WHAT'S WRONG WITH SECURITIES CLASS ACTION LAWSUITS?

The Cost to Investors of Today's Private Securities Class Action System Far Outweighs Any Benefits

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EXECUTIVE SUMMARY

The *Halliburton v. Erica P. John Fund* case now before the Supreme Court involves the validity of the "fraud on the market" principle, which relieves a plaintiff of the obligation to prove reliance on a false statement—a legally required element of securities fraud—by creating a presumption of reliance based on economic theories regarding the assumed efficiency of securities markets.

Defenders of that judicially-created legal rule—perhaps recognizing that its legal and economic justifications have been undermined significantly by more recent scholarship and experience—contend that fraud-on-the-market should nevertheless be maintained, apparently even if the rule cannot actually be justified as a legitimate substitute for proving reliance, because eliminating it "would mean the demise of private securities actions and the deterrent and compensatory role they serve."[1]

But that contention rests on two fundamental assumptions: first, that these private lawsuits do in fact benefit investors by serving an important "deterrent and compensatory role"; and, second, that eliminating the fraud-on-the-market presumption would really mean "the demise of private securities actions." As this paper will show, both assumptions are simply wrong.

Joseph A. Grundfest, a former SEC Commissioner and current professor at Stanford Law School, has explained that "**[t]he class action securities fraud litigation system is broken.** It fails [to] efficiently . . . deter fraud and fails [to] . . . rationally compensate those harmed by fraud. Its greatest proponents seem to be the class action counsel and others who profit as a consequence of the irrationally large damage exposures generated by the current regime."[2] He is not alone:

- Professor Donald Langevoort of Georgetown Law School has observed that, "[w]ere this [system] sold as an insurance product, consumer-protection advocates might well seek to have it banned as **abusive because the hidden costs are so large**."[3]

- Professor Adam Pritchard: "**No other nation has adopted the open-ended private liability for misrepresentations affecting the secondary market price of corporate securities that we have in the United States, and for good reason**. Our current regime is not the product of congressional action, but rather, judicial happenstance."[4]

This paper addresses (1) the irrationality and ineffectiveness of these lawsuits as a mechanism for compensating investors; (2) the fact that securities litigation continues to be driven and controlled by plaintiffs' lawyers, resulting in a parade of abuses mirroring the abuses that led to criminal convictions in the 2000s; (3) the negligible deterrent effect of private class actions; and (4) the multiple ways that injured investors can vindicate their rights without the fraud on the market principle.

- **Securities class actions are an irrational and ineffective means of compensation** because these cases in reality just shift billions of dollars from one group of innocent investors to another, at a cost of billions paid to plaintiff and defense lawyers. Moreover, the class action system destroys shareholder wealth; provides little or no benefit to the small investors who are its supposed beneficiaries; and produces settlements that are not based on identified wrongdoing, or even likely wrongdoing, but rather because of tremendous litigation costs and fears of unjustified, draconian verdicts. (See pages 2-8.)

- Control of securities class actions by plaintiffs' lawyers in the 1980s and 1990s led to pervasive abuse and criminal prosecutions of leading class-action lawyers. Congress enacted the Private Securities Litigation Reform Act in 1995 to address these problems, but the plaintiffs' bar has circumvented Congress's reforms. **Once again, plaintiffs' lawyers, not actual investors, control securities class action litigation, and litigation abuses have returned.** (See pages 9-16)

- **Securities class actions do little to deter future violations or uncover wrongdoing.** This system almost never holds individual wrongdoers accountable, but instead imposes huge financial burdens on innocent and guilty companies alike—private lawsuits are a "cost of doing business" that does not fall only on those who engage in wrongdoing and therefore have a negligible deterrent effect. And private actions almost always follow government enforcement actions or companies' self-reported wrongdoing; they virtually never uncover corporate fraud. (See pages 16-19.)

- **Private securities litigation is not dependent on the fraud-on-the-market principle.** Leading securities lawyers have acknowledged that private lawsuits will continue; in addition, government enforcement authority provides a strong deterrent to wrongdoing. The Securities and Exchange Commission's "fair funds" process also provides a means of compensating injured investors in appropriate circumstances. (See page 19.)

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Irrational, Ineffective Mechanism for Compensation

Defenders of the class action system point to large settlements as evidence that these cases effectively "compensate investors injured by fraud." But those numbers tell only a small part of the story. In fact:

- Settlements in securities class actions are paid not by the parties responsible for fraud, *but by other innocent investors* (who bear the cost of a settlement paid by the defendant company).

- The *transaction costs of the class action process are high*: billions of dollars each year are paid in attorneys' fees.

- The class action system *destroys shareholder wealth* by harming the company sued.

- The *small, individual investors* who have the greatest need for compensation after a fraud are the investors *least likely to be compensated* in a class action.

- The private class action process *does not produce settlements based on identified wrongdoing; rather, it forces settlements in virtually all cases that survive a motion to dismiss* because of the extraordinarily high costs of litigation and the bet-the-company size of a potential adverse judgment.

- **<u>Innocent Investors Paying Innocent Investors</u>**

Securities class actions generally accomplish little more than shifting money from one innocent investor to another. Settlements in these cases are virtually always paid by the company itself (either directly or via the company's insurance), which means that one group of innocent shareholders—those who hold stock at the time of legal judgment or settlement—ends up paying another group of innocent shareholders, those in the litigation class.[5] The individuals who are actually responsible for the alleged fraud pay *less than one-half of one percent*.[6]

  - This "dirty secret of securities class actions . . . effectively means that shareholders are paying the costs of settlements to shareholders."[7] Consequently, as *Business Week* has observed, "there is widespread agreement among legal scholars that class actions make little economic sense."[8]

    - "Securities fraud class actions are a 'pocket shifting' exercise for shareholders. . . . [T]he dollars paid in these suits come from the corporation, either directly in the settlement or indirectly in the form of premiums for insurance policies. . . . Shareholders effectively take a dollar from one pocket, pay about half of that dollar to lawyers on both sides, and then put the leftover change in their other pocket." Adam C. Pritchard, *'Basic' error is focus on loss*, Nat'l Law J., Sept. 22, 2008, at 26.

    - "Real-world [fraud-on-the-market] actions proceed on an enterprise-liability theory with corporate—as opposed to individual—defendants funding the compensation; investor 'victims' are accordingly compensated from the pockets of other innocent investors. It follows that not only does [fraud-on-the-market] fail as a compensatory mechanism, it doesn't even make sense." William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. Pa. L. Rev. 69, 73 (2011).

    - "At best, recovery via class action is an expensive rearrangement of wealth from one pocket to another—minus a cut for the lawyers." Richard A. Booth, *Class Conflict in Securities Fraud Litigation*, 14 U. Pa. J. Bus. L. 701, 706 (2012).

    - "[N]early all the money paid out as compensation in the form of judgments and settlements comes, one way or another, from investors themselves."

Donald C. Langevoort, *Capping Damages For Open Market Securities Fraud*, 38 Ariz. L. Rev. 639, 648 (1996).

