Putting the Plaintiff Class' Needs in the Lead: Reforming Class Action Litigation by Extending the Lead Plaintiff Provision of the Private Securities Litigation Reform Act

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Imagine that you discover that you are a winner of a class action lawsuit and are due a modest damages award. You would be pleasantly surprised, right? Now suppose that upon further examination you discover that your claim was actually worth more than what you will recover under the settlement award, that the reward will come in the form of coupons that require you to buy more of the product that entitled you to damage awards in the first place, and that the fee award that the class attorney arranged as part of the settlement agreement will not only reduce your award, but will also force you to pay the class attorney more than the award amount you will receive! Given these additional insights, needless to say, you are not nearly as thrilled with the outcome of this settlement agreement.

Although the facts above are a bit extreme, such self-serving settlement agreements negotiated by class attorneys at the expense of class members actually do exist. For example, a settlement with General Mills over its use of an illegal pesticide on the oats used in its Cheerios resulted in class members receiving coupons that could be exchanged for more cereal while six law firms split almost $2 million in costs and fees, plus interest.1 An even more perverse settlement agreement arose after lawyers brought a class action against Bank of Boston on behalf of 700,000 Bank customers who “claimed the bank was keeping too much of its customers’ money by placing their funds in escrow accounts and denying them interest.”2

1. Herb Field, Cereal Suit Only an Aid to Class-Action Lawyers, HARRISBURG PATRIOT & EVENING NEWS, Apr. 5, 1995, at A7 (“The total retail value of this offer is supposed to amount to at least $10 million.”); Tony Kennedy, General Mills is Proposing a Giveaway to Settle Lawsuit, STAR TRIB., Feb. 28, 1995, at A1; Saundra Torry, Going to the Head of the Class Action Settlement, WASH. POST, Apr. 8, 1996, at F7.
The judge approved a settlement that forced the Bank to pay $8.5 million in attorneys' fees and $10 to each customer. In an interesting twist, however, the attorneys' fees amounted to $100 per customer and the agreement required the Bank to deduct the fees from each customer's account. The lawsuit thus cost each class member $90!

Courts have long struggled to discover the mechanism to employ in class action litigation that will best enable class members to monitor their counsel and therefore prevent such egregiously unfavorable settlement awards. The overarching goal of any method used to manage class action suits is to establish "monitoring mechanisms to substitute for the ordinary attorney-client relationship." By simulating this relationship, the court, society, and the plaintiff class will be better assured that class counsel will make litigation decisions out of concern for the interests of the plaintiff class and not themselves. In the typical attorney-client relationship, the client retains the power to accept or reject any settlement and has the power to negotiate the lawyer's compensation in advance. These constraints, however, are not present in class action litigation: "Plaintiffs' attorneys typically do not rely on named plaintiffs for vital testimony, do not bargain with named plaintiffs over the fees they will be paid, and do not require named plaintiffs' approval of the terms on which they propose to settle class actions." The conflicts of interest inherent in class actions have led critics to claim that class action attorneys are more...

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3. Joyce, supra note 2.
4. Id.
6. Id. at 10.
7. Jill E. Fisch, Aggregation, Auctions, and Other Developments in the Selection of Lead Counsel under the PSLRA, 64 LAW & CONTEMP. PROBS. 53, 56 (2001) (discussing how monitoring has the potential to improve litigation procedures and to reduce costs).
9. Id. (footnotes omitted).
interested in maximizing their fee when settling a case than in attaining a fair award for class members.\textsuperscript{10}

The primary tool that courts use in class action litigation to simulate the traditional attorney-client relationship is the selection of both the class counsel and the class representative. Rule 23(a) of the Federal Rules of Civil Procedure requires the court to ensure that the "representative parties [lead plaintiff and lead counsel] will fairly and adequately protect the interests of the class."\textsuperscript{11} Traditionally, the court has had discretion to choose the lead plaintiff and counsel, and judges either approve a private agreement among lawyers to determine who will represent the class, or in cases where there is no agreement, decide who should serve as lead counsel.\textsuperscript{12} This selection process, however, has recently become subject to intense scrutiny because of the introduction of two new selection methods: judicial auctions and the "empowered plaintiff" provision of the Private Securities Litigation Reform Act of 1995 (PSLRA).\textsuperscript{13} Both the Task Force on Selection of Class Counsel appointed by the United States Court of Appeals for the Third Circuit and the United States Judicial Conference Advisory Committee on Civil Rules have recently considered and evaluated different methods for selecting class representatives.\textsuperscript{14}

Professors Elliott J. Weiss and John S. Beckerman proposed that one way to reduce the conflict of interest between class members and their counsel in securities class actions is to use market forces to encourage and appoint more qualified lead plaintiffs to oversee lead class counsel.\textsuperscript{15} Congress implemented this strategy in the

\textsuperscript{10} Id.
\textsuperscript{12} Third Circuit Task Force Final Report, supra note 5, at 6; Third Circuit Judge Convenes Task Force to Study Selection of Lead Class Counsel, 69 U.S.L.W. (BNA) 2489 (Feb. 20, 2001).
\textsuperscript{14} Third Circuit Task Force Final Report, supra note 5, at 1; Minutes, Mar. 12, 2001, Civil Rules Advisory Comm. 9, at http://www.uscourts.gov/rules/Minutes/CRACMM01.pdf (last visited Sept. 1, 2002) (discussing the draft for the attorney appointment Rule 23(g)).
\textsuperscript{15} Weiss \& Beckerman, supra note 8, at 2107.
PSLRA. Congress created a system in which the lead plaintiff would choose the counsel for the class, subject to review by the court. The best choice for lead plaintiff is presumptively the member of the class who has the largest financial stake. The theory, which Weiss and Beckermen argued and which Congress adopted, is that institutional investors, because of their large financial stake in the outcome of the litigation, will have an incentive to monitor lead counsel and will also "have or could readily develop the expertise necessary to assess whether plaintiffs' attorneys are acting as faithful champions for the plaintiff class." This model appears to more closely align the interests of the plaintiffs' attorneys with the interests of the plaintiff class than traditional court-appointment methods.

Recent studies and cases show that institutional investors are beginning to take a more active role in securities class actions under the PSLRA and are achieving higher settlement amounts. In light of this development, this Note argues that the provisions of the PSLRA requiring (1) that the lead plaintiff be more credible and involved in the litigation and (2) that the lead plaintiff choose lead counsel create a better framework for ensuring adequate class representation in Rule 23(b)(2) class action lawsuits for money damages than allowing the court to directly appoint class counsel or conduct auctions.

For class actions such as mass tort and small claims litigation in which the lead plaintiff provision will not be more effective, many reform alternatives exist that will improve the class' ability to monitor its counsel. Mass tort class litigation could be improved by increasing the opportunity for class members to opt out in response to an inadequate settlement agreement. Small claims class actions would benefit from (1) providing judges with more information with which to review settlement agreements, (2) employing a loser-pays fee shifting mechanism, (3) imposing sanctions on class counsel who enter into abusive settlement agreements, and (4) subjecting settlement agreements to greater scrutiny by the public.

This Note critically analyzes current class action reform proposals and the probable outcome of employing the lead plaintiff provision in more types of class action litigation. By way of background, Part I provides insight into the rationale for class action litigation and the challenges it presents. Part II discusses and evaluates the PSLRA and current class action reform proposals. Part III discusses successful elements of the lead plaintiff provision in securities class actions and the types of class actions in which the provision can be most successfully employed, namely antitrust actions. Having proved that the lead plaintiff provision can be extended to some class actions, Part IV provides some insights into alternative reform measures for those areas in which it cannot be similarly extended.

I. HISTORY AND SCOPE OF CLASS ACTIONS UNDER RULE 23 OF THE FEDERAL RULES OF CIVIL PROCEDURE

Although the exact motivation behind the drafting of Rule 23 of the Federal Rules of Civil Procedure remains unclear, it has
effectively allowed class members to pursue litigation and receive damages for claims that involve such small losses that they could not realistically be pursued individually.\textsuperscript{23} Some argue that the original intent of the drafters was to "enable litigation that could not be brought on an individual basis, in pursuit of larger social goals such as enforcing government regulations and deterring unsafe behavior."\textsuperscript{24} The reality, however, is that the majority of class actions, and those which are the focus of this Note, involve damage class actions brought under Rule 23(b)(3) rather than social reform actions seeking injunctions pursuant to Rule 23(b)(2).\textsuperscript{25}
Damages class actions typically involve the areas of (1) consumer cases alleging fraudulent business practices or antitrust violations, (2) mass tort claims, and (3) securities class action suits. Indeed, in 2000, “almost one-third of the class actions pending in federal courts were securities cases” commanding “more judicial time than any other category of class action.”

Rule 23 requires “large numbers of parties (often termed the ‘numerosity’ requirement), brought together by common issues of law or fact (‘commonality’), represented by individuals or entities whose claims or defenses are typical of those they represent (‘typicality’), and who may be relied on to protect the interests of the latter (‘representativeness’).” Historically, private attorneys have assumed the role of finding legal violations, identifying individuals to serve as lead plaintiffs, and filing class actions on behalf of the group. This role has evolved because of (1) the lack of incentive and resources individuals who suffer small harms have to bring a suit individually or to find others who have suffered similar harms to bring an action collectively and (2) a strong incentive for attorneys to bring the suits because of the fees that they will receive if their suit is successful. Attorneys’ fees are more attractive in class action suits than in ordinary litigation because judges determine the amount an attorney will receive from a “common fund,” which consists of a pool of damages resulting from settlement or litigation. Lawyers receive compensation from the fund for “creating it [the class action], as well as a risk premium for bearing

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Id. 23(b)(3). Title VII of the Civil Rights Act of 1964 as amended by the Civil Rights Act of 1991, however, is a statutory provision separate from Rule 23 that permits a class to bring disparate impact claims against a discriminatory employer and seek both an injunction and a damage recovery. 42 U.S.C. § 2000(e) (2000).

26. See HENSLE ET AL., supra note 22, at 52-68.


29. Id. at 71-72. If they lose, however, the attorneys must cover their own expenses.

30. Id. at 71. If they lose, however, the attorneys must cover their own expenses.

31. YEAZELL, supra note 22, at 248-49 (“[C]lass suits seeking money damages carry the potential for high fees ... from that so-called common fund.... By contrast, in a suit that seeks only injunctive relief, there will be no common fund and thus no fee to be recovered from it.”); see also HENSLE ET AL., supra note 22, at 77.
all the financial risks of litigation.\textsuperscript{32} This differs from ordinary litigation in which the parties themselves negotiate fee arrangements with their attorneys before the litigation has concluded.\textsuperscript{33} “Common fund cases” create strong incentives for lawyers to negotiate the size of their fees as part of settlement negotiations, which in turn are subject to approval by the judge.\textsuperscript{34} Many believe that the publicity regarding class action results, in which the plaintiffs’ attorneys received much larger amounts than class members, contributed to judges assuming a more active role in scrutinizing settlement fee provisions, controlling attorney fees, and appointing lead counsel.\textsuperscript{35}

The importance of settlement agreements and easy abuse by class action attorneys becomes clearer in light of two important facts. First, similar to most civil lawsuits, most class actions do not go to verdict but instead end in a settlement agreement.\textsuperscript{36} Second, lead counsel typically do not seek or require class members’ approval of the terms on which they propose to settle class actions.\textsuperscript{37} Rule 23(e) charges judges with approving settlements and determining whether settlements are “fair, adequate and reasonable.”\textsuperscript{38} Because of the volume of settlement agreements resolving class action suits and the slim judicial review of settlement agreements,\textsuperscript{39} it is not surprising that critics have argued for better devices to

\begin{itemize}
\item \textsuperscript{32} Third Circuit Task Force Final Report, supra note 5, at 4.
\item \textsuperscript{33} Hensler et al., supra note 22, at 77.
\item \textsuperscript{34} Id. at 78-79.
\item \textsuperscript{35} Third Circuit Task Force on the Selection of Lead Counsel: Draft Report 5 (on file with author).
\item The Task Force suspects, but cannot be certain, that the adverse publicity associated with some class action results, particularly the cases in which the plaintiffs receive apparently little and the lawyers apparently much, have affected not only the judicial willingness to approve settlements but might also have incited in some judges the desire to become more actively involved in controlling attorney fees. This may have contributed to an interest in some judges in using the bidding process for appointment of lead counsel.
\item Id.
\item \textsuperscript{36} Hensler et al., supra note 22, at 75.
\item \textsuperscript{37} Weiss & Beckerman, supra note 8, at 2065.
\item \textsuperscript{38} Fed. R. Civ. P. 23(e); see also Hensler et al., supra note 22, at 76.
\item \textsuperscript{39} Weiss & Beckerman, supra note 8, at 2067 (“[J]udges generally feel pressured to move their dockets and have an interest in approving settlements.... Lacking any incentive to probe deeply, and lacking the time and information necessary to do so, it is not surprising that courts tend to approve almost all class action settlements.”).
\end{itemize}
monitor lead counsel in negotiating settlement agreements that will be (or are) in the best interests of the class and not in the best interest of counsels' fees.

