COMMENT: THE IMPACT TO DATE OF THE LEAD PLAINTIFF PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT

Elliott J. Weiss

Professor Fisch begins her very interesting paper by suggesting that Congress’ goal in passing the lead plaintiff provisions of the Private Securities Litigation Reform Act (the “Reform Act”) was “to transfer control of [securities class action] litigation away from lawyers and back to clients.” I am generally hesitant to speculate about the reasons why Congress took any given action and I am particularly hesitant to attribute Congressional adoption of the Reform Act to any single motive. My impression is that the members of Congress who supported the Act were moved by a variety of motives, ranging from the desire of some to eliminate all private securities litigation to the desire of others to curry favor with particular groups of constituents or with past or potential campaign contributors. It is striking, nonetheless, that Congress not only passed the Reform Act, but passed it over President Clinton’s veto.

What gave the issue of securities litigation reform such political appeal? The answer, I believe, is that securities class actions, particularly those alleging open market fraud, had taken on such an appearance of impropriety that they were especially vulnerable to attack. Much of the discussion that preceded passage of the Act focused on the fact that a relatively small number of plaintiffs’ attorneys regularly were filing class actions only hours or days after the disclosure of information that

4. See, for example, actions in which the plaintiff class was alleging that a corporation had issued materially false or misleading statements and thus had misled public investors. See generally Basic Inc. v. Levinson, 485 U.S. 224 (1988) (holding that courts should presume that any such misrepresentations had caused investors’ losses).
precipitated a major move in the price of a corporation's stock. It seemed apparent, even to people sympathetic to claims of open market fraud, that the moving force behind most class actions was not investors aggrieved by the defendants' alleged misrepresentations but plaintiffs' attorneys seeking to earn potentially large contingent fees. The investors in whose names class action were filed were mere figureheads; their function was to provide these attorneys with "the key to the courthouse."

Several plaintiffs' attorneys have pointed out to me that they really had no choice—that an attorney who wanted to be named lead counsel in a securities class action had to try to be the first to file. I agree. Courts, in general, appointed as lead counsel in securities class actions the first lawyer to file a complaint alleging open market fraud. Thus, courts, not plaintiffs' attorneys, bore most of the responsibility for precipitating the "race to the courthouse." But it was plaintiffs' attorneys, not courts, who were recruiting "clients" and racing to the courthouse and thus it was plaintiffs' attorneys, not courts, whose conduct appeared improper.

Moreover, concerns about the conduct of plaintiffs' attorneys extended beyond the process by which suits were initiated. A substantial body of academic commentary was critical of the manner in which securities class actions were being prosecuted and settled. This added to the impression that securities class action litigation far too often served the financial interests of plaintiffs' attorneys rather than the interests of the investors on whose behalf such lawsuits ostensibly were being prosecuted.

7. It is hard to imagine that investors, within one or two days after some corporate disclosure, regularly (1) decided to consider seeking legal redress; (2) contacted some member of the plaintiffs' bar; (3) received and evaluated the results of their attorney's investigation; (4) decided there existed legitimate grounds to seek tens or hundreds of millions of dollars in damages; and (5) authorized their attorneys to file suit. What seems more likely, and what anecdotal evidence suggests, was that whenever some unexpected disclosure was followed by a sharp move in the price of a company's stock, members of the plaintiffs' bar would quickly evaluate whether a potentially meritorious class action could be filed and, if they reached a positive conclusion, would arrange to have some member of the putative class serve as the plaintiff in whose name the complaint would be filed. See id. at 2060.
9. See Weiss & Beckerman, supra note 6, at 2074–79 (discussing "direct evidence" of instances in which plaintiffs' attorneys agreed to settlement terms prejudicial to the interests of class members with large claims).
The lead plaintiff provisions of the Reform Act were directed at problems associated with attorneys’ initiation and control of securities class actions.10 Congress based the lead plaintiff provisions in large part on an article John Beckerman and I co-authored, in which we suggested that courts interpret Federal Rule of Civil Procedure 23 so as to encourage institutional investors to become lead plaintiffs in securities class actions and to assume responsibility for selecting lead counsel for the plaintiff class.° The thrust of our argument was not that institutional investors, assuming they would volunteer to serve as lead plaintiffs in securities class actions, should be placed in “control” of such actions. We recognized, as does Professor Fisch,11 that attorneys prosecuting class actions almost always will have so much more information and expertise than the lead plaintiff that they, not the lead plaintiff, will effectively control most litigation decisions.12 We believed, however, that institutional investors with large stakes in securities class actions were likely to monitor the attorneys representing the class more effectively than either the investors who have been serving as “figurehead plaintiffs” or the courts, whose approval is needed before a class action can be settled.13 In particular, we suggested that plaintiffs’ attorneys, if they had to be retained by institutional clients in order to become lead counsel in securities class actions, would be likely to become considerably more concerned with developing “reputations as effective advocates of investors’ interests.”14 We also suggested that institutional investors were likely to negotiate fee arrangements that more closely aligned the interests of plaintiffs’ attorneys with those of the plaintiff class than do the fee structures that courts generally employ.15

