (explaining that public pension funds, which have been more active than mutual funds, have nevertheless “steered clear of demanding specific changes in strategy or management, have not engaged in proxy contests, and, so far, have not even joined forces with hedge funds in opposing or triggering corporate control transactions”).

⁵⁹ Process and structure issues include things like “the value of confidential voting, the desirability of poison pills and other antitakeover devices, the composition and structure of the board of directors, the process by which directors are nominated, whether a company should have a nonexecutive chairman, and the form of management compensation.” Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 818 (1992) [hereinafter *Agents Watching Agents*]. Company-specific issues, by contrast, include such things as “whether to recapitalize; whether to fund a new project by borrowing or by selling stock; whether to make a particular acquisition or divestiture; whether to vote for the incumbent directors or for a dissident slate.” Black, *Shareholder Passivity Reexamined*, *supra* note 51, at 581.

⁶⁰ Black, *Agents Watching Agents*, *supra* note 59, at 822.

⁶¹ See Gilson & Gordon, *supra* note 29, at 887-88 (“Over the 2004 and 2005 proxy seasons, mutual funds voted in favor of shareholder proposals to require shareholder approval before adopting a poison pill almost 80% of the time, and in favor of proposals to declassify the board of directors 90% of the time. The same results appear for the 2003 through 2008 period: Mutual fund voting in favor of shareholder proposals to declassify the board reached 87.4%, and with respect to shareholder proposals to require shareholder approval for a poison pill, 68.4%.”). Public pension funds have been more active in advancing shareholder proposals than mutual funds. Mutual funds have,

this regard, their activities strengthen the claims of this Article, by providing greater reason to believe in the efficacy of widely-used public company governance tools: those tools are subject to greater shareholder scrutiny than ever before.

Over the course of the last decade, activist hedge funds have also become an important part of the “smart money” crowd. Unlike mutual funds and public pension funds, activist hedge funds routinely take outsized positions in particular firms. They do this precisely in order to challenge underperforming management teams,⁶² with the hope of profiting off the increased stock price expected to result from their efforts.⁶³ The changes sought often are not of general governance practices, but relate to the company’s strategic direction.⁶⁴ For example, activist hedge funds might demand that a company return cash to shareholders rather than pursue a plan of reinvestment, at the threat of a campaign to oust some or all of the board of directors. Activist hedge funds typically do not have the voting power to credibly threaten change alone, but rather must garner the support of traditional

however, frequently voted in favor of shareholder proposals advanced by public pension funds, and have also “adopted policies to vote against certain changes in governance rules that entrench the current board if such changes are proposed by the board of directors, and these funds have sometimes withheld votes (i.e., abstained) in director elections.” Kahan & Rock, *supra* note 46, at 1043.

⁶² See Alessio M. Paccès, *Exit, Voice and Loyalty from the Perspective of Hedge Funds Activism in Corporate Governance*, 9 ERASMUS L. REV. 199, 199 (2016) (explaining that “[a]ctivist hedge funds engage the management of an underperforming listed company in which they have bought a significant stake,” seeking “to determine a change in the governance or in the strategy, from which they will profit by selling their shares at a premium after performance has returned to full potential”). *But see* John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 582-83 (2016) (observing that studies do not consistently support the idea that hedge funds target only firms with poor managerial performance or high agency costs).

⁶³ See Kahan & Rock, *supra* note 46, at 1027 (explaining that, unlike mutual and pension funds, hedge funds “tak[e] high stakes in portfolio companies in order to become an activist, rather than diversifying and becoming involved (if at all) only ex post when companies are underperforming”). Activist hedge funds differ from traditional institutional investors in other ways, as well. For example, “they suffer from fewer conflicts of interest, face fewer regulatory restrictions, and have . . . [an] incentive structure” that better aligns fund managers’ interests with those of fund investors. Nickolay Gantchev, *The Costs of Shareholder Activism: Evidence from a Sequential Decision Model*, 107 J. FIN. ECON. 610, 611 (2013); *see also* Paccès, *supra* note 62, at 203 (explaining that, “[d]ifferently from other institutional investors, hedge funds managers charge a performance fee in addition to a percentage of the asset under management,” which operates to “align[] their incentives with investors having a relatively high appetite for risk”).

⁶⁴ See, e.g., Kahan & Rock, *supra* note 46, at 1029-43 (discussing examples).

institutional investors to accomplish their goals.⁶⁵ Thus, the two groups today work together to impact corporate management, with the mere potential of their involvement affecting managerial incentives *ex ante*.⁶⁶

The social value of activist hedge funds is a hotly debated issue. Some view them as providing important discipline that helps align managerial incentives with those of shareholders,⁶⁷ whereas others believe that they (or some subset of them) seek short-term stock price bumps at the expense of long-term firm value.⁶⁸ The empirical evidence evaluating these claims is mixed and inconclusive.⁶⁹ For our purposes, the important point is that, for better or for worse, activist hedge funds clearly influence how public companies are managed today. There are no analogous forces shaping class action governance.

Supporting Infrastructure. Another important difference between public companies and class actions has already been alluded to. Public companies benefit tremendously from a market infrastructure that supports their agency-cost-reduction efforts.⁷⁰ Share depository institutions, for example, assist in identifying current shareholders for purposes of disseminating voting information.⁷¹ Voting is further assisted by the existence of firms specializing in proxy administrative functions.⁷² Share depository institutions also lower the transaction

⁶⁵ “The average activist block is roughly 8%, far less than a control block.” Gilson & Gordon, *supra* note 29, at 899.

⁶⁶ *See id.* at 897.

⁶⁷ *See, e.g., id.* at 917 (taking this view while acknowledging the risk “that both institutional investors and activist investors may be myopic, to the end of increasing the value of a speculative option”).

⁶⁸ *See, e.g.,* Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 *YALE L.J.* 1870, 1873 (2017) (taking this view).

⁶⁹ *See* Coffee, Jr. & Palia, *supra* note 62, at 551-52; Gilson & Gordon, *supra* note 29, at 901; Paces, *supra* note 62, at 201.

⁷⁰ *See Using EDGAR to Research Investments*, *supra* note 23 and accompanying text.

⁷¹ For a description of this process, see *Roundtable on Proxy Voting Mechanics*, U.S. SEC. & EXCH. COMM’N, <https://www.sec.gov/spotlight/proxyprocess/proxyvotingbrief.htm> (last modified May 23, 2007) [<https://perma.cc/V7W9-Q4WN>]. The mechanics of shareholder voting are far from optimal, however. *See generally* Concept Release on the U.S. Proxy System, 75 Fed. Reg. 42,982 (July 22, 2010) (exploring the weaknesses); Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 *GEO. L.J.* 1227 (2008) (same). The SEC is currently evaluating ways to improve the voting process. *See, e.g.,* *November 15, 2018: Roundtable on the Proxy Process*, U.S. SEC. & EXCH. COMM’N, <https://www.sec.gov/proxy-roundtable-2018> (last modified Feb. 22, 2019) [<https://perma.cc/YE4C-8A5Z>].

⁷² *See* Steve Schaefer, *The Broad Reach of Broadridge, the Most Important Financial Firm You’ve Never Heard Of*, *FORBES* (Oct. 30, 2013, 8:00 AM EDT), <https://www.forbes.com/>

costs associated with secondary market transactions, as do organized stock exchanges and clearinghouses.⁷³ In addition, the SEC offers investors a free, trustworthy, and easily searchable online database of public company disclosures.⁷⁴ Class actions lack a comparable infrastructure. There is no free, easy to search centralized database of class action filings.⁷⁵ Identifying and communicating with class members remains a difficult and often very expensive process.⁷⁶ And no platform currently exists that would facilitate the low-cost exchange of class claims.

The differences spelled out above caution against rashly concluding that public company governance tools necessarily belong in the class action toolkit. But they do not negate the usefulness of the analogy. Even if public company governance techniques are not directly transplantable to the class action context due to underlying differences, they might still inspire analogous techniques that could work effectively for class actions. Moreover, changes to class action practice and procedure might open up opportunities for transplantation that do not currently exist. Indeed, certain of the reforms discussed in Part IV — such as the creation of Classaction.gov — would have precisely this effect. The remainder of this Article demonstrates that, notwithstanding the foregoing differences, there are vast, as-of-yet unexplored

sites/steveschaefer/2013/10/30/the-broad-reach-of-broadridge-the-most-important-financial-firm-youve-never-heard-of/#cff4df033e04 [https://perma.cc/9XK8-DXXU].

⁷³ See generally Neal L. Wolkoff & Jason B. Werner, *The History of Regulation of Clearing in the Securities and Futures Markets, and Its Impact on Competition*, 30 REV. BANKING & FIN. L. 313, 315-39 (2011) (discussing the evolution of a central clearing and settlement system for securities in the United States).

⁷⁴ See EDGAR – Search and Access, U.S. SEC. & EXCH. COMM’N, <https://www.sec.gov/edgar/searchedgar/webusers.htm> (last modified July 15, 2020) [https://perma.cc/F9HZ-CBD4].

⁷⁵ Stanford Law School, in collaboration with Cornerstone Research, has created a free searchable database of filings in federal securities class actions. *Securities Class Action Clearinghouse*, STAN. L. SCH., <http://securities.stanford.edu/filings.html> (last visited July 23, 2020) [https://perma.cc/2CH3-PPMV]. But nothing comparable exists for class actions more generally. Public Access to Court Electronic Records (“PACER”) is an electronic public access service of United States federal court documents, including those filed in class actions brought in federal court, but it is fee-based, difficult to use, and excludes information about state court cases. See *Find a Case (PACER)*, U.S. COURTS, <https://www.uscourts.gov/court-records/find-case-pacer> (last visited Aug. 28, 2020) [https://perma.cc/TR5L-ADUW].

⁷⁶ Rose, *supra* note 26, at 26-27.

opportunities for intellectual arbitrage from the public company to the class action context.

II. AGENCY-COST-REDUCTION STRATEGIES

A common vocabulary will facilitate comparison of the approaches taken to reduce agency costs in class actions and public companies. The “exit-voice-loyalty” taxonomy has sometimes been used to discuss agency-cost-reduction strategies in both settings,⁷⁷ with “exit” referring to the discipline that agents feel if disappointed principals can freely exit the relationship, “voice” referring to principals’ ability to directly influence the behavior of the organization and/or its agents, and “loyalty” referring to legally-imposed fiduciary duties that agents owe their principals.⁷⁸ It is an insightful taxonomy, but it is limited by its generality. The ACL taxonomy developed in *THE ANATOMY OF CORPORATE LAW* is more nuanced and functional.⁷⁹ While specifically designed to assist in a cross-country comparison of corporate governance techniques, the ACL taxonomy transcends subject matter and thus offers a useful vocabulary for our task.⁸⁰ This Part both introduces readers to the ACL taxonomy and uses it to familiarize them with the most important techniques used to reduce agency costs in U.S. public companies.

A. The ACL Taxonomy

The agency-cost-reduction strategies that comprise the ACL taxonomy are divided into three groups: incentive alignment strategies, governance strategies, and regulatory strategies. Incentive alignment strategies work by manipulating agent incentives to bring them closer in line with those of principals.⁸¹ Governance strategies empower

⁷⁷ See *supra* note 6 and accompanying text.

⁷⁸ This conception of loyalty is different from the one that Hirschman used in his seminal book, *EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES*. Hirschman conceived of loyalty in terms of the attachment that principals feel for an organization, which increases the likelihood that they will chose to exercise voice rather than exit when agents disappoint. See HIRSCHMAN, *supra* note 6, at 77-78.

⁷⁹ See KRAAKMAN ET AL., *supra* note 14, at 31-38 (describing a taxonomy of legal strategies for protecting principals).

⁸⁰ See *id.* at 32 (explaining that the legal strategies described “span the law’s principle methods of dealing with agency problems”; “[t]hese strategies are not limited to the corporate context; they can be deployed to protect nearly *any* vulnerable principal-agent relationship”).

⁸¹ See *id.* at 35-36.

principals by facilitating their control over agent behavior.⁸² Regulatory strategies, by contrast, are prescriptive, “dictat[ing] substantive terms that govern the content of the principal-agent relationship” and “tending to constrain the agent’s behavior directly.”⁸³ Key to the efficacy of incentive alignment strategies is the ability to understand and manipulate agent incentives correctly. The efficacy of governance strategies depends on the ability of principals to use their control rights effectively, something that will be influenced by the severity of the collective action problem they face.⁸⁴ Regulatory strategies, for their part, “depend for efficacy on the ability of an external authority — a court or regulatory body — with sufficient expertise to determine whether or not the agent complied with particular prescriptions.”⁸⁵

As depicted in Table 1, incentive alignment, governance, and regulatory strategies may each be further divided. Incentive alignment strategies seek to remove or mitigate conflicts of interest through either a “trusteeship” or “rewards” approach.⁸⁶ Trusteeship involves identifying parties who will be driven primarily by conscience, pride or reputation (as opposed to high-powered monetary incentives) and placing them in a position to manage the enterprise or, more commonly in the corporate context, in a position to monitor the financially-incentivized agents tasked with managing the enterprise.⁸⁷ A rewards approach, by contrast, seeks to improve agent incentives by promising agents a financial reward if they successfully advance the principals’ interests.⁸⁸ Governance strategies may be subdivided into “appointment rights,” which refer to the power of principals to select and remove agents (or those who oversee the agents), and “decision rights,” which refer to principals’ power to initiate or ratify agent decisions.⁸⁹ Finally, regulatory strategies may be subdivided into “agent constraints,” which refer to rules and standards that regulate the actions of agents during the course of the principal-agent relationship, and “affiliation terms,” which affect the terms upon which agents may enter the principal-agent

⁸² *Id.* at 31.

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *Id.* at 32.

⁸⁶ *Id.* at 35-36.

⁸⁷ *Id.* at 35.

⁸⁸ *Id.* at 36.

⁸⁹ *Id.* at 37.

relationship, as well as the terms upon which principals may exit the relationship.⁹⁰

Incentive Alignment (mitigates conflicts)		Governance (empowers principals)		Regulatory (prescriptive)	
Trusteeship	Rewards	Appointment Rights	Decision Rights	Agent Constraints	Affiliation Terms

B. The U.S. Public Company Example

Using the ACL taxonomy as an organizational device, this subpart provides an overview of the agency-cost-reduction strategies typically employed by public companies in the United States. The techniques to be discussed are summarized in Table 2; readers who are familiar with them may wish to skip ahead to the last paragraph of this subpart.

Incentive Alignment	Governance	Regulatory
<i>Trusteeship</i> Independent Boards Other Gatekeepers	<i>Appointment Rights</i> Election/Removal of Directors	<i>Agent Constraints</i> Fiduciary Duty
<i>Rewards</i> Incentive Compensation	<i>Decision Rights</i> Bylaw Amendments Fundamental Transactions	<i>Affiliation Terms</i> Mandatory Disclosure Appraisal Free Transferability

1. Incentive Alignment Strategies

From the independent board of directors to high-powered executive compensation packages, incentive alignment strategies play a key role in the fight against agency costs in U.S. public companies.

a. Trusteeship

The corporate board of directors is a central feature of public company governance in the United States and an example of the trusteeship strategy in action. While the primary operational and strategic management of public companies is delegated to the corporation's executive officers, who are clearly motivated by high-powered financial incentives, these executives are overseen by a board of directors possessing ultimate authority.⁹¹ The board, whose members

⁹⁰ *Id.* at 32-33.

⁹¹ Delaware law, which governs the vast majority of public companies in the United States, mandates that "The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors." DEL. CODE ANN. tit. 8, § 141(a) (2019).

are elected by and thus ultimately accountable to shareholders, is responsible for hiring the chief executive officer (“CEO”), setting the terms of executive compensation, monitoring executive performance, and approving major initiatives, among other functions.

Unlike executives, directors are not full-time employees of the corporation, meeting in person as a full board only four to five times a year on average and typically holding significant business positions elsewhere.⁹² They are therefore compensated more modestly than members of the executive suite, and generally are motivated more by reputational considerations than financial ones.⁹³ As a result, they are less likely to engage in self-dealing or to conspire with those who are.⁹⁴ This is true at least for those directors who are not also members of the executive suite (so-called “outside” directors) and who are otherwise independent from it — a group that, due to regulatory requirements, today must comprise a majority of the entire board and the entirety of the board’s audit, compensation, and nominating committees.⁹⁵

The corporate board of directors is an example of a decision system that separates decision management (initiation and implementation) from decision control (ratification and monitoring), the former being delegated to executives and the latter reserved to the board. Professors Fama and Jensen have hypothesized that any voluntary organization that separates residual risk bearing from decision-making control will adopt such a system — any organization where the managers do not bear the major wealth effects of their decisions, thus creating the risk of

⁹² See NATALIE COOPER, BOB LAMM & RANDI VAL MORRISON, DELOITTE, BOARD PRACTICES REPORT: COMMON THREADS ACROSS BOARDROOMS 11 (2018), <https://www2.deloitte.com/us/en/pages/center-for-board-effectiveness/articles/us-board-practices-report-common-threads.html> [<https://perma.cc/4HJM-QMPA>].

⁹³ Compare Bernie Tenenbaum, *How Much Should I Pay the Director on My Board in 2020?*, FORBES (Jan. 16, 2020), <https://www.forbes.com/sites/bernietenenbaum/2020/01/16/how-much-should-i-pay-the-directors-on-my-board-in-2020/#7858d8305372> [<https://perma.cc/8M7D-E4GV>] (estimating average total annual compensation for public company directors at \$170,000), with David F. Larcker & Brian Tayan, CORP. GOVERNANCE RESEARCH INITIATIVE, CEO COMPENSATION: DATA SPOTLIGHT 2 (2019), <https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-quick-guide-17-ceo-compensation-data.pdf> [<https://perma.cc/7JKX-86VM>] (“The typical CEO of an S&P 500 company receives approximately \$10 million in annual compensation.”).

⁹⁴ See KRAAKMAN ET AL., *supra* note 14, at 35.

⁹⁵ See 15 U.S.C. § 78j-1(m)(3) (2018); NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 303A.01-07 (2009); NASDAQ LISTING RULE § 5605 (2017). Both the NYSE and NASDAQ “define ‘independence’ similarly: a director will be deemed independent if she has no financial or familial ties to the firm or its management other than her directorship.” Urska Velikonja, *The Political Economy of Board Independence*, 92 N.C. L. REV. 855, 857 n.2 (2014).

significant agency costs.⁹⁶ Decision hierarchies where higher level agents ratify and monitor the decision initiatives of lower level agents and evaluate their performance, they argue, make it more difficult for decision agents at all levels of the organization to take actions that benefit themselves at the expense of residual claimants.⁹⁷

Another example of the trusteeship strategy in action is the use of external “gatekeepers” whose association with public companies is thought to discourage fraud and other forms of malfeasance.⁹⁸ These gatekeepers include accounting firms, who audit public company financial statements, as well as investment banks who assist companies in the public offering process.⁹⁹ While compensated monetarily for their services, these firms should not ordinarily be willing to sacrifice their reputation for the sake of a single client.¹⁰⁰ Thus, if in their close interactions with a client company they were to detect managerial misconduct, they could be expected to blow the whistle, to the board or outside authorities.

b. Rewards

Direct board monitoring of executive performance has its limitations. Independent directors have competing obligations and suffer from informational asymmetries relative to members of the executive suite, giving inside directors significant influence.¹⁰¹ Board monitoring of executives is therefore typically supplemented by the use of high-powered incentive compensation, most importantly restricted stock awards and stock options.¹⁰² Restricted stock does not vest, and thus cannot be sold by the executive, for a period of time after it is granted. Stock option awards give executives the right, for a period of time after

⁹⁶ See Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 301-02 (1983).

⁹⁷ *Id.* at 310.

⁹⁸ STEPHEN J. CHOI & A.C. PRITCHARD, *SECURITIES REGULATION: CASES AND ANALYSIS* 938 (5th ed. 2019).

⁹⁹ *Id.*

¹⁰⁰ See, e.g., *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir. 1990) (Easterbrook, J.) (“An accountant’s greatest asset is its reputation for honesty, followed closely by its reputation for careful work. Fees for two years’ audits could not approach the losses [the auditor] would suffer from a perception that it would muffle a client’s fraud.”).

¹⁰¹ See Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 161 (2010) (“Informational asymmetries inherent in the role of independent directors . . . limit such directors’ ability to be effective monitors.”).

¹⁰² See MATTEO TONELLO, PAUL HODGSON & JAMES REDA, *THE CONFERENCE BOARD, CEO AND EXECUTIVE COMPENSATION PRACTICES* 40 fig.1.4 (2017).

some vesting period, to purchase stock from the company at a pre-determined “strike” price, which is usually the market price of the stock at the date of the grant.¹⁰³ During the vesting periods, restricted stock and stock options create incentives for public company executives to work hard to increase their firm’s stock price, even if their contributions are otherwise unobservable to the board.¹⁰⁴ But this type of compensation also operates to increase the firm-specific risk executives bear, driving a further wedge between their risk preferences and those of diversified shareholders.¹⁰⁵ Stock options uniquely have a “built-in antidote” for this problem, however, because they are valuable to executives only on the upside and thus encourage risk taking.¹⁰⁶

Of course, the devil is in the details. Pay packages, however structured, present an opportunity for agent self-dealing. To help guard against executives manipulating the terms of their own compensation, a variety of supporting agency-cost-reduction techniques are employed, nicely demonstrating how the various strategies for constraining agency costs in public companies mutually support one another. For example, the details of executive compensation packages are negotiated by the board’s independent remuneration committee, with the advice of third-party compensation consultants, thus marrying the trusteeship and rewards strategies.¹⁰⁷ Governance strategies also play a supporting role: as discussed below, the pay packages of top executives are now subject to a periodic advisory shareholder vote, a (quasi) decision right.¹⁰⁸ Moreover, board and shareholder oversight of executive pay is aided through the regulatory strategy of mandatory disclosure. In addition, the free transferability of shares — also a regulatory strategy — is what permits secondary market trading in public company shares, creating the stock prices which in turn function as an objective compensation metric.¹⁰⁹ Free transferability also permits hostile takeovers and activist hedge fund campaigns, the threat of which helps guard against agency

¹⁰³ See David I. Walker, *Evolving Executive Equity Compensation and the Limits of Optimal Contracting*, 64 VAND. L. REV. 611, 618-19 (2011).

¹⁰⁴ They also aid in retention, because the awards are typically forfeited if the recipient does not remain employed with company on the vesting date. See *id.* at 650.

