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Uncovering the Hidden Conflicts in Securities Class Action Litigation: Lessons from the State Street Case

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By Benjamin P. Edwards and Anthony Rickey***

Courts, Congress, and commentators have long worried that stockholder plaintiffs in securities and M&A litigation and their counsel may pursue suits that benefit themselves rather than absent stockholders or the corporations in which they invest. Following congressional reforms that encouraged the appointment of institutional stockholders as lead plaintiffs in securities actions, significant academic commentary has focused on the problem of "pay to play"—the possibility that class action law firms encourage litigation by making donations to politicians with influence over institutional stockholders, particularly public sector pension funds.

A recent federal securities class action in the District of Massachusetts, however, suggests that the networks of influence between class plaintiffs and their counsel are much more complex and difficult to detect. After appointing a special master to look into fee issues, the court discovered that a large class action firm had paid over $4 million in "bare referral" fees to an attorney who did little work on the case but had recommended the larger firm to a public sector pension fund "after considerable favors, political activity, money spent and time dedicated in Arkansas."

This is only one of the less-visible ways that class counsel may route benefits to class plaintiffs. Current class action processes do not routinely identify these potential conflicts of interest. Instead, they tend to surface when nonlitigants bring them to public attention.

Because neither the lead plaintiff nor the defendants have a strong incentive to voluntarily address these conflicts, we propose revisions to the class certification process that would require class plaintiffs to disclose more information regarding their relationships with class counsel. We also propose that courts routinely appoint special masters or class guardians as part of the settlement approval process to ensure that class plaintiffs' statements are subject to discovery and adversarial review.

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I. Introduction

Congress, courts, and academics have long worried that securities class action plaintiffs and their counsel may bring lawsuits that benefit themselves rather than their corporations or absent stockholders.[1] Enticed by lucrative class action awards, class counsel may pursue cases more with a view toward maximizing law firm profit than vindicating stockholder rights.

In theory, representative plaintiffs can monitor their counsel to ensure that the lawyers are protecting stockholders' interests. However, class plaintiffs may also suffer from conflicts of interest. The most straightforward conflict arises when class counsel agrees to share fees with a client outright—a practice that has famously resulted in the criminal convictions of prominent class action attorneys.[2] Other potential conflicts are more subtle. Class representatives with small stockholdings may have insufficient motive to monitor counsel. Meanwhile, class counsel may entice institutional investors, and particularly public sector pension funds, by contributing to politicians with influence over the funds.

The need for stockholder plaintiffs to monitor their attorneys is most acute in the settlement context, when class counsel typically ask a court both to terminate a lawsuit, releasing corporate defendants from further litigation risk, and to approve the payment of counsel's fees, either from corporate coffers or the stockholders' recovery.[3] Although judicial review provides some bulwark against compromised plaintiffs and counsel, adversarial review of settlements is rare,

1. *See infra* notes 19–25 and accompanying text.

2. *See* John C. Coffee, Jr., Entrepreneurial Litigation: Its Rise, Fall, and Future 76 (2015) ("[I]nvestigation found that Milberg had retained some individuals to serve as 'in-house' plaintiffs, promising them, in some cases, a percentage of the overall class recovery. . . . Ultimately, four of the 'name' partners of Milberg, Weiss—Weiss, Lerach, Bershad, and Schulman—went to prison.").

3. *See, e.g.*, *In re* Trulia, Inc. S'holders Litig., 129 A.3d 884, 892–94 (Del. Ch. 2016) (describing settlement process); Grosso v. Fid. Nat'l Title Ins. Co., 983 So. 2d 1165, 1169 (Fla. Dist. Ct. App. 2008).

and no settling party has a reason to bring uncomfortable facts to the attention of a reviewing court.[4] Plaintiffs who benefit from side deals have little reason to disclose them; and settling defendants have scant incentive to disrupt a settlement process by highlighting such relationships to a court, even if they are aware of troubling facts.

Partly in response to these concerns, Congress enacted the Private Securities Litigation Reform Act ("PSLRA") in 1995.[5] The PSLRA, adopting a suggestion from an academic article, sought to improve plaintiff monitoring of class counsel by adopting a presumption that the largest plaintiff stockholder—often an institution like a pension fund—would be the presumptive lead plaintiff.[6]

The PSLRA's reforms, however, did less to address conflicts of interest that might afflict institutional stockholders. In the years following the PSLRA's enactment, scholars discussed the risk of "pay to play"—the risk that class counsel would entice politically connected public sector plaintiffs, and in particular pension funds, by converting some of their fees into payments to politicians well placed to influence the funds.[7] To date, however, this scholarship has focused primarily on direct political donations.[8]

A recent $300 million settlement in litigation against State Street Bank and Trust Company (the "State Street litigation"),[9] however, suggests that the potential conflicts between institutional plaintiffs and class counsel extend beyond this straightforward "pay to play." A newspaper investigation revealed that the plaintiffs' lawyers, who had received nearly $75 million in fees, had double-counted some of their staff attorney hours, "inflating their combined bills by $4 million."[10] Unsettled by the revelations, the United States District Court for the District of Massachusetts appointed a special master to look into fee-related issues.[11]

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4. *See* Frederick C. Dunbar & Vinita M. Juneja, *Making Securities Class Actions More Responsive to the Modern Shareholder*, *in* Securities Class Actions: Abuses and Remedies 181, 184 (Edward J. Yodowitz et al. eds., 1994) ("By the time fees are recommended, defendants have already agreed to the settlement and do not care how it is divided among the shareholders and their attorneys."); Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. Chi. L. Rev. 1, 46 (1991) ("[S]ettlement hearings are typically pep rallies jointly orchestrated by plaintiffs' counsel and defense counsel. Because both parties desire that the settlement be approved, they have every incentive to present it as entirely fair.").

5. *See* H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 730.

6. *See infra* notes 19–25 and accompanying text.

7. *See* Coffee, *supra* note 2, at 74 ("By making generous donations to a comptroller's campaign fund, plaintiff's law firms in effect gained the right to rent the pension fund and use it as their lead plaintiff in securities litigation.").

8. *See, e.g.*, Stephen J. Choi, Drew T. Johnson-Skinner & A.C. Pritchard, *The Price of Pay to Play in Securities Class Actions*, 8 J. Empirical Legal Stud. 650 (2011).

9. Ark. Teacher Ret. Sys. v. State St. Bank & Tr. Co., C.A. Nos. 11-10230-MLW, 11-12049-MLW, 12-11698-MLW (D. Mass.).

10. Andrea Estes, *Critics Hit Law Firm's Bills After Class Action Lawsuit*, Bos. Globe (Dec. 17, 2016), https://www.bostonglobe.com/metro/2016/12/17/lawyers-overstated-legal-costs-millions-state-street-case-opening-window-questionable-billing-practices/tmeeuAaEaa4Ki6VhBpQHQM/story.html.

11. *See infra* text accompanying notes 35–37.

That investigation revealed further cause for concern. After receiving its portion of the fee award, Labaton Sucharow LLP ("Labaton") paid $4.1 million to a Texas attorney named Damon Chargois ("Chargois") for introducing Labaton to the lead plaintiff, the Arkansas Teacher Retirement System ("ATRS").[12] Chargois described his relationship to Labaton in an email to the law firm:

> We got you ATRS as a client after considerable favors, political activity, money spent and time dedicated in Arkansas, and Labaton would use ATRS to seek lead counsel appointments in institutional investor fraud and misrepresentation cases. Where Labaton is successful in getting appointed lead counsel and obtains a settlement or judgment award, we split Labaton's attorney fee award 80/20, period.[13]

However, the district court found that Chargois had "done no work on the case" and that his name, payment, and role had not been disclosed to ATRS, the class, or the court.[14]

The email, undisclosed fee, and other revelations in the State Street litigation provide a window into what may be a hidden market, where politically connected lawyers broker relationships between institutional investors and class counsel who earn fees in contingency class actions.[15] This market remains hidden from judicial scrutiny, kept invisible by the often nonadversarial nature of the settlement and class certification processes.