  - "[T]he familiar secondary market 'stock drop' case . . . essentially involves shareholders suing shareholders. Inevitably, the settlement cost imposed on the defendant corporation in a securities class action falls principally on its shareholders. This means that the plaintiff class recovers from the other shareholders, with the result that secondary market securities litigation largely generates pocket-shifting wealth transfers among largely diversified shareholders." "[T]he odds are high that shareholders are made systematically worse off by securities class actions." John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. Pa. L. Rev. 229, 304 (2007).

- Often, the two groups of innocent investors overlap to a considerable degree, because an investor that purchased the stock at the allegedly inflated price continues to hold those shares at the time of the settlement payment. Thus, "**the plaintiff class is, in effect, suing itself**."[9]

- Even when a company's insurance covers some of the settlement and litigation costs, investors as a group end up footing the bill because insurance premiums inevitably increase to reflect the higher risk of liability. The funds that insurance companies pay out come from policyholders' payments—there is no other source of money. These spiraling expenditures explain in part why "insurance costs for a Fortune 500 company are over six times higher in the United States than in Europe."[10]

- Professor John C. Coffee of Columbia Law School has aptly analogized this "**perverse**" system "to **punishing the victims** of burglary for their failure to take greater precautions."[11]

- This circularity problem arises from a characteristic of securities class actions that is different from virtually every other type of "fraud" lawsuit: the party that profited from the fraud is not required to disgorge those gains—damages instead are sought from a party that ***did not*** profit. Here's why:

  - The typical class action alleges that a company's stock price was inflated by false statements that painted an unduly rosy picture of the company—regarding the company's prospects, profits, inventions, etc.—and that the members of the plaintiff class purchased stock at an inflated price, which is demonstrated by the fact that when the "true facts" were revealed, the stock price fell.

  - The parties who profited from this alleged "fraud" are the investors who sold stock in the open market to the class members at the allegedly inflated price. But those sellers retain their gains and are not parties to the lawsuit (except in the unusual situation in which a corporate insider is a seller), because they are innocent beneficiaries of the supposed fraud. As Professor Adam Pritchard has commented, "[t]he investors lucky enough to have been selling during the period of the fraud do not have to disgorge their profits."[12]

- The burden of financing these settlements therefore falls squarely on the corporation and its existing shareholders, who did not realize any gains from the alleged fraud because they continued to hold the stock after the price fell due to the revelation of the alleged fraud.

- In sum, as Professor Coffee has observed, "[f]rom a compensatory perspective, the conclusion seems inescapable that the securities class action performs poorly."[13]

- **<u>Huge Transaction Costs in the Form of Billions in Legal Fees</u>**

Compounding the circularity problem is the fact that the billions of dollars paid in settlements do not simply travel from innocent investor to innocent investor; instead, the legal fees of lawyers, both those who file these lawsuits and those that defend them, come out of investors' pockets along the way. These fees themselves amount to billions of dollars each year—a substantial portion of the total economic burden that these lawsuits impose on shareholders.

- Fees awarded to the plaintiffs' lawyers can consume up to one-third of the settlement amount. In 2013, fee and expense awards totaled **$1.1 billion**.[14] **Over $10 billion was allocated to plaintiffs' attorneys** over the past decade alone.[15]

  - According to one study, the average securities class action settlement yielded over $12 million in fees to plaintiffs' counsel between 1993 and 2008.[16] In cases with the largest settlements, legal fees can frequently run into the **hundreds of millions of dollars**.[17]

  - **Legal fees in securities class actions are especially high**: the hourly rate awarded to plaintiffs' lawyers in settled securities class actions—averaging **$1,370 per hour,** according to one study—is significantly higher than the rate in antitrust, labor, discrimination, or mass tort class actions.[18]

    - Accordingly, as the *Wall Street Journal* has commented, "**the biggest pay disparity in the country" might be the one "between class members and the lawyers who purportedly represent them**."[19]

- Total legal fees for defending these actions—paid by the defendant companies and therefore, again, borne by their shareholders—almost certainly exceed the total plaintiff lawyers' fees,[20] for several reasons.

  - Virtually all securities class actions include multiple defendants—at least the company, key officers, and some or all directors. Legal ethics rules require that these different parties be represented by separate counsel, all of whom are paid by the company. Defense fees therefore increase at a faster rate than the plaintiff's fees. Given the amount of plaintiffs' fees paid in 2013, the amount of defense fees in that year necessarily totals well in excess of $1 billion.[21]

- In assessing the burdens on investors, it is also necessary to take into account the fees paid to defend against claims that are not successful—fees that also are paid by companies and, therefore, borne by investors. More than 40 percent of these lawsuits are disposed of without a class settlement—on average over 100 cases each year. These proceedings (often involving the granting of a motion to dismiss or denial of class certification) are complex and can take years to resolve. That potentially subjects investors to hundreds of millions of dollars in additional costs.

- The greatly reduced amount of money left over after lawyers' fees are taken out of a settlement fund may explain why even sophisticated investors rarely file claims in settlement proceedings. One study found that institutional investors submit claims **less than 30% of the time**.[22] Even for the investors with potentially large claims, securities class actions often deliver little given the cost of submitting a claim; most investors "can not be bothered to spend the time necessary to fill out and mail a claim form."[23]

- **<u>Destruction of Shareholder Value</u>**

Securities class actions impose other significant costs on investors:

- The mere filing of lawsuits like securities class actions **wipes out an average of approximately 3.5 percent of the equity value of a company** subjected to such litigation.[24]

- This effect is not surprising. The Supreme Court recognized nearly four decades ago that "**litigation under Rule 10b-5 presents a danger of vexatiousness** different in degree and in kind from that which accompanies litigation in general. . . . The **very pendency of the lawsuit may frustrate or delay normal business activity** of the defendant which is totally unrelated to the lawsuit."[25]

- Indeed, **approximately 30 percent of defendant companies in securities class action settlements file for bankruptcy or have their stock delisted.**[26]

- Class action litigation is **particularly harmful to smaller businesses**, which experience a greater percentage wealth loss when such a lawsuit is filed against them than larger businesses.[27]

- **<u>Small Investors Bear The Costs But Receive Little Benefit</u>**

Defenders of the class action mechanism often argue that it opens the legal system to those individual investors with claims that are too small to justify a stand-alone lawsuit. Perversely, however, it is small investors who are ***least likely*** to benefit from a class action settlement.

- Most small investors are "unable to navigate the myriad obstacles to recovery, including complex forms, high fees, and unnecessary middlemen. . . . Even when small investors do receive compensation—in most cases an amount far less than their alleged investment losses—it may only come years after the case has settled."[28]

- Most securities class action settlements, moreover, contain a minimum distribution threshold, sometimes called a "*de minimis* provision," which provides that claims below a certain amount will not be paid. Shareholders whose claims are deemed to be "too small" thus ***give up all of their claims against the defendant without getting anything in return.*** In other types of class actions (such as consumer class actions), such an unfair exchange usually makes courts suspicious of a proposed settlement,[29] but judges routinely approve of *de minimis* provisions in securities class actions without raising an eyebrow.