¹⁰⁵ See *supra* note 33 and accompanying text.

¹⁰⁶ David M. Schizer, *Executives and Hedging: The Fragile Legal Foundation of Incentive Compatibility*, 100 COLUM. L. REV. 440, 456 (2000).

¹⁰⁷ See KRAAKMAN ET AL., *supra* note 14, at 66-67.

¹⁰⁸ Equity compensation plans are also subject to a shareholder vote pursuant to stock exchange listing rules. See NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 303A.08 (2009); NASDAQ LISTING RULE § IM-5635-1 (2017).

¹⁰⁹ See *infra* note 176 and accompanying text.

costs, including extreme compensation abuses.¹¹⁰ And while courts have been reluctant to police pay as a general matter, fiduciary duties — another regulatory strategy — may play a small role in constraining gross abuses in the negotiation of executive pay packages.¹¹¹

2. Governance Strategies

While the board of directors has primary responsibility for monitoring executives and setting the terms of their compensation, shareholders retain some power of self-governance. This power has become more meaningful in recent years, as the rise of institutional investors has mitigated the severity of the collective action problem shareholders face.

a. Appointment Rights

Shareholders have the right to elect and remove members of the board of directors.¹¹² This should, in theory at least, tie the allegiance of directors to shareholders, making them faithful monitors of the executive team. Historically, however, shareholder appointment rights have not been viewed as an important restraint on boards (at least outside the takeover context), making independent director requirements a relatively more promising approach for preventing board capture by executives.¹¹³ In part, this is because boards, not shareholders, have tended to control the election and removal process.

¹¹⁰ See *infra* notes 179–184 and accompanying text.

¹¹¹ See Randall S. Thomas & Harwell Wells, *Executive Compensation in the Courts: Board Capture, Optimal Contracting, and Officers' Fiduciary Duties*, 95 MINN. L. REV. 846, 848-49 (2011). Even with these safeguards, the efficacy of executive pay as a constraint on managerial agency costs remains a topic of robust debate. For divergent perspectives, compare LUCIAN BEBCHUK & JESSE FRIED, *PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION* (2004), with John E. Core, Wayne R. Guay & Randall S. Thomas, *Is U.S. CEO Compensation Inefficient Pay without Performance?*, 103 MICH. L. REV. 1142 (2005).

¹¹² The default rule is that shareholders may vote to remove directors with or without cause, except cause is required if the corporation has a staggered board or, under some circumstances, if it has adopted cumulative voting. DEL. CODE ANN. tit. 8, § 141(k) (2020). Common shareholders typically have one vote per share, but classes of high-, low-, and no-vote common stock may also be issued. For an overview of the considerations raised by the use of such dual-class equity structures, see generally Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585 (2017).

¹¹³ See WILLIAM ALLEN & REINIER KRAAKMAN, *COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION* 164-65 (5th ed. 2016).

To see why, one must understand that it is cost-prohibitive for most shareholders to appear in person at annual shareholder meetings, where votes on director elections and other matters are cast.¹¹⁴ If these shareholders wish to vote, they must usually appoint another person who will be present at the meeting to act as their “proxy” and vote on their behalf.¹¹⁵ The incumbent board always seeks proxy authority from shareholders, at the corporation’s expense (this is necessary so that shareholder quorum requirements are met).¹¹⁶ But traditionally the board has not been required to offer to cast proxy votes for candidates other than those that the board itself has nominated, and it has not been required to offer to cast proxy votes on a petition for removal of a director from the board. The board has, in other words, controlled the content of its proxy ballot (subject to important limitations created by Rule 14a-8, discussed *infra*).¹¹⁷ This means that if a shareholder-proposed removal petition or director candidate were to stand a chance of being approved, the proponent would have to solicit proxy authority from fellow shareholders independently. This is an expensive process, due to, *inter alia*, a federal requirement that the soliciting party prepare and disseminate a substantive disclosure document subject to SEC review and antifraud liability.¹¹⁸ As a result, it has traditionally been

¹¹⁴ Moreover, most beneficial owners of public company stock are not record owners, which adds a layer of complication. For an overview of how public company stock is held in the United States, see *Roundtable on Proxy Voting Mechanics*, *supra* note 71.

¹¹⁵ Since 2000, Delaware has permitted remote participation at shareholder meetings at the board’s sole discretion. See DEL. CODE ANN. tit. 8, § 211(a)(2) (2020). Thus, today boards may permit absent shareholders to cast direct votes online. But proxy voting remains the norm. For an overview of the topic, see generally Lisa M. Fairfax, *Virtual Shareholder Meetings Reconsidered*, 40 SETON HALL L. REV. 1367 (2010).

¹¹⁶ See ALLEN & KRAAKMAN, *supra* note 113, at 173.

¹¹⁷ For a critique of regulations that have led to this result and argument in favor of changes that would require use of a universal proxy ballot, see Jill E. Fisch, *The Destructive Ambiguity of Federal Proxy Access*, 61 EMORY L.J. 435, 495-97 (2012). In 2016, the SEC proposed a rule that would mandate a type of universal proxy ballot but the rule has not yet been finalized. Universal Proxy, 81 Fed. Reg. 79122 (proposed Oct. 26, 2016) (to be codified at 12 C.F.R. pt. 240); Tiffany Fobes Campion, Christopher R. Drewry & Joshua M. Dubofsky, *Universal Proxies: What Companies Need to Know*, HARV. L. SCH. (Dec. 5, 2018), <https://corpgov.law.harvard.edu/2018/12/05/universal-proxies-what-companies-need-to-know> [<https://perma.cc/PL9M-PNK2>].

¹¹⁸ Shareholders who run a proxy solicitation are not guaranteed reimbursement of these expenses. See Lucian Arye Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Towards Proxy Contests*, 78 CALIF. L. REV. 1071, 1106-10 (1990); cf. DEL. CODE ANN. tit. 8, § 113 (2020) (permitting but not requiring bylaws that provide for the reimbursement by the corporation of expenses incurred by a stockholder in soliciting proxies in connection with an election of directors). The SEC has made some efforts to limit the costs of complying with the federal proxy rules. In 2007, it passed amendments

very rare to see removal petitions or contested elections for board seats outside of the takeover context — or, more recently, outside of the context of an activist hedge fund campaign.¹¹⁹ Boards have thus tended to self-perpetuate, with default rules of plurality voting ensuring that even very unpopular candidates retain their seats.¹²⁰

The voting process has changed in recent years, however, as institutional investors have gained more clout.¹²¹ The SEC tried, albeit unsuccessfully, to change the law to require boards to offer to cast proxy votes for competing board nominees under certain circumstances (referred to as “proxy access” because it would give shareholders access to the board’s proxy ballot to list competing director candidates).¹²² Despite the SEC’s failure to change the law, this has in fact become the norm at large U.S. public companies through company-specific bylaw amendments. Indeed, today 71% of S&P 500 companies allow some form of proxy access — up from 1% in just 2014.¹²³ Typically, proxy access bylaws require the nominating shareholder or group of shareholders to own at least 3% of the company’s stock for three years and limits them to placing nominees on the board’s proxy ballot that would, if elected, constitute 20% or less of the board.¹²⁴ Moreover, the nominating shareholders typically cannot have acquired their shares with the “intent to change or influence control” at the company (a requirement that, along with the three-year holding requirement, makes proxy access effectively unavailable to hostile takeover bidders and activist hedge funds).¹²⁵

Institutional shareholders have also instigated bylaw amendments at many public companies changing the default rule of plurality voting for

to the proxy rules to allow proxy materials to be posted on a website, reducing what needs to be physically mailed to recipients to a notice of internet availability (which itself can be sent via email if the shareholder has already elected to receive proxy materials by electronic delivery). Physical copies need be sent only if the shareholder requests them. See 17 C.F.R. § 240.14a-16 (2020).

¹¹⁹ See Lisa M. Fairfax, *The Future of Shareholder Democracy*, 84 IND. L.J. 1259, 1265 (2009).

¹²⁰ See William K. Sjostrom, Jr. & Young Sang Kim, *Majority Voting for the Election of Directors*, 40 CONN. L. REV. 459, 461-62 (2007).

¹²¹ For an overview, see ALLEN & KRAAKMAN, *supra* note 113, at 165-66.

¹²² See *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1156 (D.C. Cir. 2011) (striking down the SEC’s proxy access rule).

¹²³ SIDLEY, SIDLEY UPDATE: THE LATEST ON PROXY ACCESS 2 (Jan. 11, 2019), <https://www.sidley.com/-/media/update-pdfs/2019/01/20190111-corporate-governance-update.pdf?la=en> [<https://perma.cc/EZD4-XPE5>].

¹²⁴ *Id.* at 8.

¹²⁵ See *id.* at 10.

director elections to a rule of majority voting.¹²⁶ The result is that directors who fail to achieve majority support will not be re-elected even if no competing candidates are proposed.¹²⁷ Institutional shareholders have also repealed other bylaw provisions that dampen the power of shareholder appointment rights, such as staggered board provisions limiting annual elections to just a third of the board.¹²⁸

Shareholders have yet to do much with their reinvigorated appointment rights, however. Proxy access has not yet been successfully utilized,¹²⁹ and very few directors have failed reelection due to majority-vote provisions.¹³⁰ Perhaps this state of affairs will change if, as time passes, institutional investors become more comfortable taking an active role in the election process, or if reforms are enacted to help better align the incentives of those who manage institutional funds with the funds' beneficial owners. More optimistically, it is also possible that the existence of more robust shareholder appointment rights is serving a disciplining function currently, without necessitating their actual use — like the proverbial shotgun in the closet.

The foregoing is not meant to suggest that appointment rights have been a trivial tool for reducing managerial agency costs in public companies. As just noted, they may be serving a deterrent function presently. Moreover, appointment rights have long played an important supporting role in the context of hostile takeovers, and more recently in the context of activist hedge fund campaigns.¹³¹ This is because both hostile bidders and activist hedge funds are often willing to incur the

¹²⁶ See Stephen J. Choi, Jill E. Fisch, Marcel Kahan & Edward B. Rock, *Does Majority Voting Improve Board Accountability?*, 83 U. CHI. L. REV. 1119, 1121 (2016) (“Over the last decade, the move from plurality to majority voting for corporate directors has been one of the most popular and successful corporate governance reform efforts.”).

¹²⁷ A director who fails to achieve a majority vote “stays on until the director resigns, the director is removed, or a successor is elected.” *Id.* at 1122.

¹²⁸ See KOSMAS PAPADOPOULOS, ROBERT KALB, ANGELICA VALDERRAMA & JARED SORHAINDO, INSTITUTIONAL SHAREHOLDER SERVICES, U.S. BOARD STUDY: BOARD ACCOUNTABILITY PRACTICES REVIEW 5 (2018), <https://www.issgovernance.com/file/publications/board-accountability-practices-review-2018.pdf> [<https://perma.cc/E34T-5AQL>] (observing that, as a result of shareholder pressure, today the full board stands for reelection annually at a “majority of companies in each of the S&P 500, S&P 400, and S&P 600”).

¹²⁹ See SIDLEY, *supra* note 123, at 12.

¹³⁰ See, e.g., COUNCIL OF INSTITUTIONAL INVESTORS, FAQ: MAJORITY VOTING FOR DIRECTORS 4, https://www.cii.org/files/issues_and_advocacy/board_accountability/majority_voting_directors/CII%20Majority%20Voting%20FAQ%201-4-17.pdf (last visited Jan. 24, 2020) [<https://perma.cc/923W-ZT9J>].

¹³¹ As discussed, a hostile bidder must couple a tender offer with a proxy contest in order to disable a company's poison pill. See *infra* note 182 and accompanying text.

expense of a proxy contest to get preferred director candidates on the board.¹³²

When contested elections do occur, shareholders confront the difficult choice of who to support. Without assistance, they may find it irrational to take the time necessary to make an informed choice. In addition to taking cues from stock price performance, shareholders have two other ways that they commonly economize on voting decision costs: (1) by relying on proxy advisory firms, who specialize in providing research, data and recommendations on voting matters,¹³³ and (2) by delegating their voting authority to a trusted third party. A shareholder who knows little about competing director candidates, for example, may be familiar with the reputation of a hedge fund that is soliciting proxies in connection with the election, and may choose to grant the fund its proxy on this basis.¹³⁴

b. Decision Rights

In addition to their right to elect and remove members of the board of directors, shareholders are empowered to make certain other decisions. As already alluded to, they have the power to both initiate and approve bylaw amendments, so long as the proposed amendments are process-oriented and do not infringe on the board's substantive discretion in overseeing the management of the corporation.¹³⁵ As with shareholder-proposed candidates for the board, shareholder-proposed bylaw amendments stand little chance of being approved at a shareholder meeting unless the proponent can marshal the votes of absent shareholders. If this required that the proponent solicit proxy authority independently, the cost would deter exercise of the decision right, just as it has traditionally discouraged exercise of shareholder appointment rights. But typically shareholders proposing bylaw amendments do not need to run an independent proxy solicitation. This is because SEC Rule 14a-8 requires boards to include shareholder proposals on their proxy ballots, subject to important limitations

¹³² Because they own a larger share of the company's equity than a typical shareholder, these actors are more likely to find that the benefits to them of waging a proxy contest exceed the costs.

¹³³ The two largest are Institutional Shareholders Services ("ISS") and Glass Lewis.

¹³⁴ See C.N.V. Krishnan, Frank Partnoy & Randall S. Thomas, *The Second Wave of Hedge Fund Activism: The Importance of Reputation, Clout and Expertise*, 40 J. CORP. FIN. 296, 298 (2016) (finding that high reputation hedge funds "win about three times as many proxy fights" as other hedge funds).

¹³⁵ See *CA, Inc. v. American Fed'n of State, Cty. and Mun. Emps. Pension Plan*, 953 A.2d 227, 234-38 (Del. 2008).

(including a requirement that the proposal comport with state corporate law and not involve director nominations or removals).¹³⁶ When applicable, Rule 14a-8 eliminates the bulk of the cost a shareholder proponent would otherwise face if left to solicit proxies independently. For many decades, Rule 14a-8 was used primarily by investors pursuing a social agenda, but with the rise of institutional investors it has in recent years become an important tool for effecting corporate governance change.¹³⁷ Indeed, the process-oriented corporate governance reforms previously discussed, such as proxy access, majority voting, and board de-staggering proposals, have mostly come about through institutional investors' use of Rule 14a-8.¹³⁸

Shareholders also have the right to vote on certain fundamental transactions, such as mergers.¹³⁹ Unlike with bylaw amendments, shareholders do not have the right to initiate these transactions, they only possess the right to approve or veto them. In deference to managements' expertise, and in recognition of shareholders' expected apathy, most substantive decisions about the corporation's affairs are left to the unfettered discretion of the executive suite, subject to board oversight. Mergers stand as a principled exception. Mergers represent a very significant event in the life of most companies, and they also present an area where conflicts of interest between executives and shareholders are rife. Thus, less deference to management may be warranted, and shareholders may be more likely to cast an informed vote. Shareholders' right to vote on other fundamental transactions may be justified on a similar basis, such as shareholders' right to vote on charter amendments and corporate liquidations and dissolutions.¹⁴⁰

A recent addition to the panoply of shareholder decision rights is the so-called "say on pay" vote — a periodic shareholder vote on the pay of top executives mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.¹⁴¹ Proponents of say-on-pay view it

¹³⁶ 17 C.F.R. § 240.14a-8 (2020).

¹³⁷ See ALLEN & KRAAKMAN, *supra* note 113, at 208-09.

¹³⁸ See *id.* at 209.

¹³⁹ See DEL. CODE ANN. tit. 8, § 251 (2020). Stock exchange listing rules also require shareholder approval for certain transactions. See, e.g., NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 312.03 (2009) (describing the situations in which shareholder approval is a prerequisite to issuing securities).

¹⁴⁰ For a fuller treatment of the possible justifications for shareholder voting rights, see Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 129 (2009).

¹⁴¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899 (2010). Stock exchange listing rules also require shareholder approval of equity compensation plans. See *supra* note 108.

as a way to ensure that executives do not unduly influence the board's compensation decisions.¹⁴² The vote is merely advisory, and thus constitutes at most a quasi-decision right, but the failure to garner significant shareholder support in a say-on-pay vote appears to influence the future pay practices of corporate boards.¹⁴³ Indeed, the mere threat of a close say-on-pay vote may temper pay abuses.¹⁴⁴

Shareholders are sometimes given additional decision rights at the board's discretion. For example, while only a majority shareholder vote is typically required to approve a merger,¹⁴⁵ boards may choose to condition a merger on a higher threshold of shareholder approval. The board may also give shareholders the opportunity to vote on certain conflicted transactions when it is not technically required to do so. As will be discussed in the next section, this is done to protect directors and officers if the transaction results in fiduciary duty litigation.¹⁴⁶

3. Regulatory Strategies

Key regulatory strategies for constraining agency costs in U.S. public companies include: fiduciary duties; mandatory disclosure obligations; the right (in certain limited circumstances) to a judicial appraisal of one's shares; and the free transferability of shares. It is admittedly odd to discuss free transferability of shares under the regulatory heading. After all, it is important to the fight against agency costs precisely because it unleashes powerful *market* forces — including hostile takeovers and hedge fund activism. Nevertheless, free transferability technically constitutes an affiliation term governing principal exit and thus will be discussed in subsection b, below.

¹⁴² See James F. Cotter, Alan R. Palmiter & Randall S. Thomas, *The First Year of Say-on-Pay Under Dodd-Frank: An Empirical Analysis and Look Forward*, 81 GEO. WASH. L. REV. 967, 971-74 (2013) (surveying the arguments in favor of say-on-pay).

¹⁴³ See Randall S. Thomas, Alan R. Palmiter & James F. Cotter, *Dodd-Frank's Say on Pay: Will It Lead to a Greater Role for Shareholders in Corporate Governance?*, 97 CORNELL L. REV. 1213, 1259 (2012).

¹⁴⁴ See *id.* at 1257-58.

¹⁴⁵ DEL. CODE ANN. tit. 8, § 251 (2020).

¹⁴⁶ See, e.g., *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 937 (Del. 1983) (“[A]n informed vote of a majority of the minority shareholders, while not a legal prerequisite, shifts the burden of proving the unfairness of the merger entirely to the plaintiffs.”); *Byrne v. Lord*, 1995 Del. Ch. LEXIS 131, at *21 (Oct. 27, 1995) (“[A]lthough shareholder ratification is not required for a court to uphold a [stock option compensation] plan, it does tip the balance in favor of upholding a plan by shifting the burden to the plan's challengers.”).

a. Agent Constraints

In the vast number of situations in which neither statutory law nor the corporation's charter or bylaws dictate precisely what they should do, directors and officers ("D&Os") are nonetheless constrained by common law fiduciary principles. These principles impose a duty of care on D&Os, requiring them to act in their stewardship of the corporation in the same manner as would a prudent man looking after his own affairs,¹⁴⁷ as well as a duty of loyalty, which prohibits self-interested behavior.¹⁴⁸ Shareholders have the right to enforce these duties in a derivative suit on the corporation's behalf, when the harm is to the corporation itself, or in a class action, when shareholder rights have been affected directly.¹⁴⁹ Notwithstanding the broad and lofty language of fiduciary standards, and plaintiff-friendly rules on attorneys' fees which encourage enforcement, as outlined below several factors operate to dampen the importance of fiduciary duty litigation as a constraint on agency costs in public companies.

This is particularly true in the duty of care context, where liability has been so pared down as to serve almost no practical function. First, the so-called "business judgment rule" reflects the judiciary's baseline position that it will not review the substantive decisions of D&Os, if otherwise un-conflicted, taken in good faith and consistent with positive law, absent a showing of gross negligence in the decision-making process — such as a failure to inform oneself of the facts relevant to the decision.¹⁵⁰ Second, this means of overcoming the business judgment rule can itself be eliminated vis-à-vis director defendants in cases seeking monetary damages, if the corporation's charter contains a provision limiting directorial liability for gross negligence, as almost all charters of U.S. public companies do.¹⁵¹ Finally, in derivative suits the plaintiff-shareholder must establish that it would have been futile to ask the board to bring the suit in question.¹⁵² To establish "demand futility," as it is called, plaintiffs must usually plead with particularity facts showing that a majority of the board faces a substantial probability of personal liability, or is beholden to another

¹⁴⁷ See PRINCIPLES OF CORPORATE GOVERNANCE § 4.01 (AM. LAW INST. 1994).

¹⁴⁸ See *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993).

¹⁴⁹ See *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1036-39 (Del. 2003).

¹⁵⁰ See, e.g., *Cede*, 634 A.2d at 360-61; see also *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (setting forth a director-deferential standard for liability based on oversight failures).

¹⁵¹ See DEL. CODE ANN. tit. 8, § 102(b)(7) (2020).

¹⁵² See *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993).

that does.¹⁵³ And even if demand futility can be shown, the board may form a “special litigation committee” comprised of untainted directors who, after investigating the claims, may petition the court to dismiss the case out from under the shareholder-plaintiff.¹⁵⁴ To the extent that D&Os remain subject to duty of care litigation notwithstanding the foregoing, their personal financial exposure is negligible, as any defense costs or amounts paid in settlement will typically be covered by company-funded indemnification or company-purchased liability insurance.¹⁵⁵

The significant protection afforded D&Os against personal liability for breaches of the duty of care is not without justification. Such protection is believed necessary to prevent the threat of liability from deterring D&Os from taking risks with corporate assets that are in shareholders’ best interests.¹⁵⁶ Chilling risk-taking is less of a concern when the focus of the litigation is a conflict-of-interest transaction or otherwise involves bad faith conduct, thus implicating the duty of loyalty; consequently, the law is more solicitous of suits involving such transactions. Breaches of the duty of loyalty are not protected by the business judgment rule,¹⁵⁷ cannot be exculpated via the corporate charter,¹⁵⁸ and present an easier case for establishing demand futility.¹⁵⁹ The default standard of review when a conflict-of-interest transaction is at issue is “entire fairness,” with the defendants required to prove that both the negotiation process and the substance of the transaction was entirely fair to the corporation notwithstanding the conflict — an onerous burden.¹⁶⁰

Even when it comes to conflicted transactions, however, liability is far from guaranteed. Courts are loathe to judge in hindsight whether a business decision was substantively fair, given the difficulty of doing so.¹⁶¹ They have therefore developed procedural workarounds that allow courts to effectively rely on the board’s voluntary, *ex ante* use of other agency-cost-reduction strategies in lieu of making an

¹⁵³ See *id.* at 933-34 (discussing the demand futility doctrine).