Based on the revelations from the State Street litigation and other stockholder class actions, this article recommends reforms that would enable reviewing courts to monitor class action settlements more closely for potential conflicts of interest. First, we briefly summarize the role lead plaintiffs play in corporate and securities litigation. We then describe the unusual circumstances in the State Street litigation that led to the discovery of ties between a securities litigation powerhouse, a state pension fund, and the attorney who brought them together (for a fee). Next, we compare these techniques to others that securities litigators may employ to transfer benefits to institutional investors without directly sharing fees and explain why current class certification procedures would not uncover these relationships. Finally, we propose reforms that would allow courts to detect troubling relationships between class plaintiffs and their counsel so that judges may better defend stockholders from the risk that litigants will pursue cases for their own benefit rather than for the benefit of the stockholders that they purportedly represent.

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12. Ark. Teacher Ret. Sys. v. State St. Bank & Tr. Co., C.A. No. 11-10230-MLW, C.A. No. 11-12049-MLW, C.A. No. 12-11698-MLW, 2018 WL 3216012, at *2–3 (D. Mass. June 28, 2018).

13. *Id.* (quoting email from Chargois).

14. *Id.*

15. *See* John C. Coffee, *The Market for Lead Plaintiffs*, THE CLS BLUE SKY BLOG (Sept. 24, 2018), http://clsbluesky.law.columbia.edu/2018/09/24/the-market-for-lead-plaintiffs/ ("[A]n active market may today exist in which politically connected attorneys charge extraordinary contingent fees, requiring payments in the millions of dollars, for introducing and connecting prominent plaintiffs' law firms with public pension funds and other institutions capable of serving as lead plaintiffs in major class actions."); *see also* Choi et al., *supra* note 8, at 651 ("The available anecdotal evidence raises suspicion that class action law firms are buying lead counsel status with campaign contributions, that is, lawyers are paying to play.").

II. The Role of Lead Plaintiffs in Corporate Class Actions

Securities litigator William Lerach boasted that he had "the greatest law practice in the world" because he had "no clients."[16] While this may be an overstatement, many individual stockholder plaintiffs play a markedly passive role in securities litigation. Moreover, the nonadversarial nature of the class settlement process makes it difficult to detect when class counsel influence their clients by inappropriately sharing class action fees. Lerach famously served time in federal prison after pleading guilty to a conspiracy charge related to the payment of kickbacks to class action plaintiffs.[17] These payments came to light only after one of his firm's clients—facing charges for insurance fraud—agreed to testify against the firm in the hope of receiving a lighter sentence.[18]

In 1995, Congress enacted the Private Securities Litigation Reform Act, in part in response to the perceived threat posed by such relationships.[19] Attempting to revitalize client oversight for securities class action litigation, Congress embraced an idea proposed in a 1995 law review article: encouraging institutional investors to serve as lead plaintiffs.[20] The article suggested that the stockholder with the largest loss should serve as the presumptive lead plaintiff for the class, an idea that ultimately formed the basis for the PSLRA's lead plaintiff provision.[21] Theoretically, a sophisticated pension fund or other institutional investor with a significant loss would more diligently oversee class counsel than a small stockholder, who might otherwise permit her lawyers to settle cases

16. Peter J. Henning, *Behind the Rise and Fall of a Class Action King*, N.Y. Times DealBook (Mar. 1, 2010), https://dealbook.nytimes.com/2010/03/01/behind-the-rise-and-fall-of-a-class-action-king/; *see also* Carrie Johnson, *Lerach Gets Two Years in Prison for Kickbacks*, Wash. Post (Feb. 12, 2008), http://www.washingtonpost.com/wp-dyn/content/article/2008/02/11/AR2008021101454.html.

17. *Lerach Is Sentenced to 2 Years in Prison*, N.Y. Times DealBook (Feb. 11, 2008), https://dealbook.nytimes.com/2008/02/11/lerach-is-sentenced-to-2-years-in-prison/ (describing prosecution's claim that Lerach's firm paid $11.3 million in kickbacks to people who became plaintiffs); *see also* John Nocera, *Serving Time, but Lacking Remorse*, N.Y. Times (June 7, 2008), https://www.nytimes.com/2008/06/07/business/07nocera.html (describing problem of secretly paying off "professional plaintiffs").

18. *See* Peter Elkind, *The Fall of America's Meanest Law Firm*, Fortune (Nov. 3, 2006), http://archive.fortune.com/magazines/fortune/fortune_archive/2006/11/13/8393127/index.htm.

19. *See* H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 730.

20. *See* Elliot J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 Yale L.J. 2053 (1995); Elliott J. Weiss, *The Lead Plaintiff Provisions of the PSLRA After a Decade, or "Look What's Happened to My Baby,"* 61 Vand. L. Rev. 543, 549 (2008) ("The Committee thereafter reported out a bill that substantially mirrored our recommendations, providing for . . . selection as lead plaintiff of the plaintiff or applicant with the largest financial interest, allowing the lead plaintiff to appoint and retain lead counsel, and restricting discovery directed at applicants for appointment as lead plaintiff.").

21. *Compare* Weiss & Beckerman, *supra* note 20, at 2105 ("[B]ecause the named plaintiff or group of plaintiffs with the largest financial stake in the outcome of an action has the greatest economic incentive to monitor class counsel's performance effectively, courts should adopt a presumption that that plaintiff or group will 'most adequately' represent class members' interests."), *with* 15 U.S.C. § 78u-4(a)(3)(B)(iii), (vi) (2018) (creating rebuttable presumption that stockholder with the largest financial stake is the "most adequate" representative).

quickly for contingency fees.[22] The article memorably proposed to "let the money do the monitoring," relying upon institutional investor lead plaintiffs to have the capability and incentives to oversee counsel.[23]

Although institutional lead plaintiffs have been associated with some positive effects, they have not proved to monitor their lawyers as independently and vigorously as Congress might have hoped.[24] Institutional investors—particularly state pension funds—have political, financial, and legal interests not shared by other stockholders. For instance, the leaders of state pension funds may be elected by union members or appointed by elected representatives. One academic study noted that any restraining effect that institutional stockholders had on contingency fee requests virtually disappeared among institutional investors whose managers had accepted campaign contributions from class counsel.[25]

Thus, although the presence of sophisticated lead plaintiffs can theoretically protect against a host of harms to passive and absent class members, that is not always true in practice. The State Street litigation shows how this theoretical oversight role can be undermined by a complex web of real-world relationships that judicial eyes rarely see.

III. The State Street Revelations

In late 2016, the *Boston Globe's* Spotlight Team turned its attention to Boston's Thornton Law Firm ("Thornton").[26] The *Globe's* initial stories involved allegations of potential straw donations from Thornton partners to political candidates.[27] A few months later, the *Globe* began asking more questions about how fees from the State Street litigation flowed through Thornton. The Spotlight

22. *See* Weiss & Beckerman, *supra* note 20, at 2054–55 ("Controversy abounds about securities class actions, centering on . . . attorneys operating on a contingent fee basis initiat[ing] most such suits in the names of 'figurehead' plaintiffs with little at stake . . . . [C]ritics focus on the agency costs inherent in class actions initiated and maintained by attorneys who operate without meaningful client supervision.").

23. *Id.* at 2126 (explaining that institutional investors "have the knowledge and financial sophistication necessary to serve as effective litigation monitors" and that their financial state "would give them an incentive to do that job well").