II. ANALYSIS OF ADEQUACY OF REFORM PROPOSALS FOR SELECTING
CLASS REPRESENTATION

A. Traditional Appointment Procedures

For comparison purposes, this analysis will first discuss the methods courts have traditionally employed in selecting the class counsel and the lead plaintiff. Most courts usually appoint the attorney who files the first complaint as lead counsel. Other courts, however, allow all lawyers who have filed suits containing the same or similar claims to determine among themselves a voluntary plan to allocate lead counsel responsibility, or, when this "private ordering" fails, the court appoints lead counsel. Both of these scenarios reward lawyers who file early and, thus, usually result in what is commonly known as a "race to the courthouse."

Criticism abounds of courts awarding lead counsel position to the first lawyer to file a complaint. Chief among the criticisms is that (1) the practice encourages attorneys to file "skeletal" complaints based on skimpy research, and (2) filing first is not a good predictor for the quality of the attorney's representation.

In October 2001, the Third Circuit Task Force, charged with evaluating methods for selecting lead counsel, recommended not only preserving the court appointment procedures regarding lead counsel, but also enhancing the selection criteria by requiring courts to consider more than simply which attorney filed the

40. Id. at 2062.
41. THIRD CIRCUIT TASK FORCE FINAL REPORT, supra note 5, at 6. Private ordering is subject to approval of the court, which is usually granted. Id.
42. Weiss & Beckerman, supra note 8, at 2062.
43. See, e.g., H.R. CONF. REP. No. 104-369, at 33-35 (1995) (lamenting that speed supplanted diligence in drafting complaints for class action suits that ultimately were lawyer-driven).
44. THIRD CIRCUIT TASK FORCE FINAL REPORT, supra note 5, at 99.
45. The Task Force was "made up of members of the judiciary, academics, plaintiff and defense lawyers (including representatives of institutional investors such as pension funds), and attorneys who are experts on the economics of the practice of law." Id. at 13.
The Task Force submitted a list of factors the court should consider in selecting class counsel, most notably: the amount of pre-filing investigation the attorney conducted, the attorney's reputation in handling class action litigation, and the effectiveness of the counsel's representation thus far. The Task Force's recommendations closely match those of a proposed amendment to Rule 23, 23(g), which would require the court, when appointing an attorney lead counsel, to consider:

(i) the counsel's experience in handling class actions and other complex litigation, (ii) the work counsel has done in identifying or investigating potential claims in this case, and (iii) the resources counsel will commit to representing the class, and [would allow the court to] consider any other matter pertinent to counsel's ability to fairly and adequately represent the interests of the class.

Proposed Rule 23(g)(2)(A) would also encourage the court to require attorneys seeking appointment as lead counsel to apply for the position within a "reasonable period after the commencement of the action ..., although the court would retain discretion." Both the Third Circuit Task Force and the Advisory Committee on Civil Rules also recommend stricter review of attorneys' fees. They encourage courts to monitor the work of class counsel throughout the litigation.

These reform measures, however, fail to solve the problems associated with judicial review of appointing lead counsel and settlement agreements. Defendants virtually never challenge the

46. Id. at 99-101.
47. Id. 48. FED. R. CIV. P. 23(g)(2)(B) (proposed July 2001), in PROPOSED RULES AMENDMENTS PUBLISHED FOR COMMENT: REPORT OF THE CIVIL RULES ADVISORY COMM., at 33 [hereinafter REPORT OF THE CIVIL RULES ADVISORY COMM.], available at http://www.uscourts.gov/rules. 49. Id. 50. THIRD CIRCUIT TASK FORCE FINAL REPORT, supra note 5, at 101-02; FED. R. CIV. P. 23(h), in REPORT OF THE CIVIL RULES ADVISORY COMM., supra note 48, at 14-16. 51. FED. R. CIV. P. 23(h) committee note (proposed July 2001), in REPORT OF THE CIVIL RULES ADVISORY COMM., supra note 48, at 46; THIRD CIRCUIT TASK FORCE FINAL REPORT, supra note 5, at 101. The Third Circuit Task Force also recommends that judges "direct counsel to propose the terms for a potential award of fees" to "provide a helpful structure for the court when it conducts its reasonableness review at the end of the case." Id. at 101.
appointment of lead counsel or settlement agreements. This is because both plaintiffs and defendants want their agreement to be accepted during the settlement hearing. Without the adversarial process to expose improper fee arrangements and settlement agreements, even the most motivated judges are ill-equipped to evaluate an agreement's reasonableness. They are also constrained by the limited record that is compiled during settlement negotiations between the parties and therefore face further difficulties in evaluating its fairness. Encouraging judges to more strictly review negotiation agreements and select lead counsel is ineffective because the reform measures do not provide judges with increased access to information that would enable them to make better decisions. Without access to better information in appointing lead counsel, judges will, by necessity, continue to rely on such inadequate factors as primacy in filing a complaint and personal past experience with the attorneys who seek to serve as lead counsel. These reforms, therefore, do not cure the inability of judges to effectively monitor lead counsel and thereby prevent unreasonable fee awards in settlement agreements.

B. Auction Method

Judge Vaughn R. Walker was the first to use the auction method in In re Oracle Securities Litigation (Oracle I). The principal goal of lead counsel auction is “to emulate the arrangements and decisions that the class itself would make were it able to negotiate [for legal services].” Through a competitive bidding process, prospective lead counsel submit proposals to the court by a specified deadline. The courts often require proposals to include a

53. See id. at 46.
54. Id. at 45-46.
55. Id. at 46.
56. THIRD CIRCUIT TASK FORCE FINAL REPORT, supra note 5, at 10-11.
57. 131 F.R.D. 688, 698 (N.D. Cal. 1990) [hereinafter Oracle I].
58. In re Wells Fargo Sec. Litig., 157 F.R.D. 467, 468 (N.D. Cal. 1994) [hereinafter Wells Fargo II].
combination of monetary and nonmonetary factors. Usually, however, because the candidate firms are so similar with respect to their experience and background regarding class action litigation, the price the firm will charge is the deciding factor in selecting lead counsel. "The cardinal assumption underlying lead counsel auctions is that the best ways to maximize plaintiffs' net recovery are to reduce the price of legal services through competition and to encourage attorneys to contain their costs as much as possible.

Although there have been variations on the lead counsel auction method employed by Judge Walker in *In re Oracle Securities Litigation (Oracle II)*, it still illustrates the essential mechanics of the method. In *Oracle II*, Judge Walker conducted a sealed-bid auction and solicited bids from any firm wishing to act as lead counsel for the class. Firms had to prepare and submit their bids within a three-week period and discovery was neither taken nor allowed during this time. Judge Walker selected the lowest bidder within two months after the bids were submitted.

Despite the novelty of the bidding approach in simulating a competitive market and relieving the court of any obligation to regulate attorneys' fees, it has not gained widespread acceptance. Only five district courts and seven judges have employed this


1) The firm's experience, and those of the attorneys, 2) the firm's qualifications, including its willingness to post a "completion bond or other security for the faithful completion of its services to the class," 3) the firm's malpractice insurance coverage, 4) the percentage of any recovery the firm will charge in the event of recovery, 5) other terms of the proposed fee arrangement, 6) certain certifications on behalf of the firm regarding bid procedure.

Id. at 229.


61. Id. at 1839-40.

method of selecting lead counsel and only in securities (twelve cases) and antitrust (two cases) class actions.

Proponents argue for increased use of the auction method because it lowered attorneys' fees in some cases, thereby providing a larger portion of the settlement award to each class member. For example, lead counsel's $3.5 million fee in *In re Amino Acid Lysine Antitrust Litigation* amounted to 7% of the $49 million settlement. Professor Joseph Grundfest of Stanford University asserts that early evidence demonstrates the auction method's effect of lowering attorneys' fee awards. In an ongoing study, Grundfest found that the average fee award for securities class action cases in the 1990s was about 30% of the settlement amount. This is consistent with a 1996 study conducted by the


69. Id. at 6.

The average fee award in 733 federal class action securities fraud cases filed between January 1991 and May 1999 was approximately 30.12 percent of the settlement amount. Thus, of the total $6.1 billion in settlements in these actions, approximately $1.837 billion was paid to class counsel and $4.263 billion was retained by members of the class.
Federal Judicial Center which found that attorneys’ fees for all class actions typically fell between 27 and 30% of the settlement amount. In contrast, Grundfest discovered that in the few cases that employed the auction method, the attorneys’ fee awards ranged from 7 to 21.2%, a markedly lower percentage. This range is also lower than the normal range of between 25 and 33% that judges typically award in class actions that do not utilize the auction method; this difference raises questions about whether the normal range accurately simulates market-driven fee awards.

Judges are among the most enthusiastic supporters of the auction method because, they argue, it conserves judicial resources by quickly resolving cases that would have otherwise stayed on the docket for years. For example, Judge Shadur originally considered early resolution of Amino Acid Lysine to be improbable. After selecting lead counsel and establishing attorneys’ fees using the auction method, however, the case settled within months. Judge Walker contends that the auction method reduces “the amount of judicial time it takes to monitor and administer large class action cases and to determine an appropriate fee for class counsel at the successful conclusion of such cases.”

Id. (footnote omitted).

70. Kathryn Kranhold & Richard B. Schmitt, To Rein In Fees, Some Judges Ask Attorneys to Bid, WALL ST. J., Dec. 6, 2000, at B1. The 1996 study followed 400 class action suits. Id.

71. Grundfest, supra note 68, at 7 (noting that the lowest fee was awarded in the $30 million settlement of In re Network Associates, Inc. Securities Litigation, 76 F. Supp. 2d 1017 (N.D. Cal. 1999), and the highest fee was awarded in the 1995 Wells Fargo settlement for $13.5 million. Wells Fargo II, 157 F.R.D. 467, 467 (N.D. Cal. 1994). Grundfest cautions that these percentages are derived from cases “involving hard bargaining by competent, named plaintiff[s].” Grundfest, supra note 68, at 7. He also cautions against complete reliance on the data because it is derived from a small sample of cases (the fourteen cases in which auction methods have been employed) and because of the significant variance in the auctioning procedures used by courts. Id.

72. Grundfest, supra note 68, at 6. Grundfest explained:

I am currently in the process of tracing back the roots of the 25 percent to 33 percent norm, and have as yet discovered no persuasive argument that the norm was ever a reasonable approximation of the fee that would result from an arm’s length bargain over representation in a securities fraud class action lawsuit.