¹⁵⁴ See *Zapata Corp. v. Maldonado*, 430 A.2d 779, 788-89 (Del. 1980).

¹⁵⁵ See DEL. CODE ANN. tit. 8, § 145 (2020).

¹⁵⁶ See *Gagliardi v. TriFoods Int’l. Inc.*, 683 A.2d 1049, 1052-53 (Del. Ch. 1996).

¹⁵⁷ See *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1993).

¹⁵⁸ DEL. CODE ANN. tit. 8, § 102(b)(7) (2020).

¹⁵⁹ See *Rales v. Blasband*, 634 A.2d 927, 932-34 (Del. 1993).

¹⁶⁰ See *Cede*, 634 A.2d at 361.

¹⁶¹ See *Solash v. Telex Corp.*, 1988 Del. Ch. LEXIS 7, at *21 (Jan. 19, 1988) (“[C]ourts have long been reluctant to second-guess [business] decisions when they appear to have been made in good faith.”).

independent, *ex post* judgment regarding the merits of the challenged transaction.¹⁶² Take, for example, the case of a conflicted merger between the corporation and an entity controlled by the corporation's existing executives. If independent, non-conflicted directors were given the resources and authority to negotiate the transaction on behalf of the corporation (the trusteeship strategy), and if a majority of independent, non-conflicted shareholders approved the transaction after full disclosure (the decision rights strategy), courts will assume the substantive fairness of the transaction notwithstanding its conflicted nature.¹⁶³

One of the most significant real-world impacts of fiduciary duty litigation has been to encourage the use of these procedural mechanisms in transaction design. Through the development of instructive judicial case law, fiduciary duty litigation has also heavily influenced board practices in certain other areas. For example, case law explicates the type of board defenses to threatened hostile takeovers that are permissible.¹⁶⁴ It also sets forth minimum standards that boards must follow to avoid liability when overseeing the sale of the company.¹⁶⁵

b. Affiliation Terms

Entry. To access the public capital markets, federal securities law requires corporate agents to disclose significant amounts of information related to their management of the company and its financial condition.¹⁶⁶ These mandatory disclosure obligations continue to apply after the company has completed its first public offering: companies that have gone public must, on an ongoing basis, prepare and publish annual reports with audited financial statements, as well as quarterly reports, reports in connection with proxy solicitations, and interim reports

¹⁶² See, e.g., *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 937 (Del. 1983) (noting that while a shareholder vote approving the merger was “not a legal prerequisite,” it relieved defendant directors of the burden of proof); *Byrne v. Lord*, 1995 Del. Ch. LEXIS 131, at *21 (Oct. 27, 1995) (explaining that “although shareholder ratification is not required for a court to uphold a plan, it does tip the balance in favor of upholding a plan by shifting the burden to the plan’s challengers”).

¹⁶³ See *In re MFW S'holders Litig.*, 67 A.3d 496, 502-03 (Del. Ch. 2013), *aff'd*, 88 A.3d 635 (Del. 2014).

¹⁶⁴ For an overview of this jurisprudence, see Brian R. Cheffins, *Delaware and the Transformation of Corporate Governance*, 40 DEL. J. CORP. L. 1, 46-69 (2015).

¹⁶⁵ See generally Brandon Mordue, *The Revlon Divergence: Evolution of Judicial Review of Merger Litigation*, 12 VA. L. & BUS. REV. 531 (2018) (discussing these standards).

¹⁶⁶ See CHOI & PRITCHARD, *supra* note 98, at 498-501.

whenever certain specified events occur between periodic filings.¹⁶⁷ Driven in part by the specter of stringent antifraud liability, extensive care is taken in the preparation of these reports, with various gatekeepers involved in the process.¹⁶⁸

Disclosure provides critical support to the other agency-cost-reduction strategies discussed. For example, without high-quality information, shareholders could not cast informed votes, undermining the value of their appointment and decision rights. A lack of high-quality information would also make it more difficult for independent directors to monitor executives and for lawyers to discern potential breaches of fiduciary duty. Moreover, if the free transferability of shares is to produce stock prices that accurately approximate firm value — a precondition to effective use of a stock-based rewards strategy — the market must receive high quality information. Those considering launching a hostile takeover or activist hedge fund campaign likewise benefit from accurate information and the efficient stock prices its dissemination promotes.¹⁶⁹

Exit. In addition to mandatory disclosure, other important affiliation terms include appraisal and the free transferability of shares, both techniques focused on how principals may *exit* the principal-agent relationship. Appraisal refers to the right that shareholders possess under state corporate law to sell their shares back to the corporation at a judicially determined price under certain specified conditions.¹⁷⁰ Under Delaware law, which governs the vast majority of U.S. public companies, appraisal rights are triggered in the case of corporate mergers (unless the merger consideration is stock in another publicly traded company).¹⁷¹ Thus, if a shareholder believes that the management team has negotiated an inadequate price in the merger

¹⁶⁷ See *id.* at 203-07.

¹⁶⁸ Involved gatekeepers include independent auditors, who certify public company financial statements, and investment banks, who underwrite public offerings of securities. See *id.* at 938-39 (describing these and other gatekeepers involved in the public company disclosure process).

¹⁶⁹ See Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383, 384-88 (1970) [hereinafter *Efficient Capital Markets*]. Mandatory disclosure can also affect agent behavior more directly. For example, Section 404 of the Sarbanes-Oxley Act of 2002 requires public companies to report on the effectiveness of their internal control processes, a disclosure requirement that in practice acts like an agent constraint, insofar as it serves as a *de facto* requirement to adopt effective internal controls. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 404, 116 Stat. 745, 789 (codified at 15 U.S.C. § 7262).

¹⁷⁰ ALLEN & KRAAKMAN, *supra* note 113, at 488.

¹⁷¹ See DEL. CODE ANN. tit. 8, § 262 (2020).

(perhaps in exchange for side-payments or other personal benefits), but the merger nevertheless garners a majority shareholder vote (perhaps as a result of collective action problems), the dissenting shareholder has the option of foregoing the merger consideration and instead forcing the company to buy its shares at a (hopefully higher) price to be determined by the court.

For a shareholder to be entitled to appraisal, however, they must endure a lengthy and costly legal proceeding as well as meet several cumbersome procedural requirements.¹⁷² And because appraisal claims cannot be brought as a class action, shareholders must bear these costs individually.¹⁷³ Until recently, this discouraged shareholders from seeking appraisal, making it a relatively insignificant tool for reducing agency costs. In recent years, it has come to play a more important role, as hedge funds have begun to accumulate large blocks of shares in anticipation of a merger, with the intention of pursuing appraisal if unsuccessful in instigating an increase in the merger consideration.¹⁷⁴ Thus, the appraisal right today may serve to discourage underpriced mergers by increasing their anticipated costs.¹⁷⁵

While shareholders can force a public company to buy their shares in an appraisal proceeding only in certain limited circumstances, they enjoy nearly complete freedom to resell their shares to third parties on the secondary market. Free transferability of shares is a core feature of the corporate form, and as already previewed does significant work to help reduce agency costs in public companies. First, secondary market trading in public company stock produces a stock price which at any given time reflects all publicly available information about the firm, including about the quality of its management team (assuming the preconditions to the operation of the efficient capital markets hypothesis are met¹⁷⁶). The existence of such prices helps discipline public company managers in a variety of ways. For example, the information conveyed by stock prices assists independent directors as

¹⁷² See *id.*

¹⁷³ ALLEN & KRAAKMAN, *supra* note 113, at 490.

¹⁷⁴ See generally Wei Jiang, Tao Li, Danqing Mei & Randall Thomas, *Appraisal: Shareholder Remedy or Litigation Arbitrage?*, 29 J.L. & ECON. 697 (2016) (discussing these developments); Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U. L. REV. 1551 (2015) (same).

¹⁷⁵ Some question the value of appraisal rights. For an introduction to the debate, see Charles Korsmo & Minor Myers, *Reforming Modern Appraisal Litigation*, 41 DEL. J. CORP. L. 279, 282 (2017).

¹⁷⁶ See generally Fama, *Efficient Capital Markets*, *supra* note 169, at 384-88 (discussing the efficient markets model).

well as shareholders in evaluating managerial performance.¹⁷⁷ Stock prices are also the foundation upon which stock-based incentive compensation packages are built. Thus, as with mandatory disclosure, free transferability of shares supports many of the other agency-cost-reduction strategies that have been discussed.

In addition, it is only because of the opportunities presented by the free transferability of shares that hostile takeovers exist. When a company is underperforming due to poor management, its stock price will suffer. This creates a buying opportunity for a hostile bidder, who can profit by amassing a controlling block of the company's stock on the secondary market and changing its management team, causing the value of the firm's stock to increase.¹⁷⁸

The disciplining effect the mere threat of a hostile takeover can have on corporate executives was first recognized by academics in the 1960s,¹⁷⁹ but the potency of the threat has diminished substantially since then.¹⁸⁰ This is because boards, with the blessing of the courts, have devised takeover defenses that dramatically increase the cost of hostile acquisitions to bidders and thus make them less likely.¹⁸¹ The prime example is the so-called "poison pill," which operates to substantially dilute the value of a shareholder's investment in a firm, if the shareholder passes a threshold of ownership without the board's prior consent. Boards that adopt a poison pill effectively force a would-be hostile bidder to negotiate the acquisition with the board, rather than affecting it through secondary market purchases directly. If the board is unwilling to negotiate, or if the terms it demands are unacceptable to the bidder, the only realistic alternative is for the bidder to run an expensive proxy contest to replace the current board with sympathetic directors.¹⁸²

¹⁷⁷ Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 *STAN. L. REV.* 1465, 1541 (2007) ("As stock prices become more informative, the directors' monitoring role increasingly consists of using stock price metrics to measure the firm's performance over time and against relevant intra-industry comparisons.").

¹⁷⁸ ALLEN & KRAAKMAN, *supra* note 113, at 531.

¹⁷⁹ See Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 *J. POL. ECON.* 110, 112-13 (1965).

¹⁸⁰ Jonathan R. Macey & Geoffrey P. Miller, *Corporate Governance and Commercial Banking: A Comparative Examination of Germany, Japan, and the United States*, 48 *STAN. L. REV.* 73, 102 (1995) (discussing the precipitous decline in the number of hostile takeovers in the United States since the high of forty-six in 1988).

¹⁸¹ See Cheffins, *supra* note 164, at 49-56.

¹⁸² In the hands of a faithful board, poison pills can be used to help shareholders by placing the board in a position of strength from which to bargain with the would-be

While institutional investors have, in recent years, succeeded in encouraging boards to adopt more shareholder-friendly poison pills and to disable other defensive measures, hostile takeovers remain a rare occurrence, limiting (though certainly not eliminating) their importance in combating agency costs.¹⁸³ Activist hedge funds, by contrast, today present a much more salient threat to public company executives. Their *modus operandi* has already been discussed¹⁸⁴ and will not be rehashed here, except to emphasize that it is the free transferability of shares that makes hedge fund activism possible. Hedge funds could not serve their governance function without the ability to acquire shares of an underperforming company on the secondary market at a price that reflects the company's poor management, and to later resell those shares at a higher price once improvements have been achieved.¹⁸⁵

A few general themes emerge from the foregoing overview of the agency-cost-reduction strategies utilized in public companies. First, there is not excessive reliance on any one strategy. Instead, the strategies operate as fail safes to one another. Faith is not placed only in corporate boards, or in rewards systems, shareholder voting, judicial oversight, or the pressures created by the threat of hostile takeovers and hedge fund activism. Instead, it is placed in the collective of all of these strategies, with the hope that if one fails to work as expected the others will do an adequate job to fill the breach. Second, in addition to acting as fail safes to one another, the various strategies also mutually support one another in critical ways. The important supporting role played by mandatory disclosure and informed stock prices has already been discussed, as has the support courts draw from the use of independent director approval and shareholder decision rights in discharging their fiduciary oversight obligations. As yet another example, shareholder appointment rights give legitimacy to the board of directors and are an essential tool in the toolkit of both hostile bidders and hedge fund activists. Third and finally, the relative importance of various strategies has not remained static over time. For example, as changing patterns of share ownership have helped to mitigate the severity of the collective action problems shareholders face, governance strategies and the regulatory strategy of

acquirer over price and deal terms. But in the hands of an unfaithful board, poison pills can be used to protect underperforming executives from capital market discipline.

¹⁸³ See *supra* note 180.

¹⁸⁴ See *supra* notes 61–66 and accompanying text.

¹⁸⁵ See Kahan & Rock, *supra* note 46, at 1028.

appraisal have taken on greater importance than in the past.¹⁸⁶ And as governance strategies have increased in importance, courts have increased their willingness to relax their scrutiny of transactions approved by shareholder-elected boards and/or shareholders themselves, thereby marking a reduction in the importance of fiduciary duty as an agency-cost-reduction technique.¹⁸⁷

III. CLASS ACTION GOVERNANCE

This Part turns to class action governance, evaluating the techniques utilized in the class action context to reduce agency costs and comparing them to those used in the public company setting. These techniques can be categorized using the ACL taxonomy as depicted in Table 3. As will become clear, there is far less redundancy in the techniques used in the class action context, and hence there are fewer opportunities for cross-cutting support and dynamism. Specifically, court-centered agent constraints and rewards strategies dominate, with no serious reliance placed on trusteeship, governance or affiliation strategies. Given well-recognized problems with judicial oversight of class counsel as well as with the setting of fees, the near exclusive dependence on agent constraints and rewards to combat class action agency costs is likely suboptimal. Part IV will therefore turn to the topic of reform, proposing several changes to class action practice inspired by the public-company analogy. These changes seek to build in some of the redundancy in agency-cost-reduction techniques observed in the public company context, albeit in a scaled-back manner that acknowledges important differences between class actions and public companies.

¹⁸⁶ See *supra* Parts II.B.2.a, II.B.3.b.

¹⁸⁷ See J. Travis Laster, *Changing Attitudes: The Stark Results of Thirty Years of Evolution in Delaware M&A Litigation*, in RESEARCH HANDBOOK ON SHAREHOLDER LITIGATION 202-28 (2018).

Incentive Alignment	Governance	Regulatory
<i>Trusteeship</i> Class Representatives Objectors	<i>Appointment Rights</i> None	<i>Agent Constraints</i> Judicial Approval of Settlement/Fees
<i>Rewards</i> Percentage of Recovery	<i>Decision Rights</i> None	Rule 11/ Ethical Rules Malpractice / Collateral Attack <i>Affiliation Terms</i> Bar Membership Judicial Appointment Notice / Opt-Out Rights

A. Incentive Alignment Strategies

Recall that incentive alignment strategies rely on either a trusteeship or rewards approach.¹⁸⁸ Both approaches play an important role in public company governance, whereas in the class action context only the latter does.

1. Trusteeship

As previously explained, trusteeship involves identifying parties who will be driven primarily by conscience, pride, or reputation and placing them in a position to either manage the enterprise or to monitor the financially-incentivized agents tasked with managing the enterprise. The independent board of directors plays the most important trusteeship role in the public company context; the class representative might be thought of as an analogue in the class action context.¹⁸⁹ Class actions are required to have a class representative (also called a lead plaintiff), just as corporations are required to have a board of directors.¹⁹⁰ Neither class representatives nor directors are typically given high-powered financial incentives for their service.¹⁹¹ Ideally, a class representative is motivated by conscience to “fairly and adequately represent the interests of the class,” as Rule 23 requires.¹⁹² Indeed, Wright & Miller state that a class representative should be “of such a

¹⁸⁸ See *supra* Part II.A.

¹⁸⁹ The court might be conceptualized as a type of trustee for the class, but its role in class action governance is an example of a regulatory strategy, discussed *infra*.

¹⁹⁰ See FED. R. CIV. P. 23(a).

¹⁹¹ Serving as a class representative is not lucrative, if it involves any special compensation above a pro rata share of the class recovery. See Theodore Eisenberg & Geoffrey Miller, *Incentive Awards to Class Action Plaintiffs: An Empirical Study*, 53 UCLA L. REV. 1303, 1347 (2005); William B. Rubenstein, *The Fairness Hearing: Adversarial and Regulatory Approaches*, 53 UCLA L. REV. 1435, 1442 (2006).

¹⁹² FED. R. CIV. P. 23(a)(4).

character as to assure the vigorous prosecution . . . of the action so that the members' rights are certain to be protected."¹⁹³ This is the language of trusteeship.

The class representative differs from the independent board of directors, however, in ways that make it a far less effective trustee. First, unlike directors, class representatives are not elected by residual claimants. With the exception of shareholder class actions (discussed below), the class representative is simply the member of the plaintiff class named by counsel in the class complaint, subject to judicial approval for typicality and adequacy.¹⁹⁴ Judicial approval is not rigorous, so in effect the agent picks its monitor.¹⁹⁵ As a result, the class representative cannot be expected to provide true oversight of class counsel. While similar critiques have been leveled at public company directors, the hey-day of the CEO-dominated board has largely passed.¹⁹⁶ Independent director requirements today mitigate, at least to an extent, executive dominance of the board and, given the rise of institutional investors, shareholder voting ties director loyalty to shareholders more than it once did.¹⁹⁷

The class representative position differs from the public company board in another important way: it does not create a true decision hierarchy. Unlike the public company board vis-à-vis corporate

¹⁹³ CHARLES A. WRIGHT, VIKRAM DAVID AMAR, JEFFREY BELLIN, DANIEL D. BLINKA, EDWARD H. COOPER, RICHARD D. FREER, VICTOR JAMES GOLD, KENNETH W. GRAHAM, JR., PETER J. HENNING, HELEN HERSHKOFF, MARY KAY KANE, THE LATE CHARLES H. KOCH, ANDREW D. LEIPOLD, RICHARD L. MARCUS, ARTHUR R. MILLER, RICHARD W. MURPHY, ANN MURPHY, A. BENJAMIN SPENCER, ADAM STEINMAN, JOAN E. STEINMAN, CATHERINE T. STRUVE & SARAH N. WELLING, *FEDERAL PRACTICE AND PROCEDURE* § 1766 (3d ed. 2020).

¹⁹⁴ See Rubenstein, *supra* note 191, at 1443 (“Class counsel typically identify class actions, select the class representatives from among their client pool or potential client pool, and then largely ignore the class representative thereafter.”). Theoretically the court could choose another class member to serve as class representative, but “Rule 23 contains no requirement of precertification notice to absent putative class members,” so there is “no mechanism for absent putative class members to learn that a putative class action is pending, much less that they are entitled to seek to displace the named plaintiff in that lawsuit as class representative.” *China Agritech, Inc. v. Resh*, 138 S. Ct. 1800, 1812 (2018) (Sotomayor, J., concurring).

¹⁹⁵ See Linda S. Mullenix, *Taking Adequacy Seriously: The Inadequate Assessment of Adequacy in Litigation and Settlement Classes*, 57 *VAND. L. REV.* 1687, 1692 (2004) (observing that courts “fail to robustly engage in any meaningful inquiry to establish the existence of . . . adequate representation”).

¹⁹⁶ See, e.g., Yaron Nili, *Contributions: Successor CEOs*, 99 *B.U. L. REV.* 787, 796 (2019) (explaining that in recent years “shareholders have pushed to separate the CEO and chairperson of the board positions in favor of an ‘independent’ chair as a method to improve board independence”).

¹⁹⁷ See *supra* Part II.B.1.a.

executives, the class representative exercises no decision control over class counsel. Indeed, the class representative lacks authority to do anything dispositive: it does not hire class counsel or set attorneys' fees; it lacks authority to fire class counsel; it has no role in crafting litigation strategy; and its approval is not required for a settlement to be reached.¹⁹⁸ In sharp contrast, the public company board possesses ultimate authority over the management of the corporation.¹⁹⁹

In the special case of securities class actions, reforms have been implemented to make the class representative more faithful to the interests of residual claimants and more powerful — more akin to the public company board. The Private Securities Litigation Reform Act of 1995 (“PSLRA”) requires notice be given to prospective class members of the pendency of a putative federal securities class action within 20 days of the complaint being filed; recipients must be informed, *inter alia*, of their right to move the court to serve as lead plaintiff.²⁰⁰ If competing lead plaintiff candidates emerge, the PSLRA creates a rebuttable presumption that the most adequate lead plaintiff among them is the person or group of persons with the largest financial interest in the relief sought by the class.²⁰¹ The provision is designed to encourage institutional investors to serve as lead plaintiff, on the basis that such investors will have a better incentive and ability to monitor class counsel in the interests of the class than smaller-stakes shareholders selected by counsel.²⁰² For the same reason, the PSLRA grants the lead plaintiff appointed through this process the authority to select counsel to represent the class, and to negotiate fee agreements, subject to deferential court review.²⁰³

¹⁹⁸ Class representatives have for this reason long been viewed as mere “figureheads.” See generally Jean Wegman Burns, *Decorative Figureheads: Eliminating Class Representatives in Class Actions*, 42 HASTINGS L.J. 165 (1990) (suggesting that the role of class representative serves no useful purpose).

¹⁹⁹ See DEL. CODE ANN. tit. 8, § 141(a) (2020).

²⁰⁰ 15 U.S.C. § 78u-4(a)(3) (2018).

²⁰¹ *Id.*

²⁰² The inspiration for the PSLRA's lead plaintiff provision originated in 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). See Elliot J. Weiss, *The Lead Plaintiff Provisions of the PSLRA After a Decade, or “Look What’s Happened to My Baby,”* 61 VAND. L. REV. 543, 548-50 (2008) (recounting this history).

²⁰³ See 15 U.S.C. § 78u-4(a)(3)(b)(v); see also *In re Cendant Corp. Litig.*, 264 F.3d 201, 276, 282 (3d Cir. 2001) (lead plaintiffs' counsel selection and fee arrangement should be afforded a strong presumption of validity). Delaware courts likewise favor institutional investor lead plaintiffs in shareholder class actions brought under state law. David H. Webber, *Private Policing of Mergers and Acquisitions: An Empirical Assessment of Institutional Lead Plaintiffs in Transactional Class and Derivative Actions*, 38 DEL. J.