24. *See* Jessica Erickson, *The Gatekeepers of Shareholder Litigation*, 70 Okla. L. Rev. 237, 250 (2017) ("[I]nstitutional investors have not exercised their new monitoring responsibilities as well or as creatively as lawmakers might have hoped.").

25. *See* Choi et al., *supra* note 8, at 651 ("State pension funds whose managers have received campaign contributions, however, appear to be less vigorous in negotiating attorney fees. The state pension funds whose officials received the largest contributions from the lead attorney firms negotiate for attorney fees that are statistically indistinguishable from the fees in cases with individual investors serving as lead plaintiffs.").

26. *See* Andrea Estes & Viveca Novak, *Law Firm "Bonuses" Tied to Political Donations*, Bos. Globe (Oct. 29, 2016), https://www.bostonglobe.com/metro/2016/10/29/prominent-democratic-law-firm-pays-questionable-bonuses-partners-for-campaign-contributions/GpD5tRQZR7pRe8hwAvQw8N/story.html.

27. *Id.* For its part, Thornton stated that the payments "weren't really bonuses but the partners' own money, taken out of each one's equity in the firm." Andrea Estes, *Thornton Law Firm Didn't Break State Campaign Finance Laws, Prosecutor Says*, Bos. Globe (Apr. 19, 2018), https://www.bostonglobe.com/metro/2018/04/18/thornton-law-firm-didn-break-state-campaign-finance-laws-prosecutor-says/XiRBRPxjEWyrfsmPvhxxtM/story.html.

investigation pointed out that Thornton's managing partner, Garrett Bradley, had claimed that his younger brother, Michael Bradley, worked for the firm as "a $500-an-hour 'staff attorney,'" even though the younger Bradley brother often worked for "$53 an hour as a court-appointed defender in Quincy District Court."[28] The reporters also discovered that at least one lawyer whose rate was listed as $425 an hour was "actually paid just $30 an hour."[29] These pointed questions prompted Labaton, lead counsel in the State Street litigation, to write to United States District Court Judge Mark L. Wolf to inform him that some "inadvertent errors" had been made in the materials submitted in support of its fee award, including the double-counting of some staff attorney hours.[30]

A month later, the *Globe* published yet another story on Thornton, describing the firm's managing partner as "essentially work[ing] as a salesman for Labaton."[31] The story described the flow of funds from class action fee awards, through Thornton and Labaton, into the election campaign treasuries of officials who oversaw a pension fund—a client of Labaton and Thornton.[32] According to the *Boston Globe*, about half of one county treasurer's campaign donations over a ten-year period—about $100,000—came from lawyers at Thornton and Labaton.[33] That official oversaw the Plymouth County retirement system, on whose behalf Thornton and Labaton had filed several securities class action lawsuits.[34]

The facts revealed by the *Boston Globe* and Labaton's letter caused the State Street court to reconsider whether the $75 million dollar fee award was appropriate.[35] Nine days after the *Boston Globe* published its story detailing the connections between Thornton, Labaton, and Plymouth County, Judge Wolf issued a memorandum and order discussing his "questions about the accuracy and reliability of the representations plaintiffs' counsel made" in their request for an award of fees and setting a "hearing to address the possible appointment of a special master."[36] After giving the parties an opportunity to object, Judge Wolf "took the evidently then-unprecedented step of appointing a master to investigate

28. Andrea Estes, *Critics Hit Law Firm's Bills After Class Action Lawsuit*, Bos. Globe (Dec. 17, 2016), https://www.bostonglobe.com/metro/2016/12/17/lawyers-overstated-legal-costs-millions-state-street-case-opening-window-questionable-billing-practices/tmeeuAaEaa4Ki6VhBpQHQM/story.html.

29. *Id.*

30. Letter from David J. Goldsmith to U.S. Dist. Ct. Judge Mark L. Wolf, Ark. Teacher Ret. Sys. v. State St. Bank & Tr. Co., Case No. 1:11-cv-10230-MLW (D. Mass. Nov. 10, 2016).

31. Andrea Estes, *Firms Profited from Garrett Bradley's Ties*, Bos. Globe (Jan. 28, 2017), https://www.bostonglobe.com/metro/2017/01/28/prim-and-proper-statehouse-leader-law-firm-profited-from-ties-public-retirement-funds/YKWbyFzQb6Li2VNTjbu18O/story.html.

32. *Id.*

33. *Id.*

34. *Id.*

35. *See* Ark. Teacher Ret. Sys. v. State St. Bank & Tr. Co., 232 F. Supp. 3d 189, 193 (D. Mass. 2017).

36. *Id.* at 191. In issuing his order, the court relied on Federal Rule of Civil Procedure 23(h)(4), which allows a court to "'refer issues related to the amount of the [attorneys' fee] award to a special master . . . as provided in Rule 54(d)(2)(D).'" *Id.* at 193 (quoting Rule 23(h)(4)). Rule 54(d)(2)(D) allows referrals for a special master to consider "the value of services." Fed. R. Civ. P. 54(d)(2)(D) ("[T]he court may refer issues concerning the value of services to a special master . . . .").

whether false and misleading statements had been made in the petition for fees and related issues."[37]

The master's investigation soon uncovered additional cause for concern. Among other things, the master discovered that Labaton had paid Chargois $4.1 million for his role in introducing Labaton to ATRS. It also emerged that "political leaders" in Arkansas had "persuaded" ATRS's executive director to give priority to class action lawsuits.[38]

Judge Wolf expressed concern that "the origins of Labaton's relationship with ATRS . . . might diminish ATRS' incentive to represent the class vigorously" and noted that the master's report raised questions about "whether 'all of those millions of dollars stopped with Mr. Chargois.'"[39] After all, Mr. Chargois' email explained that he needed to collect his 20 percent to justify the cost of procuring the relationship "'after considerable favors, political activity, money spent and time dedicated in Arkansas.'"[40]

In theory, a vigorous lead plaintiff actively supervises its lead counsel, examining fee requests to maximize the portion of the settlement retained by the class. The efforts that ATRS undertook to supervise its class counsel remain unclear, but they do not seem to have been effective. In the State Street litigation, Judge Wolf harshly criticized Thornton for declaring, under oath, that one attorney's regular rate was $500 per hour, when the firm could only identify one case in which that attorney had been charged at even $300 per hour.[41] He similarly noted that Labaton submitted as "regular rates" for services hourly rates that had "never been charged to paying clients."[42] ATRS did not volunteer these facts. They were only discovered because the State Street court took the apparently unprecedented step of appointing a special master to investigate.[43]

The State Street litigation remains active and Judge Wolf has not yet decided whether to impose sanctions. For its part, Labaton has submitted a report prepared by a retired federal judge finding that the bare referrals paid to Chargois were "unique" and "aberrational."[44]

37. Ark. Teacher Ret. Sys. v. State St. Bank & Tr. Co., C.A. No. 11-10230-MLW, C.A. No. 11-12049-MLW, C.A. No. 12-11698-MLW, 2018 WL 3216012, at *1 (D. Mass. June 28, 2018).

38. *Id.* at *3.

39. *Id.* (quoting the court's own comment at a hearing).

40. *Id.* at *2 (quoting email from Chargois).

41. *Ark. Teacher Ret. Sys.*, 2018 WL 3216012, at *12 ("Although he claimed that Thornton's regular rate for Michael Bradley was $500 an hour, Garrett Bradley could not identify any case in which a client had been charged that rate, and identified only one Thornton case in which his brother was billed at a rate of as much as $300 an hour.").

42. *Id.* ("[T]he statements of Sucharow and Garrett Bradley heightened my concern about whether false and misleading statements had been made under oath.").