  - A *de minimis* provision may wipe out the claims of an astonishing number of small shareholders. In one securities class action in New York, the lead plaintiff's lawyers reported to the judge that the minimum distribution threshold in the settlement agreement would exclude nearly 58,000 of the roughly 120,000 otherwise-valid claims that class members had filed—**meaning that almost half of all claimants would have their claims released without being able to recover a cent**.[30]

  - In another class action against Dell, a district judge in Texas rejected a $10 minimum distribution threshold, noting that, because of the small amount of damages per share being paid under the settlement agreement, "a class member **would have had to own approximately 1,200 shares**" in order to be able to recover anything.[31] In order to acquire that many shares during the class period, an investor would need to have invested **over $38,000 in Dell stock**.[32]

  - There is a cruel irony to the use of such provisions in securities class actions: many class members are still shareholders of the defendant company. If their claims are erased by a *de minimis* provision, they end up funding the settlement while recovering nothing. In other words, **the settlement actually makes these shareholders "worse off**."[33]

- **<u>No Findings of Actual Fraud</u>**

Securities class action settlements often are portrayed as evidence that fraud was committed, but there is no determination of wrongdoing. Moreover, the number of cases in which a class-action fraud claim has been upheld on the merits is miniscule: virtually all cases that are not dismissed are settled. These transfers of billions upon billions of dollars among investors, with many billions deducted in transaction costs, therefore may not even be justified by the existence of some underlying wrongdoing. Rather, as many have concluded, these wealth transfers may simply result from a desire to avoid the enormous costs of a trial and the risk of a huge, unjustified adverse verdict.

- These suits are widespread: "Since 1996, over 40% of corporations listed on major U.S. stock exchanges have been targeted by a securities class action suit,"[34] and a

U.S. company was “83% more likely to be the target of a securities class action” in 2013 than from 1996-2000.[35]

- Empirical research indicates that a substantial percentage of securities class actions, **about 30%, appear to lack all merit** and may be nothing more than “**strike suits**”—“baseless actions sought for no greater purpose than to extort a settlement, most of which is diverted to the suit’s attorneys.”[36]

- The weakness of many securities class actions is unsurprising given how quickly plaintiffs’ lawyers rush to file cases after any plausibly negative disclosure by a company. In 2013, the median lag time between the end of an alleged class period and the filing of a securities class action was **15 days**, and a quarter of all cases were filed ***within five days***.[37] No credible determination that fraud existed, or even might existed, could be made in such a short time.

- ***Settlement costs continue to rise, however, because the pressure to settle even meritless suits is overwhelming.*** Virtually all companies settle rather than test the merits of plaintiffs’ claims at trial—of the **more than 4,000** securities class actions filed since the PSLRA was enacted in 1996, “**only 20 went to trial, and only 14 of them reached a verdict**.”[38] ***Otherwise, cases that survived motions to dismiss resulted in settlements***.

- Companies pay up even when the underlying suit lacks merit because (i) going to trial imposes **substantial costs** on the company in terms of attorneys’ fees, bad publicity, and management distraction, and (ii) even when a claim has little chance of success, there is an **untenable risk** of a massive jury verdict.[39] **As the Supreme Court recognized in *Stoneridge***, “extensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies.”[40]

- For many companies facing a securities fraud class action, Professor Adam Pritchard has commented, “the choice is settle or risk the very real possibility of a ***jury verdict that threatens bankruptcy***.”[41] Moreover, “[i]f the threat of bankruptcy-inducing damages were not enough, any case plausible enough to get past a motion to dismiss may be worth settling just to avoid the **costs of discovery and attorneys’ fees, which can be enormous** in [securities] cases.”[42]

    - Indeed, for 65% of the cases settled in 2013 the settlement amount (including the plaintiff attorneys’ fees) was less than $20 million; for more than 50% of the cases it was less than $10 million.[43] Given the high cost of litigating these claims, those settlement values confirm Pritchard’s conclusion that ***cases often settle for a relatively small increment over litigation costs—which provides further confirmation of the lack of merit of the underlying claims.***

- Former Attorney General **Dick Thornburgh** (Presidents Ronald Reagan and George H.W. Bush): “Outcomes [of securities class actions] are often **less a matter of justice than of negotiation**, as many defendants decide it is better to settle than to incur the enormous costs, inconvenience and risks associated with what may become virtually endless litigation."[44]

- o Former Clinton Administration official Robert Litan: "[S]ome defendants can feel **financially pressured to settle even if they have done nothing wrong**, believing it not to be worth betting their companies on a subsequent mistaken jury verdict that can be difficult to overturn on an appeal."[45]

The prevalence of settlements provides further confirmation that these lawsuits cannot be justified on compensation grounds—not only do they simply transfer funds among investors with a huge deduction for legal fees, but they do so without proof of an underlying fraud and with a regularity that precludes any merits-based rationale. The only "compensation" that these actions invariably provide is compensation—extraordinarily large compensation—for the lawyers who litigate these cases.

<u>Lawyer-Controlled Lawsuits Rife With Abusive Practices</u>

It is no surprise that these claims are an irrational and ineffective means of compensating investors (as just discussed) and that they have little or no effect in deterring wrongdoing (as discussed below). ***Unlike the typical individual lawsuits in our system, where the parties are in control and direct the activities of their lawyers, these class actions are initiated by lawyers, controlled by lawyers, and transfer billions of dollars from investors (the putative "beneficiaries") to lawyers.*** This lawyer control produces a much-larger-than-usual incidence of abusive practices by lawyers.

Congress enacted the Private Securities Litigation Reform Act in 1995 to address this very problem of securities litigation abuse. It found that that the initiative for filing securities class actions came "almost entirely from the [plaintiffs'] lawyers, not from genuine investors" and that "today certain lawyers file frivolous 'strike' suits alleging violations of the Federal securities laws in the hope that defendants will quickly settle to avoid the expense of litigation," with the lawsuit "often based on nothing more than a company's announcement of bad news, not evidence of fraud." S. Rep. 104-98, 104th Cong., 1st Sess. 4, 6, 11 (1995). Seeking to place control of these lawsuits in the hands of plaintiffs, not lawyers—and reacting to lawyers' use of individuals with small holdings in numerous companies as "professional plaintiffs"—Congress enacted a new procedure for selecting a "lead plaintiff" containing a preference for large investors.[46] ***The plaintiffs' bar has found ways to circumvent these reforms, and reinstitute the old abusive practices in a new form. We first explain how government and union pension funds have become the new "pet plaintiffs" (pages 9-12), with lawyers' control mirroring their authority over the professional plaintiffs of the 1990s (pages 13-14), and then catalog the abusive practices that continue to infect this type of litigation (pages 14-16).***

- ***Government and union pension funds are the new "professional plaintiffs" controlled by plaintiffs' lawyers.*** Plaintiffs' law firms seek to ensure their status as lead counsel through **contributions to the political campaigns** of officials who control the large public pension funds that often serve as lead plaintiffs in securities class actions.