While not without its problems,²⁰⁴ the PSLRA's lead plaintiff provision is generally viewed as improving the management of securities class actions.²⁰⁵ But the approach cannot be effectively replicated, at least under current practice, in most other small-claims class actions. This is because such actions typically lack class members with a sufficient financial stake in the outcome of the litigation and level of sophistication to make them effective monitors.²⁰⁶

In addition to the independent board of directors, certain outside third parties also serve a trusteeship role in the public company context, albeit a less central one. Recall that investment banks and auditors serve as reputational intermediaries whose affiliation with a public company sends a positive signal to the market. One might view objectors, who make their views on a proposed settlement or fee petition known to the court, as serving an analogous role in the class action context.²⁰⁷ But the influence of these actors on the court differs in important ways from the influence of reputational intermediaries on the securities markets.

CORP. L. 907, 911 (2014) [hereinafter *Private Policing of Mergers and Acquisitions*]. Some scholars take issue with the premise that institutional investors should be placed at the helm of securities class actions, observing that their interests may sometimes conflict with the interests of smaller stakes class members. See, e.g., Burch, *supra* note 4, at 1123-27; David H. Webber, *The Plight of the Individual Investor in Securities Class Actions*, 106 NW. U. L. REV. 157, 160 (2012).

²⁰⁴ The most troubling concern is the possibility that public pension fund lead plaintiffs may allow political contributions to influence their counsel selection. See James D. Cox & Randall S. Thomas, *Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587, 1611-15 (2006).

²⁰⁵ For an overview of the empirical literature evaluating the PSLRA's lead plaintiff provision, as well as an empirical assessment of the use of institutional lead plaintiffs in shareholder class actions brought under state law, see generally Webber, *Private Policing of Mergers and Acquisitions*, *supra* note 203.

²⁰⁶ See Jill E. Fisch, *Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction*, 102 COLUM. L. REV. 650, 725 (2002) [hereinafter *Lawyers on the Auction Block*] (explaining that the PSLRA's "empowered lead plaintiff" model is unlikely to work well in small claims class actions, "such as consumer fraud cases or nonpersonal injury products liability cases," because "no class member is likely to have a sufficient stake in the case to make active participation viable"; "[t]hus collective action problems will dominate, and lead plaintiff oversight is unlikely to overcome excessive lawyer control"); Rubenstein, *supra* note 191, at 1444 (noting that the lead plaintiff approach taken in the PSLRA "cannot be replicated for most other types of representative litigation, where the stakes are usually far smaller and the largest plaintiffs lack institutional incentives to monitor").

²⁰⁷ Lahav, *Fundamental Principles*, *supra* note 7, at 119 (similarly observing that in the class action context "informational intermediaries may include objectors, who analyze the information provided by class counsel and determine whether or not . . . opposition to . . . proposed settlements is appropriate").

First, when auditors and investment bankers express opinions about their public company clients, those opinions are based on inside information that they have been given special access to. Objectors, by contrast, typically possess no informational advantage relative to the court. They are not, for example, present at settlement negotiations or privy to discussions regarding litigation strategy.²⁰⁸ The only new information they usually bring to the table is their opinion about the fairness of a settlement or fee petition based on their analysis of information already in the court's possession.²⁰⁹

Second, objectors play only a sporadic role in class action governance. Indeed, in most cases no objections are lodged,²¹⁰ and the absence of objections is not properly interpreted as a signal of approval. The absence of objections might be because the settlement or fee petition contains nothing objectionable, but it could also reflect a collective action problem — the personal costs of lodging a valid objection will typically outweigh the personal benefits, even if the class as a whole would be better off.²¹¹ By contrast, public company auditors are true

²⁰⁸ Objectors have no legal rights until after the settlement has been reached. See FED. R. CIV. P. 23(e).

²⁰⁹ While objectors can seek discovery, courts are hesitant to grant it. See, e.g., *Bowling v. Pfizer*, 143 F.R.D. 141, 153 n.10 (S.D. Ohio 1992). Moore's Federal Practice warns:

Discovery should be minimal and conditioned on a showing of need, because it will delay settlement, introduce uncertainty, and might be undertaken primarily to justify an award of attorney fees to the objector's counsel. A court should monitor postsettlement discovery by objectors and limit it to providing objectors with information central to the fairness of the proposed settlement. A court should not allow discovery into the settlement-negotiation process unless the objector makes a preliminary showing of collusion or other improper behavior.

DANIEL R. COQUILLETTE, GREGORY P. JOSEPH, GEORGENE M. VAIRO & CHILTON DAVIS VARNER, 32 MOORE'S FEDERAL PRACTICE § 21.6 (3d ed. 2020).

²¹⁰ See THOMAS E. WILLGING, LAURAL L. HOOPER & ROBERT J. NIEMIC, FED. JUDICIAL CTR., EMPIRICAL STUDY OF CLASS ACTIONS IN FOUR FEDERAL DISTRICT COURTS: FINAL REPORT OF THE ADVISORY COMMITTEE ON CIVIL RULES 178 (1996).

²¹¹ See Brian T. Fitzpatrick, *The End of Objector Blackmail?*, 62 VAND. L. REV. 1623, 1631 (2009) [hereinafter *The End of Objector Blackmail?*] ("The small number of objections is usually attributed to the fact that class members often have little at stake individually in a settlement, making it economically irrational for many of them to go through the trouble of filing objections."); Lahav, *Fundamental Principles*, *supra* note 7, at 86 (discussing reasons why objectors may not materialize, unrelated to the fairness of the settlement). Scholars have suggested various forms of incentive payments to encourage objectors, but funding such payments is difficult and may lead to perverse incentives. See, e.g., Susan P. Koniak & George M. Cohen, *Under Cloak of Settlement*, 82 VA. L. REV. 1051, 1108 (1996) (encouraging "courts and rulemakers to devise

“gatekeepers”: every public company is required to have their financial statements certified by a public company auditor at least once a year, when they file their annual reports.²¹² Moreover, investment banks are almost always involved in public securities offerings in the United States.²¹³

Third, in the subset of cases where objections are lodged, the quality of the signal sent to the court will not be as strong as the quality of the signal sent to the capital markets by auditors and investment banks. This is in part because, as already noted, auditors and investment banks have access to inside information whereas objectors typically do not. But that is only half the story. Auditors and investment banks also have substantial reputational capital at risk whenever they affiliate with a public company.²¹⁴ The irrationality of risking that capital for a single client is why the market interprets their affiliation with that client positively. Class member objectors, by contrast, do not have comparable reputational capital at risk when they lodge an objection with the court, and their motivations for objecting are always inherently suspect.²¹⁵

In addition to class members, non-profits and government actors sometimes object to a proposed settlement or fee petition in a class action.²¹⁶ The signal sent by these objectors may be of higher quality. This is especially so if they have a track record of working to protect the interests of the class of people represented in the case and face no conflicts of interest.²¹⁷ The potential value of government input

methods to pay objectors,” but expressing doubt that a successful model could be devised); Rubenstein, *supra* note 191, at 1456-59 (outlining an approach whereby objectors could be funded by bonds posted by settling parties).

²¹² CHOI & PRITCHARD, *supra* note 98, at 214-16.

²¹³ *Id.* at 493.

²¹⁴ See *supra* note 101 and accompanying text.

²¹⁵ See, e.g., Edward Brunet, *Class Action Objectors: Extortionist Free Riders or Fairness Guarantors*, 2003 U. CHI. LEGAL F. 403, 425-34 (discussing perverse incentives that may motivate class action objectors); Fitzpatrick, *The End of Objector Blackmail?*, *supra* note 211, at 1633-40 (same); Lahav, *Fundamental Principles*, *supra* note 7, at 90 (discussing perverse incentives that may motivate class action objectors). To discourage objections designed merely to extract a side payment, Rule 23(e)(5) prohibits the withdrawal of an objection in either the district court or on appeal in exchange for consideration unless approved by the court. FED. R. CIV. P. 23(e)(5).

²¹⁶ For example, the Center for Class Action Fairness is a non-profit whose stated mission is to represent consumers and shareholders pro bono against settlements it views as abusive. See HAMILTON LINCOLN L. INST., <https://hlli.org> (last visited July 9, 2020) [<https://perma.cc/9V2V-7BX2>].

²¹⁷ See BARBARA J. ROTHSTEIN & THOMAS E. WILLGING, *MANAGING CLASS ACTION LITIGATION: A POCKET GUIDE FOR JUDGES* 11 (2005) (“Generally, government bodies such as the Federal Trade Commission or state attorneys general, or nonprofit entities have class-oriented goals of ensuring that class members receive fair, reasonable, and

motivated a provision in the Class Action Fairness Act requiring relevant government actors be notified of a proposed settlement of a class action at least ninety days prior to final approval, affording those actors time to make their views known to the court.²¹⁸ Unfortunately, non-profits and government agencies only sporadically make their views known to the court, and given the resource constraints they face it is inappropriate to interpret their silence as tacit approval.²¹⁹

Fourth and finally, in the very small subset of cases where objectors do step forward *and* are credible, there is no guarantee that the court will respond appropriately to the signal received. As discussed further *infra*, the court will be naturally biased in favor of approving the settlement and thus may dismiss or undervalue the input provided by even trustworthy objectors.²²⁰ By contrast, when working efficiently, the capital markets provide an unbiased estimate of the value of information, including the information conveyed by reputational intermediaries.

adequate compensation for any injuries suffered.”); Brunet, *supra* note 215, at 448-64 (explaining that public sector objectors, including government actors and public interest groups, have better motivations than private objectors); Lahav, *Fundamental Principles*, *supra* note 7, at 132 (“Experienced not-for-profit objectors, such as Public Citizen Litigation Group, Trial Lawyers for Public Justice, or states’ attorneys general should be encouraged to [object] because of their limited financial interest and their history of responsible involvement in egregious cases.”).

²¹⁸ 28 U.S.C. § 1715 (2018).

²¹⁹ In February 2018, the outgoing Associate Attorney General stated in a speech that the “DOJ [has] receive[d] over 700 CAFA notices every year, but has only participated in two cases, and those were more than a decade ago.” Rachel Brand, Assoc. Att’y Gen., U.S. Dep’t of Justice, Remarks to the Washington, D.C. Lawyers Chapter of the Federalist Society (Feb. 15, 2018). She explained that delays in processing the notices were to blame and indicated that the DOJ would take a more active role in policing class actions moving forward. *Id.*

²²⁰ See Fitzpatrick, *The End of Objector Blackmail?*, *supra* note 211, at 1631 (observing that it “is rare . . . for district courts to reject proposed class action settlements on the basis of objections; only somewhat more frequently do district courts award fees less lucrative than those sought by class counsel”); Lahav, *Fundamental Principles*, *supra* note 7, at 83 n.73 (collecting cases where a court approved a class settlement despite significant objections). In some cases objectors have had better results. See Sean J. Griffith & Anthony A. Rickey, *Objections to Disclosure Settlements: A How-To Guide*, 70 OKLA. L. REV. 281, 285 (2017) (describing the authors’ success at lodging objections to disclosure-only settlements in merger class actions: “these objections have resulted in settlements being dismissed, releases being narrowed to preserve potential claims, or fees to class counsel being reduced”).

2. Rewards

The rewards approach plays a vastly more important role in class action governance today than the trusteeship approach. Under the percentage-of-the-recovery method of awarding attorneys' fees, class counsel is awarded a percentage of the settlement fund in payment for its services.²²¹ This helps to align the interests of class counsel with those of the class because the larger the settlement fund, the larger the fees awarded. The similarity to stock-based executive pay is obvious. Indeed, it is often said that contingency fee arrangements effectively grant the plaintiffs' attorney an equity interest in the outcome of the case.²²²

The percentage-of-the-recovery method of awarding attorneys' fees and stock-based executive pay do very important work to combat agency costs in their respective domains. But neither is a panacea. Class action attorneys can game the pay system to reap unjustified rewards, just like corporate executives. For example, cases brought on the heels of a government enforcement action may result in a low-risk, near-certain settlement, and courts may fail to adjust downward the fee award, giving counsel an undeserved windfall. Non-indexed options provide a similar windfall to corporate executives, who benefit when the increase in the company's stock price is attributable to market trends rather than company-specific performance.²²³ Class action attorneys

²²¹ "The percentage-of-the-recovery method has now become the dominant method for awarding fees in class action cases," eclipsing the lodestar method. Fitzpatrick, *Do Class Action Lawyers Make Too Little?*, *supra* note 28, at 2052. Under the lodestar method, class counsel is "awarded fees equal to the number of hours they worked on the case (to the extent the hours were reasonable), multiplied by a reasonable hourly rate as well as by a discretionary multiplier that could reward class counsel for the risk of non-recovery." *Id.* at 2051. A so-called "lodestar cross-check" is often performed on fees calculated pursuant to percentage-of-the-recovery percentage method, however, to ensure that the fee is not excessive. See Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees and Expenses in Class Action Settlements: 1993-2008*, 7 J. EMPIRICAL LEGAL STUD. 248, 272 (2010) [hereinafter *Attorney Fees and Expenses in Class Action Settlements*]; Theodore Eisenberg, Geoffrey Miller & Roy Germano, *Attorneys' Fees in Class Actions: 2009-2013*, 92 N.Y.U. L. REV. 937, 945 (2017). In addition to being awarded a percentage of the recovery, class counsel is reimbursed dollar for dollar for certain expenses. See Andrew K. Niebler, *In Search of Bargained-For Fees for Class Action Plaintiffs' Lawyers: The Promise and Pitfalls of Auctioning the Position of Lead Counsel*, 54 BUS. LAW. 763, 798 (1999).

²²² Geoffrey P. Miller, *Some Agency Problems in Settlement*, 16 J. LEGAL STUD. 189, 189 (1987) (equating a contingency fee with an equity interest in litigation).

²²³ See Lucian Arye Bebchuk, Jesse M. Fried & David I. Walker, *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 798-801 (2002) (discussing this windfall and how indexing can correct it).

can also attempt to artificially inflate the perceived value of the settlement fund, just like corporate executives can seek to artificially inflate the company's stock price.²²⁴ And in both settings, while principled arguments can be made about fee structure, it is difficult to get a handle on the appropriate overall level. Judges look at what judges have awarded in other cases,²²⁵ corporate boards look at what corporate boards have awarded in other companies.²²⁶ In both settings, the decision makers are spending other people's money, and the payouts are often eye popping.²²⁷

While class action attorneys and corporate executives are compensated in similar ways, there are also important differences in

²²⁴ This can be done by assigning a higher value to non-monetary relief than is warranted, or by calculating requested fees based on a settlement that may not actually end up being paid out in full to the class. See Klement, *supra* note 3, at 42-43. The Delaware courts have recently taken steps to tamp down the first sort of abuse in merger class actions. See, e.g., *In re Trulia, Inc. Stockholder Litig.*, 129 A.3d 884 (Del. Ch. 2016) (noting that practitioners should expect that settlements in merger litigation where the consideration is supplemental disclosures "are likely to be met with continued disfavor in the future unless the supplemental disclosures address a plainly material misrepresentation or omission"). In CAFA, Congress also sought to curb these sorts of abuses. See 28 U.S.C. § 1712(a), (d) (2018).

²²⁵ Fitzpatrick, *Do Class Action Lawyers Make Too Little?*, *supra* note 28, at 2054 ("[M]any commentators believe that district courts have no choice but to award percentages based on little more than intuition or to replicate the percentages awarded by other courts, which, of course, were probably based on intuition as well."). Courts often cite a multifactor test when determining the percentage to award, but the test is so indeterminate that it operates as no real constraint on judicial discretion. See *id.* at 2053-54. But see FED. R. CIV. P. 23(h) (specifying only that the fee must be "reasonable").

²²⁶ See, e.g., Charles M. Elson & Craig K. Ferrere, *Executive Superstars, Peer Groups, and Overcompensation: Cause, Effect, and Solution*, 38 IOWA J. CORP. L. 487, 493 (2013) ("In setting the pay of their CEO, boards invariably reference the pay of the executives at other enterprises in similar industries and of similar size and complexity.").

²²⁷ Class counsel might also use their power to block a settlement to siphon value from class members, just like executives might use their power to block a corporate sale to siphon value from shareholders. Class counsel might, for example, condition acceptance of an inadequate settlement on the defendant's promise to support an excessive fee petition. A corporate executive might similarly condition acceptance of an inadequate merger price on the acquirer's agreement to pay the executive excessive amounts for future service to the merged entity. See generally Brian Broughman, *CEO Side Payments in Mergers and Acquisitions*, 2017 B.Y.U. L. REV. 67. Disclosure rules exist to help mitigate this sort of abuse in both settings. See 15 U.S.C. § 78n-1(b) (2018) (requiring, when shareholders are asked to vote on a merger, disclosure of any agreement concerning any compensation that may be paid to executives in relation thereto, as well as a separate advisory shareholder vote); FED. R. CIV. P. 23(e)(3) (requiring the parties seeking approval of a proposed settlement to file a statement identifying any agreement made in connection therewith).

how their pay is set and in its composition. These differences help to illuminate potential weaknesses in class action governance. Recall that in the public company setting, the rewards strategy is buttressed by the trusteeship strategy: executive pay packages are negotiated by the board's independent remuneration committee, which is assisted by third-party compensation consultants.²²⁸ Governance strategies also lend support: periodically, there is an advisory shareholder vote on the company's pay practices. Judicial oversight of executive pay provides only a limited, last line of defense.²²⁹ In the class action context, by contrast, the court is the first and last line of defense.²³⁰ While courts are well equipped to resolve adversarial disputes, fee petitions in class actions are typically unopposed by the settling defendant.²³¹ And objectors, as discussed above, are rare and often unconvincing. The court is therefore left alone to determine the appropriate fee. If the presiding judge grants the fees requested, she clears a case from her docket, so the structural incentive is to acquiesce rather than to try and determine the optimal fee award.²³²

Another important difference concerns when pay determinations are made. Executive pay packages are always negotiated *ex ante*; class counsel's fees, by contrast, are usually determined *ex post*.²³³ This undermines their incentive-alignment function. To be sure, class action attorneys know at the outset of the case that they will receive some percentage of any settlement fund they create; but they do not know exactly what that percentage will be.²³⁴ This uncertainty makes it

²²⁸ See *supra* Part II.B.1.

²²⁹ See *supra* note 111 and accompanying text.

²³⁰ Securities class actions governed by the PSLRA are the notable exception. In these cases, the lead plaintiff may negotiate class counsel's pay *ex ante*. See *In re Cendant Corp. Litig.*, 264 F.3d 201, 276, 282 (3d Cir. 2001). But see Lynn A. Baker, Michael A. Perino & Charles Silver, *Is the Price Right? An Empirical Study of Fee-Setting in Securities Class Actions*, 115 COLUM. L. REV. 1371, 1380 (2015) [hereinafter *Is the Price Right?*] (empirical study showing that in many securities class actions, attorneys' fees are still set by the court *ex post* rather than negotiated by the lead plaintiff *ex ante*).

²³¹ "Defendants are typically indifferent to fee awards because in a common fund case, the fee is deducted from the settlement and therefore simply involves the allocation of an already fixed sum between class counsel and class members." Baker et al., *supra* note 230, at 1387.

²³² Empirical studies show that courts grant the fees requested approximately 78% of the time. Eisenberg et al., *supra* note 221, at 953.

²³³ But see *supra* note 230.

²³⁴ See William J. Lynk, *The Courts and the Plaintiffs' Bar: Awarding the Attorney's Fee in Class-Action Litigation*, 23 J. LEGAL STUD. 185, 191 (1994) ("[T]he plaintiff's lawyer will infer an implicit contract governing how his fee will likely be computed, an inference presumably based on the history of *ex post* fee awards in comparable cases.").

difficult for them to determine the optimal amount to invest in the case.²³⁵ By increasing the risk that they face, it also exacerbates the perverse settlement tendencies discussed below.²³⁶

The timing of the fee determination also affects the perspective of the fee setter. When setting fees *ex ante*, the focus of the corporate board is directed toward the incentive effects of the fee arrangement. When setting counsel fees *ex post*, courts are more likely to focus on distributional effects.²³⁷ Even if courts do consider incentive effects, hindsight bias is likely to lead them to underestimate the risk assumed by class counsel in litigating the case if a large recovery is actually obtained.²³⁸ Either of these tendencies could help explain why courts reduce the fee percentage awarded the higher the recovery, despite the fact that — as explained below — theory suggests this is precisely the wrong thing to do.²³⁹

Empirical studies indicate that the average and median percentage awarded hovers around 25%, but there is considerable variance. Eisenberg et al., *supra* note 221, at 947; see Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, *supra* note 38, at 833.

²³⁵ See Lynn A. Baker, Michael A. Perino & Charles Silver, *Setting Attorneys' Fees in Securities Class Actions: An Empirical Assessment*, 66 VAND. L. REV. 1677, 1715 (“[I]t is reasonable to expect that lawyers will make better decisions throughout a litigation when fee terms are clear than when they can only guess what they will earn”); Lynk, *supra* note 234, at 194 (“Counsel for the plaintiff class cannot invest rationally in a case without some idea of how the pie is to be divided if they win.”).

²³⁶ See Baker et al., *Is the Price Right?*, *supra* note 230, at 1441 (“Leaving the core fee term unsettled creates uncertainty about compensation, causing lawyers to decline some risks that clients would rationally want them to take. The predictable result will be suboptimal recoveries that leave clients and lawyers poorer than they might have been.”).

²³⁷ *Id.* at 1440 (observing that courts are more likely to view fee setting as zero sum game because the legal services have already been provided); Bruce L. Hay, *The Theory of Fee Regulation in Class Action Settlements*, 46 AM. U. L. REV. 1429, 1434 (1997) (observing that courts ask “in essence, whether a fee award represents a fair distributional share of the amount obtained, taking the settlement amount as given,” when they should “ask how counsel’s anticipated fee determines her settlement demands”).

²³⁸ See Baker et al., *Is the Price Right?*, *supra* note 230, at 1441 (observing that *ex post* judicial fee setting “creates significant potential for the hindsight bias to poison judges’ assessments of litigation risk” with the “predictable result . . . that fee percentages will be set too low”).