43. *Id.* at *13 ("[N]one of those cases resulted in the appointment of a master to investigate . . . . I am evidently the first judge to have done that.").

44. Phase I Report at 15, Ark. Teacher Ret. Sys. v. State St. Bank & Tr. Co., No. 1:11-cv-10230-MLW (D. Mass. Jan. 8, 2019) (as amended Feb. 6, 2019) [hereinafter Brown Report"].

IV. The Problem of Undisclosed Benefits to Institutional Class Plaintiffs

The State Street litigation demonstrates how the standard process for approving class actions in state and federal courts fails to uncover potential conflicts between class counsel and institutional plaintiffs and, in particular, public sector pension funds. The case presents a rare example of a court taking extreme measures to ascertain whether class counsel channeled settlement proceeds to clients, the fiduciaries who control institutional clients, or third parties who could influence them to become plaintiffs. However, the State Street court did not appoint a special master because the plaintiff stumbled over some typical procedural safeguard. Indeed, the court initially granted plaintiff's counsels' request for $75 million in fees and expenses.[45] Adversarial scrutiny only began once the Spotlight Team made its extrajudicial case in the *Boston Globe*.

Much of the Spotlight Team's investigation did not require resorting to whistleblowers, secret informants, or the shoe-leather techniques of investigative journalism. Anyone willing to scour through reams of dry data looking for inconsistencies could have spotted key facts, such as the difference between a contract-attorney's supposed hourly rates and his or her court-awarded payments or the double-counting of certain contract attorneys by multiple firms.[46] In most securities and corporate class actions, however, no one conducts a detailed inquiry into the plaintiff or class counsel as part of the settlement process. The limited review means that courts may never be made aware of potential conflicts of interest or odd billing practices.

The possibility that courts are unknowingly approving payments between class counsel and "referral" counsel is particularly troubling. The best that could be said for this practice is that stockholders benefit by permitting class counsel to pay bounties to referral firms where such bounties secure class representatives who serve as effective monitors of counsel. Real-life data contradicts this Panglossian view: a $4 million payment to Chargois did not secure a class representative who noticed, for instance, double-counting of staff-attorney time.[47] Even if one accepted that entrepreneurial attorneys might engage in a "race for the top," seeking to pay for more effective class plaintiffs rather than less-effective monitors, the current lack of voluntary disclosure prevents reviewing courts or absent stockholders from evaluating the motive behind "referral" payments.

It is likely that a closer look at other corporate or securities class actions would uncover other potential conflicts. Consider, for instance, *Garber v. Pharmacia Corp.*, a securities class action filed in the United States District Court for the District of New Jersey.[48] On August 12, 2003, the district court appointed the Sarasota Firefighter's Pension Fund ("Sarasota") as one of six pension funds to lead

45. Ark. Teacher Ret. Sys. v. State St. Bank & Tr. Co., 232 F. Supp. 3d 189, 191 (D. Mass. 2017).
46. Estes, *supra* note 28.
47. *See supra* notes 35–42 and accompanying text.
48. Civ. A. No. 03-1519 (AET) (D.N.J. Aug. 12, 2003).

the class action and appointed the fund group's chosen attorneys—a leading national class action firm—as class counsel.[49] However, nine years later, when the case settled, Sarasota's papers also listed, as additional counsel for plaintiffs, a local Florida law firm that represents the pension fund in other matters.[50]

In early 2013, the *Garber* court approved the settlement and awarded class counsel, collectively, approximately $45 million in fees and expenses.[51] As in most securities class actions, the district court did not inquire into how much each plaintiff's firm would receive in fees. Instead, it allowed lead counsel discretion to allocate fees "in a manner which . . . reflects each counsel's contribution to the institution, prosecution, and resolution of the litigation."[52] Other publicly available information, however, suggests that Sarasota's Florida counsel received a portion of the *Garber* fee.[53]

However, the Florida law firm's relationship to Sarasota extended beyond class actions: Sarasota paid the firm fees as compensation for other non-contingency action work.[54] After the district court approved the *Garber* settlement, Sarasota's Florida counsel informed Sarasota's board of its decision not to raise Sarasota's monthly retainer fee, in part because the firm had received fees from Sarasota's securities litigation:

> We understand that the last ten years have been a difficult one for everybody so we haven't sought to increase our fees. So we are proposing not to do so through 2014. . . . We obviously did receive some income from the work we did on the securities litigation case, which we disclosed to you obviously. . . . We are obviously very appreciative of you having the confidence in us. And this is kind of our way of paying you back a little bit. As legally as we can.[55]

The next month, the Florida law firm also announced its creation of a $25,000 scholarship fund for the benefit of the families of Sarasota firefighters—Sarasota's constituent members.[56]

49. *See* Garber v. Pharmacia Corp., Civ. A. No. 03-1519 (AET) (D.N.J. Aug. 12, 2003) (memorandum and order).

50. *See* Memorandum in Support of Lead Plaintiffs' Motion for Final Approval of Class Action Settlement and Plan of Allocation of Settlement Proceeds and an Award of Attorneys' Fees and Expenses and Lead Plaintiffs' Expenses at 24, Alaska Elec. Pension Fund v. Pharmacia Corp., C.A. No. 03-1519 (D.N.J. Dec. 14, 2012).

51. *See* Order Awarding Plaintiffs' Counsel's Attorneys' Fees and Expenses at 2, Alaska Elec. Pension Fund v. Pharmacia Corp., C.A. No. 03-1519 (D.N.J. Jan. 30, 2013).

52. *Id.*

53. *City of Sarasota Firefighters Pension Board, Video of Firefighters' Pension Board Meeting*, GRANICUS.COM (Mar. 27, 2013), http://sarasota.granicus.com/ViewPublisher.php?view_id=21 (discussion at 2:29–2:32). Notably, while the video of Sarasota's board meeting does not identify the class "securities litigation case" as *Garber*, the timing is indicative. The meeting took place approximately two months after the *Garber* court approved the relevant fee award. *See supra* note 51.

54. *City of Sarasota Firefighters Pension Board, Video of Firefighters' Pension Board Meeting*, GRANICUS.COM (Mar. 27, 2013), http://sarasota.granicus.com/ViewPublisher.php?view_id=21 (discussion at 2:29–2:32).

55. *Id.*

56. *See City of Sarasota Firefighters' Pension Board, Minutes of the Regular Meeting of the Firefighters' Pension Board of Trustees of April 24, 2013*, GRANICUS.COM 3 (Aug. 24, 2013), http://sarasota.granicus.com/MinutesViewer.php?view_id=21.&clip_id=5792.

This arrangement is not unique: at least one other Florida public sector pension fund received a reduced monthly retainer from the same local law firm following that firm's receipt of funds from a securities class action. The December 2011 minutes from the Pompano Beach Police and Firefighters' Retirement System ("Pompano") describe an agreement with its local Florida counsel to reduce its monthly retainer by $2,000 for one year, based in part on income received from class actions.[57] Pompano stated that while the law firm was "not legally allowed to share the fees that they receive for this work with their clients, they [were] able to reevaluate fee arrangements based on all work performed on behalf of a client and to take into account current economic conditions."[58] The minutes also note that while Pompano would receive a discount for non-retainer work, the law firm "wanted to be able to charge their full rates for securities litigation work that they do on a contingency basis."[59] Pompano's members also enjoy a scholarship fund set up by the same firm, while the fund received at least one other minor perk from its national counsel.[60]

The prevalence of this type of beneficial relationship between frequent-filing class plaintiffs, their local counsel, and class counsel is impossible to estimate. Florida has adopted strong "sunshine" laws requiring the boards of public sector pension funds like Sarasota and Pompano to make meeting minutes publicly available.[61] Not all jurisdictions have such rules, however, nor do they apply to private-sector labor union pension funds. Further, discussion of these arrangements may occur in executive session and not be included in public minutes. While publicly available documents confirm that these arrangements exist, they may not reflect the true scope of the problem.