Id. at 9.

73. 918 F. Supp. 1190 (N.D. Ill. 1996).

74. Sachnoff & Gilbert, supra note 67, at 541.

75. Id. at 539 (quoting Judge Walker).
Although class members may benefit from the more expeditious conclusion of their case, they may also pay the price for the resource-saving benefits of the auction method because it can reduce the quality of their representation and the overall monetary amount that class members ultimately receive. A principal criticism of auctions is that the lowest price is not necessarily an indicator of the quality of the representation. The quality of representation is likely to suffer because auctions diminish the incentives for lead counsel to adequately invest in litigation. This is because the auction process does not take into account the possibility that a higher bidder may have budgeted for more resources to be invested in the action, or is simply a higher quality firm that would have a better chance for recovery of a higher settlement. Also, if firms underbid, they could resort to settling too early or expending fewer resources on the case in order to maintain a profit margin.

Auctions also dampen incentives for lawyers to discover potential claims because there is no assurance that they will succeed at auction and thereby recover their expenses. Even more, the investigating firm will probably lose the bid because it starts the bidding process with a disadvantage. It must factor its investigatory expenses into the bid whereas a competing firm, which has the benefit of the already filed complaint, has no investigatory expenses, and therefore can submit a lower bid. Consequently, higher-quality firms will have less of an incentive to represent a plaintiff class in cases where they will have to compete to serve as lead counsel because their efforts will not be rewarded if noninvestigating firms consistently win the auction. Indeed, this process has already been termed the “lemon” problem: “[H]igh-quality firms are unwilling to represent victims of fraud and incur

76. THIRD CIRCUIT TASK FORCE FINAL REPORT, supra note 5, at 46.
77. See id.
78. Id. at 42.
79. Id. at 45.
80. THIRD CIRCUIT TASK FORCE FINAL REPORT, supra note 5, at 52-54; The Paths of Civil Litigation, supra note 60, at 1843-44.
82. Id. at 361.
bidding costs to enter an unwinnable auction, leaving the court to select from a motley crew of ‘lemon’ lawyers.”83 There is already evidence that “plaintiffs’ lawyers may simply vote with their feet” and abandon any class action case in which the court will employ the auction method to select lead counsel.84 A shortage of qualified bidders seriously undermines the ability of the auction process to function.

In addition to the diminished quality in representation, the auction method may also cause class members to receive a smaller settlement award. Poorly designed bidding rules can create huge disincentives for the winning bidder to maximize recovery for the class.85 For example, in Amino Acid Lysine86 one firm entered a bid in which it would receive the following declining percentages: 20% on the first $5 million recovered, 15% of the next $10 million, and 10% of the next $10 million.87 The firm would therefore receive 0% of amounts greater than $25 million and a maximum of only $3.5 million, even if recovery exceeded $25 million.88 Predictably, the case settled for exactly $25 million “after only minimal discovery had been completed and before the labor-intensive deposition phase.”89 The $25 million amount in this case is an example of what is commonly referred to as a “fee cap.” Many critics warn that fee caps reduce class members’ recovery amounts because they depress plaintiffs’ counsel’s incentives to incur the risks associated with pursuing a higher settlement amount.90 Furthermore, the fee cap provides strategic information to defendants because they can

83. Id. at 362 (footnote omitted).
84. The Paths of Civil Litigation, supra note 60, at 1844. In Wenderhold v. Cylink, 188 F.R.D. 577 (N.D. Cal. 1999), after Judge Walker requested competitive bids for the position of lead counsel, only one of the six firms submitted a bid. Id. Furthermore, the law firms that have become “gun shy” are those that specialize in class actions because they consider the risk of investing resources into developing claims “too great in light of the statistical probability that they will lose in the bidding process and go uncompensated for pre-bid work.” Robbins & Burnside, supra note 81, at 363. This lends further support to the theory that auctions are discouraging the more experienced law firms and leaving class members to be represented by “lemon” lawyers, if at all.
87. Coffee, supra note 85; Scott Medintz, Big Suits: Lysine Antitrust Settlement, 18 AM. LAW. 114 (1996).
88. Coffee, supra note 85; Medintz, supra note 87, at 114.
89. Medintz, supra note 87, at 114 (1996); Coffee, supra note 85.
90. Coffee, supra note 85.
"conduct an expensive war of attrition" and force the plaintiffs’ counsel to exceed their budgeted expenses and incur unreimbursed costs.\textsuperscript{91} Even more alarming, if defendants know that the winning bid used a declining-percentage-of-the-recovery formula, the defendants will know that plaintiff’s counsel will have "little to gain from holding out for a larger settlement."\textsuperscript{92} Many, therefore, strongly argue against using fee caps or the declining-percentage-of-the-recovery formula. Instead, some, including Professor John Coffee, an expert in class action lawsuits,\textsuperscript{93} recommend encouraging competing counsel to submit bids using an increasing-percentage-of-the-recovery formula so that plaintiffs’ attorneys will receive greater portions of the recovery as the recovery exceeds certain benchmarks.\textsuperscript{94} This type of formula could be designed to prevent windfalls by limiting the maximum percentage recovery to forty percent which will still provide attorneys with incentives to achieve the greatest recovery possible for the class.\textsuperscript{95}

Critics also contend that in contrast to the purported beneficial reduction in the percentage of attorneys’ fee awards caused by using auctions, "[n]on-auction cases have also resulted in fee awards below traditional benchmarks ... and auctions do not guarantee reasonable fees."\textsuperscript{96} The most often cited illustration of auctions not guaranteeing reasonable fees involves the fee award in \textit{In re Cendant Corp. Securities Litigation}.\textsuperscript{97} The district court overrode the contractual fee agreement that the class counsel and lead plaintiff had negotiated as part of the settlement agreement. Instead, the court approved a $262 million fee award using the fee

\begin{itemize}
\item \textsuperscript{91} \textit{Id.}
\item \textsuperscript{92} \textit{Id.}
\item \textsuperscript{93} See Class Action Lawsuits: Examining Victim Compensation and Attorneys’ Fees: Hearing Before the Subcomm. on Administrative Oversight and the Courts of the Senate Comm. on the Judiciary, 105th Cong. 30 (1997) (statement of Lewis H. Goldfarb). Professor Coffee also "served as legal consultant and adviser to the White House’s Office of General Counsel during the PSLRA’s consideration and passage ...." Robbins & Burnside, \textit{supra} note 80, at 350-51.
\item \textsuperscript{94} Coffee, \textit{supra} note 85.
\item \textsuperscript{95} \textit{Id.}
\item \textsuperscript{96} Skupien & McSherry, \textit{supra} note 27, at 8.
\item \textsuperscript{97} 109 F. Supp. 2d 285 (D.N.J. 2000).
\end{itemize}
This award exceeded the fee amount that the parties had negotiated by $76 million, and the award constituted about 8.4% of the settlement.

The result in Cendant Corp. supports the argument that fee awards established by the courts during the auction conducted at the beginning of litigation should be reviewed for reasonableness after the parties reach a settlement agreement. Many judges assert that this is especially true for securities class actions because the PSLRA instructs courts to ensure that “[t]otal attorneys’ fees and expenses awarded by the court to counsel for the plaintiff class shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class.”°

In perhaps the most detailed analysis of the issue, Judge Ellis explained in In re Microstrategy Inc. Securities Litigation° that the fee amount should not be finalized through an auction.

The ultimate fee structure is within a district court’s control throughout the litigation, because, at the conclusion of the litigation, a district court has a statutory obligation to ensure that the ultimate award of attorney’s fees is reasonable.... Instead, a district court should approve plaintiff’s choice of lead counsel based solely on that counsel’s competence, experience, and resources, saving the question of fees until the conclusion of the litigation.°

Professor Coffee has recommended a compromise position with respect to auctions and attorneys’ fee awards. He suggests that auctions clearly generate useful information about the actual market rates for various levels of risk.° Courts, therefore, should

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100. 15 U.S.C. § 78u-4(a)(6) (2000). The conference report to the PSLRA also encourages ex post review of fee awards because it expressly states that “[b]y not fixing the percentage of fees and costs counsel may receive, the Conference Committee intends to give the court flexibility in determining what is reasonable on a case-by-case basis.” H.R. CONF. REP. NO. 104-369, at 36 (1995).


102. Id. at 438 (citation omitted).

103. Coffee, supra note 98.
conduct auctions regarding attorney fees at the outset of litigation and use the information to generate presumptive fee formulas that will be based on real market conditions. These market-based formulas, Professor Coffee argues, will be superior to the arbitrary percentages ranging from twenty-five and thirty-three percent that judges have used over the last ten years.\footnote{104}

Another significant problem with auctions involves comparing bids that use different formulas and tactics. For example, in \textit{Wells Fargo II}\footnote{105} one of the firms offered to absorb all of its litigation expenses in exchange for higher fee percentages;\footnote{106} whereas "[t]he winning bidder proposed to deduct its litigation expenses from the total amount of any recovery before application of its fee percentage."\footnote{107} Another problem involves comparing a flat percentage fee formula with either a declining-percentage-of-the-recovery formula or an increasing-percentage-of-the-recovery formula. Professor Coffee notes that for judges to compare the different formulas, they must make a prediction about the likely settlement value of the case, thereby causing them to compromise the court's neutrality.\footnote{108}

In general, the majority of commentators have not approved of the auction method for selecting class counsel. The Third Circuit Task Force charged with evaluating the use of auctions strongly recommended against it.\footnote{109} The Task Force concluded that auctions fail to replicate the private market for legal services because they do not adequately account for factors other than price, such as "reputation, experience, firm resources, particularized competence, prior track record in similar matters, personal qualities, pre-existing lawyer-client relationship, relationship of counsel to other parties and their lawyers, and commitment to a prompt resolution of [the] matter" that play an important role in selecting counsel.\footnote{110}

\section*{C. Lead Plaintiff Provision of the PSLRA}

In response to growing discontent with traditional methods of appointing lead counsel, who in turn would recruit lead plaintiffs, Congress enacted the PSLRA\textsuperscript{111} in 1995 to reform securities class action lawsuits.\textsuperscript{112} The goal of the PSLRA was to encourage institutional investors to play a more active role in securities class action litigation by monitoring class counsel.\textsuperscript{113} Congress hoped that closer monitoring would increase the probability of obtaining better settlement outcomes in the interests of the class members and that it would reduce the number of frivolous securities class actions.\textsuperscript{114}

To accomplish this, as part of the PSLRA, Congress developed the lead plaintiff provision which allows the lead plaintiff to “select and retain counsel to represent the class.”\textsuperscript{115} The statute stipulates procedures for the court to adopt in selecting the lead plaintiff who is the “most capable of adequately representing the interests of class members.”\textsuperscript{116} The court is to presume that the most adequate plaintiff is the one who has the largest financial interest in the relief sought by the class.\textsuperscript{117} A member of the purported plaintiff class is the only person who may rebut the presumption by showing that the presumed most adequate plaintiff “will not fairly and adequately protect the interests of the class,”\textsuperscript{118} or is “subject to unique defenses that render such plaintiff incapable of adequately representing the class.”\textsuperscript{119} It is clear, therefore, that the PSLRA shifts the court’s focus from the selection of lead counsel to the selection of a lead plaintiff who will assume the court’s traditional

\begin{itemize}
  \item \textsuperscript{112} S. REP. No. 104-98, at 8-10 (1995).
  \item \textsuperscript{113} H.R. CONF. REP. No. 104-369, at 32 (1995) (emphasizing that the Act is “intended to increase the likelihood that parties with significant holdings in issuers, whose interests are more strongly aligned with the class of shareholders, will participate in the litigation and exercise control over the selection and actions of plaintiff’s counsel”).
  \item \textsuperscript{114} Id. at 34 (explaining that Congress wanted to encourage institutional investors to take a more active role in securities class action lawsuits which would “ultimately benefit shareholders and assist courts by improving the quality of representation”).
  \item \textsuperscript{116} Id. § 78-u4(a)(3)(B)(i).
  \item \textsuperscript{117} Id. § 78-u4(a)(3)(B)(ii)(IX)(bb) (“The court shall adopt a presumption that the most adequate plaintiff ... is the person or group of persons that ... in the determination of the court, has the largest financial interest in the relief sought by the class.”).
  \item \textsuperscript{118} Id. § 78-u4(a)(3)(B)(ii)(II)(aa).
  \item \textsuperscript{119} Id. § 78-u4(a)(3)(B)(ii)(II)(bb).
\end{itemize}
role of monitoring lead counsel and negotiating the attorney's fee. In other words, the PSLRA advances the "client-driven" model of class action.