²³⁹ See Eisenberg & Miller, *Attorney Fees and Expenses in Class Action Settlements*, *supra* note 221, at 263-65 (documenting the existence of a scaling effect, in which the fee percent decreases as the class recovery increases). A difference in the percentages awarded in cases involving large potential damages and in cases involving small potential damages may be warranted because “in light of the economies of scale of class litigation, courts might be able to induce class counsel to bring large class actions at lower percentages than small class actions.” Fitzpatrick, *Do Class Action Lawyers Make*

Fee awards in class actions also differ from executive pay packages in composition. The anticipation of being paid a percentage of any eventual recovery in a class action is akin to a corporate executive being paid entirely in restricted stock that vests at retirement. Executive pay packages are more multifaceted than this, and for good reason: this sort of compensation arrangement would dramatically increase the risk preference misalignment that already exists between executives and diversified shareholders by virtue of the significant investment of human and reputational capital executives make in their companies.²⁴⁰

Stock options, for example, are an important component of executive pay at public companies. Stock options encourage executives to take risks they might otherwise avoid — risks that shareholders would want them to take — because options pay off only on the upside.²⁴¹ In class actions, by contrast, there is no option component to class counsel pay that would help to align class counsel's risk preferences with those of the class. This means that when confronted with the choice of taking a sure thing settlement or threatening trial unless the defendant pays more, class counsel will be more inclined to take the safe path than class members would prefer.

If class action attorneys were awarded higher percentage shares of the recovery as the amount of the recovery increased, it would help to mitigate this risk preference misalignment by making upside payoffs relatively more valuable to them. Rising marginal contingency fees also help with a distinct problem: class action attorneys often face diminishing returns to effort. That is, the “last dollars of recovery are generally the most costly to produce.”²⁴² This means that class action attorneys “may have reduced incentives to seek higher recoveries because of the increased probability that [their] costs will exceed [their] marginal return.”²⁴³ This problem, like the risk preference misalignment problem, creates an incentive for class action attorneys to accept lower settlements than the class would prefer. But despite the virtues of rising marginal contingency fees, courts do not award them. To the contrary, as noted above they seem to do exactly the opposite, awarding smaller percentages the higher the recovery.²⁴⁴

Too Little?, *supra* note 28, at 2066. But, within a case, scaling the percentage downward as the recovery increases is problematic for the reasons discussed *infra*.

²⁴⁰ See *supra* note 33 and accompanying text.

²⁴¹ See *supra* note 106 and accompanying text.

²⁴² Fisch, *Lawyers on the Auction Block*, *supra* note 206, at 678.

²⁴³ Niebler, *supra* note 221, at 789.

²⁴⁴ See *supra* note 239 and accompanying text.

In addition to restricted stock and stock options, executive compensation packages also typically include a cash salary, and executives have the ability to cash out their equity grants periodically as they vest.²⁴⁵ They can use this cash to diversify. Class action attorneys, by contrast, are paid nothing from the class unless and until a settlement is achieved. And ethical rules limit the ability of class action attorneys to cash out part of their investment in the case early in order to diversify. Class counsel can bring in co-counsel to help fund the litigation in exchange for a portion of the fees, and they can seek to diversify by acting as co-counsel in other cases on similar terms, but they cannot sell part of their anticipated contingency fee for cash to a third party.²⁴⁶

B. Governance Strategies

Whereas governance strategies have always been utilized in public companies, they are non-existent in class actions. Class members do not vote to elect their class “representative,” nor do they vote on whether to accept a settlement, or on anything at all. Public company shareholders, by contrast, vote to elect the members of the board of directors. They also vote on, *inter alia*, whether to approve a sale of the corporation or substantially all of its assets.²⁴⁷ To be sure, governance rights in the public company setting have been hampered by the lack of a universal proxy ballot, the expense of running a competing proxy solicitation, and general collective action problems.²⁴⁸ But courts, regulators, and shareholder advocates nevertheless preciously guard the shareholder franchise. As the Delaware Supreme Court has explained, “whether the vote is seen functionally as an unimportant formalism, or as an important tool of discipline, it is clear that it is critical to the theory that legitimates the exercise of power by some (directors and officers) over vast aggregations of property that they do not own.”²⁴⁹

²⁴⁵ See TONELLO ET AL., *supra* note 102, at 124-26, figs. 4.15 & 4.16.

²⁴⁶ See MODEL RULES OF PROF'L CONDUCT r. 5.4(a) (AM. BAR ASS'N 2020). *But see* Brian T. Fitzpatrick, *Can and Should the New Third-Party Litigation Financing Come to Class Actions?*, 19 THEORETICAL INQUIRIES L. 109, 117 (2018) [hereinafter *Can and Should the New Third-Party*] (discussing ways that class action attorneys presently skirt these rules); Anthony J. Sebok, *Selling Attorney's Fees*, 2018 U. ILL. L. REV. 1207, 1252-53 (2018) (arguing that this is an incorrect reading of the ethical rules).

²⁴⁷ See DEL. CODE ANN. tit. 8, § 271 (2020); *see also supra* note 139 and accompanying text.

²⁴⁸ *See supra* notes 117-19 and accompanying text.

²⁴⁹ *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988).

Class action scholars, by contrast, have largely accepted the lack of class member governance rights as inevitable. While some have suggested techniques for sampling the viewpoints of class members,²⁵⁰ I am unaware of any proposal recommending a full class member vote on key issues like the identity of the class representative or settlement approval. Rather, the consensus is that costs combined with rational apathy and other collective action problems make class member voting nonsensical in small claims class actions.²⁵¹

This is likely true under current practice. As noted in Part I, class actions lack any supporting infrastructure that would help to reduce the costs of communicating with class members or processing their votes. And given the dismal number of class members who even bother to submit claims forms, it is difficult to imagine that many would make the effort to read, complete and return a ballot.

C. Regulatory Strategies

Recall that regulatory strategies are enforced by authorities external to the agency relationship and take two forms: agent constraints, represented by rules and standards that govern the behavior of the agent during the course of the agency relationship, and affiliation terms, which regulate agent entry into and principal exit from that

²⁵⁰ See, e.g., Alexandra D. Lahav, *Two Views of the Class Action*, 79 *FORDHAM L. REV.* 1939, 1962 (2010). To the extent that these proposals are meant to address intra-class conflicts, they are not immediately relevant to this Article, which as explained in note 36, *supra*, is focused on class actions possessing a large degree of class member homogeneity and cohesion. See, e.g., Burns, *supra* note 198, at 197 n.130 (“Some commentators have explored the possibility of using surveys of absent class members or ‘town meetings’ as a means to insure that conflicting views within the class are brought to class counsel’s attention.”); cf. Deborah L. Rhode, *Class Conflicts in Class Actions*, 34 *STAN. L. REV.* 1183 (1982) (discussing pluralistic and majoritarian techniques for assessing class member views in class actions seeking structural reform).

²⁵¹ See, e.g., Coffee, Jr., *Class Action Accountability*, *supra* note 6, at 417 (“Small claimants have little incentive to vote. Thus, not only will these small claimants be hard to identify or contact, but they have little reason to respond to any solicitation.”); Issacharoff, *Governance and Legitimacy in the Law of Class Actions*, *supra* note 6, at 373 (“[I]t is difficult to avoid skepticism in the face of strategies to police class actions that require greater individual oversight . . . through participation.”); Issacharoff, *The Governance Problem in Aggregate Litigation*, *supra* note 7, at 3182 (noting “there are generally massive transaction problems with even putatively engaging the participants, so that surveying the class, elections, and periodic review are all not often meaningfully available”); Lahav, *Fundamental Principles for Class Action Governance*, *supra* note 7, at 104-05 (discussing problems with class member voting, including “the natural apathy of the class members with small stakes in the litigation and the cost of voting mechanisms as well as voter education”).

relationship.²⁵² Whereas in the public company context agent constraints play at most a supporting role, they are lead actor in the class action context. Conversely, affiliation terms — specifically the free transferability of shares — play a hugely important role in the public company context, but serve as only a trivial constraint on agency costs in the class action setting.

1. Agent Constraints

Class actions rely more on agent constraints than any other agency-cost-reduction strategy.²⁵³ Rule 23 seeks to protect class members' interests by requiring judicial approval of any settlement and authorizing the court to award only "reasonable" attorneys' fees to class counsel.²⁵⁴ To approve a settlement, the court must determine that it is "fair, reasonable, and adequate," after providing notice and an opportunity to object to class members and holding a hearing.²⁵⁵ The procedure for awarding fees is similar to that for approving a settlement: class counsel files a petition with the court requesting a certain fee award (typically framed as a percentage of the class recovery), class members are notified and given an opportunity to object, and a hearing may be held (in conjunction with the settlement hearing or subsequent thereto).²⁵⁶ The court may grant the fees requested if it determines them to be reasonable or award a different amount.

Public company sales and executive compensation packages are similarly subject to judicial oversight, but only as a backstop. For example, fiduciary duty suits challenging executive pay are dismissed unless the plaintiff pleads facts suggesting that the compensation constituted "corporate waste," i.e., "an exchange . . . so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration."²⁵⁷ This is an

²⁵² See *supra* Part II.A.

²⁵³ As discussed above, I use of the percentage-of-the-recovery method of determining attorneys' fees (a rewards strategy) is a very important tool for aligning the interests of class counsel with those of the class. But it is implemented through the court and in this way is embedded within, and dependent upon, an agent constraint. See *supra* note 221 and accompanying text.

²⁵⁴ FED. R. CIV. P. 23(e), (h).

²⁵⁵ FED. R. CIV. P. 23(e)(2) (outlining factors that courts must consider when approving a settlement); see also FED. JUDICIAL CTR., MANUAL FOR COMPLEX LITIGATION § 21.634 (4th ed. 2004) (describing the fairness hearing).

²⁵⁶ See FED. R. CIV. P. 23(h); FED. JUDICIAL CTR., *supra* note 255 § 21.71–21.726 (describing the procedure for reviewing fee requests).

²⁵⁷ *Brehm v. Eisner*, 746 A.2d 244, 263 (Del. 2000).

incredibly high burden in practice, and reflects a judicial determination that executive pay is better policed through other agency-cost-reduction techniques, such as trusteeship.²⁵⁸ Similarly, courts have devised ways to dismiss suits challenging corporate sales if other agency-cost-reduction techniques were utilized in the negotiation and approval of the deal.²⁵⁹

At first blush, the heavier reliance placed on agent constraints in the class action setting appears justified: judges are more competent to evaluate settlement agreements and fee petitions than the terms of a corporate sale or executive compensation package, and they are natural candidates to do so, given that they are already involved in overseeing the case. But unlike courts deciding fiduciary duty claims, courts reviewing class action settlements and fee petitions operate without the benefit of the adversarial process: the defendant stands arm-in-arm with class counsel in seeking approval of the settlement and has no reason to contest fees that will be paid from the class's recovery. In the absence of opposition, the court will be inclined to approve the parties' request, since doing so comports not only with the interests of the lawyers before the court but also with the court's own interest in docket clearing.²⁶⁰ While objectors could inject some adversarialness into the settlement and fee-approval process, as discussed above objectors are rare and often incredible. It is also the case that courts preliminarily approve a proposed settlement before notifying class members and holding a hearing.²⁶¹ The purpose of preliminary approval is to avoid the substantial costs associated with providing notice to class members unless the settlement is likely to be approved, but the practical effect is

²⁵⁸ One former Chancellor of the Delaware Chancery court wrote that "the likelihood of the existence of a case that would 'meet the legal standard of waste' was about as likely as the existence of the Loch Ness Monster." Thomas & Wells, *supra* note 111, at 874.

²⁵⁹ See *supra* Part II.B.3.a.

²⁶⁰ Judges' reputational interests in being perceived as fair may not adequately counteract these incentives, because they do not face significant public scrutiny with respect to their decisions approving class action settlements and fee petitions. See Koniak & Cohen, *supra* note 211, at 1125-27. The decisions of the Delaware Chancery Court in cases alleging breach of fiduciary duty by public company officials, by contrast, are closely scrutinized by both the corporate bar and the financial press. See, e.g., Faith Stevelman, *Regulatory Competition, Choice of Forum, and Delaware's Stake in Corporate Law*, 34 DEL. J. CORP. L. 57, 60 (2009) (describing Delaware corporate law's "extraordinary respect and prestige" and noting that "[l]itigation involving powerful, Delaware-incorporated companies fills the docket of the Delaware Court of Chancery . . . and the cover pages of The Wall Street Journal").

²⁶¹ This longstanding practice became a Rule 23 requirement as part of recent amendments to the rule. See FED. R. CIV. P. 23(e)(1)(B).

to weaken further the potential influence of objectors, because the court will be predisposed to affirm its preliminary assessment of the settlement's fairness.

For these reasons, the broad academic consensus is that Rule 23's requirement for court approval of settlements and attorneys' fees is an ineffective check on class action agency costs.²⁶² The agent constraints applicable to class counsel that originate outside of Rule 23 — such as Rule 11 sanctions (and state court analogues), various rules of professional responsibility, malpractice liability, and the specter of a collateral attack on a class settlement — hold even less promise: courts very rarely choose to impose Rule 11 sanctions, and class action agency costs are unlikely to manifest in conduct that would warrant such sanctions in any event²⁶³; the likelihood that a state bar association would detect and prosecute ethical violations is also extremely low²⁶⁴; malpractice claims against class counsel are rare²⁶⁵; and the prospect of a successful collateral attack on a class settlement is far too remote to have a meaningful disciplining influence.²⁶⁶

²⁶² See, e.g., Brunet, *supra* note 215, at 405-06, 406 n.16 (including sources cited therein); Jill E. Fisch, *Aggregation, Auctions, and Other Developments in the Selection of Lead Counsel Under the PSLRA*, 64 L. & CONTEMP. PROBS. 53, 58 (2001); Koniak & Cohen, *supra* note 211, at 1104; 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, 44-50 (1991); Rubenstein, *supra* note 191, at 1444-46; Randall S. Thomas & Robert G. Hansen, *Auctioning Class Action and Derivative Lawsuits: A Critical Analysis*, 87 NW. U. L. REV. 423, 432-34 (1993); Weiss & Beckerman, *supra* note 202, at 2057. As an empirical matter, courts approve fee requests with little or no modification in the vast majority of cases, and only very rarely disapprove class action settlements. See, e.g., Eisenberg et al., *supra* note 221, at 953.

²⁶³ Rule 11 punishes the assertion of frivolous claims and defenses and does not directly police attorney fidelity toward their client. See FED. R. CIV. P. 11.

²⁶⁴ See Weiss & Beckerman, *supra* note 202, at 2065 ("The rules governing attorneys' professional conduct . . . do not effectively constrain plaintiffs' attorneys in class actions.").

²⁶⁵ See Marcel Kahan & Linda Silberman, *Matsushita and Beyond: The Role of State Courts in Class Actions Involving Exclusive Federal Claims*, 1996 SUP. CT. REV. 219, 253 n.122 (identifying obstacles to suing class counsel for malpractice after a class settlement has been approved). See generally Koniak & Cohen, *supra* note 211 (arguing for increased use of malpractice suits as a means to discipline class counsel).

²⁶⁶ For the challenges involved in collaterally attacking a class settlement, see Kahan & Silberman, *supra* note 265, at 262-64, and see also Rubenstein, *supra* note 191, at 1437 n.4 (collecting articles on point).

2. Affiliation Terms

The free transferability of shares is an exit-based affiliation term that, as previously discussed, plays a vital role in helping to constrain agency costs in the public company setting.²⁶⁷ It has no analogue in the context of small claims class actions, given that class members have no practical ability to sell their class claims to third parties on a secondary market. Class members do have the ability to opt-out of the class at the time it is certified, and they are often given another chance to opt out at the time of settlement.²⁶⁸ But the opt-out right is illusory in class actions involving small claims because to act on it would be economically irrational. Staying in the class holds out the possibility of receiving some recovery, however inadequate. To recover anything after opting out would require pursuing individual litigation, the cost of which would vastly exceed the value of any class member's claim.²⁶⁹ So, in reality, small claims class members have no exit rights at all.

Entry-based affiliation terms play only a modest role in small claims class actions. Like all attorneys, class counsel must be licensed to practice law, for example. This implies both a basic level of competency and ensures that class counsel has been exposed to the inculcation of professional ethical norms that begins in law school. Class counsel must also be appointed by the court, and Rule 23 instructs that the court may only appoint "adequate" applicants.²⁷⁰ Rule 23 sets forth a laundry list of factors that the court is instructed to consider in determining adequacy,²⁷¹ but the perception is that, at least in class actions where multiple applicants are not vying for the position of lead counsel, "courts do not take the adequacy inquiry very seriously and virtually always presumptively ratify whomever 'steps up to the plate.'"²⁷² In the small subset of class actions where applicants do compete for

²⁶⁷ See *supra* Part II.B.1.b.

²⁶⁸ See FED. R. CIV. P. 23(c)(2)(B)(v), (e)(4).

²⁶⁹ See, e.g., Michael A. Perino, *Class Action Chaos? The Theory of the Core and an Analysis of Opt-Out Rights in Mass Tort Class Actions*, 46 EMORY L.J. 85, 144 (1997) ("Although claimants have a theoretical right to opt out, they have no practical ability to do so."). If class members did utilize their opt out rights in large numbers, it would have a destabilizing effect — just like abandoning capital lock-in would destabilize the corporate form. Cf. David Rosenberg, *Adding a Second Opt-Out to Rule 23(b)(3) Class Actions: Cost Without Benefit*, 2003 U. CHI. LEGAL F. 19, 24 (arguing that use of opt-out is "detrimental to the welfare of individuals in need of insurance supplied by civil liability recoveries").

²⁷⁰ FED. R. CIV. P. 23(g)(2).

²⁷¹ See FED. R. CIV. P. 23(g)(1).

²⁷² Mullenix, *supra* note 195, at 1701.

appointment as class counsel,²⁷³ some valuable judicial screening may occur, although unlike the corporate board of directors searching for a CEO, the judge will have only a small, self-selected set of candidates to choose from.²⁷⁴

Class counsel is also subject to narrow disclosure requirements. Specifically, Rule 23 requires class counsel to provide class members with notice of the certification and their right to opt out, notice of any proposed settlement that has been preliminarily approved by the court, and with notice of a petition for attorneys' fees.²⁷⁵ Class counsel is also required by the Class Action Fairness Act ("CAFA") to notify certain government actors of a proposed settlement at least ninety days prior to final approval.²⁷⁶ Recall that in the public company context, disclosure does important work by supporting the other agency-cost-reduction techniques utilized²⁷⁷; its role in the class action setting is naturally more limited, because there are far fewer other agency-cost-reduction tools to support. Whereas disclosure can aid in the exercise of shareholders governance rights, for example, class members cannot do anything with the information provided to them by class counsel except opt-out or object — neither of which will be economically rational in a case involving small claims.²⁷⁸ Government actors informed of a pending settlement, by contrast, might be provoked to object. In this way, CAFA's notice provision lends support to the trusteeship strategy.

²⁷³ In non-securities cases where multiple complaints have been filed and consolidated before a single judge, competing candidates for class counsel may emerge. Most commonly, however, the various lawyers will agree on who will serve as lead counsel (with the non-selected counsel promised a share of the legal work and fees), and the judge will defer to their choice. FED. JUDICIAL CTR., *supra* note 255, § 21.272, at 279. In securities class actions, the court will typically defer to the lead plaintiffs' choice of lead counsel. *See supra* note 203 and accompanying text.

²⁷⁴ Some courts have experimented with a competitive bidding approach, which entails "inviting applicants for appointment as class counsel to submit competing bids." FED. JUDICIAL CTR., *supra* note 255, § 21.272, at 280. But the auction approach to selecting lead counsel has been subject to significant criticism and is uncommon today.

²⁷⁵ *See* FED. R. CIV. P. 23(c)(2)(B) (notice of certification and right to opt out), 23(e)(1) (notice of settlement), 23(h)(1) (notice of motion for attorneys' fees). Notice is also constitutionally required. *See Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 812-13 (1985).

²⁷⁶ *See* 28 U.S.C. § 1715 (2018).

²⁷⁷ *See supra* Part II.B.

²⁷⁸ *See supra* notes 211 & 269 and accompanying text.

IV. PUBLIC-COMPANY INSPIRED CLASS ACTION REFORMS

The exercise of comparing the governance techniques used in public companies to those used in class actions inspires several interesting reform proposals. Some of these proposals build on old ideas, others are entirely novel. Most are grouped below according to where they fit in the ACL taxonomy. But one exists outside that taxonomy. I begin with this reform, as it provides a foundation for several of the reform ideas that follow.

A. *Build a Supporting Infrastructure: Classaction.gov*

As explained earlier, a market infrastructure lends critical support to public companies' agency-cost-reduction efforts.²⁷⁹ Mandatory disclosure is meaningful because investors and analysts can freely and easily access public companies' SEC filings via the SEC's EDGAR database. Share depository institutions and firms specializing in proxy administrative functions facilitate shareholder voting. The free transferability of shares produces the myriad benefits it does because organized exchanges, clearinghouses and share depository institutions make secondary trading cheap and easy. Without this infrastructure, transaction costs would render the use of these tools inefficient, or at least vastly less efficient than it is today.²⁸⁰

Class actions have no similar supporting infrastructure. There is no centralized database of class action filings, for example, that government actors and other interested parties can freely and easily search in order to identify class actions to monitor and, when appropriate, serve as an objector in.²⁸¹ Nor is there a central repository that tracks potential class members and provides an efficient method for identifying and communicating with them. In many types of cases, such

²⁷⁹ See *supra* notes 71–74 and accompanying text.

²⁸⁰ This is not to suggest that capital market infrastructure cannot be improved, particularly with respect to shareholder voting. See *supra* note 117 and accompanying text.

²⁸¹ Past calls for the creation of such a database have gone unheeded. See, e.g., DEBORAH R. HENSLER, BONNIE DOMBEY-MOORE, BETH GIDDENS, JENNIFER GROSS, ERIK K. MOLLER & NICHOLAS M. PACE, RAND INST. FOR CIVIL JUSTICE, CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAIN 36-37 (1999) (recommending comprehensive reporting of class action litigation); Robert H. Klonoff, Mark Herrmann & Bradley W. Harrison, *Making Class Actions Work: The Untapped Potential of the Internet*, 69 U. PITT. L. REV. 727, 755-57 (2008) (noting the benefits of a class action litigation database); Nicholas M. Pace & William B. Rubenstein, *How Transparent Are Class Action Outcomes?: Empirical Research on the Availability of Class Action Claims Data* 44 (Rand Inst. for Civil Justice, Working Paper No. WR-599-ICJ, 2008) (advocating for a “central repository for class action outcomes”).

as those brought on behalf of purchasers of small consumer products, locating class members is extremely difficult,²⁸² requiring resort to (usually ineffective) publication notice campaigns.²⁸³ Providing individual notice to those class members who can be located, as is required by Rule 23 and due process, is also very costly. A class member with a \$5 claim would see nearly 10% of her recovery consumed by a single postage stamp. She will see considerably more consumed by the expense of processing her claim and distributing her settlement funds — if she even responds to the notices she receives, as class members are highly likely to disregard class action notices as junk mail.²⁸⁴ Finally, no platform exists that would allow class members to easily sell their class claims to a third party.