State Street and *Garber* provide strong anecdotal evidence that the networks of influence potentially compromising a lead plaintiff's independence are more complex than may have been previously thought: they extend beyond simple campaign contributions to include relationships with outside counsel who may not appear on court papers.[62] Such nuanced relationships rarely receive judicial attention. The problem lies in the class leadership, class certification,

57. *See* Minutes, Pompano Beach Police and Firefighters' Retirement System (Dec. 12, 2011), https://drive.google.com/file/d/1UHm-RsX8NV1cx0L3EtJmZzzDSq187hce/view (noting that discount was provided "as a result of receiving $500 thousand for the work that they performed in the Washington Mutual litigation").

58. *Id.*

59. *Id.*

60. *See Broward College Scholarship Fund*, Pompano Beach Police & Firefighters' Ret. Sys. (July 10, 2014), http://www.pbpfrs.org/wp-content/uploads/2019/04/Broward-College-Scholarship-Fund-Brochure-Revised-2014-07-10.pdf; *see also, e.g.*, *Minutes*, Pompano Beach Police & Firefighters' Ret. Sys. (Jan. 22, 2019), https://www.pbpfrs.org/wp-content/uploads/2019/04/2019-01-22-Minutes-Final.pdf (describing to-be-filed gift disclosure form from national securities counsel relating to hosting a holiday dinner).

61. *See* Fla. Stat. Ann. § 286.011 (West 2019).

62. Scholarly attention has mostly focused on campaign donations by large class action law firms to politicians with influence over public sector pension funds. *See, e.g.*, Choi et al., *supra* note 8, at 650 ("We study the effect of campaign contributions to lead plaintiffs."); Erickson, *supra* note 24, at 248–49; David H. Webber, *Is "Pay-to-Play" Driving Public Pension Fund Activism in Securities Class Actions? An Empirical Study*, 90 B.U. L. Rev. 2031, 2080–81 (2010) (studying correlation between

or settlement approval processes, and courts rarely delve deeper than the relationship between class plaintiffs and the lead counsel who appear in an action. This is true even in the Delaware Court of Chancery—often considered America's preeminent business court—as two recent class leadership contests demonstrate.

In October 2018, the Court of Chancery reviewed competing applications for leadership in a class action challenging the squeeze-out merger of AmTrust Financial Service's minority stockholders.[63] Cambridge Retirement System ("Cambridge") sought the appointment of Labaton (along with two other firms) as lead counsel, while Pompano (along with two other Florida pension funds) moved to be appointed co-lead plaintiff alongside Cambridge and to have their law firms added to the leadership team.[64] In their competing motion papers, Pompano Beach did not mention Labaton's role in the State Street litigation, and Cambridge did not discuss Pompano's history of its local counsel's forbearing from increasing its non-contingency rates after receiving fees in class actions. Indeed, the parties eventually stipulated a co-lead counsel arrangement, which the Court of Chancery accepted.[65] There is no indication that the Court of Chancery was aware of, let alone approved, these potential conflicts of interest.[66]

Similarly, in March 2019, the Court of Chancery resolved a contested derivative leadership dispute in favor of Steamfitters Local 499 Pension Plan ("Steamfitters") and their counsel (Labaton, along with Quinn Emanuel Urquhart & Sullivan, LLP) in a case challenging Dell's decision to redeem a certain class of outstanding

political donations and lead plaintiffs and concluding that "pay-to-play does not drive public pension activism in securities litigation").

The question of whether "pay to play" payments are illegal is separate from whether they represent a conflict of interest. Such donations may be legal. *See* Estes, *supra* note 27 ("Thornton Law Firm didn't violate state campaign finance laws when it reimbursed its partners for up to $175,000 in donations to state and local politicians, a special prosecutor said Wednesday."). Even so, the existence of payments between class counsel and plaintiffs who are meant to act as fiduciaries for a class presents a potential conflict that at least merits disclosure. Corporate fiduciaries are required to disclose many potential conflicts—even if legal—prior to a stockholder vote. *See, e.g.*, *In re* Topps Co. S'holder Litig., 926 A.2d 58, 73–74 (Del. Ch. 2007) (enjoining merger pending disclosure of buyer's assurance of continued employment to target management). Surely stockholders should be similarly aware, when asked whether to object to class certification or a settlement that will eliminate their rights, whether their purported representative stands to receive some separate consideration. *Cf.* Del. Ct. Ch. R. 23.1(b), (c) (requiring certification that derivative plaintiff has not received compensation from serving as a representative party in the action, absent court approval).

63. *See* Motion for Appointment of Lead Plaintiff and Co-Lead Counsel, Cambridge Ret. Sys. v. DeCarlo, C.A. No. 2018-0402-CB (Del. Ch. Sept. 20, 2018) (public redacted version).

64. *See* The Pompano Group's Motion to Appoint Co-Lead Plaintiffs and Co-Lead Counsel, Pompano Beach Police & Firefighters' Ret. Sys. v. Zyskind, C.A. No. 2018-0396-CB (Del. Ch. Sept. 18, 2018).

65. Pompano Beach Police & Firefighters' Ret. Sys. v. Zyskind, C.A. No. 2018-0396-CB (Del. Ch. Oct. 10, 2018) (order for appointment of co-lead plaintiffs and lead counsel).

66. *Id.* at 3 (noting, in appointing both Cambridge and Pompano, that "there are no apparent conflicts at issue"). Potential conflicts of interest remained unmentioned when a separate plaintiff, a large investor, sought to resist a motion by lead counsel to consolidate the investor's individual action into the class action. *See* Arca's Opposition to Motion to Consolidate and Cross-Motion to Coordinate or, in the Alternative, to Appoint Arca as Co-Lead Plaintiff, *In re* AmTrust Fin. Servs. Inc. S'holder Litig., Consol. C.A. No. 2018-0396-AGB (Del. Ch. Mar. 15, 2019).

stock.[67] Two Florida pension funds (Hallandale Beach Police and Fire Retirement Plan ("Hallandale") and Miramar Police Officers' Retirement Plan ("Miramar")) filed a competing application for leadership, proposing alternate lead counsel.[68] The docket does not reflect any discovery served by either of the opposing plaintiffs into the relationship between the proposed lead plaintiffs and their law firms.[69] The Florida pension funds did not discuss Labaton's role in the State Street litigation in their briefs to the court. Thus, in awarding leadership to Labaton, the court held that "[n]o one has suggested that any of [the plaintiffs] have any interest that would diverge from the class."[70]

As in the AmTrust and Dell cases, the plaintiff/counsel relationship often remains unexplored even when contingency firms vie for leadership.[71] If even adversarial plaintiffs do not bring the details of a client relationship to a court's attention, and defendants remain silent, such details will rarely, if ever, be addressed.

V. Proposed Reforms

The State Street, *Garber*, AmTrust, and Dell cases demonstrate that courts face an informational vacuum in addressing conflicts of interest between securities class action plaintiffs and their counsel. More often than not, no litigant stands to gain by raising potential conflicts, particularly when the parties jointly present a proposed settlement.[72] Even when corporate defendants contest class certification, they often have little incentive to raise issues that would disqualify a class plaintiff: a successful challenge does not dismiss the action but instead offers an opportunity for a less-compromised stockholder to take up the case. Thus, potential conflicts either come to a court's attention through the efforts of third parties, or they never surface at all.