- As the late Judge Edward Becker, one of the most respected members of the federal judiciary, recognized: **"[P]ublic pension funds are in many cases controlled by politicians, and politicians get campaign contributions**. The question arises then as to whether the lead plaintiff, a huge public pension fund, will select lead counsel on the basis of political contributions made by law firms to the public officers who control the pension funds and who, therefore, have a lot of say in selecting who counsel is."[47]

    - Indeed, Professor Coffee has stated that, "**unless halted, 'pay to play' will likely become the dominant technique for locking-in a large plaintiff as a client.**"[48]

    - The dangers of pay-to-play have prompted some states, such as Illinois, to enact legislation that bars business entities contracting with the state from giving campaign contributions to an official with power to award a contract. The Illinois legislature acted in the wake of the extraordinary incidences of corruption perpetrated by former Governor Blagojevich.[49]

- A 2011 empirical study by securities law scholars found that, although pension funds can negotiate lower fees with plaintiffs' attorneys in securities cases, "**the hard bargaining by state pension funds largely disappears when decisionmakers for those funds receive political contributions—particularly when those contributions are large**." The scholars concluded that "pay to play imposes a real cost on investors" in the form of higher legal fees and may be undermining the reforms Congress enacted in the PSLRA.[50]

- The clear track record of campaign contributions made by plaintiffs' attorneys to public officials with control over pension funds shows that this is a far-from-uncommon phenomenon.

    - An in-depth *USA Today* investigation in 2001, which included an analysis of campaign-finance records in 5 states and 2 cities, and a review of dozens of securities class actions, showed that "**[l]aw firms chasing jackpot-size fees are showering money on politicians with influence at large public pension funds—which, in turn, are hiring them to file multimillion-dollar lawsuits against U.S. companies.**"[51]

    - Despite having no physical presence in Louisiana, out-of-state plaintiffs' firms have contributed large sums of money to the campaigns of John Kennedy, the Louisiana State Treasurer, who sits on the board of one of the state's largest public pension funds, the Louisiana Municipal Police Employees' Retirement System (LMPERS).

        - Plaintiffs' firm Berman DeValerio, for example, twice contributed the maximum amount permissible under Louisiana law to Kennedy's campaigns—even though he ran unopposed each time. The firm went on to represent the state's major pension funds in at least six major securities class action lawsuits.

- Under the influence of these plaintiffs' lawyers, LMPERS has become one of the most active plaintiffs in securities lawsuits in the country. Since 2007, the fund has filed at least 108 securities lawsuits, many of which are still pending. "[B]y his own admission," a recent report noted, the fund's general counsel "**clearly has not . . . managed his plaintiffs' attorneys that well**."[52]

▪ In Mississippi, the current Attorney General, Jim Hood, has final authority over the selection of outside counsel for one of the state's pension funds, Mississippi PERS. Hood "received no campaign contributions from securities class actions firms" in his first campaign for Attorney General in 2003—but since taking office, he has "**attracted considerable financial support from a number of plaintiffs' firms,"** all of which are out of state.[53]

- Hood's office has retained at least 27 different law firms to represent the state in at least 20 separate lawsuits, after partners at those firms contributed more than $500,000 to Hood's reelection campaign. Moreover, Mississippi PERS was "lead plaintiff in 16 securities class actions between 2005 and 2011, notwithstanding the PSLRA's prohibition against appearing more than five times in a three-year period."[54]

▪ The pattern repeats in New Mexico, where several law firms with no ties to the state have contributed large sums of money to politicians with control over pension fund litigation activity.

- A former associate at Labaton Sucharow filed a federal complaint alleging that a senior partner bragged about how he "got New Mexico" as a client because he "went around the firm and convinced his partners to give money to Bill Richardson."[55]

- Labaton Sucharow—which has represented the state's public pension fund on numerous occasions—has been investing in New Mexico politics for years. The firm has given $49,500 to Gary King, the state's Attorney General[56]—the state officer with the most control over the state's legal work. Labaton's contributions sparked a battle of contributions among the plaintiffs' bar that provoked other out-of-state firms to make contributions.

▪ In Ohio, the sheer number and extent of campaign contributions from out-of-state law firms to candidates for state Attorney General, as well as to the Ohio Democratic and Republican Parties, demonstrate the **entrenched nature of the "pay-to-play" practice.** Out-of-state law firms have pumped more than **a million dollars** into Ohio state politics in recent years. More often than not, these firms subsequently obtained contracts to represent the state's public pension funds in securities class actions.

- The law firm representing two Ohio state retirement funds in a fraud suit against Fannie Mae in 2007 was replaced by the state's new attorney general overseeing the case, sparking the concern that the irregular switch was made for political considerations. In the 2006 election for attorney general, **the son of the lead lawyer at the newly retained firm had contributed $25,000 to the winning candidate's campaign and to his party**, whereas the firm that was replaced had contributed more to the candidate's political opponent than to him.[57]

- The firms chosen by former New York state Comptroller H. Carl McCall to file the New York state pension plan's suit against the Cendant Corporation, **were ultimately awarded $55 million** in fees; it was later determined that the firms, and their partners and families, had **made "nearly $200,000 in campaign donations** to McCall."[58] Around the time that McCall announced that the same firms would represent the state in a major new case against Worldcom, one of the firms contributed more than $13,000. Moreover, another firm, **Milberg Weiss, whose partners and families had given McCall more than $220,000, was handling the state's case against Global Crossing**.

- Nor are concerns about the rise of pay-to-play limited to campaign contributions to politicians and pension fund officials. An investigation by the Chicago Tribune, for example, showed that Springfield, Illinois lawyer William Cavanagh—general counsel and longtime advisor to some of the state's largest public and private pension funds—received more than $750,000 in direct payments from the outside plaintiffs' law firm selected to represent some of those same funds in class action litigation—none other than Milberg Weiss. Cavanagh's **$750,000 in fees related to four settled cases in which his pension clients claimed losses totaling only about $225,000. The total attorneys' fees in those cases amounted to about $44 million**.[59]

- As a consequence of this pay-to-play dynamic, lawyers, not investors, effectively control the securities class action system. As Professor John Coffee describes it: **"You have the equivalent of hanging a 'for-rent' sign out over the pension fund."**[60] Pension fund officials admit as much:

  - "We don't choose them; they choose us." - Horace Schow, general counsel to the Florida State Board Administration.[61]

  - "We don't go to them, they come to us. They're simply looking for lead plaintiffs." - William Reeves, general counsel to the Teachers' Retirement System of Louisiana.[62]

    - "The truth is, there was just a bounty hunter prowling the security industry, picking things and putting our names on it." - Joseph Herkness, former director of the Philadelphia Board of Pensions and Retirement.[63]

  - **Some observers have called for increased transparency regarding such payments, including the Committee on Capital Markets Regulation**, which recommended that, at a minimum, courts require "disclosure of all political contributions or fee-sharing arrangements between class counsel and a lead plaintiff (or controlling individuals within the lead plaintiff organization)."[64] In addition, **a number of States have enacted "transparency in private attorney contracting" laws** requiring a transparent procedure for selecting outside counsel and imposing limits on contingent-fee compensation.[65]

- **These lawyer-controlled plaintiffs** often act merely as pawns for plaintiffs' attorneys and lack any real knowledge about the suit they are nominally shepherding. **Indeed, some such plaintiffs—including several state pension funds—become *"frequent filers"* of securities lawsuits.**

  - When interviewed in 2013, the general counsel of LMPERS—a serial participant in securities class actions—"**couldn't say how many cases the fund had going, how many firms represented the fund, or how much the fund had recovered from cases.**"[66]

  - In denying class representative status to a lead pension fund plaintiff in a securities class action in 2008, one court noted that the fund's chairman "did not know the name of either individual defendant," did not know if the fund ever owned the defendant's stock, and had never even seen any complaint in the action. **The judge refused to let his court "be a party to this sham."**[67]

  - A federal court in New York similarly dismissed a suit after **the lead plaintiff admitted that he believed his own claims lacked merit.** A new, substituted lead plaintiff was not much better: he **had filed 25 other lawsuits against companies, many of which he knew little about**. In dismissing the case, the court decried the "**scandalous**" origins of the lawsuit, which **"[f]rom the start … ha[d] been controlled by counsel with absentee plaintiffs."**[68]

  - And, as in the 1990s, **suits are filed almost immediately after a company announces "bad news"**—far too quickly for anyone to conclude that a fraud took place, or even could have occurred (see page 8).