1. The Lead Plaintiff as a Trustworthy Monitor

The reason courts have not historically focused their resources on appointing an adequate lead plaintiff instead of lead counsel is due to economic incentives. "[T]he small size of ... individual claims creates enormous free-rider effects: no rational plaintiff would take on the role of litigation monitor because she would incur all the costs of doing so but would realize only her pro rata share of the benefits." Professors Weiss and Beckerman, however, were able to convince Congress that institutional investors in securities class actions are more capable than typical figurehead plaintiffs at effectively monitoring lead counsel because (1) they have large financial stakes in the outcome of the litigation, and (2) they have, or could readily develop, the necessary expertise to determine whether "plaintiffs' attorneys are acting as faithful champions for the plaintiff class." They determined that serving as lead plaintiff would put institutional investors in "the most advantageous position" to monitor lead counsel. This is because as lead plaintiff, the institutional investor could appoint his attorney to serve as lead counsel, as opposed to being a passive member of the class where he would have to hire and pay another attorney to challenge a settlement after it had already been reached. Because courts are rarely receptive to objectors' claims and frequently force them to bear their own attorneys' fees, an institutional investor who is just...
another member of the class faces huge disincentives to become more active in monitoring lead counsel by challenging settlement agreements. In contrast, the institutional investor—acting as lead plaintiff—could monitor settlement negotiations as they are made, thus saving the expense of challenging the agreement after it has already been reached.

2. Institutional Investors as Lead Plaintiffs

The success of the PSLRA in encouraging institutional investors to become more active in securities class actions by assuming the role of lead plaintiff and monitoring lead counsel is still somewhat unclear. It appears, however, that institutional investors are beginning to take a more active role, as illustrated by the University of California’s role as lead plaintiff in the much publicized class action suit against Enron, despite early reports that institutions continued to remain “on the sidelines.” Two years after the PSLRA was enacted, the Securities and Exchange Commission (SEC) conducted research revealing two primary reasons why institutional investors are reluctant to serve as lead plaintiffs: (1) institutions are concerned that acting as lead plaintiff “could expose them to liability to other class members” and (2) institutions obtain higher returns by bringing their own individual suits. At least the second phenomenon is still occurring among institutional investors because investors feel that they can present a stronger individual claim than class members can establish in a class action.

126. Id. at 2104.
129. Id. at 21 (statement of Hon. Arthur Levitt, Chairman, SEC) (“For example, other class members could sue the lead plaintiff if the terms of the settlement were claimed to be inadequate.”).
130. Id.
Past reluctance, however, may be diminishing as new evidence shows that the benefits institutional investors receive from being lead plaintiffs is greater than they initially predicted. Recently, for example, in In re Cendant Corp. Litigation,\(^\text{132}\) two institutional investors served as lead plaintiffs and secured a $3.1 billion settlement.\(^\text{133}\) Evidence further shows that the “average post-Reform Act settlement is $17.5 million, compared to just $5 million before [the PSLRA was enacted]—a 300% increase.”\(^\text{134}\) The large beneficial impact institutional investors are having on settlement recoveries appears to be reversing the tide of passivity.

In addition to the financial incentives for monitoring lead counsel, Professors Weiss and Beckerman also think that the expertise of institutional investors who serve as lead plaintiffs can be an important factor in effective monitoring. Indeed, the Fifth Circuit recently held that the PSLRA raises the standard Rule 23(a) adequacy threshold.\(^\text{135}\) The court held that the PSLRA requires

\(^{133}\) 264 F.3d 286, 288 (3d Cir. 2001); Coffee, supra note 98. Cendant Corporation was formed by a merger of CUC International and HFS, Inc. In 1998, a suit was initiated on behalf of Cendant Corporation’s shareholders after the company discovered that predecessor CUC’s financial statements for 1997 contained irregularities. The United States District Court for the District of New Jersey appointed a lead plaintiff to “pursue claims involving income and growth PRIDES derivative securities based on Cendant common stock.” Bids for Cendant Class Counsel Must be Unsealed, 16 ANDREWS CORP. OFF. & DIRECTORS LIAB. LITIG. REP. 11 (2001). CAIPERS and the New York Common Fund served as the lead plaintiffs. Lerach, supra note 20. Judge William Walls used the auction method to select lead counsel. On March 18, 1999, the court gave preliminary approval to a proposed settlement of the case worth about $341.5 million. Bids for Cendant Class Counsel Must be Unsealed, supra, at 11.

\(^{134}\) Lerach, supra note 20.

\(^{135}\) Berger v. Compaq Computer Corp., 257 F.3d 475, 483 (5th Cir. 2001). Michael Brown, one of several class members, sued Compaq Computer Corporation for allegedly artificially inflating its stock price by engaging in “channel stuffing” (“overselling products to distributors with the knowledge that the distributors would not be able to resell the products to end users”). Miranda S. Schiller & Haron W. Murage, Securities Fraud Plaintiffs Bear a Heavier Burden of Demonstrating That They Can Adequately Represent a Class after the Reform Act, METRO. CORP. COUNS., Nov. 2001, at 8. The district court appointed four plaintiffs to serve as lead plaintiffs who then moved for class certification. Compaq opposed class certification on the grounds that plaintiffs had not demonstrated that they were controlling the litigation. Id. To support their claim, defendants noted that Michael Brown and other deposed lead plaintiffs, were unable to factually support their allegation that Compaq’s former chief executive knowingly misstated revenue targets. Jerry Markon, Ruling Affects Lawsuits Filed by Shareholders, WALL ST. J., Aug. 29, 2001, at C1. The district court, however, granted plaintiffs’ motion for class certification and appointed the four lead plaintiffs who had appeared for depositions as class representatives. Compaq, pursuant to
“that securities class actions be managed by active, able class representatives who are informed and can demonstrate they are directing the litigation.”\(^{136}\) It determined that the correct legal standard is to determine whether lead plaintiffs will “take an active role in and control the litigation”\(^{137}\) and demonstrate that they “know more than that they were ‘involved in a bad business deal.’”\(^{138}\) The court summed up the purpose of ensuring that lead plaintiffs are better informed and have more expertise with the following: “Class action lawsuits are intended to serve as a vehicle for capable, committed advocates to pursue the goals of the class members through counsel, not for capable, committed counsel to pursue their own goals though those class members.”\(^{139}\) After its emphatic insistence on informed lead plaintiffs controlling the litigation, the court completely vacated the class certification and remanded the case, sending a clear message that it will closely scrutinize the capacity of lead plaintiffs to control securities class actions now and in the future.\(^{140}\)

The greatest strength of the PSLRA in terms of providing incentives to institutional investors for assuming the role of lead plaintiff is its provision allowing these investors to appoint lead counsel. This provision encourages institutional investors to play a more active role because it affords them the opportunity to work with counsel with whom they are familiar.\(^{141}\)

Representatives of

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Rule 23(f), sought interlocutory appellate review of the certification decision which the federal appeals court in New Orleans granted. Schiller & Murage, supra. The court’s ruling sent a message to plaintiffs’ attorneys that their clients must understand the case and cannot merely serve as class figureheads. Indeed, the court set a higher standard that demands that the class members have enough knowledge to direct the litigation. Markon, supra. Specifically, the court held that courts commit reversible error when they (1) “invert[] the requirement that the party seeking certification bears the burden of proving all elements of Rule 23(a),” and (2) “effectively abdicate[]—to a self-interested party—the court’s duty to ensure that the due process rights of the absent class members are safeguarded.” Berger, 257 F.3d at 482.

136. Berger, 257 F.3d at 483.
137. Id.
138. Id. (quoting Kelley v. Mid-America Racing Stables, Inc., 139 F.R.D. 405, 410 (W.D. Okla. 1990)).
139. Id. at 484.
140. Id.; Markon, supra note 135.
institutional investors who testified before the Third Circuit Task Force claimed that "shotgun marriages" of plaintiff with counsel whom it did not choose discourages prospective plaintiffs because they will have to take into account the risks of being "deprived of their choice of counsel or their preferred fee arrangement."Congress intended for the court to disturb the lead plaintiff's choice of counsel only if it appears "necessary to protect the interests of the plaintiff class."

The SEC supports, at maximum, a "floating test" in those rare circumstances where the court may need to exercise greater scrutiny of the lead plaintiff's choice for counsel. "Greater scrutiny is warranted where it appears that the lead plaintiff has not played an active, effective role in choosing counsel." The SEC, however, urges the courts to trust the judgment of a lead plaintiff who "possesses the qualities and acts in the manner contemplated by Congress" because "failing to do so could enhance counsel's control of the litigation, which is contrary to Congress' intent" and could also "deprive institutional investors of a core reason for serving as lead plaintiff."

III. EXTENDING THE PSLRA TO OTHER TYPES OF CLASS ACTION LITIGATION

A. Successful Elements of Lead Plaintiff Provision in Securities Class Actions

The success of the lead plaintiff provision in monitoring lead counsel and ensuring better settlement outcomes supports argu-

institutional investors "may find it difficult to work with [sic] unfamiliar counsel and thus may play a less active and effective role on behalf of the class"), available at http://www.sec.gov/litigation/briefs/cendnt.htm (last visited Nov. 22, 2002).

142. THIRD CIRCUIT TASK FORCE FINAL REPORT, supra note 5, at 56.


145. Brief of Amicus Curiae Securities and Exchange Commission, supra note 141.
ments for extending the provision to other damages class action litigation. The feasibility of such an extension, however, requires considering the various unique aspects of securities class actions and their role in the PSLRA's success.

Shareholders bring most securities class actions claiming damages against a company for fraudulently affecting or misrepresenting their stock price. All of the shareholders suffer the same type of damage, although to varying degrees depending on the amount of shares they own. Because damages can be so objectively and fairly quantified, "an automatic allocation formula exists, thereby usually reducing intra-class tensions."¹⁴⁶

Lack of class tensions is important because conflicts among class members and between class members and their representatives (lead counsel and plaintiff) are the biggest obstacles to effective class representation.¹⁴⁷ Internal conflicts, for example, can impede the ability of lead counsel to represent the entire class if factions within the class are fighting over allocation of the settlement.¹⁴⁸ If some class members have more at stake than others, they may be more risk-averse and more eager to accept a settlement than those who have less at stake and prefer to risk going to trial.¹⁴⁹ This can significantly impair the lead plaintiff's ability to protect the best interests of the class if it is willing to tolerate less risk. Even more, lead counsel themselves may be biased by their own risk-aversions resulting from significant opportunity costs created by the amount

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¹⁴⁷. Cf. id. at 385-93. These risks include:
   (1) internal conflicts that exist within the class—typically, because subcategories of class members are competing over the allocation of the settlement; (2) external conflicts that arise because class members (or their attorneys) have some extraneous reason for favoring a settlement that does not truly benefit the interests of all class members; (3) risk conflicts that arise because class members or class counsel have very different attitudes about the level of risk they are willing to bear; and (4) conflicts over control of the litigation.
   idc. at 386.
¹⁴⁸. Id. at 386-88 (citing Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 626 (1997)).
¹⁴⁹. Id. at 389-90.
of time and financial resources they have invested in bringing the lawsuit.\(^{150}\)

Fortunately, in securities class actions, many of these conflicts are not present or have minimal impact. The fact that class members suffer the same type of damages reduces fighting about the allocation of the settlement because of the innate and objective allocation formula discussed earlier.\(^{151}\) There is a difference in the level of risk that the lead plaintiff is willing to tolerate compared to the class members because the lead plaintiff under the PSLRA is usually the investor who has the largest financial stake in the litigation.\(^{152}\) The number of large institutional investors who choose to opt out of class action suits and bring individual suits separate from the class is evidence of this.\(^{153}\) Given the recent success of institutional investors in securing large settlements in class actions suits, however, it appears that this disparity in risk tolerance is not a significant obstacle.\(^{154}\) Finally, the ability of a lead plaintiff to choose lead counsel in a securities class action under the PSLRA moderates lead counsel’s risk preferences by keeping the preferences of the class in the forefront and forcing lead counsel to consider them in addition to his own desires.