Current class certification procedures lack safeguards that would routinely identify institutional plaintiffs' potential conflicts of interest and, in particular,

67. *See In re* Dell Techs. Inc. Class V S'holders Litig., C.A. No. 2018-0816-JTL, 2019 WL 1259867 (Del. Ch. Mar. 18, 2019) (order). Friedman Oster & Tejtel PLLC and Andrews & Springer LLC also formed part of the prevailing leadership team. *See id.* at *1.

68. *See* Brief in Support of Motion by Plaintiffs Hallandale Beach Police and Fire Retirement Plan and Miramar Police Officers' Retirement Plan for Appointment of Lead Plaintiffs and Lead Counsel, *In re* Dell Techs. Inc. Class V S'holders Litig., C.A. No. 2018-0816-JTL (Del. Ch. Mar. 18, 2019) (public redacted version).

69. To be clear, although there is no way of knowing what discovery would uncover, our review of the publicly available minutes of the two Florida pension funds involved in the Dell case did not turn up discussion of relationships between Hallandale or Miramar and their counsel similar to those found in the public records concerning Sarasota or Pompano.

70. *Dell Techs.*, 2019 WL 1259867, at *2.

71. One reason contingency law firms may be reticent to explore the attorney/client relationships of competing lead plaintiffs is that they compete to provide services to opposing institutions. For instance, Miramar's minutes state that, as recently as October 2017, the fund decided to use Labaton to provide certain unspecified services regarding securities. *See Minutes of Meeting*, Miramar Police Officers' Ret. Plan (Oct. 5, 2017), https://miramarparks.org/DocumentCenter/View/9042/October-5-2017-Minutes. Contingency firms may be wary of challenging actions taken by funds that are former clients, or could be clients in the future.

72. *See supra* notes 3–4 and accompanying text

their political interests. Otherwise, Labaton could not have paid at least half a dozen "bare referral fees" to Chargois before the payments came to light.[73] Similarly, the authors are unaware of any institutional plaintiff ever voluntarily disclosing to a court that it received law-firm-funded academic scholarships or reduced fees for non-contingency work. Thus, there is no judicial authority addressing whether these benefits are a "form of compensation . . . for prosecuting or serving as a representative party" that would be inappropriate in Delaware without court approval.[74] If these arrangements are not brought to a court's attention, there never will be a judicial decision.

Class plaintiffs cannot be relied upon consistently to volunteer information regarding potential conflicts, and the class action system cannot rely upon the *Boston Globe* or other journalists to provide unpaid adversarial research in every action. However, the lessons learned from these cases could form the basis for a number of reforms that would routinely surface conflicts of interest peculiar to institutional class plaintiffs.

A. Increased Disclosure Concerning Legal Fees and Expenses

The United States Chamber of Commerce recently urged Congress to enact a "bill of rights for securities investors" requiring the disclosure of personal, professional, and economic relationships between lead plaintiffs and their counsel in securities class actions.[75] The proposal is a good start: had the PSLRA contained such provisions, the relationship between Labaton, Chargois, and ATRS might have been uncovered long ago. However, this single reform may not be sufficient: plaintiffs could respond by pursuing lawsuits in state court or by bringing actions as individuals without seeking class certification.

At a minimum, plaintiffs should be required to identify at the outset of any securities class action or derivative case, whether brought in federal or state court, every law firm engaged on behalf of a plaintiff, its role in the case (whether or not a firm formally appears as counsel on the docket), its proposed fee arrangements, and any other personal, political, or economic relationships between counsel and client. This disclosure should be updated whenever a new law firm is engaged and at class certification. As part of any fee petition, class

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73. *See* Ark. Teacher Ret. Sys. v. State St. Bank & Tr. Co., No. 11-cv-10230-MLW, at 124 (D. Mass. June 28, 2018) (Master's Report) ("Since the Chargois Arrangement began in 2008, Labaton has represented ATRS in at least nine cases for which it has paid Chargois a percentage of Labaton's total fee award."). Labaton's internal review maintains that there were only seven payments of "bare referral fees," including the State Street litigation. *See* Brown Report, *supra* note 44, at 11–12.

74. Del. Ct. Ch. R. 23(aa).

75. U.S. Chamber Inst. for Legal Reform, Containing the Contagion: Proposals to Reform the Broken Securities Class Action System 18 (Feb. 2019), https://www.instituteforlegalreform.com/research/containing-the-contagion-proposals-to-reform-the-broken-securities-class-action-system [hereinafter Contagion]; *see also* U.S. Chamber Inst. for Legal Reform, A Rising Threat: The New Class Action Racket that Harms Investors and the Economy 23 (Oct. 2018), https://www.instituteforlegal reform.com/uploads/sites/1/A_Rising_Threat_Research_Paper-web_1.pdf (encouraging Congress to take up PSLRA reform to confront purportedly "abusive practices that undermine the ability of parties and the courts to address the merits of securities class action claims").

counsel should also disclose the number of hours each firm and attorney has committed to the litigation. Information concerning a law firm's hourly rates should include any discounts given to the class representative in non-contingency work. If a firm employs contract attorneys at a low hourly rate, that rate should also be disclosed, as well as whether the firm has ever charged a paying client the markup rate proposed to a reviewing court. Armed with this information, courts and absent stockholders would be able to evaluate whether fees are reasonable and identify the type of "bare referral fee" at issue in State Street.

In context, the mere existence of referral agreements or other inducements that might tilt institutional investors toward participation in securities class or derivative litigation may not overly concern courts. Once disclosed, potential conflicts may be assessed and considered. Some benefits, such as a cup of coffee, may be so small that a court would not view them as disabling. Others—such as the "favors, political activity, money spent and time dedicated in Arkansas" uncovered in the State Street Litigation—may prompt further judicial scrutiny. Importantly, courts can only review and approve or disapprove of conflicts after they come to light.

Analogous disclosure procedures from other areas of law provide a roadmap for reform. For instance, some courts and legislatures require litigants to disclose third-party litigation financing arrangements in class action cases.[76] Similarly, attorneys seeking to work on behalf of certain entities in bankruptcy cases must disclose, among other things, "any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, [or] any other party in interest."[77] Failure to identify and disclose relationships may result in courts cutting fee awards substantially.[78]

In a similar manner, courts could provide, by local rule or specific order, that stockholder class action plaintiffs and lead counsel disclose all law firms that stand to receive payment in a case. In the alternative, Congress could require disclosure of entities entitled to receive fees, perhaps as an amendment to the PSLRA.

76. *See, e.g.*, U.S. Dist. Ct. for the N. Dist. of Cal., Standing Order for All Judges of the Northern District of California 2 (effective Nov. 1, 2018), https://www.cand.uscourts.gov/siorders (requiring disclosure of "any person or entity funding the prosecution of any claim or counterclaim" in any "proposed class, collective, or representative action"); Wis. Stat. Ann. § 804.01 (West 2018) (requiring disclosure of "any agreement under which any person, other than an attorney permitted to charge a contingent fee representing a party, has a right to receive compensation that is contingent on and sourced from any proceeds of the civil action, by settlement, judgment, or otherwise"). It is unclear whether a rule like Wisconsin's—which does not apply to attorneys permitted to charge a contingency fee—would have resulted in the disclosure of the payments to Chargois.

77. Fed. R. Bankr. P. 2014(a). The rule requires attorneys and other professional service providers to identify potential conflicts of interest for the court. *See In re* Martin, 817 F.2d 175, 182 (1st Cir. 1987) (explaining that lawyers seeking to receive fees in bankruptcy proceedings have "a responsibility to leave no reasonable stone unturned in bringing [potential conflicts of interest or other relationships] to a head at the earliest practical moment").

78. *See In re* Byington, 454 B.R. 648, 657 (Bankr. W.D. Va. 2011) ("Published bankruptcy court decisions are quite consistent in requiring that debtors-in-possession and their attorneys, whose employment is sought to be approved, be meticulous in disclosing 'all connections' with the debtor and other parties in interest, the failure to do so justifying a court's taking significant punitive or corrective action.").