- This leads to the filing of **securities class actions on the basis of the flimsiest of evidence—**or even **outright misrepresentations.**

  - The Louisiana Sheriffs' Pension & Relief Fund is currently serving as lead plaintiff in a securities class action against women's apparel company Lululemon; according to one media report, the lawsuit alleges, among other things, that the company "intended to sell hundreds of thousands of nearly sheer yoga pants and hope[d] consumers wouldn't notice"[69]—a contention that seems preposterous.

- Wolf Haldenstein, a prominent class-action firm, was recently sanctioned by a federal judge in the Southern District of New York for bringing a securities class action against AOL Inc. **based on a theory derived from a blog post**. The plaintiffs alleged that AOL had secretly arranged to sell $1 billion worth of patents to Microsoft before engaging in a share buyback, and that its auction of those patents after the buyback was illegitimate. The judge called this allegation a "**conspiracy theory**" and commented that the plaintiffs' attorneys had given her "**essentially no basis to find that sanctions should not be imposed**."[70]

- The Seventh Circuit recently chastised the plaintiffs' firm of Robbins Geller Rudman & Dowd LLP in a securities class action brought against Boeing, alleging that it misled investors about the results of "stress tests" on its 787 aircraft. After the plaintiffs' first complaint was dismissed, Robbins Geller filed a second complaint supposedly based in part on an investigator's interview with a confidential source employed at Boeing. As it turned out, the source **had never worked for Boeing**, **likely knew nothing** about the company's internal communications about the "stress tests" and, when deposed, "denied virtually everything that the investigator had reported."[71]

    - As the Seventh Circuit later described the case, the district judge thought that the plaintiffs' lawyers' "failure to attempt to verify the allegations . . . amounted to a **fraud on the court**" and dismissed this second complaint with prejudice.[72]

    - On appeal, Judge Posner wrote for the court that behavior by class counsel "puts one in mind of **ostrich tactics**" and could be grounds for **Rule 11 sanctions**. He noted that Robbins Geller had been "criticized for **misleading allegations**, concerning confidential sources, **made to stave off dismissal** of a securities-fraud case much like this one" and other "similar misconduct" in **three other cases**, indicating a degree of **"[r]ecidivism**" that would bear on any sanctions imposed on the firm.[73]

- **Plaintiffs' firms also push the ethical envelope in order to maximize their fees.**

    - A case from Connecticut "illustrates how plaintiff attorneys in securities class actions have an incentive to hire small armies of temp attorneys to justify their fees to judges."[74] In that case, lawyers who settled a securities class action against Xerox and its auditor marked up a fee request for contract attorneys who essentially performed "glorified secretarial work" from $11 million to a whopping $83 million—**requesting nearly $500/hour for lawyers who were apparently paid as little as $30-40/hour**. Despite objections, the Second Circuit upheld the fee award, amounting to $3.3 million in expenses plus a 16 percent cut of the $750 million settlement.[75]

Overcharging clients for contract attorneys' services appears to a consistent tactic. Just last year, a district judge in New York cut plaintiffs' firm Kirby McInerney's fee request in a securities settlement by 27%, after finding that the firm was billing contract attorneys at **"significantly inflated" rates** of hundreds of dollars an hour while only paying them $32 an hour. The judge also further slashed the firm's fee award because it spent "tens of thousands of hours" on the case *after* it settled, which the judge called "**waste and inefficiency that a paying client would not accept**."[76]

- A Delaware judge in 2008 sanctioned two law firms who brought a securities class action even though the lead plaintiff owned no stock in the company he was suing. The judge said that **the firms tried to keep confidential "damaging facts" in a cover-up that "served only to advance their selfish motives."**[77]

- In taking the unusual step of rejecting a proposed settlement because of the size of the requested fee, one federal judge in California observed that "**[t]he prospect of a sizeable attorney fee award can drive a wedge between the class and class counsel, the former interested in the largest settlement obtainable for the class and the latter in the largest fee award obtainable."**[78]

- A federal district judge remarked in 2009 that he "needed a defibrillator" once he realized that lawyers in a securities fraud case were in fact seeking a **bonus of $*11* million**, not $*1.1* million, ***on top* of the receivership fees already charged** to innocent investors, who would recover only "a fraction of their losses." The SEC opposed the enhancement, arguing that the requested bonus would result in reduced payments to investors and **give the lawyers a windfall of more than $800 per hour.** One investor sent a letter to the judge, stating that he was "appalled" by the lawyers' request. "Please, let's get these funds back where they belong -- in the hands of the investors -- and away from greedy hands," another investor said.[79]

- In one California class action, the plaintiffs' attorneys initially "represented that the case was worth hundreds of millions of dollars in damages," only to settle the case a year later for $15 million. "[T]he district court concluded that counsel had engaged in **'minimal' discovery, 'on the borderline of acceptability'** given the purported scope of the case," yet these attorneys "pocketed $2.5 million in fees and expenses all taken from the common settlement fund."[80]

- **This pattern of abuse is not at all surprising. There is a long history of wrongful behavior in connection with securities class action lawsuits**.

  - In a series of indictments beginning in May 2006, federal prosecutors charged Milberg Weiss LLP (now known as Milberg LLP)—the nation's then-preeminent plaintiffs' firm specializing in class-action securities lawsuits—along with four of the firm's former or then-current named partners, with paying millions of dollars in illegal kickbacks to a handful of repeat plaintiffs and experts while engaging in a campaign of class-action lawsuits that over several decades **extracted more than $45 billion** from American corporations (and, ultimately, American investors and consumers).

  - **According to prosecutors, between 1979 and 2005, senior firm partners formed a conspiracy to obstruct** justice, perjure themselves, and engage in bribery and fraud by paying kickbacks to repeat plaintiffs. The indictment alleged that this scheme brought in **more than $216 million in "tainted attorneys' fees."**[81] In June 2008 **the firm admitted wrongdoing and settled the federal suit for $75 million**.[82] The prosecution produced no less than **eight guilty pleas** by former named or managing partners, repeat plaintiffs, and one expert witness, all of whom disgorged their profits, paid penalties, and were sentenced to significant periods of incarceration.