Another challenge that securities class actions are able to overcome by their very nature is the influence that an institutional investor as lead plaintiff is able to exert. Simply because the lead plaintiff is allowed to appoint lead counsel does not mean that lead counsel will abide by the lead plaintiff’s wishes. Indeed, lead counsel easily could argue that once appointed, her job is to serve the best interests of the class and not solely the interests of the lead plaintiff. She could, therefore, override the lead plaintiff’s desires in settlement negotiations by justifying her actions in the name of serving the class. The PSLRA does not secure the lead plaintiff’s influence over the appointed counsel. In fact, “[t]he PSLRA is silent as to whether the lead plaintiff has any ability to dismiss the

\(^{150}\) Id. at 390-91.
\(^{151}\) See supra note 146 and accompanying text.
\(^{152}\) See supra notes 115-19 and accompanying text.
\(^{153}\) See supra notes 128-31 and accompanying text.
\(^{154}\) See supra notes 132-34 and accompanying text.
counsel it retains" if a conflict develops. The most important source of influence for institutional investors is the likelihood that, because they hold so many securities, they will have the opportunity to repeatedly serve as lead plaintiffs in securities class actions and select counsel in the future. Reputation, therefore, is an extremely powerful enforcement device in securities class actions, forcing the lead counsel to consider the lead plaintiff's opinions and desires.

Finally, perhaps the most obvious aspect of securities class actions playing a role in the success of the PSLRA is that the institutional investor with the largest financial stake in the litigation is presumed to be, and usually is, the most adequate lead plaintiff. Choosing the institutional investor with the largest financial stake as lead plaintiff is easy for the court, thereby reducing the drain on resources, and generally resulting in the most sophisticated member of the class becoming lead plaintiff. Furthermore, institutional investors have adequate financial resources with which to monitor the litigation and lead counsel. In other class actions, determining the most sophisticated plaintiff who has the expertise, motivation, and financial resources to monitor the lead counsel may not be as easy to objectively determine.

In summary, several major factors have made the lead plaintiff provision successful in securities class actions: (1) the plaintiff's homogenous damages that can be fairly and objectively allocated in a settlement agreement, (2) the probability of repeat performances by institutional investors as lead plaintiffs, which increases their influence over lead counsel, and (3) an objective factor, the size of

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155. Coffee, supra note 146, at 414 (stating that the only section in the PSLRA detailing the powers of the lead plaintiff is § 78u-4(a)(3)(B)(v) which mandates that the lead plaintiff select and retain counsel to represent the class subject to the approval of the court); see also 15 U.S.C. § 78u-4(a)(3)(B)(v) (2000). This is the only section that describes the function of the lead plaintiff. The PSLRA, therefore, does not address whether the lead plaintiff has the power to replace counsel it retains. Legislative history is also silent on this issue.

156. See supra notes 117, 123-25, 135-40 and accompanying text.

157. Institutional investors have greater incentives to be knowledgeable about the facts and play a more active role in the litigation than noninstitutional class members. See supra notes 123-25, 1320-34, 135-42 and accompanying text.

158. See Weiss & Beckerman, supra note 8, at 2096.
the investor's financial stake, that a court can use in accurately determining the most adequate plaintiff in terms of both sophistication and financial resources.

B. Extending the Lead Plaintiff Provision to Antitrust Class Actions

The lead plaintiff provision could be expanded to class actions in which (1) members of the class suffered from similar types of damages, so that settlement allocation would only have to account for quantitative differences, (2) the lead plaintiff has some mechanism available for exercising influence over lead counsel, and (3) an objective or closely objective test could be employed to fairly and accurately determine the most adequate plaintiff.

Antitrust class action lawsuits most closely meet the above criteria. Class members have usually suffered some economic

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159. Some antitrust plaintiffs such as indirect purchasers, most of whom are consumers, are not permitted to bring an antitrust action for damages in federal court. Illinois Brick Co. v. Illinois, 431 U.S. 720, 745-46 (1997) (holding that an indirect purchaser from an antitrust defendant (for example, a retail consumer who purchases a product from a retail vendor, who purchased the product from a monopolistic manufacturer) cannot bring an action for damages against the manufacturer in federal court). Indirect purchasers, however, can bring actions for injunctions in federal court, and several states have amended their antitrust statutes to permit indirect purchaser lawsuits in state court such as Alabama, California, and Minnesota. California v. ARC America Corp., 490 U.S. 93, 98 n.3 (1989). Such state statutes allowing actions by indirect purchases are not preempted by federal antitrust law. Id. at 101-02.

Reforming federal law to apply the lead plaintiff requirement to antitrust class action lawsuits, therefore, may not benefit indirect purchasers who are unable to bring an antitrust class action seeking damages in federal court. The reality, however, is that despite the prohibition against indirect purchaser claims in federal court, the majority of antitrust enforcement comes from lawsuits brought by private plaintiffs in federal court. HERBERT HOVENKAMP, ANTITRUST 278 (Black Letter Series, 3d ed. 1999). In the year 2000, for example, antitrust class actions comprised 8.9% of all federal class actions. 2001 Federal Court Class Action Statistics, tbl: 5: Antitrust (2001), at http://classactionreports.com/classactionreports/stats5.htm [hereinafter 2001 Federal Court Class Action Statistics]. Applying the lead plaintiff provision to only federal law, therefore, would still have a substantial reform impact on antitrust class action litigation.

Indeed, the lead plaintiff provision could enjoy even more widespread success if state legislatures also adopt the provision and thereby apply the reform to antitrust class actions brought by indirect purchasers in state courts. Whether the provision is adopted only at the
loss due to collusion or other monopolistic activity that results in higher prices to the consumer. Therefore, all class members will suffer the same type of damages (economic loss) with the only differences being the amount of loss each class member suffered. This quantitative difference creates a simple method for allocation of the recovery and an objective method for determining who should be the lead plaintiff—presumably the class member who has suffered the greatest loss.

The largest antitrust class action lawsuit brought against the airlines in the past decade illustrates how the lead plaintiff provision of the PSLRA could have prevented a settlement that outrageously favored class attorneys at the expense of class members. Four airlines were accused of violating federal antitrust laws by colluding to fix prices through an elaborate scheme in which they "conducted complex negotiations, offered explanations, traded concessions with one another, took actions against their independent self-interests, punished recalcitrant airlines that discounted fares and exchanged commitments and assurances, all to the end of reaching agreements to increase fares, eliminate discounts and set fare restrictions." The suit’s class included people who flew on any of the named airlines between January 1, 1988 and August 7, 1991, and who flew through one of twenty-three hubs of operation. The airlines agreed to settle the charges of illegally setting ticket prices by paying $44 million in cash and $368.5 million in discount fare coupons.
Although on its face the settlement appeared generous, in reality it cost the class members more than they gained and meanwhile provided their attorneys with $16 million in fees and expenses.\footnote{Judiciary Hearings, supra note 160, at 2 (statement of Sen. Charles E. Grassley).} Fliers who received the discount coupons had to purchase tickets in order to use the coupon and thereby benefit from the settlement.\footnote{Id. (statement of Sen. Charles E. Grassley).} For example, “a $10 certificate [could] only be used to purchase a roundtrip ticket costing $50 or more” forcing the plaintiff “to spend at least $40 of his or her own money to get benefits worth $10.”\footnote{Id. (statement of Sen. Charles E. Grassley).} The maximum recovery allowable to an individual class member was $150 worth of certificates that could be used to purchase a roundtrip ticket of $1,500 or more.\footnote{Id. (statement of Sen. Charles E. Grassley).} The cash portion of the settlement, on the other hand, was “spent on administrative expenses surrounding these coupons ... given to charities, and ... went for attorneys’ fees ....”\footnote{Id. (statement of Sen. Charles E. Grassley).}

A lead plaintiff charged with representing the class interests in this case would have prevented the egregious disparity between class member and attorney recovery. Analogizing to the PSLRA, the lead plaintiff for this case would presumably have been the class member who had spent the most on airline tickets between January 1, 1988 and August 7, 1991. Interestingly enough, similar to the institutional investors in securities class actions, this class member would likely have been an “institution,” a travel agency or other business engaged in the travel industry. Thus, such a corporate lead plaintiff could exert substantial influence over the settlement amount because they regularly do business with the airlines and because of their potential to serve as repeat plaintiffs in future class actions against airlines. Due to the potentially large amount of economic loss that this one individual class member or institution could have sustained, such a lead plaintiff has great incentives to monitor the lead counsel and any settlement negotiations to ensure that the recovery amount will cure the losses the class sustained. Certainly if there had been a lead plaintiff, the lead counsel would never have been able to agree to a settlement that would force class

\footnote{Judiciary Hearings, supra note 160, at 2 (statement of Sen. Charles E. Grassley).}

\footnote{Pulley & O’Brien, supra note 160.}

\footnote{Id. (statement of Sen. Charles E. Grassley).}

\footnote{Id. (statement of Sen. Charles E. Grassley).}
members to pay even more money to the airlines in order to recover their previous economic loss!

C. Adapting the Lead Plaintiff Provision to Other Class Actions

Extending the lead plaintiff provision of the PSLRA to class action lawsuits other than those involving antitrust or securities claims requires the court to discover and appoint the plaintiff who most closely resembles the securities class action institutional investor. Because a class member's financial stake in the litigation is a factor unique to securities (and possibly antitrust) class actions, the court will have to consider more than this one objective characteristic. The Third Circuit Task Force suggested that in determining whether the lead plaintiff possesses the requisite experience and incentive to monitor counsel and negotiate a reasonable fee, the court should focus on the relationship between the prospective counsel and plaintiff to determine:

(1) whether the party has exercised control over the litigation to date; (2) whether the party has experience in managing litigation; (3) whether the party has experience in acting as a fiduciary; (4) any pre-existing lawyer-client relationship, including in prior class actions; and (5) whether the party has the financial resources and time to commit to managing the litigation.169

These recommendations, however, introduce an element of subjectivity that could create problems similar to those associated with traditional judicial selection of lead counsel.170 In order for the lead plaintiff provision to work effectively, the lead plaintiff must be able to exert influence over the lead counsel. Most class actions outside of securities litigation do not involve repeat players such as

169. THIRD CIRCUIT TASK FORCE FINAL REPORT, supra note 5, at 94-95 (citing testimony of Professor Joseph A. Grundfest) (footnote omitted).
170. See supra notes 40-56 and accompanying text.
in institutional investors. It is unlikely, therefore, that the lead counsel’s interest in preserving his or her reputation will be a powerful tool for lead plaintiffs. A substitute tool might be for the lead plaintiff and counsel to enter into a contractual agreement. Such an agreement might allow class representatives to replace lead counsel in the event of a disagreement over the adequacy of the settlement; the original lead counsel would “then be entitled to immediate repayment of the litigation expenses ... and to eventual payment of a reasonable contingent fee based on the originally proposed settlement.” The disadvantage to such a contract, however, is that the dismissed counsel would be forced to rely on the successor counsel to negotiate a large enough settlement to cover his contingency fee, the successor’s contingency fee, and a reasonable recovery for the class members. This disadvantage, however, should not severely affect the applicability of the lead plaintiff provision to other class actions for two reasons: (1) the lead plaintiff and counsel may be able to reach a contractual agreement that, while it may not as fairly balance their interests, will not suffer from such heavy financial pressures, and (2) such a contract, despite its onerous disadvantage (maybe even because of it), may be just as powerful of a tool as reputation in deterring lead counsel from ignoring the lead plaintiff’s desires.