Disclosure-based reforms, however, have a limited track record of success and are unlikely to be a panacea on their own. The PSLRA already includes similar measures that attempt to restrain "professional plaintiffs," in part by requiring plaintiffs to identify any other PSLRA-related actions filed in a preceding three-year period.[79] The results have been, at best, mixed. Some repeat plaintiffs have responded by recasting their filings as individual actions or shareholder derivative actions, rather than securities class action complaints.[80] Others simply omit earlier cases from their certifications.[81]

A disclosure rule only incentivizes class plaintiffs to disclose potential conflicts if they perceive a risk of being caught—and punished—for noncompliance.[82] Busy courts may have difficulty enforcing disclosure regimes. Class certification motions routinely confront jurists with hundreds of pages of information.[83] Even if class plaintiffs disclose information concerning conflicts of interest, courts may not have the time to scrutinize them effectively. Normally, courts expect a party's adversary to surface the key facts necessary for judicial review. An effective class certification regime may, therefore, require courts to engineer adversaries—and adversarial process—when no effective adversary exists.

B. Restoring Adversarial Scrutiny to the Class Settlement Process

The *Boston Globe's* investigation prompted the State Street court to look more closely into the relationship between Thornton, Labaton, Chargois, and ATRS, when earlier courts had not.[84] Rather than rely upon the occasional journalistic exposé, however, courts can restore regular adversarial review to the class

79. *See* 15 U.S.C. § 78u-4(a)(2)(A)(v) (2018).

80. *See, e.g.*, Complaint for Violations of Sections 14(a) and 20(a) of the Securities Exchange Act of 1934, Carlyle v. Akorn, Inc., No. 1:17-cv-05022 (M.D. La. June 20, 2017) (individual plaintiff's complaint to enjoin corporate merger based on allegedly misleading proxy statement); *cf.* Jessica Erickson, *The New Professional Plaintiffs in Shareholder Litigation*, 65 Fla. L. Rev. 1089, 1135 (2013) ("[T]he legal system has not won the war against professional plaintiffs. Instead these plaintiffs may have simply moved into new legal territory.").

81. As Professor Erickson has noted, although "[t]he PSLRA requires plaintiffs to identify all other securities class actions 'in which the plaintiff has sought to serve as a representative party' . . . [m]any shareholders appear to have interpreted this requirement to require disclosure only of the suits in which shareholders have sought to serve as lead plaintiff." Erickson, *supra* note 80, at 1135. This interpretation persists despite federal opinions criticizing the practice. *See, e.g.*, *In re* OSI Pharms., Inc. Sec. Litig., No. 04-CV-5505 (JS) (ETB), 2005 WL 6171305, at *8 (E.D.N.Y. Sept. 21, 2005) ("It cannot be seriously argued that a party commencing a securities class action does not seek to serve as a 'representative party on behalf of a class.'"); Greater Penn. Carpenters Pension Fund v. Whitehall Jewellers, Inc., No. 04 C 1107, 2005 WL 1563206, at *4 (N.D. Ill. June 30, 2005).

82. Notably, neither the *OSI Pharmaceuticals* nor *Greater Pennsylvania Carpenters Pension Fund* rulings disqualified non-compliant plaintiffs as class representatives. Both courts merely allowed the plaintiffs to refile amended certifications and try again. *See OSI Pharms.*, 2005 WL 6171305, at *9; *GPCPF*, 2005 WL 1563206, at *6.

83. The motion for final approval in *Garber*, for instance, weighs in at over 480 pages of text, including exhibits. *See* Lead Plaintiffs' Motion for Final Approval of Class Action Settlement and Plan of Allocation of Settlement Proceeds and an Award of Attorneys' Fees and Expenses and Lead Plaintiffs' Expenses, Alaska Elec. Pension Fund v. Pharmacia Corp., C.A. No. 03-1519 (D.N.J. Dec. 14, 2012).

84. *See supra* text accompanying note 73.

certification process by appointing class guardians or other proxies for absent class members.

The idea is not novel. In a similar nonadversarial context—the settlement of a wage-and-hour class action—California Supreme Court Justice Goodwin Liu recommended that trial courts consider appointing a "devil's advocate" to raise arguments against class action fee arrangements.[85] Similarly, the Delaware Court of Chancery allows its judges to appoint *amicus curiae*, with fees taxed to the settling parties, to argue against settlements in mergers and acquisitions cases.[86] These calls to action have gone largely unheeded, however: trial courts do not routinely appoint special masters to undertake State-Street-style investigations.

Similarly, the United States Chamber of Commerce suggests that courts could appoint "independent monitor[s]" to scrutinize plaintiff's fee requests.[87] Again, the Chamber's proposed reform would be helpful, but insufficient to protect stockholder interests. If a compromised plaintiff enters into a suboptimal settlement with defendants, stockholders are harmed not merely by an unearned fee but by the loss of the right to pursue a potentially valuable case. Thus, any court-appointed monitor should be instructed to investigate, and potentially challenge, any proposed stockholder settlement—not merely the fee award.

The regular appointment of a class guardian to contest settlements and fee motions would surface and discourage "pay to play" arrangements, dubious "referral fees," and other potential conflicts facing institutional class plaintiffs. As a court-appointed litigant, a class guardian could engage in limited discovery to uncover an institutional stockholder's litigation history, the identity of all of their legal representatives, and any relationships between those attorneys and relevant political actors.[88] Because the guardian's pay would not be contingent upon

85. *See* Laffitte v. Robert Half Int'l Inc., 376 P.3d 672, 691 (Cal. 2016) (Liu, J., concurring); *see also* William B. Rubenstein, *The Fairness Hearing: Adversarial and Regulatory Approaches*, 53 UCLA L. Rev. 1435, 1475–77 (2006) (arguing for a devil's advocate to evaluate substantive settlements in class actions). In *Laffitte*, Justice Liu contrasted consumer class actions, which lack effective monitors, with the purportedly greater monitoring role of institutional plaintiffs in securities litigation. *See Laffitte*, 376 P.3d at 691.

86. *See In re* Trulia, Inc. S'holders Litig., 129 A.3d 884, 898–99 (Del. Ch. 2016). Although the Court of Chancery has proposed appointing such *amici*, to date we are unaware of it actually doing so.

87. *See* Contagion, *supra* note 75, at 18.

88. The regular appointment of class guardians would also reduce the "cat and mouse" nature of securities litigation reform, in which courts or Congress respond to perceived abusive litigation by proposing new rules, and class litigants respond by seeking new loopholes in the reforms. For instance, many contingency law firms responded to the Court of Chancery's *Trulia* opinion by filing M&A lawsuits in non-Delaware courts, citing older Delaware precedent, and simply not mentioning *Trulia* to the non-Delaware court. *See* William B. Chandler III & Anthony A. Rickey, *The Trouble with* Trulia, *in* Can Delaware Be Dethroned?: Evaluating Delaware's Dominance of Corporate Law 145, 165–69 (Stephen M. Bainbridge, Iman Anabtawi, Sung Hui Kim & James Park eds., 2018).

Reformers cannot anticipate every potential means by which entrepreneurial contingency counsel may attempt to circumvent reforms and channel rents to class plaintiffs. For instance, a firm might attempt to conceal the role of an attorney similar to Chargois in the State Street litigation, even after the disclosure reforms described above, by hiring the attorney as an in-house "of counsel," paying him or her a salary (including a "performance bonus" not nominally linked to case payouts), and then not disclosing that attorney's involvement in the case. Contingency counsel are more likely to forego seeking novel forms of Chargois-style relationships if they know that a court-appointed adverthe success of the settlement or fee motion, she would have every incentive to bring relevant issues to a court's attention. Reviewing courts could then consider a complete record and determine which relationships are and are not disabling conflicts of interest.