  - An empirical study by Professor Michael Perino suggests that, **while this conduct may have enriched the lawyers and the repeat plaintiffs involved, it did not benefit absent class members** in terms of leading to higher shareholder recoveries.[83]

- Bill Lerach, one of the convicted former Milberg Weiss partners, said that what the firm did "**was an industry practice**" and that "**everybody was paying plaintiffs so they could bring their cases**."[84] One columnist for the *New York Times* stated that Lerach was a "**cunning economic terrorist**" who "ran a kind of extortion racket," taking advantage of companies' rational economic judgment to coerce settlements in meritless lawsuits by "torturing them with motions, discovery and depositions until they settled."[85]

- The investigation also revealed that John Torkelsen, **an expert witness used by Milberg and other plaintiffs' firms in hundreds of cases**, colluded with Milberg to submit false and inflated fee requests to courts. According to federal prosecutors, Torkelsen hid the fact that he was paid on a contingency-fee basis, instead presenting himself to the court as an independent expert. Torkelsen's secret contingency stake in the value of plaintiffs' claims and the outcome of Milberg's and other firms' lawsuits made him **a biased and unreliable witness**. In May 2008, Torkelsen pleaded guilty to perjury for lying to federal courts to line the pockets of plaintiffs' law firms like Milberg.[86]

- Prominent plaintiffs' lawyer Gene Cauley, a protégée of Bill Lerach, made headlines in 2009 for failing to distribute **more than $9 million** from a securities class action settlement fund.

  - A federal judge uncovered the scheme, and Cauley admitted to misappropriating the money, which had been intended for his clients.

  - Cauley pleaded guilty to one count each of wire fraud and criminal contempt, and he was sentenced to more than seven years in federal prison.[87]

<u>Negligible Deterrent Effect</u>

Defenders of securities class actions contend that these lawsuits deter individuals from committing fraud and encourage companies to exert greater control over their officers and employees. The prospect of a big recovery, moreover, supposedly incentivizes potential plaintiffs and informants to root out evidence of fraud.

As Professor John Coffee has observed, however, this deterrence theory "***encounters serious problems once we examine the reality of actual securities litigation***."[88] Indeed, *BusinessWeek* has reported "widespread agreement among legal scholars that class actions . . . are anemic deterrents to fraud."[89]

Securities class actions are almost always settled rather than tried, and the settlement is virtually always paid out by the defendant company or its liability insurer rather than by the persons responsible for the alleged fraud. The system thus rarely holds individual wrongdoers accountable, but instead imposes huge financial burdens on innocent and guilty companies alike. And most fraud is disclosed by means other than private lawsuits, which are usually filed only after a fraud has already come to light. Our securities litigation system simply doesn't deliver deterrence.

- **Virtually all securities class actions that are not dismissed settle before trial, and therefore do not separate those innocently accused from wrongdoers and impose their financial burden only on the latter.**

    - Because the potential damages in these cases are often colossal, few defendants can afford to risk going to trial, even when a plaintiff's allegations are entirely frivolous. That is why (as discussed above, see pages 7-9) almost all securities class actions that are not dismissed—even the weakest ones—settle. (Of course, denial of a motion to dismiss says nothing about the underlying merits of a claim, because a court considering a motion to dismiss must ***assume*** that the facts alleged in the complaint are true.)

    - In the vast majority of these settlements, the defendants do not admit any wrongdoing; indeed, defendants often deny that they have done something wrong, and plaintiffs have been unable to show that misconduct exists. It is therefore difficult to see how securities class actions can possibly be deterring fraud: "**both wrongful and innocent conduct is punished**."[90]

    - As Professor Coffee has noted, "[d]eterrence works best when it is focused on the culpable, but there is little evidence that securities class actions today satisfy this standard."[91] ***Rather, the economic burden of settlements falls on the innocent and guilty alike because guilt is never adjudicated***.

- **The private litigation system does virtually nothing to discourage individuals from committing fraud.**

    - Individual defendants—one or more of whom might have been responsible for any wrongdoing that actually occurred—virtually never contribute anything out of their own pockets to a securities class action settlement. A recent study (April 2013) found that individual officers contributed to ***just 2%*** of settlements in cases filed between

2006 and 2010, and that *no* individual directors contributed to settlements in cases from that period.[92] Because the people who are culpable for fraud are so rarely "hit in the pocketbook," Professor Joseph Grundfest notes, securities litigation produces little in the way of "individual responsibility."[93]

- Imposing penalties on corporations themselves, meanwhile, is a poor way of deterring directors and officers from committing securities fraud. Scholars have long recognized that individuals usually commit securities fraud when they fear that their firm is failing and that they are about to lose their jobs anyway; in such circumstances, there is little that a corporation can do to deter its employees from breaking the law.[94]

- **Public enforcement provides the real deterrent.**

  - Since 1988, the **SEC's budget has increased by a factor of five**, after adjusting for inflation,[95] giving the agency a much greater capability to deal with securities fraud than it had when *Basic* was decided.

  - The SEC has access to a varied arsenal of remedies for fraud, including "**civil money penalties**, tiered in amount depending on the egregiousness of the violation; **officer and director bars**; **injunctive relief**; **cease and desist** orders; **disgorgement** of ill-gotten gains; and orders requiring **corrective disclosures and corporate governance changes**," and it can "refer cases to the Justice Department for **criminal prosecution.**"[96] Private plaintiffs "have only the blunderbuss remedy of out-of-pocket damages in their toolkit."[97]

  - The SEC can compensate investors through the creation of "fair funds" that are disbursed to victims of fraud. This authority "**enhances the Commission's ability to act as a substitute** for the compensation fruition" touted by proponents of private litigation.[98]

  - SEC enforcement is also a far more effective deterrent of fraud than private litigation. Indeed, one empirical study found that **93.6% of individuals named in SEC or DOJ enforcement actions lose their jobs** within 90 days of the final agency proceeding.[99]

- **Private class actions rarely uncover corporate fraud, and there are more effective and less costly ways of uncovering fraud.**

  - In a 2008 study, three leading business law scholars found that **only 3%** of corporate frauds were initially revealed as a result of a private securities lawsuit. It is far more common for fraud to come to light as a result of a government investigation, an employee blowing the whistle, a corporate audit, a media report, or some other means.[100]

  - Rather than revealing previously unknown acts of fraud, private securities class actions usually just "piggyback" on earlier disclosures resulting from one of these alternative sources of information. Professor Amanda Rose calls this pattern "hardly surprising," since plaintiffs' lawyers are "corporate outsiders" with "no inherent advantage in detecting corporate misconduct."[101]

- New developments have also rendered private class actions obsolete as a means of uncovering fraud. Most important, the Dodd-Frank Act created a new "SEC Whistleblower Program," which provides monetary incentives to persons who come forward and give the SEC information about violations of the securities laws.[102] Stanley Bernstein, a prominent plaintiffs' lawyer, calls the Program "**definitely a game-changer**" and notes that the SEC is doing an "incredible job" of preserving whistleblowers' anonymity.[103] Working with the SEC will likely be more attractive to whistleblowers than bringing their information to private plaintiffs' lawyers, thus "leav[ing] little for [fraud-on-the-market] suits to do, except generate deadweight costs."[104] Indeed, Professor Rose describes the Program as the "**nail in the [fraud-on-the-market] class action coffin.**"[105]

Given the at-most-negligible deterrent effect of the threat of private class actions litigation—and the other, much more significant deterrent effect of the threat of government enforcement and SEC whistleblowers—preservation of the current system cannot be justified on deterrence grounds.