D. Lead Plaintiff Provision is a Superior Alternative to Other Reform Proposals

Although the increased subjectiveness of selecting the lead plaintiff and the need for contractual arrangements between the lead plaintiff and counsel may weaken the effectiveness of the lead plaintiff provision in other class action suits, it still remains a better alternative to traditional lead counsel appointment methods and auctions.

In class actions in which a member of the class has the motivation, expertise, and financial resources to monitor lead counsel, the lead plaintiff provision is a superior alternative to traditional methods of appointing lead counsel for several reasons.

171. Coffee, supra note 146, at 411-12.
172. Cf. id. at 412.
First, it is more effective for the lead plaintiff to challenge settlement terms on behalf of class members as they are made rather than leaving the entire class to oppose the settlement agreement ex post when their objections are likely to be ignored by the judge. Second, lead plaintiffs are better advocates of class interests than judges because they have access to information that judges lack. This enables them to more adequately evaluate settlement agreements. Finally, allowing lead plaintiffs to monitor lead counsel preserves vital court resources that would have to be employed to obtain the same amount of effective representation.

The lead plaintiff provision is also more effective than auctions. First, lead plaintiffs consider more than price in selecting lead counsel and, therefore, are better able to simulate the process that clients in normal litigation use in selecting their counsel. By using the lead plaintiff provision, the class will also be able to obtain one of the benefits of the auction method, namely expeditious settlement, without sacrificing quality representation. Second, the lead plaintiff provision avoids the problem of "shotgun marriages" that shift control back to the lead counsel. Third, in contrast to the disincentives auctions create for class counsel to investigate and pursue claims, the lead plaintiff provision ensures that attorneys will still be able to recover their fees and thereby preserves their willingness to participate in and discover class action claims. Indeed, the lead plaintiff provision creates an incentive for quality firms to develop relationships with recurring lead plaintiffs, analogous to institutional investors in securities class actions, because it increases their chances of being selected to serve as lead counsel in future litigation. The lead counsel's interest in preserving this relationship also fosters more reasonable fee awards and a better overall settlement award for the class than the auction method, especially if the auction awarded the bid to a firm

173. See supra notes 37, 52-56, and accompanying text.
174. Weiss & Beckerman, supra note 8, at 2095.
175. See supra notes 51-56 and accompanying text.
176. Fisch, supra note 7, at 53, 83.
177. See supra notes 73-75 and accompanying text.
178. See supra notes 141-45 and accompanying text.
restricted by fee caps. Finally, the lead plaintiff provision is more efficient than conducting an auction for the purpose of selecting lead counsel because it eliminates the time, costs, and difficulties associated with collecting bids and comparing them.

E. Types of Class Actions in Which the Lead Plaintiff Provision Cannot be Successfully Employed

The primary obstacle to applying the lead plaintiff provision to other class actions is not whether it will be more effective than other alternatives, but whether it is a practical alternative. Effectively applying the lead plaintiff provision to other class actions requires the class action to contain (1) members who have suffered similar damages, and (2) motivated members who have the financial resources to monitor lead counsel. These requirements significantly limit the class action landscape to which PSLRA-like reform is applicable. At one extreme, many class actions are comprised of a large number of claimants with small losses. In these small claim class actions it is highly unlikely that any member will be willing to outlay the necessary time and financial resources to monitor lead counsel because such monitoring will either cost more than the loss or the actual loss will not be large enough to motivate any one class member to monitor the lead counsel.

At the other extreme, according to the Administrative Office of the United States Courts, 10.7% of all class action suits filed in 1998 involved mass tort litigation. Mass tort class actions are

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179. See supra notes 85-95 and accompanying text (explaining how fee caps create disincentives for the winning bidder to maximize recovery for the class).
180. See supra note 62 and accompanying text.
181. Class action lawsuits by class members seeking homogenous damages comprised only 22.7% of class action lawsuits filed and 52.1% of pending class actions between 1973 and 2001. The two types of class actions containing class members with homogenous damages—securities and antitrust class actions—comprise 13.4% and 5.2% (respectively) of the total number of class actions filed between 1973 and 1998. 2001 Federal Court Class Action Statistics, tbl. 1: Federal Court Class Actions by Type (citing statistics reported by the Administrative Office of the United States Courts).
183. See Coffee, supra note 146, at 412 (discussing the collective action problem).
significantly different from other class actions in that individual members suffer diverse injuries and damages. This diversity makes intra-class conflict more likely and makes it virtually impossible for one class member to effectively represent the entire class. The lead plaintiff provision, therefore, is probably not suitable for class actions in which one of the elements—either homogenous damages or members who have the financial resources to monitor lead counsel—is absent, such as mass tort and small claim class actions.

The lead counsel provision will be most effective when both elements are present; its effectiveness will correlate to the degree that each of the elements are satisfied. A class action, for example, which has a willing and able lead plaintiff but which also has slight differences among class members with respect to the substance and size of damages, might still be able to effectively utilize the lead plaintiff provision to monitor lead counsel. Such minor differences will most likely not be great enough to overpower the lead plaintiff and counsel's ability to fairly allocate the settlement.

Some class actions involving employment discrimination exemplify this scenario. In these suits, employees and/or employee applicants band together to allege that they suffered similar damages from an employer's alleged policy of intentional discrimination. In 1998, employment class action filings comprised 31.2% of all civil rights class actions which comprised 14.1% of all class actions. Two recent cases illustrate this type of class action involving employment discrimination: Smith v. Texaco, Inc. and Osgood v. Harrah's Entertainment, Inc. In Smith, the named plaintiffs, representing a class of approximately two hundred other salaried black employees, asserted that their employer, Texaco, and its subsidiary, Star, discriminated in giving “promotions, compensation, and other benefits and privileges of employment.” The plaintiffs sought “monetary damages including ... compensatory

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185. See supra notes 146-52 and accompanying text.
186. See 2001 Federal Court Class Action Statistics, tbl. 6: Civil Rights (depicting statistics reported by the Administrative Office of the United States Courts and showing in parenthesis the number of civil rights class actions involving employment discrimination though not specifying the number of employment discrimination class actions that sought monetary relief (Rule 23(b)(3) class action) as opposed to injunctive relief (Rule 23(b)(2)).
187. 263 F.3d 394 (5th Cir. 2001), vacated, 281 F.3d 477 (5th Cir. 2002).
189. Smith, 263 F.3d at 403.
and punitive damages.” Likewise, Mary Osgood, a caucasian female, brought an individual and class action suit against her employer, a casino, for discriminating by “deny[ing][] employment opportunities such as job positions, promotions, potential for advancement and management training on the basis of the race of the applicant or employee.” As did the class plaintiffs in Smith, Osgood sought monetary relief.

The damages suffered in each case were identical in the sense that the employer discriminated against the plaintiffs. The plaintiffs suffered different damages, however, in the manner in which the employer discriminated against them, such as through hiring, firing, promoting, and demoting their employees. The damages among class members also differed with respect to the amount that would fairly compensate each individual for emotional and other intangible injuries.

Despite these differences, the lead plaintiff provision could be an effective tool for the plaintiff classes because all of them suffered damages from discrimination and pursued compensation for emotional or intangible harm. Because the law focuses more on the degree to which the employer discriminates and the amount of harm it causes to the employee than on the way in which the employer discriminates, it is very unlikely that intra-class conflict will arise between class members because the employer discriminated against them differently. Moreover, because lead plaintiffs have suffered the same injury as their class members, the only obstacle with respect to damages will be allocating the damage award to reflect the degree to which each member suffered. This is very similar to the scenario a lead plaintiff faces in a securities class action; the only difference being that a securities damage award is objectively allocated based on the amount of securities each member owns in contrast to a damage award from an employee-discrimination class action which must be allocated on a subjective compensatory basis. Employee discrimination class actions, therefore, would be a good candidate for the lead plaintiff provision because the damages are relatively homogenous and given

190. Id.
191. Osgood, 202 F.R.D. at 123 (citations omitted) (quoting the plaintiff’s brief).
192. Id. at 117.
the emotional nature of the claim, it is likely that a class member will be willing to serve as lead plaintiff.

There are, however, several obstacles to the success of applying the lead plaintiff provision to such Title VII class actions that suggest using caution before extending it to these cases. Although the emotional nature of the claim increases the willingness of a class member to serve as lead plaintiff, it is uncertain that the volunteer member will possess the necessary expertise and financial resources to adequately supervise lead counsel and protect the interests of other class members. Additionally, because the class members suffer almost equivalent damages, the court must select the lead plaintiff pursuant to subjective criteria. Therefore, although the lead plaintiff provision could improve the quality of representation in some employment discrimination class actions, it is not clear that it will be as effective as it will be for class actions that more closely resemble securities litigation, such as antitrust class actions.

IV. ALTERNATIVE REFORM SUGGESTIONS FOR CLASS ACTIONS UNSUITABLE FOR LEAD PLAINTIFF PROVISION

There are other alternatives beyond judicial appointment and auctions that could increase the probability of class members receiving fairer settlements in class actions that are not conducive to the lead plaintiff provision. As previously discussed, the goal of class action reform is to implement mechanisms that will simulate the attorney-client relationship between the lead counsel and class members in class actions. The problem, however, is that lead counsel and class members often have competing interests. The source of these competing interests is partially a result of the fact that the attorney, by financing the class action, becomes a joint venturer who has more at stake than the individual class members. The attorney, therefore, has a lower threshold for taking risks and seeking a larger settlement on behalf of class

193. See supra notes 5-7 and accompanying text.
194. See supra notes 149-50 and accompanying text.
195. Coffee, supra note 146, at 418.
members. Professor Coffee explained the dynamics between the different class action players as follows:

Motivated by a contingent fee, class counsel would particularly not want to risk being replaced by a successor counsel if class members elected to take a long-shot gamble on trial. Class counsel's rational fear would be that after it had funded the action for years, it might be replaced on the brink of trial and victory, because it rationally counseled caution. Class members in turn would fear that plaintiffs' counsel, the defendants, and a trial court that was usually inclined to prefer settlement over trial might conspire to strike a deal that ignored the class's own preferences.

Under Civil Procedure Rule 23(c)(2), class members must be given notice of the action and the opportunity to opt out. Because opt-outs reduce the size of the settlement, however, lead counsel has an incentive to set the opt-out deadline prior to the approval of the proposed settlement. Currently, therefore, the only course of action available to those who object to the settlement terms is for them to hire an independent attorney to challenge the agreement during the settlement hearing. As discussed previously, for a variety of reasons these contests usually fail. Professor Coffee, therefore, recommends delaying the opt-out deadline until after the approval of the proposed settlement to give objectors an additional, and perhaps more effective, course of action in expressing their disagreement with counsel actions. The greatest strength of the class is in their number; the larger the class, the greater their chances for recovery and the higher the settlement amount. It is, therefore, lead counsel's greatest fear that class members will defect, upset settlement negotiations, and also reduce the likelihood that the counsel will recover his fee. On the other hand, while opt-outs have the opportunity to band together and bring a separate

196. See supra note 150 and accompanying text.
197. Coffee, supra note 146, at 418-19 (citation omitted).
198. FED. R. CIV. P. 23(c)(2).
199. Coffee, supra note 146, at 419-20.
200. See supra notes 39, 52-56, and accompanying text.
201. Coffee, supra note 146, at 420.
202. Id. at 421.
class action, the time and expense of doing so would act as a sufficient deterrent to foolishly defecting. Thus, increasing the class members' opt-out power could be an extremely useful tool in deterring lead counsel from proposing an inadequate or unattractive settlement.