The class action website and supporting administration that I describe in *Classaction.gov* would provide the backbone of this missing infrastructure.²⁸⁵ Imagine if the federal government, after a broad and effective publicity campaign, required persons to register on a government-run website in order to participate in any future class actions. Registrants would be required to provide basic information about themselves (e.g., name, phone number, email, and physical addresses), which would allow for the creation of a secure database that could be searched to identify potential class members in particular cases. To alert class members who were not identified as a result of the database search, notices could also be posted on the website and emailed to registrants who had opted to receive such communications; these class members could then self-identify via the website. All communications with class members could be sent by emails originating from a trustworthy @Classaction.gov email address and would be presented in a uniform, easy-to-digest format. Settlement funds would be escrowed with the federal government and then deposited electronically into the accounts specified by eligible class members. Every case would also have a dedicated page on the website where court filings and other important information would be posted

²⁸² See Rose, *supra* note 26, at 26-27.

²⁸³ In a recent study of class action settlements, the claims rates in cases when publication notice was used as a supplement to direct notice were not different from the claims rates when direct notice was used alone, suggesting that publication notice is generally ineffective. See FED. TRADE COMM'N, CONSUMERS AND CLASS ACTIONS: A RETROSPECTIVE AND ANALYSIS OF SETTLEMENT CAMPAIGNS 11 (2019), <https://www.ftc.gov/reports/consumers-class-actions-retrospective-analysis-settlement-campaigns> [<https://perma.cc/9WW8-XFFC>].

²⁸⁴ See *id.* (reporting that the median percentage of direct notice recipients who made claims in the cases studied was 9% and the weighted mean was 4%).

²⁸⁵ See generally Rose, *supra* note 26.

in a standardized format, and where opt-outs and claims forms could be submitted and objections lodged. Actual settlement distribution data would be made publicly available on the case's webpage. Court filings and settlement distribution data would also be fed into a comprehensive, searchable class action database that would be made freely available to scholars and the general public.

Classaction.gov promises to dramatically improve class action practice, separate and apart from its ability to support the reforms suggested in this Article. Among other things, it could (1) meaningfully increase the number of class members that actually receive notice and share in settlement funds; (2) reduce the costs associated with notice and claims administration, leaving more money on the table for class members; and (3) render class actions transparent, allowing researchers and the public to intelligently assess their value in our society. For a fulsome discussion of these benefits, as well as a detailed description and defense of the basic idea, I refer readers to *Classaction.gov*. I do not rehash the same arguments here. Instead, in the subparts that follow I discuss how the website and supporting administration described in *Classaction.gov* and sketched out above could be built upon to facilitate some of the public-company inspired reforms proposed in this Article.

B. Incentive Alignment-Based Reforms

The public company analogy both (1) suggests ways that trusteeship strategies might be introduced into class action practice and (2) highlights how the rewards strategy currently employed in class actions might be improved.

1. Trusteeship

a. *Create an Independent Class Oversight Position with Authority More Akin to a Public Company Board*

As previously explained, the class representative makes for a very poor trustee.²⁸⁶ Because it is selected by class counsel, the class representative's loyalties run not to the residual claimants of the enterprise — the class members — but to the very agent it is meant to supervise. Moreover, the class representative lacks authority to actually control any aspect of the litigation. In these ways, it is very different from the public company board. The public company board is elected by shareholders and possesses ultimate authority over corporate affairs;

²⁸⁶ See *supra* Part III.A.1.

the loyalty of directors to shareholders is further bolstered by independence requirements. Securities class actions come closer to mimicking the public company board model, by encouraging institutional investors to serve as lead plaintiffs and granting lead plaintiffs authority over counsel selection and compensation. But this approach is not easily translatable to small claims class actions due to the lack of large stakes, sophisticated class members.

A trusteeship position more akin to the public company board could be created for small claims class actions, however, if persons other than class members were permitted to serve in the role. There is no requirement that public company directors be shareholders, and creating a similarly liberalized class action oversight position — to be filled by third parties whose motivations, like independent directors, are reputation based — is an intriguing idea.²⁸⁷ Public company boards are typically multi-member institutions, but given the lesser complexity and smaller size of class actions, a single-member class overseer is probably best.²⁸⁸ Candidates for the position might include government officials, non-profit organizations, academics and law school clinics. The only strict requirement should be the independence of the overseer from class counsel and the defendant.²⁸⁹

Jean Wegman Burns has similarly recommended that the class representative position be replaced with one that need not be staffed by a class member, recognizing that “[i]n many cases, the most effective monitor may be a nonmember organization with a special interest in the subject matter of the lawsuit.”²⁹⁰ But Burns envisioned that the new

²⁸⁷ If necessary, a traditional class representative could be selected to satisfy constitutional standing requirements and to submit to discovery demands, but without monitoring expectations. *Cf.* Burns, *supra* note 198, at 192-200 (suggesting that “exemplary class members” could be used for such purposes).

²⁸⁸ The use of lead plaintiff groups in the securities class action setting has been subject to critique. *See, e.g.*, Fisch, *supra* note 262, at 69-78 (noting the cons of using a lead plaintiff group). *But see* Burch, *supra* note 4, at 1155-60 (discussing the benefits of small and cognitively diverse lead-plaintiff groups).

²⁸⁹ The class overseer should have no material financial or familial relationship with class counsel or the defendant. The class overseer’s past use of class counsel in other legal matters should not, however, be disqualifying if the class overseer paid standard rates for the legal services received. Other eligibility criteria might include the absence of criminal history, the absence of any court or administrative finding of unethical or dishonest conduct in the past ten years, and compliance with required disclosures. To be sure, this will not ensure perfect interest alignment, but that is an impossible ideal. *Cf.* Margaret H. Lemos, *Aggregate Litigation Goes Public: Representative Suits by State Attorneys General*, 126 HARV. L. REV. 486, 511-30 (2012) (exploring the agency costs and other problems that can arise in *parens patriae* actions).

²⁹⁰ Burns, *supra* note 198, at 196.

position would be filled in the same manner as the class representative position is under current practice: with a candidate proposed by class counsel and approved by the court.²⁹¹ To ensure true independence, it is critical that the class overseer *not* be selected by counsel. Ideally, candidates for the position would be elected by class members via a class member vote. This would legitimize the overseer and tie its allegiance to the class, in a similar way as shareholder elections legitimize the corporate board and tie its allegiance to shareholders.²⁹² As discussed below in the subpart on governance-based reforms, cost and rational apathy concerns need not doom class member appointment rights if the election process is smartly designed and executed via the Classaction.gov website.

The improved loyalties and greater sophistication the envisioned class overseers would possess, relative to class representatives under current practice, might justify granting them greater authority. Like the public company board vis-à-vis the corporate enterprise, class overseers could be given real decision control over the management of the class action. They could, like the lead plaintiff in a securities class action, be granted authority to select class counsel and negotiate the terms of compensation, subject to deferential judicial review.²⁹³ Their support could also ordinarily be required for a settlement advanced by class

²⁹¹ *See id.*

²⁹² Unlike corporate directors, who typically must secure reelection annually, class overseers would not face reelection pressure within the case. Once elected, they would serve for the life of the class action. But if class overseers wished to serve the role again in future class actions, anticipated future elections may play a similar disciplining function. This assumes, of course, that the reputation of candidates will matter to election outcomes. Part IV.C identifies ways to ensure that this is, in fact, the case. *Cf.* Richard A. Nagareda, *Class Actions in the Administrative State: Kalven & Rosenfield Revisited*, 75 U. CHI. L. REV. 603, 645-46 (2008) (similarly observing that if courts considered class counsel's reputation in the counsel selection process, it would help to address the legitimacy problem that arises due to the one-shot nature of class representation).

²⁹³ The court's decision on a certification motion would precede the election of class overseer, as might the court's decision on certain other motions. *See* FED. JUDICIAL CTR., *supra* note 255, § 21.133, at 253 (explaining that the court may, and often should, rule on motions pursuant to Rule 12, Rule 56, or other threshold issues before deciding on certification; such rulings bind only the named parties). Two things follow from this. First, these motions would need to be handled on behalf of the putative class by interim counsel — either the attorney who filed the putative class complaint (if only one complaint has been filed) or interim counsel selected by the court (if multiple complaints have been filed). Such counsel should be entitled to compensation for its efforts from any subsequent settlement fund, even if not retained as class counsel by the class overseer. Second, all settlement discussions would need to be delayed until after the class was certified, the class overseer elected, and class counsel selected.

counsel to be presented to the court for approval, just like board support of a corporate sale proposed by executives is required before it can be presented for a shareholder vote. To protect the class and class counsel from the whims of a rogue class overseer who would use this power to force a trial when it is not in the class' best interest, the court might be permitted to approve a settlement over the class overseer's head, but only if class counsel satisfies a high burden.

To prevent corruption of the counsel appointment process, rules prohibiting pay-to-play arrangements would need to be adopted. SEC Rule 206(4)-5 and Rule G-37 of the Municipal Securities Rulemaking Board provide a possible model. These rules, among other things, prohibit government clients from hiring investment advisors and municipal advisors, respectively, if the advisors or their employees have made a financial contribution to the organization or those who control it in the past two years.²⁹⁴ A class overseer could similarly be forbidden from hiring as class counsel any firm that has, or whose members have, made campaign or charitable contributions to the overseer or those who control it for a designated period of time.²⁹⁵ If the class overseer is a professor, she could similarly be forbidden from hiring firms that have retained her as an expert witness or consultant in that timeframe.

One might question whether reputable non-class members would volunteer to be candidates for class overseer, given the failure of government actors and non-profits to lodge objections with any regularity under current practice. There are several reasons to believe that these actors would be more interested in the class overseer position.²⁹⁶

First, objectors usually go uncompensated for their efforts,²⁹⁷ and government actors and non-profits are resource constrained. Calls to increase objector funding have been criticized because they risk

²⁹⁴ See SEC Investment Advisers Act of 1940, 17 C.F.R. § 275.206(4)-5 (2020); MUN. SEC. RULEMAKING BD., RULE BOOK, Rule G-37, at 298 (2019).

²⁹⁵ Professors Cox and Thomas have similarly recommended a ban modeled on Rule G-37 be adopted to curb pay-to-play practices between class counsel and public pension funds in securities class actions. See Cox & Thomas, *supra* note 204, at 1614-15.

²⁹⁶ Like independent directors on a public company board, class overseers should enjoy broad immunity from liability for breaches of the duty of care so as to encourage service and risk-taking. See *supra* Part II.B.3.a.

²⁹⁷ Courts may award attorneys' fees to objectors' counsel. See FED. R. CIV. P. 23(h) (advisory committee's note to 2003 amendment). But this is rare and does not compensate the objector for their time and effort, as distinct from their attorney's. See Bruce D. Greenberg, *Keeping the Flies Out of the Ointment: Restricting Objectors to Class Action Settlements*, 84 ST. JOHN'S L. REV. 949, 987 (2010) (observing that "[f]ee awards to class action objectors are 'few and far between'").

encouraging frivolous objections.²⁹⁸ Class overseers, by contrast, could be offered incentive payments for their service without raising similar concerns. Such payments would need to be significant enough to make it rational for them to assume the role, but not so high as to alter their primary, reputation-based motivation for doing so. The monetary fund created by a settlement or trial judgment is an obvious source for this payment. If it were the only source, however, the class overseer would, like class counsel, have an incentive to favor a sure thing settlement over a risky trial, even when it would be in class members' best interest to pursue the latter. To be sure, the misalignment of interest in this regard would be less dramatic with respect to the class overseer than with respect to class counsel, given that the class overseer would have less at risk financially if the case lost at trial and more at risk reputationally if it sold out the class.²⁹⁹ But the misalignment would exist. An alternative funding source for incentive payments in cases that do not produce a monetary recovery should therefore be identified.³⁰⁰ A requirement that plaintiffs' counsel post a bond to cover the class overseer's incentive payment in the event no monetary recovery is achieved is one possibility;³⁰¹ others could be devised.³⁰²

A second reason that organizations that have not lodged objections in class actions with any regularity might be more willing to serve as class overseers concerns impact. Objectors have very limited influence over the court's determination whether to approve a settlement or grant a fee petition. The class overseer, by contrast, would have real power to shape the progress of the litigation and influence the terms of the settlement. This should make the position more attractive to entities looking to do maximum good with limited resources.

²⁹⁸ See, e.g., Koniak & Cohen, *supra* note 211, at 1108-09 (noting obstacles when objectors are used).

²⁹⁹ See Klement, *supra* note 3, at 63 (noting that, "[c]ompared to litigating a class action, monitoring is much cheaper and easier to perform;" "[p]eriodical examination of relevant files and records, constant communication with the class attorney, and consistent participation in settlement conferences and important hearings would often suffice to supervise the class attorney").

³⁰⁰ Cf. Macey & Miller, *supra* note 262, at 48 (similarly observing that it would be undesirable to pay a guardian ad litem through "a contingent interest in the settlement fund, because this would create a perverse incentive for the guardian to support settlements in order to assure a fee").

³⁰¹ See Rubenstein, *supra* note 191, at 1456-57 (suggesting this funding mechanism for objectors).

³⁰² For example, a court-administered fund for this purpose could be created with unclaimed settlement monies. See Sylvia R. Lazos, *Abuse in Plaintiff Class Action Settlements: The Need for a Guardian During Pretrial Settlement Negotiations*, 84 MICH. L. REV. 308, 331 (1985) (suggesting funding mechanisms for guardian ad litem).

Third, objectors under current practice face significant search costs.³⁰³ Classaction.gov promises to vastly reduce the costs associated with discovering cases of interest to particular organizations. Notice of the opportunity to step forward as a class overseer candidate could be emailed to potential class members along with the notice of the certification; it could simultaneously be posted on Classaction.gov for the public at large, and emailed to those persons and entities who have requested to receive alerts when certification notices are issued.³⁰⁴ An interested organization's search costs would therefore be reduced to setting the appropriate alerts on Classaction.gov, reading the certification notices that subsequently land in the organization's inbox, and reading supporting case documents (freely available at a click of the mouse on Classaction.gov) in the subset of cases deemed of interest to the organization.

Fourth, because it is a more substantial role, the class overseer would garner more publicity than objectors do. This may motivate politicians looking to secure reelection, non-profits looking for funding, and academics looking to increase their profile. This last point, however, also suggests a potential weakness. While class actions alleging egregious abuses on the part of the defendant may attract the attention of many reputable class overseer candidates, other class actions may attract less or even none — either because the underlying claims are of dubious merit or simply are not salacious enough to attract attention.

It is difficult to predict how significant of a problem this would be. There are thousands of law school professors in the United States, many of whom might be willing to serve. And because it would be a compensated position, it is possible that class oversight would become a new niche legal specialty, drawing in private attorneys to fill any shortage in supply.³⁰⁵ New law school clinics might also step in to fill the void. But even if class overseer candidates did not emerge in every case, it would not negate their value. That subset of cases could simply revert to the current approach of relying on judicial oversight to protect

³⁰³ See Rose, *supra* note 26, at 22-23.

³⁰⁴ Class actions would be tagged on Classaction.gov by reference to various criteria, such as subject matter (e.g., automotive), legal claims being asserted (e.g., products liability), and the jurisdiction in which they are filed (e.g., California state court). Registrants on the site could then, by reference to these tags, select the type of cases with respect to which they want to receive alerts.

³⁰⁵ While such attorneys would be profit-driven, they would still be functioning as a trustee because their ability to get elected to the position would depend on their reputation for serving the interests of class members. See *supra* note 292; *infra* Part IV.C.

the class's interests. Class members in these cases would therefore be no worse off than they are today.

The possibility that *bad* class overseers would be elected must also be addressed. If this happened, class members might find themselves worse off than they would be under the status quo.³⁰⁶ Independence requirements and pay-to-play prohibitions will not necessarily weed out incompetent class overseers, nor will they weed out class overseers whose interests are antithetical to the class due to some ideological conflict of interest (such as a hostility toward the substantive claims being asserted or to class actions in general). As discussed *infra*, the election process — if designed well — could go a long way to prevent the election of such candidates. Disclosure rules, for example, could operate to reveal incompetencies and ideological conflicts, making it less likely that these candidates would secure significant votes. To prevent anomalous outcomes in elections where all of the candidates are undesirable, class members could always be given the option of voting for judicial oversight in lieu of any class overseer candidate. Moreover, judicial oversight could be the default for cases in which no candidate hits a minimum vote threshold or quorum requirements are not met.

A distinct concern is that the class overseer would be *too effective* in advancing the interests of the class. This Article is in dialogue with the class action literature focused on reducing agency costs in class actions; another important strain of class action literature focuses on the potential for the class device to distort, or exacerbate underlying defects in, the substantive law, leading to over-deterrence.³⁰⁷ A reputationally-motivated class overseer might take over-deterrence concerns into account in exercising their oversight responsibilities. For example, a consumer advocacy organization might be sensitive to the impact of class action litigation on consumer prices when considering settlement decisions. But one might fear that class overseers would instead use their authority to push the boundaries of the law to achieve the highest possible recovery for the class. While this might be in the class' narrow self-interest in the particular case, it may lead to social welfare losses. While I am sensitive to this concern,³⁰⁸ relying on the agency costs of

³⁰⁶ While the court should retain some discretion to disapprove counsel selection, fee agreements and settlements approved by the class overseer, it should afford substantial deference to the class overseer's choices.

³⁰⁷ See, e.g., Hay & Rosenberg, *supra* note 2 (discussing concerns about "blackmail" settlements in class actions).

³⁰⁸ Indeed, I have written extensively on the over-deterrence potential of securities fraud class actions. See, e.g., Amanda M. Rose, *Better Bounty Hunting: How the SEC's New*

class actions to mitigate underlying problems with Rule 23 or the substantive law is unsound. If class actions, vigorously pursued, are not socially valuable, either in particular contexts or across the board, then more targeted reforms are in order.

Many other countries rely on government actors or non-profits to bring claims on behalf of consumers and other dispersed groups.³⁰⁹ While this proposal would similarly place reputationally-motivated parties at the helm of small claims class actions in the United States, it does not represent a radical shift toward a foreign model of aggregate litigation. To the contrary, even if the class overseer reform were adopted, the American class action would retain its exceptionalism. Entrepreneurial lawyers would still initiate litigation in the hopes of earning a contingency fee in opt-out litigation.³¹⁰ They would simply be subject, in most cases at least, to monitoring and control by a duly-elected, reputationally-motivated class overseer — just as CEOs are subject to monitoring and control by independent boards.³¹¹

Whistleblower Program Changes the Securities Fraud Class Action Debate, 108 Nw. U. L. REV. 1235, 1245-60 (2014); Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301, 1326-37 (2008); Amanda M. Rose, *The Multi-Enforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2183-84 (2010).

³⁰⁹ See, e.g., John C. Coffee Jr., *Litigation Governance: Taking Accountability Seriously*, 110 COLUM. L. REV. 288, 302 (2010) (observing that “Europe has considerable experience with representative actions brought by special entities, such as ombudsmen, private consumer organizations, or other nonprofit associations that seek to enforce particular statutes on behalf of consumers or others”); Ching-Ping Shao, *Representative Litigations in Corporate and Securities Laws by Government-Sanctioned Non-Profit Organizations: Lessons from Taiwan*, 15 ASIAN-PACIFIC L. & POL’Y J. 58, 60-61 (2013) (describing the Taiwanese model for corporate and securities law claims, which relies on suits initiated by a government-sponsored non-profit organization).

³¹⁰ The class overseer would negotiate fees with the counsel it selects to represent the class but would not be expected to pay the fee itself; the fee would therefore of necessity remain contingent. In order to retain strong incentives for attorneys to initiate class litigation, those who file suit but are not retained as class counsel by the class overseer should be entitled to a judicially-determined contingency fee to compensate them for their efforts.

³¹¹ The efficiencies that Classaction.gov would introduce would make opt-in class actions a potentially viable alternative for claims aggregation. Cf. Coffee, Jr., *supra* note 309, at 305 (observing that changes in technology, such as websites and email, “make the opt-in class more feasible than in the past”). Whether such a switch is desirable is beyond the scope of this Article, however. The focus here is how to reduce class action agency costs within the existing opt-out system.

b. Encourage Input from Reputational Intermediaries

A more modest way to enhance reliance on trusteeship would be to make objectors better reputational intermediaries. The focus should be on encouraging greater participation by government actors and non-profits, rather than class members. As explained *supra*, when class members do object they fail to send a credible signal to the court given that they lack a significant interest in the case — reputational or financial.³¹² If claims transfer were allowed, as proposed *infra*, it is possible that larger stakes class members would emerge whose views on settlement might be more persuasive. Absent that, however, encouraging greater input by government actors and non-profit organizations is the more promising path. There are several potential ways to achieve this.

First, to the extent that low participation is caused by the difficulty of learning about pending cases and filing timely objections, Classaction.gov would eliminate the problem. Greater input by reputational intermediaries could also be encouraged if Rule 23 were amended to require courts to adjust the level of scrutiny they apply to proposed settlements and fee petitions depending on whether positive input has been received by the government agency required to be notified under CAFA.³¹³ This might encourage class counsel to seek out such approval and, perhaps, to act more faithfully to the class in anticipation of the need to do so.³¹⁴ Analogously, in the public company setting courts adjust the level of scrutiny applied to certain conflicted transactions depending on whether those transactions were approved by independent directors, thereby encouraging reliance on trusteeship.

If government agencies indicated an inability or unwillingness to provide input at the levels that might be requested of them, Rule 23 could instead be amended to require that the court appoint a guardian *ad litem* to opine on class action settlements and fee petitions, with the guardian's endorsement (or lack thereof) affecting the level of judicial

³¹² See *supra* Part III.A.1.

³¹³ Cf. Lahav, *Fundamental Principles*, *supra* note 7, at 138 (suggesting that the standard of review applied in appeals of class action settlements should be influenced by the level of protections afforded class members in the trial court).

³¹⁴ To prevent corruption of this process, the same sort of independence requirements and pay-to-play prohibitions discussed in connection with the class overseer reform should be considered in this context as well. See *supra* notes 289 & 294 and accompanying text. At minimum, a government actor endorsing a proposed settlement should be required to disclose any promises or payments that it, or those who control it, have received from class counsel, so that the court can discount the endorsement as appropriate.

scrutiny applied. This would ensure that at least one independent third party weighed in.