<u>Private Securities Litigation Will Continue</u>

Eliminating the fraud on the market presumption will not end private securities litigation. Indeed, leading securities class action lawyers have acknowledged that large numbers of lawsuits will continue unaffected.

- ***Investors who purchase securities in initial public offerings bring suit under Section 11 of the Securities Act, which does not require the plaintiff to prove reliance***. The fraud on the market doctrine is therefore irrelevant. That is "no small point," Professor Grundfest has observed, "inasmuch as many of the largest recoveries in class action securities fraud history arise from Section 11 claims."[106]

- ***Large investors will file individual claims***. As leading plaintiffs' lawyer Stanley Bernstein explained, "The largest pension funds in the country will sue. Now, they often sit back and collect claims forms in a class action." "You'll have hundreds of lawsuits and they'll all probably be consolidated and then it's going to be difficult to settle them all. There will be twenty-five or fifty parallel litigations in every major fraud."[107]

    - Kevin LaCroix, author of the well-respected D&O Diary blog, agrees that "the way securities cases are being litigated was already changing in significant ways. . . . [T]he fact is that the leading plaintiffs' firms all already have extensive experience litigating securities cases on other than a class basis. In addition the plaintiffs' firms have established significant client relationships with pension funds and other large institutional investors whose claims could be aggregated to present a collective action on behalf of a group of investors, even if those claimants might not be able to proceed as a class action."[108]

- Thus, according to plaintiffs' attorney Bernstein, large investors "will likely recover even larger amounts than under the current system. . . . While class actions pay five or ten cents on the dollar, individual or opt-out plaintiffs sue for a much higher percent of damages and get multiples of that."[109]

- ***Plaintiffs will argue that that they can continue to litigate key elements of securities claims on a class-wide basis***—such as the falsity of the challenged statement, the statement's materiality, and whether the defendant acted with scienter (the required bad intent)—under Federal Rule of Civil Procedure 23(c)(4). That would, if permitted by the court, give class members the benefit of a victory on those issues, leaving only reliance and damages to be addressed individually. Similarly, if one plaintiff prevailed on those issues in an individual action, other investors would invoke that precedent, arguing that it prevented the defendants from contesting those issues in other cases on grounds of collateral estoppel.

- ***The SEC can place penalties and disgorged profits in a "fair fund" and use those funds to compensate injured small investors***, particularly small investors.[110] It has established funds in dozens of cases[111] and distributed $815 million in Fiscal Year 2012, nearly double the planned amount.[112]

* * * * *

The facts about private securities class actions demonstrate that these lawsuits are a poor mechanism for compensating injured investors; are controlled by lawyers and litigated for the principal benefit of lawyers; and have little or no deterrent effect. Moreover, abolishing fraud on the market will not eliminate private securities litigation—but it will require plaintiffs asserting fraud claims to prove their case, and it will stop the transfer of many billions of dollars—less billions of dollars paid to lawyers—without any finding of wrongdoing.

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[1] Brief for Respondent at 24, *Halliburton Co. v. Erica P. John Fund*, No. 13-317 (Jan. 29, 2014) (capitalization of words omitted).
[2] Statement of the Honorable Joseph A. Grundfest, Stanford Law School, to the Meeting of the Advisory Committee on the Auditing Profession 4 (Feb. 4, 2008) [hereinafter Grundfest Statement] (emphasis added).
[3] Donald C. Langevoort, *On Leaving Corporate Executives "Naked, Homeless and Without Wheels": Corporate Fraud, Equitable Remedies, and the Debate over Entity Versus Individual Liability*, 42 WAKE FOREST L. REV. 627, 635 (2007) (emphasis added).
[4] Adam Pritchard, Testimony Before the United States Senate Committee on the Judiciary, Subcommittee on Crime and Drugs 2 (Sept. 17, 2009) (emphasis added), *available at* http://www.judiciary.senate.gov/pdf/09-09-17%20 Pritchard%20Testimony.pdf.
[5] COMMITTEE ON CAPITAL MARKETS REGULATION, INTERIM REPORT 78 (2006), *available at* http://www.capmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf [hereinafter "INTERIM REPORT"].
[6] *See* Donald C. Langevoort, *Capping Damages For Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639, 648 & n.43 (1996); *see also* Janet C. Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487, 1499 (1996).
[7] Pritchard, *supra* note 4, at 4.
[8] Michael Orey, *Do Shareholder Class Actions Make Sense*, BUSINESSWEEK, Sept. 28, 2009.
[9] Grundfest Statement, *supra* note 2, at 2-3 (emphasis added).
[10] INTERIM REPORT, *supra* note 5, at 78.
[11] John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1538, 1562 (2006) (emphasis added).
[12] Pritchard, *supra* note 4, at 3.