A. Suggested Reform for Mass Tort Class Actions

Increasing class members' opt-out power would be most applicable to mass tort class action suits. These suits are usually a collage of members who have widely different claims with regard to substance and size; therefore, mass tort class action litigation remains extremely controversial. In simplistic terms, the

203. Cf. id.
204. HENSLER ET AL., supra note 22, at 140.
205. The controversy stems from the tradeoff between an individual's right to have his own day in court and the efficiencies gained by consolidating duplicative litigation into one class action. The Advisory Committee notes to the 1966 proposal for Rule 23 recognized that "one or more actions agreed to by the parties as test or model actions may be preferable to a class action; or it may prove feasible and preferable to consolidate actions." Proposed Rules of Civil Procedure, 39 F.R.D. 69, 103 (1966). The notes discouraged consolidating mass tort claims due to concern that individual issues would overwhelm the common ones. Id. For this reason, it was not until the 1980s that courts became willing to certify mass tort class actions. This increased willingness arose when asbestos and other mass tort litigation including the well known Agent Orange and Dalkon Shield cases besieged the courts. Each of these cases involved nearly 200,000 or more claimants. John C. Coffee, Jr., Class Wars: The Dilemma of the Mass Tort Class Action, 95 COLUM. L. REV. 1343, 1356 (1995). Moreover, the courts realized that these cases were amenable to aggregation because they had significant overlapping issues such as general causation and would otherwise impose prohibitive costs on individual litigants, also imposing significant costs on the justice system through repetitive litigation. 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, 93-94 (1997).

The increased use of mass tort litigation, however, spawned even more controversial issues such as whether these classes should be certified under Rule 23(b)(3), which would allow class members to opt in order to pursue an individual action. The disadvantage to the opt-out provision is that it allows class members who often have the strongest individual claims to leave, thereby decreasing the chances of a favorable settlement for the remaining class members (and subjecting the defendant to having to pay a settlement twice: to the remaining class members and later to the individual litigants who opted out of the class) and also counteracting the cost-savings gained from aggregating the claims in the first place. This prompted some courts instead to certify the classes as mandatory Rule 23(b)(1) classes that have no opt-out rights. Perino, supra, at 94-103. The most specific application of mandatory class actions without opt-out rights is the limited fund doctrine that has been used when the
controversy usually surrounds arguments that individuals suffer such unique damages and usually could bring independent claims, and therefore, such class actions should be prohibited. "Although collecting such cases might be more efficient than litigating them individually, say the critics, it will deny these individuals the right to decide whether and when to litigate, to control the course of their litigation, and to obtain individually crafted case outcomes." It is not hard to predict, therefore, that mass tort litigation classes suffer from significant intra- and inter-class conflict that the Supreme Court has held justifying dividing the class into individually represented subclasses under Rule 23(c)(4)(B).

The major defendant's potential tort liability exceeds the company's assets. The limited fund is a mechanism whereby the court makes an equitable, pro rata distribution such that each claimant would receive something less than a full recovery—but, at least each would receive something. *Id.* at 98-99. Most appellate courts, however, have overturned certifications of such mandatory mass tort class actions because they feel that they do not adequately serve each individual's interest. *Id.* at 100. In recent years, the courts have once again become increasingly skeptical about the use of mass tort class actions. The future of mass tort class actions, even those with opt-out provisions, consequently, remains uncertain. See *Castano v. Am. Tobacco Co.*, 84 F.3d 734, 741-51 (5th Cir. 1996); *Georgine v. Amchem Prods. Inc.*, 83 F.3d 610, 626-34 (3d Cir. 1996); *In re Am. Med. Sys., Inc.*, 75 F.3d 1069, 1078-82 (6th Cir. 1996); *In re Rhone-Poulenc Rorer Inc.*, 51 F.3d 1293, 1298-1304 (7th Cir. 1995); Paul D. Rheingold, *Future is Uncertain for Mass Torts, Tide Turns Away from Massive Class Actions*, N.Y. L.J., Nov. 23, 1998, Supplement: Litigation, at S1.

Indeed, the number of mass tort class actions filed between 1997 and 1998 decreased by 7.1%, and the number of pending class actions fell by 16.6% during this period. 2001 Federal Court Class Action Statistics, tbl. 1: Federal Court Class Actions by Type. For more regarding the controversy over mass tort litigation, see HENSLE ET AL., supra note 22, at 99-108; Coffee, *supra*, at 1343; Perino, *supra*, at 90-103.

206. HENSLE ET AL., supra note 22, at 99.

207. *Ortiz v. Fireboard Corp.*, 527 U.S. 815, 857, 864 (1999); *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 626-27 (1997); see *FED. R. CIV. P. 23(c)(4)(B)*. *Amchem Products* involved a mass tort settlement class action, which is a class action certified for the sole purpose of settling a claim; it is intended not to litigate contested issues but to implement a settlement. JAY TIDMARSH, *MASS TORT SETTLEMENT CLASS ACTIONS: FIVE CASE STUDIES* 19 (Fed. Jud. Ctr. 1998) (footnote omitted). The case involved the settlement of perhaps millions of asbestos claims by twenty defendants. *Id.* at 25. In a six-to-two decision, the Court held that the class failed to meet the Rule 23(a) certification requirements regarding adequacy of representation and commonality of issues of fact. *Amchem Products*, 521 U.S. at 622-29. The court felt that there was a significant disparity between the currently injured and the exposure-only categories of plaintiffs and suggested that remedying this intra-class conflict and providing adequate representation required dividing the class into subclasses. *Id.* at 626-27.

*Ortiz* involved certifying another asbestos class settlement action, but was different from *Amchem Products* because it was certified under a Rule 23(b)(1)(B)—or "limited fund" theory. *See supra* note 205. The case involved Fireboard, a company that manufactured a variety of
disadvantage to sub-classing an action with serious internal conflicts is that it encourages holdouts who will opportunistically seek a greater share of the settlement by withholding their consent. Coffee, therefore, recommends abandoning the representative model for class action suits when there are serious internal conflicts and instead increasing the flexibility for opt-out provisions. This solution is more efficient in terms of reducing the role of the court and letting the class members sort out their needs for themselves by pursuing their own litigation when the class action settlement does not meet their needs.

Making the opt-out provision more available to class members, however, is not any more effective than the lead plaintiff provision at helping class members who have small individual claims. This is because members with small claims who opt out of the litigation may not have an independent claim strong enough to bring by themselves; if a large number defected, they would seriously reduce their own chances for any recovery. Small claimants also do not have any incentive to oppose a settlement agreement that is not as large as possible because as long as it is greater than or equal to their loss (which is not a difficult criterion to meet for such a small claim) they do not have an incentive to defect and incur the

products containing asbestos from the 1920s through 1971, and its insurer. The district court certified the class under a limited fund theory, and the court of appeals affirmed after noting: [Elven combining Fireboard's value of some $235 million with the $2 billion provided in the Triilateral Settlement Agreement (a settlement with the insurance company for the maximum amount of liability that the insurer would pay), the company would be unable to pay all valid claims against it within five to nine years.

Ortiz, 527 U.S. at 829 (citing In re Asbestos Litig., 134 F.3d 668, 982 (5th Cir. 1998)). Initially, the case was remanded by the United States Supreme Court for reconsideration in light of Amchem Products. On remand, the Court of Appeals for the Fifth Circuit affirmed certification of the class. The Supreme Court suggested that the applicability of Rule 23(b)(1)(B) to a limited fund was questionable, but more specifically reversed the court of appeals and held the certification impermissible because the fund was limited due to a prior settlement (i.e., subject to the defendant's own terms) rather than their true circumstances. Id. at 864. With respect to subclassing, the majority commented on the disparate interests between the pre-1969 claimants and the post-1969 claimants; the former group having more valuable claims. The Court determined that the class would have to be split in order to adequately represent these two groups and remedy the intra-class conflict. Id. at 857.

208. Coffee, supra note 148, at 435.
209. Id. at 437-39.
210. Id.
extra expense of bringing a separate action. These factors have historically made these types of class actions subject to the greatest abuse by lead counsel and are therefore in the greatest need of reform.211

B. Suggested Reforms for Small Claim Class Actions

Unfortunately, developing better monitoring mechanisms for small claim class litigation is very difficult. Because of the free-rider and collective action problems that inherently plague such actions, market mechanisms will probably fail. This is consistent with most general free-rider problems in the economy and is usually when government regulation is most justified. In this context, therefore, creating a greater role for judicial review of settlement agreements in small claim class action litigation is justified.

As discussed earlier, the reform measures the Third Circuit Task Board and the Advisory Committee on Civil Rules suggested are inadequate to cure some of the traditional problems with entrusting settlement review to the judiciary.212 The major problem with the reforms is that they do not provide judges with the necessary information to make better evaluations of settlement agreements.213 One solution might be to develop and enforce a rule or regulation that would require the parties to file supplemental pleadings that reveal more detailed information about each side's claim. To avoid jeopardizing settlement negotiations, these supplemental pleadings could be kept confidential and available only to the judge prior to reviewing a proposed settlement.

Professor Deborah R. Hensler, Senior Fellow at RAND Institute for Civil Justice, and Professor Thomas Rowe propose a more radical and controversial solution. They suggest requiring the loser of the lawsuit to pay the winner's legal expenses such that if the plaintiff class loses, the attorneys for the class would be liable for defendants' fees, but only up to the amount of their own reasonably

212. See supra notes 50-56 and accompanying text.
213. Id.
calculated fees to date. Likewise, if the plaintiff class wins, defendants would pay a separate amount directly to class counsel for class counsels’ fees and expenses. This would effectively result in courts awarding a premium to class counsel on top of the fees and expenses they are usually awarded under the “common fund” system.

Requiring the loser of a lawsuit to pay the winner’s fees is known as the English Rule, and it has been widely adopted throughout the world and consequentially, is sometimes called “the rest of the world rule.” Indeed, courts in Great Britain and Western Europe have applied the rule for many years and many think that it would vastly improve America’s legal system, which generally requires that litigants pay their own attorneys’ fees regardless of the outcome of their cases.