Many commentators have urged greater use of guardians ad litem as a way to help protect the interests of the class.³¹⁵ The fact that courts rarely choose to appoint guardians, despite having the authority to do so, highlights a major limitation of strategies that foster input by reputational intermediaries, while still leaving control in the hands of the court.³¹⁶ Such strategies will only make a difference if the court values the input received. As explained *supra*, courts may devalue such input because they are structurally biased in favor of settlement.³¹⁷ Courts may also devalue input on settlements and fees because objectors and court-appointed guardians ad litem rarely have access to information that the court does not. By contrast, independent directors involved in negotiating a conflicted transaction clearly stand in a better

³¹⁵ See, e.g., Brunet, *supra* note 215, at 464-71 (showing enthusiasm for use of guardians but warning that they need to be appointed early in the process and afforded access to necessary information); Eric D. Green, *What Will We Do When Adjudication Ends? We'll Settle in Bunches: Bringing Rule 23 Into the Twenty-First Century*, 44 UCLA L. REV. 1773, 1796 (1997) ("The appointment of a guardian ad litem, whose only duty is to review the proposed settlement on behalf of the class and advise the court on its fairness, reasonableness and adequacy, is an effective mechanism to protect absent class members' interests."); Lahav, *Fundamental Principles*, *supra* note 7, at 128 (arguing that "[i]n the absence of self-motivated objectors represented by competent counsel," courts should "appoint a third party to act as a 'devil's advocate' for the class, such as a guardian ad litem"); Lazos, *supra* note 302, at 325-32 (proposing the idea of appointing a guardian ad litem to supervise settlement negotiations, and discussing the advantages and feasibility of same); Christopher P. Lu, *Procedural Solutions to the Attorney's Fee Problem in Complex Litigation*, 26 U. RICH. L. REV. 41, 61-66 (1991) (discussing the use of guardians to help the court evaluate fee petitions); Macey & Miller, *supra* note 262, at 47-48 (expressing cautious optimism about the use of guardians); Rubenstein, *supra* note 191, at 1453-56 (discussing advantages and disadvantages of using a court appointed devil's advocate to challenge settlements); Rhonda Wasserman, *Dueling Class Actions*, 80 B.U. L. REV. 461, 529 (2000) (arguing that class counsel and defendant, upon presentation of settlement, should be required to post a bond to cover the costs of a court appointed advocate assigned the task of scrutinizing the fairness of the proposed settlement and making a report to the court); cf. Coffee, Jr., *Rescuing the Private Attorney General*, *supra* note 1, at 266 (arguing that appointing an obligatory "devil's advocate" to challenge settlements or fee awards would be uneconomical and would "overbroadly chill plaintiffs' incentive" to initiate class actions); Klement, *supra* note 3, at 50 n.66 (taking pessimistic view of the promise of guardians); Koniak & Cohen, *supra* note 211, at 1110-11 (taking a pessimistic view of the potential for court-appointed guardians to protect the interests of class members).

³¹⁶ See Macey & Miller, *supra* note 262, at 56 (observing that "[g]uardians have been appointed in a few cases, although the practice appears to be uncommon").

³¹⁷ The separation of "the judicial function of overseeing the litigation from that of settlement approval" has been suggested as one possible way of counteracting this bias, but it is a costly approach. Lahav, *Fundamental Principles*, *supra* note 7, at 136.

position to evaluate the deal's fairness than does a court *ex post*. If guardians ad litem were given greater access to, and influence over, settlements negotiations, as some have advocated, perhaps the court might value their input more.³¹⁸

An even stronger response to the concern that the views of guardians would be undervalued by the court would be to actually cede some of the court's power to them, essentially forcing their influence upon the court. For example, the guardian could be vested with authority for negotiating counsel fees,³¹⁹ or its approval could be made a precondition to judicial approval of a settlement. This would essentially transform the guardian into a court-appointed class overseer. While this approach might be an improvement over the status quo, class member election of class overseers would do better to tie their allegiance to the class and legitimize their authority. Commentators have observed that guardians ad litem may channel the court's structural biases in favor of settlement.³²⁰ This would be of particular concern if the court selected as guardians individuals or entities without a strong pre-existing reputational interest in protecting the class.

2. Rewards

If adopted, the trusteeship-based reforms described above would — it is hoped — improve use of the rewards strategy in class actions by taking sole responsibility for setting counsel fees away from the court. Recall that when it comes to executive compensation, judicial oversight provides only a last line of defense against abusive pay packages.³²¹ Trustees, in the form of independent directors, are given primary responsibility for devising executive compensation packages. Class overseers could play a comparable role in the class action setting, negotiating fees with their chosen class counsel subject to deferential

³¹⁸ See, e.g., Green, *supra* note 315, at 1797 (encouraging early appointment of guardians so that they might influence settlement negotiations).

³¹⁹ Cf. Court Awarded Att'y Fees, 108 F.R.D. 237, 255-59 (3d Cir. 1985) (recommending that courts “appoint a non-judicial representative — who typically will be an attorney — for the then putative fund beneficiaries, who will negotiate the [fee] arrangement in the usual marketplace manner and submit the proposal for the court's approval”).

³²⁰ See, e.g., Koniak & Cohen, *supra* note 211, at 1110-11 (explaining that guardians who want to be reappointed will have an incentive to cultivate “a reputation for not scuttling deals”); Macey & Miller, *supra* note 262, at 47 (observing that “[i]f the judges and lawyers are biased toward settlement they are likely to select passive and compliant guardians”).

³²¹ See *supra* Part III.A.2.

court review. Or, more modestly, reputationally-motivated third parties could be encouraged to assist the court in its fee setting efforts; compensation consultants provide similar support to the remuneration committees of public company boards.

The public company analogy suggests at least two other reforms that could strengthen the rewards strategy in class actions.

a. Shift to Ex Ante Pay Setting

As explained in Part III.A.2, *ex post* judicial fee setting is suboptimal. It increases the risk that class action attorneys face, increasing their incentive to settle more cheaply than the class would prefer. It also fosters a misplaced focus on the distributional impact of the fee award, as opposed to its incentive effects, and makes it likely that hindsight bias will distort the court's fee decision. Moving toward an *ex ante* model of fee setting — the model used in public companies — is therefore desirable. This would naturally follow if the class overseer reform were adopted, because the class overseer would be expected to negotiate fees as part of its counsel selection process.³²² But this change could be introduced even if fee setting were left to the court.

I am not the first to recommend that courts set fee terms early in class action litigation,³²³ and courts currently possess the authority to do so.³²⁴ The fact that courts rarely do suggests that they will not voluntarily adopt this change. Rule 23 should therefore be amended to *require* courts to set fee structures at the time counsel is appointed. There is little perceivable downside to this approach, particularly if judicial discretion to make changes in the face of unforeseen circumstances were preserved.

³²² To ensure this, the class overseer could be required to file a copy of the retainer agreement with the court at the outset of the litigation. See Baker et al., *supra* note 230, at 1432 (similarly arguing that the lead plaintiff in a securities class action “should disclose the terms of the negotiated fee to the district court when offering a law firm for appointment as class counsel”).

³²³ See FED. JUDICIAL CTR., *supra* note 255, § 14.211, at 200-01; ROTHSTEIN & WILLING, *supra* note 217, at 33; U.S. COURT OF APPEALS THIRD CIRCUIT, THIRD CIRCUIT TASK FORCE REPORT: SELECTION OF CLASS COUNSEL 20-22 (2002); Baker et al., *supra* note 230, at 1424-48; see also Fitzpatrick, *Can and Should the New Third-Party*, *supra* note 246, at 119 (asserting “scholars think the *best* way to set fees is at the outset of the case”).

³²⁴ Rule 23 explicitly permits judges to “order potential class counsel to . . . propose terms for attorney’s fees and nontaxable costs” and to “include in the appointing order provisions about the award of attorney’s fees or nontaxable costs.” FED. R. CIV. P. 23(g)(1)(c)–(d).

b. *Structure Pay to Address Risk Preference Misalignment*

Courts lack experience setting fees purely with incentive effects in mind, and given that it is a departure from the normal judicial function they may find the task uncomfortable and daunting. It would be wise, then, to couple a Rule 23 requirement that courts set fees *ex ante* with guidance on how to approach the task.³²⁵ Among other things, this guidance should sensitize courts to the risk preference misalignment that plagues small claims class actions and how class counsel's fee structure can operate to exacerbate or ameliorate it. The use of increasing marginal contingency fees should be encouraged as a way to address the problem. As explained in Part III.A.2, like stock options, increasing marginal contingency fees help to mitigate risk aversion by making upside payoffs relatively more valuable. Increasing marginal contingency fees also help to offset the early settlement tendencies that arise due to the fact that class action attorneys typically face diminishing returns to efforts.³²⁶

The risk preference misalignment that exists between class counsel and small claims class members could also be mitigated if class counsel could more easily offload litigation risk. As previously explained, public

³²⁵ The Advisory Committee Notes to the 2003 amendments to Rule 23 provide some guidance to courts on fee setting, but the guidance is vague and largely unhelpful. Indeed, the notes do not even take a position on whether the lodestar or percentage-of-the-recovery method of awarding fees is preferable. FED. R. CIV. P. 23 Cmt. to 2003 amendments.

³²⁶ A rising marginal contingency fee based on settlement amount might provide that for up to \$X of any recovery, class counsel will earn a 10% contingency fee, with the percentage increasing by Y% for every additional \$Z obtained. The proper bands and percentages would vary depending on the nature of the case, and scientific exactitude cannot be expected. But rough incentive alignment is better than none. If determining the proper dollar parameters proved too difficult because of the novelty of the case, or if it would be perceived as sacrificing judicial objectivity, increasing marginal contingency fees might instead be based on the phase of the litigation at the time of settlement, with higher percentages offered for settlements reached at riskier points. For example, settlements reached after decision on a motion to dismiss might result in a higher contingency fee than those reached before, and settlements reached after discovery has closed or after a summary judgment motion has been decided might result in yet higher fees. See, e.g., Coffee, Jr., *Unfaithful Champion*, *supra* note 1, at 47 (observing that it would "seem appropriate to instruct the court to award a more generous percentage in cases when the plaintiff has gone to trial and thus accepted the risk of an adverse decision"); Niebler, *supra* note 221, at 795 (discussing the benefits of "[i]ncreasing the attorneys' fee as litigation moves into phases that are more complex and demanding or that require significant additional investment of time"); cf. Bruce L. Hay, *Optimal Contingent Fees in a World of Settlement*, 26 J. LEGAL STUD. 259 (1997) (arguing that paying a higher contingency fee if the case goes to trial than if the case settles is desirable when the lawyer controls the settlement decision).

company executives are able to achieve at least some diversification by selling their equity grants upon vesting and by taking part of their compensation in cash salary.³²⁷ Class action lawyers, for their part, can attempt to diversify by bringing in co-counsel to cover some of the litigation costs in exchange for a portion of the expected attorneys' fees, and by participating as co-counsel in other cases on similar terms — but they are forbidden by ethical rules from simply selling a portion of their expected fee award for cash to a litigation financier.³²⁸ Whether the ethical rules barring this type of transaction should be modified to permit it is beyond the scope of this already lengthy Article.³²⁹ But one public company inspired observation is in order for those who would advocate such change. Corporate law scholars have spilt considerable ink worrying about the ability of managers to hedge away the incentives that their pay packages are designed to create.³³⁰ This literature suggests that, if ethical rules were liberalized to allow class action attorneys to share fees with non-lawyers for cash, the pay setter — whoever that might be — should have the authority to regulate such arrangements so

³²⁷ See *supra* Part III.A.2.

³²⁸ See *supra* note 246 and accompanying text.

³²⁹ A robust debate is currently underway in the United States on precisely this question. See, e.g., JOHN BEISNER, JESSICA MILLER & GARY RUBIN, U.S. CHAMBER INST. FOR LEGAL REFORM, *SELLING LAWSUITS, BUYING TROUBLE: THIRD-PARTY LITIGATION FUNDING IN THE UNITED STATES* (2009); U.S. CHAMBER INST. FOR LEGAL REFORM, *THIRD PARTY FINANCING: ETHICAL & LEGAL RAMIFICATIONS IN COLLECTIVE ACTIONS* (2009); Fitzpatrick, *supra* note 246; Deborah R. Hensler, *Third-Party Financing of Class Action Litigation in the United States: Will the Sky Fall?*, 63 DEPAUL L. REV. 499 (2014); Samuel Issacharoff, *Litigation Funding and the Problem of Agency Cost in Representative Actions*, 63 DEPAUL L. REV. 561 (2014); Linda S. Mullenix, *Ending Class Actions As We Know Them: Rethinking the American Class Action*, 64 EMORY L.J. 399, 445 (2014).

³³⁰ See, e.g., Lucian A. Bebchuk & Jesse M. Fried, *How to Tie Equity Compensation to Long-Term Results*, 22 J. APPLIED CORP. FIN. 99, 105 (2010) (“Given the board’s choice of an equity-based pay structure . . . the executive should not be permitted to change the structure unilaterally by using hedging and derivative transactions.”); Sanjai Bhagat & Roberta Romano, *Reforming Executive Compensation: Focusing and Committing to the Long-term*, 26 YALE J. ON REG. 359, 367-68 (2009) (“To ensure that the incentive effects of restricted stock and options are not undone by self-help efforts at diversification, executives participating in these compensation plans should be prohibited from engaging in derivative transactions, such as equity swaps, or borrowing arrangements, that enable them to hedge their interest in the restricted shares.”); Michael Faulkender, Dalida Kadyrzhanova, N. Prabhala & Lemma Senbet, *Executive Compensation: An Overview of Research on Corporate Practices and Proposed Reforms*, 22 J. APPLIED CORP. FIN. 107, 113 (2010) (“[W]e support the view that financial transactions by executives — particularly hedging transactions that significantly affect the sensitivity of executive pay to the value of the company — be disclosed to the board and the compensation committee.”).

that they understand and can control just how much skin class counsel actually has in the game.³³¹

C. *Governance-Based Reforms: Grant Class Members the Right to Vote on Class Overseer*

Shareholder appointment rights help tie directors' allegiance to shareholders and serve to legitimize the decision control vested in the corporate board of directors. If class overseers were vested with decision control over key issues in class actions — like the retention and compensation of class counsel and settlement — class members would ideally be given appointment rights as well. The process might work as follows. Interim class counsel would brief and argue the certification motion.³³² If the motion were granted, notice of the certification would be sent along with notice of the deadline by which to file motions to serve as class overseer. These notices would be emailed via Classaction.gov to class members identified through a search of the Classaction.gov database as well as to anyone who had registered on the

³³¹ See *supra* note 330. The Northern District of California has adopted a standing order requiring disclosure of any class action litigation funders. See STANDING ORDER FOR ALL JUDGES OF NORTHERN DISTRICT OF CALIFORNIA: CONTENTS OF JOINT CASE MANAGEMENT STATEMENT 2 (2018), https://www.cand.uscourts.gov/wp-content/uploads/judges/Standing_Order_All_Judges_11.1.2018.pdf [<https://perma.cc/6PQU-ZXCH>]; see also Bert I. Huang, *Litigation Finance: What Do Judges Need to Know?*, 45 COLUM. J.L. & SOC. PROBS. 525, 529-32 (2012) (describing the sort of information about litigation funding judges should seek out).

The problem of unwinding incentives is probably more severe in the public company context than it would be in the class action context. When corporate executives sell their equity grants, they sell them anonymously and piecemeal into an impersonal secondary market, not to a concentrated purchaser. If a class action attorney were to sell a portion of its eventual fee recovery to a non-lawyer, by contrast, the buyer would likely be a single financier or small syndicate of financiers. The buyer would therefore assume a significant stake in the outcome of the case, and thus would have its own incentives to monitor class counsel to ensure continued performance. Presumably, the financier would not make the investment unless it had faith it could do so effectively. See Coffee, Jr., *Unfaithful Champion*, *supra* note 1, at 66 (explaining that, for similar reasons, the danger of incentive unwinding at most “justifies an upper boundary on fee sharing arrangements and probably their disclosure to the court, but not their prohibition”); cf. Elizabeth Chamblee Burch, *Financiers as Monitors in Aggregate Litigation*, 87 N.Y.U. L. REV. 1273 (2012) (arguing that litigation financiers in non-class aggregate litigation can play a monitoring role).

³³² This would be either the attorney who filed the putative class complaint (if only one complaint has been filed) or interim counsel selected by the court (if multiple complaints have been filed). Interim class counsel might potentially handle motions on other threshold issues, as well, and would be entitled to compensation even if not retained as class counsel. See *supra* note 293.

site to receive alerts of such notices. They would also be published on the site. After the deadline for filing a motion to serve as class overseer passed, the court would screen the potential candidates based on independence and other objective eligibility criteria. All who passed the screen would then appear on a ballot emailed to class members, which would also contain a short narrative disclosure about each candidate. Class members would then have the opportunity to cast their vote on the case webpage. The winning candidate, assuming quorum and minimum vote thresholds were met, would then be tasked with retaining class counsel and negotiating a fee agreement.³³³

If parallel class actions were filed in multiple jurisdictions, the class overseer election would occur only in the first case to be certified.³³⁴ The elected class overseer, and their selected class counsel, would then rightfully represent the class in every parallel case that had been filed. Together they would make a decision about which forum to press ahead in, and class counsel would then voluntarily dismiss the suits pending in the rejected forums. This would produce a huge ancillary benefit: it would eliminate the risk of a “reverse auction” settlement by denying the defendant the opportunity to cherry pick which class action to settle.³³⁵

The idea of class members in small claims class actions voting on anything has long been dismissed as fanciful. Two reasons are typically cited: the expense associated with providing voting materials to class members, and the very low likelihood that class members would take the time to cast informed votes. I will refer to these as the “cost” and “rational apathy” concerns, respectively. As described below, neither is insuperable: the creation of *Classaction.gov* would mitigate the first concern, and smart design choices — informed by lessons from the public company — would mitigate the second.

Classaction.gov holds the key to overcoming the cost concern. Once operational, *Classaction.gov* could be used to costlessly deliver voting materials to class members via email. *Classaction.gov* could also be imbued with functionality, at fairly low cost, that would allow votes to be cast and automatically tabulated on the website. To be sure, creating and maintaining the website and supporting administration would require a significant investment, but as explained in *Classaction.gov* the

³³³ All settlement discussions would be delayed until after the class was certified, the class overseer elected, and class counsel selected.

³³⁴ *Classaction.gov* would make it easy to identify parallel class actions. See Rose, *supra* note 26, at 18, 21-22.

³³⁵ For a discussion of the reverse auction problem, see Wasserman, *supra* note 315, at 472-74.

benefits it would generate justify that investment, and funding sources exist.³³⁶

Classaction.gov would also help with the rational apathy concern. Rational class members will not bother to cast informed votes in class overseer elections if the personal costs outweigh the personal benefits. The personal costs of voting include the time it takes to physically execute one's vote and the time it takes to educate one's self about the candidates and make a decision. Classaction.gov would greatly reduce the cost of physically executing the vote. It is far less time consuming to cast a vote online than it is to take the time to fill out and mail a paper ballot. Because the voting materials would be sent from a trustworthy Classaction.gov email address, and would be presented in a consistent and easy-to-digest format, class members would also save the time they might otherwise spend determining the authenticity and meaning of those materials. These costs savings are critical, given that the personal benefits to class members from voting will necessarily be small, representing some fraction of the value of the class member's claim.

Even if the costs associated with physically executing one's vote were reduced to zero, however, the time it would take to make an informed decision might alone render class member apathy rational. How likely is this? Selecting a class overseer is one of the easier choices class members could be asked to make. The question presented is a fairly simple, easily intelligible one: which candidate has the best incentive and ability to monitor class counsel in the interests of the class? This is easier than the question of who should serve as class counsel, for example.³³⁷ It is also easier than determining the merits of a settlement proposal, which requires understanding the strength of the legal claims and defenses at issue in the case — an understanding that class members will not naturally possess and will not take the time to acquire.³³⁸ Whether the question is easy *enough* to make class member voting

³³⁶ See Rose, *supra* note 26, at 24-25.

³³⁷ Such a decision requires an understanding of the firm's experience, the fee it would demand, and its competing obligations, among other things. It is a question better left to the discretion of the class overseer (subject to deferential court review), just as the selection of corporate executives is left to the board.

³³⁸ This is one reason why I do not recommend that settlements be subject to class member approval, even though a vote on a settlement negotiated by class counsel with class overseer approval would be akin to a shareholder vote on a board-approved sale of a company. Classaction.gov would, however, allow courts to embed polls in notices of proposed settlements sent to class members. This could be particularly helpful to a court seeking to determine the true value of a coupon settlement to class members. Like shareholder say-on-pay votes, non-binding class member polls would represent a type of quasi-decision right.

rational, however, will ultimately depend on who the class overseer candidates turn out to be.

If typical candidates turn out to be high-profile individuals or respected organizations — such as government agencies or officials, well-known non-profits, or professors or clinics associated with reputable law schools — the decision may be easy enough for class members to make. Class members could quickly identify, based on pre-existing knowledge, a trustworthy candidate for whom to cast a vote simply by looking at the candidates' names and affiliations. But what if these actors do not volunteer themselves as candidates, or fail to do so in some subset of cases? One possibility, already alluded to, is that class oversight would become a niche legal specialty, with private lawyers routinely stepping up as candidates. This would present a challenge for class member voting, because class members would have no pre-existing knowledge about such candidates to help them choose between them. Mandatory disclosure of a candidate's credentials is not a complete solution to this problem, because class members are unlikely to invest time in reviewing such disclosures.³³⁹ Confronted with a list of unfamiliar names, class members might instead opt not to vote at all, or might choose blindly. The result could be the election of bad class overseers.

A few solutions to the “bad” class overseer problem were previewed earlier.³⁴⁰ For example, class members could be given the option of voting for standard judicial oversight rather than any candidate. This could also be the default if quorum requirements were not met, or if no candidate hit a minimum vote threshold. But these approaches, standing alone, threaten to throw the baby out with the bath water. While there may be some bad candidates who emerge from the private bar, there may be many more highly capable ones. What is needed is a way to make it easy for class members to distinguish between the two, resulting in class overseers being elected in more cases. The public company analogy suggests some solutions. To be sure, there is much

³³⁹ In addition to information about their experience and qualifications, to cast informed votes class members would need to know the reason for the candidate's interest in playing the role, including any ideological hostility the candidate bears towards the claims at issue or class actions in general, and any other conflicting interests the candidate may have in the case. As previously discussed, class overseers with financial or familial ties to the defendant (including by virtue of past political or charitable donations) should be flatly prohibited by independence requirements, and class overseers should be forbidden from retaining as class counsel firms with whom they have familial or financial ties (including by virtue of past political or charitable donations). See *supra* notes 289, 294–296 and accompanying text.