[13] Coffee, *supra* note 11, at 1545.
[14] RENZO COMOLLI ET AL., NERA ECON. CONSULTING, RECENT TRENDS IN SECURITIES CLASS ACTION LITIGATION: 2013 FULL-YEAR REVIEW, at 35 (Jan. 21, 2014) [herinafter NERA TRENDS 2013]
[15] *See id.*
[16] Theodore Eisenberg & Geoffrey P. Miller, *Attorneys' Fees and Expenses in Class Action Settlements: 1993-2008*, 7 J. EMP. L. STUD. 248 (2010).
[17] *See, e.g.*, *In re WorldCom, Inc. Sec. Litig.*, 388 F. Supp. 2d 319 (S.D.N.Y. 2005) (approval of $336 million fee); *In re Tyco Int'l*, 535 F. Supp. 2d 249 (D.N.H. 2007) (approval of $464 million fee).
[18] *See* Stuart J. Logan et al., *Attorney Fee Awards in Common Fund Class Actions*, 24 CLASS ACTION RPTS. 167, 196 (2003).
[19] Editorial, *The Felony Bar*, WALL ST. J., Mar. 21, 2008, at A12 (emphasis added).
[20] *See* INTERIM REPORT, *supra* note 5**Error! Bookmark not defined.**, at 79; Coffee, *supra* note 11, at 1546.
[21] See note 14 and accompanying text.
[22] See James D. Cox & Randall S. Thomas, *Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements*, 58 STAN. L. REV. 411, 413 (2005).
[23] A.C. Pritchard, *Who Cares?*, 80 WASH. U. L.Q. 883, 884 (2002) (emphasis added).
[24] ANJAN V. THAKOR, U.S. CHAMBER INST. FOR LEGAL REFORM, THE UNINTENDED CONSEQUENCES OF SECURITIES LITIGATION 14 (Oct. 2005) [hereinafter UNINTENDED CONSEQUENCES].
[25] *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739-40 (1975) (emphasis added).
[26] *See* LAURA E. SIMMONS & ELLEN M. RYAN, CORNERSTONE RESEARCH, POST REFORM-ACT SECURITIES SETTLEMENTS, 2005 REVIEW AND ANALYSIS at 14 (2006).
[27] THAKOR, UNINTENDED CONSEQUENCES, *supra* note 24, at 9-10, 14. This is likely due to (i) the inability of small firms to benefit from economies of scale in dealing with lawsuits and (ii) the susceptibility of such firms to the financial distress costs imposed by litigation. *Id.*
[28] U.S. CHAMBER INST. FOR LEGAL REFORM, SECURITIES CLASS ACTION LITIGATION 22 (2008) (citing Eleanor Laise, *Picked Clean—Plaintiff's Attorneys and Middlemen Thrive under the Securities Class-action System; What's in it for You? Pretty Much Bupkis*, SMARTMONEY, May 1, 2005).
[29] *See, e.g.*, *Mirfaishi v. Fleet Mortg. Corp.*, 356 F.3d 781, 785 (7th Cir. 2004) (Posner, J.) (criticizing a settlement that awarded no relief to 1.4 million claimants in exchange for release of their claims and thereby "sold these 1.4 million claimants down the river").
[30] *City of Livonia Emps. Ret. Sys. v. Wyeth*, No. 07 Civ. 10329(RJS), 2013 WL 4399015, at *16 (S.D.N.Y. Aug. 7, 2013).
[31] *In re Dell Inc. Sec. Litig.*, No. A–06–CA–726–SS, 2010 WL 2371834, at *9 n.3 (W.D. Tex. June 11, 2010) (emphasis added).
[32] Based on historical price data from Yahoo Finance (http://finance.yahoo.com) for Dell, Inc. stock during class period and court's calculation that an investor needed to own 1,200 shares in order to receive a distribution under the proposed minimum threshold. *See In re Dell Inc.*, 2010 WL 2371834, at *9 n.3.
[33] *See* Objection and Notice of Objection of Julia Petri at 13 & n.5, *City of Livonia Emps. Ret. Sys. v. Wyeth,* No. 07 Civ. 10329(RJS) (S.D.N.Y. Jan. 25, 2013), ECF No. 128 (emphasis added).
[34] Brief for the Committee on Capital Markets Regulation as Amicus Curiae Supporting Petitioners at 6-7, *Halliburton Co v. Erica P. John Fund, Inc.*, No. 13-317 (Jan. 6, 2014).
[35] NERA TRENDS 2013*, supra* note 14, at 3.
[36] James D. Cox et al., *There are Plaintiffs and . . . There are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements*, 61 VAND. L. REV. 355, 367, 381-83 (2008) (emphasis added); *see also* James D. Cox et al., *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 778 (2003) (finding data supporting conclusion that "many of the private suits falling within [a] low settlement range are little more than small payments to rid the issuer of the nuisance and expense of the suit").
[37] CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS 2013 YEAR IN REVIEW, at 17 (2014), *available at* http://securities.stanford.edu/research-reports/1996-2013/Cornerstone-Research-Securities-Class-Action-Filings-2013-YIR.pdf.
[38] *See* NERA TRENDS 2013, *supra* note 14, at 36 (emphasis added).
[39] TODD FOSTER ET AL., NERA ECON. CONSULTING, RECENT TRENDS IN SHAREHOLDER CLASS ACTION LITIGATION: FILINGS PLUMMET, SETTLEMENTS SOAR 7 (2007) (noting that potential investor losses "constitute the single most powerful publicly available determinant of settlements, explaining approximately 50% of their variation"); Janet

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[40] *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 163 (2008).
[41] A.C. Pritchard, Stoneridge Investment Partners v. Scientific-Atlanta: *The Political Economy of Securities Class Action Reform*, 2008 CATO SUP. CT. REV. 217, 225 (emphasis added).
[42] Pritchard, *supra* note 4, at 3.
[43] NERA TRENDS 2013, *supra* note 14, at 29.
[44] Dick Thornburgh, Commentary, *Class Action Gamesmanship*, WASH. TIMES, June 15, 2007, at A14 (emphasis added).
[45] ROBERT E. LITAN, U.S. CHAMBER INST. FOR LEGAL REFORM, THROUGH THEIR EYES: HOW FOREIGN INVESTORS VIEW AND REACT TO THE U.S. LEGAL SYSTEM 13 (Aug. 2007) (emphasis added).
[46] *See* 15 U.S.C. § 78u-4.
[47] Edward R. Becker et al., *The Private Securities Law Reform Act: Is It Working?*, 71 FORDHAM L. REV. 2363, 2369 (2003) (emphasis added).
[48] John C. Coffee, Jr., *Nobody Asked Me, But . . .*, NAT'L L. J., Jan. 18, 2007 (emphasis added).
[49] Memorandum of Craig Holman & Michael Lewis, Public Citizen, Pay-To-Play Laws in Government Contracting and the Scandals that Created Them 12 (June 26, 2012), *available at* http://www.citizen.org/documents/wagner-case-record.pdf.
[50] Stephen J. Choi et al., *The Price of Pay to Play in Securities Class Actions*, 8 J. EMP. L. STUD. 650-81 (2011) (emphasis added).
[51] Kevin McCoy, *Campaign Contributions or Conflicts of Interest?*, USA TODAY, Sept. 11, 2001 (emphasis added).
[52] Erika Fry, *The little Louisiana pension fund litigation monster*, FORBES, Oct. 7, 2013 (emphasis added).
[53] U.S. CHAMBER INST. FOR LEGAL REFORM, FREQUENT FILERS: REPEAT PLAINTIFFS IN SHAREHOLDER LITIGATION 5-6 (Sept. 2013) (emphasis added).
[54] *Id.* at 5.
[55] Verified Complaint at 24, *Adams v, Labaton Sucharow & Rudoff LLP*, No. 09/106045 E (N.Y. Sup. Ct. Apr. 29, 2009), *available at* http://amlawdaily.typepad.com/adamsvlabaton1.pdf.
[56] SUNLIGHT FOUND., INFLUENCE EXPLORER, *Gary K. King*, *available at* http://influenceexplorer.com/politician/king-gary-k/d3f9a58aacf646f2b3f0330be81e995b?cycle=-1 (last visited Jan. 31, 2014).
[57] Nathan Koppel, *Lead Counsel in Fannie Mae Suit is Switched Out*, WALL ST. J., Oct. 8, 2007, *available at* http://online.wsj.com/news/articles/SB119180559427851832.
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[59] David Kidwell, *Illinois lawyer tied to indicted law firm*, CHI. TRIBUNE, June 22, 2006, at C1.
[60] Joseph Tanfani & Craig McCoy, *Lawyers find gold mine in Phila. pension cases*, PHILA. INQUIRER, March 16, 2003 (emphasis added), *available at* http://articles.philly.com/2003-03-16/news/25474098_1_pension-fund-pensions-and-retirement-law-firms.
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[63] Tanfani & McCoy, *supra* note 60.
[64] INTERIM REPORT, *supra* note 5, at 13.
[65] *See*, *e.g.*, MISS. CODE ANN. § 7-5-8 (West 2013); 2013 Wisconsin Act 105, *available at* https://docs.legis.wisconsin.gov/2013/related/acts/105.
[66] Fry, *supra* note 52 (emphasis added).
[67] *In re Monster Worldwide, Inc. Sec. Litig.*, 251 F.R.D. 132, 136 (S.D.N.Y. 2008) (emphasis added).
[68] *In re JPMorgan Chase & Co. Shareholder Derivative Litig.*, 2008 WL 4298588, at *8 (Sep. 19, 2008) (emphasis added).
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[71] *City of Livonia Employees' Retirement System v. Boeing Co.*, 711 F.3d 754, 760 (7th Cir. 2013).
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[73] *Id.* at 762 (emphasis added).
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