Several countries, most notably Australia and Canada, have incorporated loser-pays attorney fee shifting, as the English Rule is sometimes called, into their class action system. In Australia, for example, the class representative or members of the plaintiff class who actually commenced the litigation must pay the winning party’s out-of-pocket expenses and attorneys’ fees. This provision has caused plaintiffs’ lawyers to select a straw class representative who has no assets from which the defendants can recover their costs. In return, defendants request courts to order the plaintiffs to pay the court a security of the estimated costs of the proceedings. Similarly, in Canada when a class loses, the representative plaintiff is the only one liable for the defendant’s legal fees and other costs. So far, representative plaintiffs have avoided paying the costs because most cases are settled, but


215. Id. at 153-54.


217. Id.


219. Id. at 302.

220. Id.

analysts are concerned that the rule creates a strong disincentive for qualified class members to serve as the class representative.\footnote{222}

In the early 1990s, former President Bush's Council on Competitiveness led the civil justice reform movement and urged the states to implement the English Rule.\footnote{223} Indeed, one study "found 1,974 fee shifting statutes in the fifty states and the District of Columbia,"\footnote{224} and federal law contains over two hundred statutes that shift fees to encourage enforcing public policies such as civil rights, consumer protection, and environmental laws.\footnote{225} Alaska has used the English Rule since the nineteenth century, and its Civil Rule 82 "entitles the prevailing party in a civil lawsuit to partial compensation of his or her attorney's fees from the losing party."\footnote{226}

The limited use of the English Rule by both federal and state law, particularly in Alaska, shows both the advantages and disadvantages of applying the rule in the class action context. Martha Pacold best explains the advantages of fee shifting:

Under statutory fee shifting the loser pays the fees, while under the common fund doctrine the victorious class pays them .... Under fee shifting, the court awards fees in addition to whatever primary relief it grants the plaintiffs, and the amount of fees does not change the amount or type of the plaintiffs' relief. In contrast, under the common fund doctrine, as fees are subtracted from the fund, the amount available to satisfy class members' claims diminishes. The size of the fees therefore affects the size of the class members' relief.\footnote{227}

The payment of an attorney's fees under the common fund doctrine creates conflict between the class and its attorney because the class and attorney fight over how to divide the fund. Fee shifting, however, eliminates this conflict because the defendant

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will have to pay the attorney's fees and costs separately in addition to any monetary judgment award for the class. The greatest advantage to fee shifting in the class action context, therefore, is its ability to obviate conflict between class members and their attorney because the defendant, instead of the class, will compensate the class attorney.

The biggest weakness to the fee-shifting strategy is that most fee-shifting statutes require that to receive an award of attorneys' fees and costs, the party must "prevail." Whether a class has prevailed when they settle, however, is a complicated and unsettled question. This creates enormous incentive for plaintiffs' attorneys to settle at the expense of their clients because class attorneys, who are forced to compensate the defendant's attorney if they lose the case, are much more risk adverse than their client class. This reintroduces a conflict between class members who have much less to lose by proceeding to trial than their class attorney who faces enormous costs if she loses (not only will the class attorney be unable to recover her own out-of-pocket expenses, she will also have to pay the defendant's costs and expenses). Class attorneys may prematurely settle the claim thereby lowering the class' recovery.

The evidence, however, does not conclusively support the proposition that fee shifting creates undue pressure to settle. A study of Alaska's cases found that depending on the context, fee shifting "increased the value of reasonable cases, pushed strong cases toward trial and caused some plaintiffs to discount their claims." Some even argue that this is actually an advantage because "the English Rule ... is supposed to depress the settlement value of a suit

228. Id.
229. Id. at 1012.
230. See generally id. at 1012-14 (discussing when these plaintiffs are considered the prevailing party).
231. Id. at 1008-09.
232. Mark S. Stein, The English Rule with Client-to-Lawyer Risk Shifting: A Speculative Appraisal, 71 Chi.-Kent L. Rev. 603, 621 (1995) ("Because the plaintiff does not share in these risks, it will sometimes be in the lawyer's interest to accept a settlement that is not in the plaintiff's interest.").
233. Pacold, supra note 227, at 1008-09.
that is likely to fail,” and likewise, effectively encourage the parties to bring only the strongest claims to trial.\textsuperscript{235}

As Hensler and Rowe suggest, more investigation into the potential success or failure of this proposal needs to be conducted.\textsuperscript{236} There are many ways that loser-pays attorney fee shifting could be improved to be a better tool for monitoring class counsel. For example, allowing plaintiffs who settle in certain cases to be considered “prevailing” might reduce the incentive to settle and in turn, reduce the conflict between the class and its counsel in certain situations. It might also be possible to adjust attorneys’ fees that are awarded under the shifting regime to “equalize the expected results of judgment to match those of settlement.”\textsuperscript{237}

Despite the possible conflicts that fee shifting might create, it could very well prove to be a more beneficial monitoring tool for class members in small claims class actions than the American Rule. For example, the English Rule may better serve consumer claims for relatively small amounts of money. Under the American Rule, “the fee charged by the [class attorney] may exceed the amount of recovery.”\textsuperscript{238} “Under the English Rule, a defendant would be more likely to replace or provide a refund for the cost of a consumer good if he knew he would have to pay the plaintiff’s attorney fees in addition to any judgment awarded.”\textsuperscript{239} As opposed to the current system, therefore, the English Rule could assist plaintiffs in receiving better settlements.

Another less radical alternative is to increase class members’ ability to monitor their counsel in small claims class actions in conjunction with increased judicial oversight. This proposal would allow a judge to impose sanctions on plaintiffs’ attorneys who propose a settlement that contains excessive attorneys’ fees and/or is not in the class’ best interests. This proposal is essentially an extension of Rule 11 of the Federal Rules of Civil Procedure

\textsuperscript{235} Stein, \textit{supra} note 232, at 622.
\textsuperscript{236} Hensler \& Rowe, \textit{supra} note 214, at 153.
\textsuperscript{237} Pacold, \textit{supra} note 227, at 1029-30 (suggesting four recommendations to better achieve this goal).
\textsuperscript{238} Maggs \& Weiss, \textit{supra} note 216, at 1928; see \textit{supra} notes 158-66 and accompanying text (discussing the settlement award of a class action lawsuit against major airlines that resulted in $16 million in attorneys’ fees but only nominal discount coupons for class members).
\textsuperscript{239} Maggs \& Weiss, \textit{supra} note 216, at 1928.
which allows courts to impose sanctions on attorneys for filing frivolous lawsuits. Congress, when drafting the PSLRA, in order to strengthen Rule 11's application, required "the court to include in the record specific findings, at the conclusion of the action, as to whether all parties and all attorneys have complied with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure." By encouraging courts to enforce Rule 11 more frequently, Congress intended to reduce the number of meritless securities lawsuits. Evidence suggests that since passing the PSLRA, courts have been applying this heightened Rule 11 provision.

Analogously, Congress or the Federal Rules Committee could enact another rule or amend Rule 11 to allow courts to impose sanctions on attorneys who accept a settlement that is clearly unfavorable to the class, including, but not limited to, settlements that provide class counsel with exorbitant attorneys' fees. Increasing the court's enforcement ability against settlement awards which unjustly favor class counsel at the expense of class members in small claim class actions could have a deterrent effect similar to that of applying the heightened Rule 11 provision in securities class actions.

Finally, another less drastic alternative that Marc Gross suggested in response to Hensler and Rowe's fee-shifting proposal is to subject settlement agreements to greater scrutiny by the public through posting the agreements on the Internet. Gross argues that increasing disclosure to public citizens, watchdog groups, and the press will deter frivolous and abusive settlements. Indeed, Congress has already implemented a similar provision that mandates sufficient disclosure of antitrust settlements in cases.
brought by the government to ensure that settlements are in the public interest. The Antitrust Procedures and Penalties Act, also known as the Tunney Act, requires that the Justice Department file a "competitive impact statement" with the court explaining any proposed settlement and how it will affect competition in the relevant market. The public has sixty days to submit comments after the statement is filed, and the Department must file its responses with the court and publish them in the Federal Register during this sixty-day time period. The court then holds a hearing and rules on whether the proposed settlement is in the public interest. The statute has been enforced as illustrated by a suit brought by the American Antitrust Institute (AAI) claiming that the competitive impact statement filed by the Justice Department associated with the Microsoft settlement needed to be supplemented with additional information. The AAI desired information such as the alternative remedies considered and rejected, details about the Department of Justice's evaluation, and an explanation of how the settlement would affect private antitrust lawsuits pending against Microsoft.

These are just a few suggestions for resolving this problem. It is clear, however, that small claims class actions require a regulatory solution instead of a market-based solution, as even fee shifting would require a statutory or regulatory mandate. Reformers, therefore, should focus their efforts on creating a regulatory mechanism that will allow judges, and maybe even the public, to more effectively review settlement agreements on behalf of class members.

V. CONCLUSION

For class actions in which a lead plaintiff provision analogous to the PSLRA's provision would be effective, it is the optimum tool for

246. Id. § 16(d).
247. Id. § 16(e).
248. Id.
250. Id.
emulating the ordinary attorney-client relationship. Not only does it conserve judicial resources that would otherwise be needed to select and monitor class counsel, it also ensures fairer settlements for class members, including more reasonable attorneys' fees.

Alternative reform mechanisms, such as increasing judicial oversight in selecting class counsel, reviewing settlement agreements, or selecting class counsel through conducting auctions, do not provide adequate safeguards to class members' interests. Many judges do not have adequate time or information to conduct an investigation into a settlement agreement. Likewise, settling parties have a strong disincentive to reveal any information that would jeopardize gaining the court's approval of their agreement, especially one that generously compensates class counsel.

Selecting lead counsel through a bidding process does not adequately protect class interests because the lowest bidder may provide lower quality representation, be reluctant to expend more than he can recover due to a fee cap in the bidding contract, and be risk-averse to pursuing a larger settlement that would actually be a truer reflection of the class action's worth.

There are several factors that have made the lead plaintiff provision successful in securities class actions: (1) homogenous damages that can be fairly and objectively allocated in a settlement agreement, (2) the probability of repeat performances by institutional investors as lead plaintiffs, thereby increasing their influence over lead counsel, and (3) an objective factor, namely, the size of the investor's stake, to use in easily determining the most adequate lead plaintiff in terms of both sophistication and financial resources.

Based on these factors, the lead plaintiff provision could be expanded to class actions where (1) members of the class have suffered from similar types of damages so that the settlement allocation would only have to account for quantitative differences, (2) the lead plaintiff has some mechanism available for exercising influence over lead counsel, and (3) an objective or nearly objective test could be employed to fairly and accurately determine the most adequate lead plaintiff.

Antitrust class actions most easily meet these criteria because generally all of the class members are consumers who have suffered the same type of damage, namely economic loss, from a provider's
monopolistic activities. Moreover, any damages recovered could easily be allocated based on the quantitative differences in suffered losses, and the lead plaintiff could be objectively determined as the class member who suffered the greatest loss.

Effectively applying the lead plaintiff provision to other class actions requires the class action to contain (1) members who have suffered similar damages and (2) motivated members who have the resources to monitor lead counsel. The effectiveness of the lead plaintiff provision in other class actions decreases as class damages become less similar. As illustrated by employee discrimination class actions, however, the lead plaintiff provision remains an effective tool for class actions in which there are only slight differences among class members with respect to the substance and size of their damages. At the extreme, however, damages suffered by class members of mass tort litigation are so diverse that it is impossible for one class member to effectively represent the entire class as lead plaintiff.

The lead plaintiff provision is also unsuitable for small claims litigation because the other necessary element, motivated members who have the resources to serve as lead plaintiff, is missing. Small claims litigation violates this second requirement because the time and cost involved in serving as lead counsel outweigh the damage recovery a class member is likely to receive.

There are other reform alternatives for mass tort and small claims class actions, however, that will better serve to protect class members' interests than the current system. For mass tort class actions, increasing the ability of class members to opt out of the class actions after the approval of the proposed settlement would be a more effective monitoring tool. For small claim class action litigation, providing judges more information with which to review settlement agreements, employing a loser-pays fee-shifting mechanism, imposing sanctions on class counsel who enter into abusive settlement agreements, and subjecting settlement agreements to greater scrutiny by the public are all options worthy of consideration.

The reform proposals mentioned in this Note, especially extending the lead plaintiff provision to other types of class actions, are just a few of the ways to effectively reform class actions and better protect class interests. The success of the PSLRA lead
plaintiff provision in securities class actions and its potential to help class members in other class actions better monitor their class counsel and attain better settlement awards, should spur Congress and state legislatures to employ this provision in more class action litigation, especially antitrust suits. Indeed, rulemaking bodies can no longer sit idly by or continue to advocate traditional oversight procedures that allow lawyers to recover windfall profits at the expense of their class. Without reform, the value of class action litigation will amount to little more than a free box of cereal.

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