³⁴⁰ See *supra* Part IV.B.1.a.

about shareholder voting that is rightly subject to critique.³⁴¹ Nevertheless, it is instructive to consider how public company shareholders — for whom rational apathy concerns also run high — economize on voting decision costs. As explained earlier, two common ways involve (1) following the voting recommendations of firms who specialize in providing it and (2) delegating voting authority to trusted third parties.³⁴²

In the class action context, class members could similarly economize on decision costs by relying on the voting recommendations of reputable third parties. One possibility would be an endorsement system. If government agencies and other trusted third parties took interest in a case but were unable or unwilling to serve as class overseer, they might be given an opportunity to expressly endorse one of the class overseer candidates, or to endorse a vote in favor of standard judicial oversight, if they viewed that as the best option given the low quality of the candidates. Before voting materials were sent to class members, a list of candidates could be published on Classaction.gov and emailed to registrants who have set their alerts to receive such lists. Parties interested in submitting an endorsement could then be given a period of time in which to do so. The endorsements submitted could then be prominently displayed in the voting materials sent to class members (assuming — importantly — that the endorsing party meets independence and other eligibly requirements³⁴³), along with a brief

³⁴¹ Among other things, shareholder voting has been handicapped by the lack of a universal proxy ballot and the expense of running an independent proxy solicitation. These problems do not need to be — and should not be — replicated in the class action context. For example, class members would not have to take any affirmative steps to nominate class overseer candidates or solicit votes on their behalf; instead, the expectation is that class overseer candidates would volunteer, with all who meet eligibility requirements entitled to appear on a single ballot.

³⁴² See *supra* Part II.B.2.a.

³⁴³ The endorser should be required to be independent of the class overseer candidate it endorses, in the sense of having no material familial or financial relationship with it (including by virtue of past political or charitable donations). The endorser should also be required to be independent of the defendant. The risk that endorsers would privately condition their endorsement of a class overseer on the candidate's promise to select as class counsel a firm with whom the endorser has a familial or financial tie (including by virtue of past political or charitable donations) could be dealt with in at least two ways. The first is a disclosure approach. Specifically, the endorser could be required to attest under penalty of perjury that their endorsement is not based on any such condition. The endorser could also be required to disclose whether it has any familial or financial ties (including by virtue of past political or charitable donations) to law firms that may be interested in the position of class counsel. The second approach is more prophylactic: the class overseer could simply be prohibited from retaining as class counsel any law firm or individual who has a familial

description of the endorser's identity and interest in the case. Class members could then cast votes based on the endorsements of the individuals or entities that they trust, without investing time in learning about the candidates directly.

Another approach that would require even less of class members would be a permanent proxy system. When an individual first registered on Classaction.gov, they could be given the option of choosing to delegate their voting authority in any future case that they find themselves a class member in to a trusted third party who has volunteered for the responsibility. The options could be multifaceted. For example, a consumer non-profit might be willing to serve as a proxy only in cases involving certain types of consumer claims. A registrant on Classaction.gov could choose this non-profit to act as her proxy for all such cases and select the Federal Trade Commission for all other cases. The selected proxy would then be responsible for casting a vote for class overseer on her behalf in future cases (assuming no conflict of interest³⁴⁴), unless and until she chose to revoke the proxy's authority. This approach would completely eliminate the need for class members to incur any costs at all in connection with a specific class overseer vote;

or financial tie (including by virtue of past political or charitable donations) to those who endorsed the class overseer in the election. *Cf. supra* notes 294–296 and accompanying text. The latter approach might inhibit some governmental actors from making endorsements, for fear of discouraging campaign contributions by plaintiffs'-side law firms. It is also possible that the rule could be used strategically to block certain deserving law firms from being selected as class counsel. Nevertheless, the more prophylactic approach is probably superior to the disclosure approach, given the low likelihood that class members will pay attention to disclosures. Other eligibility criteria for endorsing a class overseer candidate might include the absence of criminal history, the absence of any court or administrative finding of unethical or dishonest conduct in the past ten years, and compliance with required disclosures.

³⁴⁴ A proxy should be disqualified from voting in any case in which it has familial or financial ties to the defendant (including by virtue of past political or charitable donations); registrants on Classaction.gov could select a back-up proxy to vote on their behalf in such an eventuality. Proxies should also be barred from voting for any class overseer candidate with whom they have familial or financial ties (including by virtue of past political or charitable donations); if the proxy would prefer to abstain than vote for another candidate, affected class members' back-up proxies could vote on their behalf in the case. An exception to this bar should apply, however, if the candidate is the proxy — if a class member trusted the proxy to vote on her behalf, presumably she would be comfortable with the proxy serving as class overseer directly. As with endorser selecting who to endorse, there is a risk that proxies would privately condition their vote for a class overseer on the candidate's promise to select as class counsel a firm with whom the proxy has familial or financial ties (including by virtue of past political or charitable donations). To prevent this, the prophylactic approach described in footnote 343, *supra*, should be adopted; class members who grant a permanent proxy cannot be expected to pay attention to case-specific disclosures.

they would just need to make a one-time, up-front investment in selecting a permanent proxy.³⁴⁵

The endorsement and the permanent proxy approaches are not mutually exclusive, but could work together to help ensure that bad class overseer candidates are not elected in cases where candidates are unfamiliar to class members.³⁴⁶ These approaches would not only allow class members to economize on decision costs, they would also allow government agencies and non-profits to play a role in more cases than they would otherwise be able to: instead of assuming the more time consuming role of class overseer directly, these actors would only need to form an opinion on who the class overseer should be. Their influence in elections would also have the beneficial effect of encouraging private attorneys to be faithful trustees to the class: private attorneys who wished to garner repeat engagements as class overseer would have an incentive to do well by class members, because their reputation would matter in future class overseer elections.³⁴⁷

D. Regulatory-Based Reforms: Free Transferability of Class Claims

Reducing the costs to class members of casting an informed vote in the ways described above would mitigate the rational apathy concern. So, too, would increasing the *benefit* to class members of casting an informed vote. This could be accomplished if the aggregation of class claims was made feasible through free transferability. As explained below, free transferability would facilitate the emergence of larger stakes class members with more to gain from a case being well governed — class members that are more akin to engaged institutional investors and hedge fund activists than rationally apathetic retail investors.³⁴⁸

The existence of larger stakes class members could produce additional benefits, beyond its ability to bolster the effectiveness of a class member vote on class overseer. Larger stakes class members would themselves make compelling class overseer candidates, for example, and they might find it economically rational to take on that responsibility. Larger stakes class members might also find it

³⁴⁵ A registrant would be free to revoke the authority previously granted to a proxy at any time by simply visiting their personal settings page on the Classaction.gov website.

³⁴⁶ Indeed, all parties who will exercise proxy voting authority in a case should be required to endorse the candidate that they intend to vote for, so that class members who have granted them authority can, if desired, observe this intention and revoke the authority prior to the vote if they disagree.

³⁴⁷ See *supra* note 292.

³⁴⁸ See *supra* note 51 and accompanying text.

worthwhile to lodge objections to proposed settlements that they believe are inadequate; because of the economic stake they would have in the case, courts would likely view these objections as more credible than the sort they receive from class members today. Opting out to pursue litigation separately might also make sense for larger stakes class members, and the threat of this could in turn help to discipline class counsel.

The creation of Classaction.gov would make the aggregation of class claims feasible. In addition to its other functions, Classaction.gov could operate as a platform for the low-cost exchange of class claims. An example will help to demonstrate how it could work. Imagine a case brought on behalf of everybody who purchased widgets from Alpha Corporation in 2017. Class members, identified through a search of the Classaction.gov database using names from Alpha Corporation's customer list, would receive emailed notice of the certification and the deadline for filing a motion to serve as class overseer, as would other registrants on Classaction.gov who signed up to receive such notices. The notice would also be published on Classaction.gov. After certification, any registrant on Classaction.gov (other than the defendant and class counsel) would be permitted to post bids to purchase however many class claims they would like at whatever price they want—for example, a bidder might offer \$3 for a one-widget claim, \$6 for a two-widget claim, etc., and leave the offer open until he acquires \$20,000 worth of claims. Prior to posting, bidders would be required to electronically transfer funds to cover their bids to the Classaction.gov administrative account.³⁴⁹

To prevent an adverse selection problem from arising, only class members who had successfully verified their class claims would be eligible to accept bids posted on Classaction.gov. The required verification process would be the same as the process class members would need to undergo to later claim settlement funds. Class members would fill out an online form that poses questions to establish their eligibility and extent of damage (e.g., "Did you purchase widgets from Alpha Corporation in 2017? If so, how many do you estimate?") and, if determined by the presiding judge to be necessary, upload supporting documentation (e.g., a JPEG image of a receipt).³⁵⁰ Class members with

³⁴⁹ Unused funds would automatically revert to the bidder's account at the expiration of the bid.

³⁵⁰ This means that the content of the form would need to be determined at the time of certification, based on the allegations in the complaint and any pre-certification court rulings. If it is obvious that all potential class members identified through the database search would be entitled to participate in any recovery, were one achieved, and each in

verified claims could also post offers to sell, which any registrant on Classaction.gov (other than the defendant and class counsel) could accept by transferring the purchase price to the Classaction.gov administrative account.

Classaction.gov would record these transactions and cause appropriate funds to be transferred electronically from Classaction.gov's administrative account to the account the seller indicated they wanted funds deposited into when they registered. Once the transaction cleared, all further communications in the case would be automatically redirected to the purchaser, and the purchaser would succeed to the class member's rights to vote for class overseer (if the transaction occurred prior to the election), to opt out (if the transaction occurred before the opt-out period had ended), and to receive any future settlement funds.³⁵¹

Notice what this is *not*: it is not a mechanism for funding the litigation. The Classaction.gov exchange would facilitate secondary market trades, with the proceeds going to class members, not class counsel. The point is to potentially create a situation where larger stakes class members would emerge who, like institutional investors and hedge funds in the public company context, might take a real interest in monitoring the enterprise. Because the proceeds would not be used to fund the litigation, and because the sales would not result in any claims being brought that were not already being brought, the exchange should not raise the trio of "champerty," "maintenance," and "barratry" objections typically lodged against claims alienation proposals.³⁵²

The type of legal claims that are amenable to class treatment are typically assignable,³⁵³ and the envisioned exchange would simply

the same or a self-evident amount, then their claims would be automatically verified. Class members who self-identified after seeing the notice of certification on Classaction.gov, however, would always be required to verify in order to exercise any rights as a class member, including to participate in a class overseer election. The court should police the verification process closely to ensure that is not overly onerous. For example, in many cases supporting documentation, if even necessary, might properly be required only of class members who self-identified.

³⁵¹ In the event parallel class actions were pending in different jurisdictions, the first case to be certified would be the first and only case in which claims sales would be conducted. Purchasers of verified claims would therefore be assured of their ability to recover in whichever of the parallel actions was subsequently taken to final judgment. See *supra* note 334 and accompanying text.

³⁵² See generally Richard W. Painter, *Litigating on a Contingency: A Monopoly of Champions or a Market for Champerty?*, 71 CHI.-KENT L. REV. 625, 639 (1995) (discussing these doctrines).

³⁵³ See *id.* at 640 (explaining that while personal injury claims cannot be assigned, contract and tort claims for property damage generally can); see also 6 AM. JUR. 2D

create a low-cost way for class members to assign their legal claims to third parties who value them more.³⁵⁴ Purchasers would seek to profit by paying less for a class claim than their estimate of the claim's expected value, discounted to reflect the purchaser's own risk preferences. Selling class members might be willing to sell because they are more risk averse than the purchaser, prefer immediate over delayed payment, or have a more pessimistic view on the claim's expected value.

To be sure, there will be informational asymmetries in this market that will systematically favor purchasers over selling class members. It is not rational for a small claims class member to spend time researching the value of their legal claim, but it could be highly profitable for someone who intends to purchase hundreds or thousands of such claims. Some readers may therefore raise fairness objections to this proposal. Such objections are unwarranted. First, competitive bidding amongst purchasers may offer some protection to class members by driving prices up.³⁵⁵ Second, the sums at stake are quite small for selling class members. The injustice of a class member receiving \$3 for a claim worth \$5 should hardly keep anyone up at night, especially once the governance benefits that larger stakes class members could produce are taken into account. Finally, sophisticated investors profit by trading with less informed retail investors all the time in the public capital markets. This imbalance is not viewed as problematic so long as the exchange is voluntary, and the more informed party has not inappropriately utilized inside information. Nothing in my proposal compels class members to sell their class claims. Moreover, as noted

Assignments § 50 (2020) (explaining that statutory claims are generally assignable if remedial rather than punitive). If there was doubt regarding the assignability of the claims at issue, potential purchasers could move the court to issue a declaratory judgment on the matter before claims sales commenced. Congress might also consider passing a statute affirmatively permitting the assignment of federal claims asserted in class actions certified under FED. R. CIV. P. 23(b)(3).

³⁵⁴ Cases brought on behalf of public company shareholders should be excluded. Selling rights appurtenant to publicly traded stock would have the negative effect of diminishing the fungibility of shares. Cf. Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 95-96 (1985) (making a similar observation about the consequences of a rule of unlimited shareholder liability). It would also present practical difficulties given that most shares are held in undifferentiated bulk with the Depository Trust Company. See Charles R. Korsmo & Minor Myers, *Aggregation by Acquisition: Replacing Class Actions with a Market for Legal Claims*, 101 IOWA L. REV. 1323, 1359 (2016).

³⁵⁵ I have no illusion that there would emerge an efficient secondary market in class claims that would mimic all of the advantages of the public capital markets. But this is not necessary for the exchange to help reduce class action agency costs in the ways described above, at least in some cases.

above both class counsel and the defendant would be excluded from participating in this market.³⁵⁶ In order to trade, purchasers and sellers might also be required to check a box indicating, under penalty of perjury, that they have received no confidential or privileged information from class or defense counsel.

This proposal shares features with, but enjoys distinct advantages over, several notable market-based class action reform proposals that have been advanced by scholars in the past. For example, in a seminal article, Jonathan Macey and Geoffrey Miller proposed that small-claims class actions be sold to the highest bidder at a judicially-supervised auction.³⁵⁷ This would overcome agency costs because the “winning bidder becomes the owner of the claim, and therefore acts as its own agent.”³⁵⁸ The Macey-Miller proposal would, in essence, eliminate class action collective action problems by eliminating the collective. The public company analogy is a going private transaction. The Classaction.gov exchange could similarly facilitate the complete merger of claim ownership and control, because nothing would stop bidders from offering to purchase all outstanding class claims. Unlike with the Macey-Miller proposal, however, this could be accomplished without placing significant burdens on the court.³⁵⁹ Importantly, the Classaction.gov exchange would also allow bidders to purchase partial stakes in class actions. The expense and risk profile of this strategy

³⁵⁶ To be meaningful, this prohibition should extend to those controlling, controlled by, or under common control with class counsel and the defendant. Excluding class counsel and the defendant is warranted based on more than simple fairness concerns. Excluding class counsel would also eliminate any incentive class counsel might have to manipulate its handling of the case in the early stages, so as to create an impression that the case is weaker than it is. Excluding defendants is warranted because the exchange is intended to help reduce class action agency costs, not to provide a vehicle for defendants to exploit class member collective action problems to settle on the cheap.

³⁵⁷ See Macey & Miller, *supra* note 262, at 6. Macey and Miller were the first to fully explore this idea, which had been raised in prior literature. See, e.g., Coffee, Jr., *Unfaithful Champion*, *supra* note 1, at 78-79, 78 n.299 (attributing the idea of auctioning a class action to Professor Frank Easterbrook).

³⁵⁸ Macey & Miller, *supra* note 262, at 108.

³⁵⁹ Under the Macey-Miller proposal, in each case the court would need to determine if the class action was suitable for auction treatment based on a variety of factors, precisely define the claim (which may require the taking of discovery), devise an auction procedure, publicize and conduct the auction, and distribute the funds. By contrast, the only burden my proposal places on the court in individual cases is to approve the claims form earlier in the litigation than would otherwise be required, so as to facilitate the claims verification process. Of course, my proposal also requires that Classaction.gov and its supporting administration be created and maintained, but as argued in *Classaction.gov* this is independently worthwhile. There would also be the marginal cost of imbuing Classaction.gov with the functionality needed to act as an online exchange.

would likely be attractive to a much broader set of potential bidders than would purchasing the class action in its entirety.³⁶⁰

In a more recent article, Charles Korsmo and Minor Myers have advocated for the free alienability of legal claims as an *alternative* to class actions.³⁶¹ They argue that the severe agency costs that attend use of the class device as a mechanism for aggregating legal claims could be avoided if instead third parties simply purchased claims directly from their holders and then pursued litigation in their own right — engaging in “aggregation by acquisition,” as they dub it, instead of aggregation by procedure.³⁶² Like the Macey-Miller proposal, the Korsmo-Myers proposal would eliminate agency costs by merging ownership and control of legal claims. But unlike the Macey-Miller proposal — and like my proposal — it would avoid the need for a purchaser to come up with the funding necessary to acquire an entire class action as well as the need for the court to oversee a complicated auction process. Unfortunately, their proposal would also introduce a new set of practical difficulties. Most problematically, a would-be claims acquirer would have to personally seek out claimants and negotiate purchases on a one-on-one basis. Transaction costs would doom this endeavor in cases involving negative-value claims. As a consequence, negative-value claims aggregated today through the class device would simply not be brought at all, with a concomitant loss in deterrence. The Classaction.gov exchange that I propose would eliminate the transaction cost barrier to aggregating negative-value claims by acquisition. Purchasers could use the exchange to aggregate legal claims, then opt out of the class and pursue relief in a separate action of the type that Korsmo and Myers envision. Importantly, though, purchasers would not have to pursue litigation on their own if they did not wish to, and those class members who did not sell their legal claims would nevertheless see their claims pursued. The small claims class action, and its deterrence benefits, would therefore be preserved.

My proposal also promises to more effectively achieve the goal of a market-based class action reform proposal advanced by John Coffee. Professor Coffee has argued that opt-out rights should routinely be

³⁶⁰ Macey and Miller suggest auctioning the right to represent the class as a second-best option. This idea has garnered significant scholarly and judicial attention, with most commentators concluding that it is unworkable in practice. *See supra* note 274; *see also* Korsmo & Meyers, *supra* note 354, at 1342 (“[T]he auction of the lead counsel role has . . . attracted sustained criticism in the literature and has failed to generate any momentum in the courts.”).

³⁶¹ *See generally* Korsmo & Meyers, *supra* note 354.

³⁶² *See id.* at 1357.

delayed until after the approval of a proposed settlement, at which time competing attorneys could run opt-out campaigns to try to sway class members to join rival class actions rather than stay in the original class and accept the settlement.³⁶³ He analogizes the disciplining effect this could have on class counsel, whose fees depend on the size of the class, to the disciplining effect the threat of a hostile takeover has on corporate managers.³⁶⁴ But Professor Coffee concedes that rival opt-out solicitations are unlikely to work well in small claims class actions, given rational apathy concerns: whether to accept a settlement on the table or gamble on a rival class action brought by another unfamiliar attorney is simply too hard of a question to expect small claims class members to answer.³⁶⁵ An offer to purchase claims via the Classaction.gov exchange, by contrast, presents class members with a simple choice — even a child would understand that they should accept the offer only if the price is higher than the value they expect to derive from the class settlement. By offering a premium to the settlement, then, competing attorneys (either directly or through investor clients) could use the Classaction.gov exchange to easily amass class claims, opt out, and bring a rival action. This would discipline class counsel in precisely the way Professor Coffee seeks: “[k]nowing that class members can flee an inadequate or unattractive settlement, [class counsel has] less incentive to enter one (at least to the extent [the] expected fee award will decline); and defendants will also be less prepared to settle on such a basis.”³⁶⁶

My proposal also enjoys advantages over market-based proposals advanced by Alon Klement and Charles Silver and Sam Dinkin. While the specifics differ, both the Klement and Silver-Dinkin proposals seek to manufacture a party with good incentives to monitor class counsel by auctioning off a percentage of the class’s recovery to the highest bidder willing to assume a formal monitoring role.³⁶⁷ As with the Macey-Miller proposal, a major drawback of these proposals is the burden they would place on the court: it would be complicated for judges to structure and conduct the envisioned auctions, and there

³⁶³ See Coffee, Jr., *Class Action Accountability*, *supra* note 6, at 421-25.

³⁶⁴ See *id.* at 422.

³⁶⁵ See *id.* at 425.

³⁶⁶ *Id.* at 421.

³⁶⁷ See generally Klement, *supra* note 3; Charles Silver & Sam Dinkin, *Incentivizing Institutional Investors to Serve as Lead Plaintiffs in Securities Fraud Class Actions*, 57 DEPAUL L. REV. 471 (2008).

would be no guarantee that bidders would even emerge.³⁶⁸ My proposal would achieve comparable ends as the Klement and Silver-Dinkin proposals, but without imposing on the court: purchasers could simply buy a stake in the case by purchasing claims via Classaction.gov and then volunteer as a class overseer candidate. Importantly, though, under my proposal multiple larger stakes class members could potentially emerge, and running for class overseer would not be required. A larger stakes class member might prefer to simply cast an informed vote for another class overseer candidate, or to lodge an objection if an inadequate settlement is proposed. These actions would be beneficial in their own right.

CONCLUSION

This Article has been long. The conclusion will be short. The public company analogy provides a richer source of inspiration for class action reform than scholars have previously acknowledged. The comprehensive comparison of agency-cost-reduction techniques utilized in the public company and class action contexts undertaken herein suggests a package of bold ideas to improve the functioning of small claims class actions — ideas that are worthy of further consideration by scholars and policymakers alike.

³⁶⁸ See Geoffrey P. Miller, *Competing Bids in Class Action Settlements*, 31 HOFSTRA L. REV. 633, 643-50 (2003) (proposing an *ex post* auction for lead counsel rights but conceding that, like other auction proposals, it would place significant burdens on the court).