Delaware courts could adopt such reforms more easily than their federal counterparts. The Court of Chancery's rules already permit the appointment of attorneys *ad litem* to advocate for the interest of persons with alleged disabilities, and these rules require petitioners for guardianship to pay for the cost of the *ad litem* at a fixed rate.[89] A similar rule could require the appointment of stockholder guardians in class action and derivative cases. As Delaware law vests the Chancellor with the unilateral authority to adopt rules of procedure that apply to all Chancery judges, legislative intervention would likely be unnecessary.[90]

Uniform application of a new federal rule, however, would likely require congressional action, through an amendment either to the PSLRA or to the Federal Rules of Civil Procedure. However, individual federal jurisdictions could adopt local rules consistent with the authority cited in the State Street litigation that require the appointment of special master as part of the settlement process.[91]

While patchwork federal and state reforms would provide a laboratory for policy experimentation, Delaware's experience with reform of mergers and acquisitions class actions suggests that uniform federal regulation may be necessary. Class plaintiffs responded to Delaware's new and more stringent standards for the review of disclosure settlements, announced in early 2016,[92] not by seeking more valuable settlements but by filing class actions in other jurisdictions.[93] As a result, the number of M&A class actions filed in federal courts doubled in 2016 and then doubled again in 2017.[94] This flight from increased judicial scrutiny became even more obvious after the United States Court of Appeals for the Seventh Circuit became the first federal circuit to adopt Delaware's standards—and the only circuit to see a decline in M&A litigation in 2017.[95]

If only a handful of federal courts require the appointment of class guardians, plaintiffs and their counsel can be expected to follow the same race-to-the-bottom strategy of filing lawsuits in the jurisdictions that apply the least rigorous

sary will be investigating them *ex post*, even if it may arguably fit within a loophole to disclosure rules proposed *ex ante*.

89. *See* Del. Ct. Ch. R. 176.

90. *See* Del. Code Ann. tit. 10, § 361 (West 2019).

91. *See supra* note 36.

92. *See In re* Trulia, Inc. S'holders Litig., 129 A.3d 884, 898 (Del. Ch. 2016) ("practitioners should expect that the Court will continue to be increasingly vigilant in applying its independent judgment to its case-by-case assessment of the reasonableness of the "give" and "get" of such settlements in light of the concerns discussed above").

93. The shift from state to federal courts parallels the shift from federal to state courts in the wake of PSLRA's passage. *See* Benjamin P. Edwards, *Disaggregated Classes*, 9 Va. L. & Bus. Rev. 305, 325 (2015) (describing how after federal procedural reforms "a significant volume of cases simply shifted away from federal to state courts").

94. *See* NERA Econ. Consulting, Recent Trends in Securities Class Action Litigation: 2017 Full-Year Review 5 (Jan. 29, 2018).

95. *See id.* at 12.

scrutiny. Thus, congressional action may be required to ensure that reforms do not simply result in increased forum shopping by class counsel.

C. Make Candor to Stockholders an Explicit Component of Adequate Representation

Courts and legislatures should also impose more stringent consequences upon plaintiffs and law firms that fail to comply with disclosure requirements relating to their conflicts of interest or fee requests. Many of the law firms engaged in securities litigation are repeat players, filing dozens or hundreds of stockholder actions.[96] Even with more robust disclosure requirements, malfeasance may remain profitable for law firms willing to conceal conflicts of interest between themselves and their clients so long as they are not caught immediately and they retain the profit from prior cases. Even when plaintiffs violate existing PSLRA disclosure requirements, they rarely face significant penalties.[97]

Disclosure reforms can be meaningfully amplified if courts hold that plaintiffs or counsel who either fail to disclose information pertaining to potential conflicts of interest or engage in disapproved practices such as "bare referral fees" have provided inadequate representation to absent class members and are not suitable to serve as representatives in future class actions. A plaintiff or law firm found to have engaged in such practices could be forced to disclose its conduct to other courts and other cases. If federal courts are not willing to adopt such best practices on their own, Congress could require them to do so by amending the PSLRA.

More certain and severe penalties might mitigate the need for class guardians. Consider the incentives facing contingency counsel in a court that announces that it will appoint a special master to examine one out of every five securities cases. If contingency counsel knows that problematic conduct will be uncovered 20 percent of the time, it may compensate by requesting slightly higher fees as part of settlement. If, however, counsel expects that wrongful conduct will result in its exclusion from dozens of future class actions, the threat of random scrutiny may be sufficient to deter misbehavior, at least for law firms where class actions make up a considerable percentage of fees. In this regard, it is worth recalling the State Street court's consternation at learning that the "regular rates" for a law firm's services had "never been charged to paying clients."[98]

96. *See, e.g.*, Brown Report, *supra* note 44, at 4–5 (describing cases brought by, *inter alia*, Labaton's "Securities" and "Delaware" practice groups); *Trulia*, 129 A.3d at 891–92 (describing attorneys whose lawsuits serve no purpose for stockholders but are who are "regular players in the enterprise of routinely filing hastily drafted complaints on behalf of stockholders on the heels of the public announcement of a deal and settling quickly on terms that yield no monetary compensation to the stockholders they represent").

97. *See, e.g.*, *supra* notes 81–82.

98. Ark. Teacher Ret. Sys. v. State St. Bank & Tr. Co., C.A. No. 11-10230-MLW, 2018 WL 3216012, at *12 (D. Mass. June 28, 2018).

VI. Conclusion

The State Street case demonstrates that stockholder class actions are sufficiently profitable to allow class counsel to earmark a significant portion of its contingency fees for client acquisition and to pay counsel who does little work apart from generating an initial introduction.[99] It is difficult to guess at the scope of the problem. Labaton's internal investigation, conducted by a retired judge, concluded that Labaton's payments to Chargois were "unique and aberrational."[100] Labaton's co-chairman now insists that "[w]e will not honor any referral relationship or referral agreement from now until the end of time unless it's in full compliance with the rules and our new standards, heightened standards, we put in place."[101] On the other hand, Labaton instituted these "new standards" after the State Street court uncovered a $4.1 million payment to Chargois, a decade after the payments began.[102] How many other law firms currently have similar relationships with third parties to smooth the path to a client's door?

The failure of current class certification procedures to root out conflicts of interest between plaintiffs and their counsel is not new. The Lerach investigation began with a turncoat plaintiff; the State Street litigation kicked off after a newspaper expose. Neither came to light through class certification processes, and the State Street litigation proves that the PSLRA did not close every avenue by which class counsel can redirect fees to third parties in the hopes of garnering lucrative lead counsel appointments.

The class certification system should not depend upon journalists or other fortuitous circumstances to unearth potential conflicts of interest between class plaintiffs and their counsel. By mandating that plaintiffs disclose greater detail concerning the attorneys who stand to gain from class litigation and appointing class guardians to ensure that these disclosures are accurate, courts can uncover these hidden relationships on their own. The result would be a better stockholder class action system, in which plaintiffs are more likely to file class actions with an eye toward advancing the good of their fellow stockholders, rather than their own interests or those of their counsel.

99. *See* Coffee, *supra* note 15 ("[A]lthough plaintiffs' attorneys in securities litigation do face real risk in some cases, there seem to be significant 'rents' in the fee award system if they can willingly surrender 20 percent of their revenues (over a series of cases) simply for the introduction.").

100. Brown Report, *supra* note 44, at 1.

101. *Id.* at 15.

102. *See id.* at 10 (policy against "bare referral" fees instituted "within the last year"); *id.* at 12 (payments made to Chargois since 2007).