Now that Congress has mandated comparable changes in procedure as part of the Reform Act, our concern shifts to the lessons that can be learned from this experiment in reform. It is far too early to draw many definitive—or even tentative—conclusions. Indeed, given the pace at which securities class actions typically had proceeded, and the slower pace at which they seem to be proceeding under the Reform Act, it probably will be five years or more before we have enough data to reach more than very tentative conclusions as to how the lead plaintiff provisions have affected the conduct of securities class actions. With that caveat in mind, let me offer a few preliminary observations concerning the developments that have occurred in the year since the Reform Act became law.

Recall that the Reform Act’s lead plaintiff provisions actually comprise four elements. First, the Act requires any person filing a securities class action to

12. Fisch, supra note 2, at 552.
13. See Weiss & Beckerman, supra note 6, at 2105–07.
14. Id.
15. Id. at 2107.
16. Id. Professor Fisch suggests there may be several “dark sides” to institutional investor participation in securities class actions. See Fisch, supra note 2, at 541–50. With one exception, discussed in text at infra notes 60–63, I believe it is unlikely that the potential problems she mentions will develop.
provide early notice to members of the purported class of the filing of the action, the nature of the claims made, and the purported class period. Second, the Act instructs courts (a) to provide an opportunity for members of the purported class to seek appointment as lead plaintiff and (b) to appoint to that position the "most adequate plaintiff," which a court must presume is the aspiring plaintiff "with the largest financial interest in the relief sought by the class." Third, the Act directs courts to allow other members of the purported class to engage in discovery relating to appointment of the lead plaintiff only if they "first demonstrate[] a reasonable basis for a finding that the presumptively most adequate plaintiff is incapable of adequately representing the class." Finally, the Act authorizes the most adequate plaintiff, subject to court approval, to "select and retain counsel to represent the class."

Our goal in proposing a notice requirement was to provide institutional and other investors with early notice of the pendency of a class action that had the potential to affect their rights. It seems as if the Reform Act is well on its way to achieving this goal. The most significant development has occurred in the Northern District of California. The U.S. District Court for that district, which handles a large number of securities class actions, has adopted a local rule that requires any person filing a securities class action to file the notice that the Reform Act requires with a "Designated Internet Site" that has committed to transmit notice of all such filings, via the Internet, to any persons who have registered to receive such notices. The rule also requires the parties in securities class actions to post most other significant litigation documents, such as motions to dismiss, motions for summary judgment, and stipulations of settlement, with the Designated Internet Site.

Stanford Law School has created a site that it expects to qualify as a "Designated Internet Site." Institutional investors and others can subscribe at no cost to receive an e-mail notice whenever a complaint or other document is placed online. Moreover, the Stanford site is up and running and contains information on class actions filed not only in the Northern District of California but in other district courts and in California state courts.

The existence of this site dramatically changes the status quo ante. Prior to enactment of the Reform Act, investors often had no knowledge of, and no reliable

21. See Weiss & Beckerman, supra note 6, at 2108-09.
23. Id.
25. As of February 18, 1997, the Stanford site had 70 federal securities class action complaints online. Id.
means of obtaining information about, pending securities class actions affecting their interests. Frequently, investors did not learn of such actions until they received a notice of conditional class certification and proposed settlement—far too late to have much impact on how such actions were conducted.\textsuperscript{26} Now, institutional (and other) investors can obtain prompt notice, at almost no cost, that securities class actions affecting their interests have been filed. That information also will allow them to assess, on a timely basis, whether they have a major stake in such actions and whether the actions appear to have merit.

Armed with that information, institutional investors will be able to make preliminary determinations as to whether to consider applying to be named lead plaintiff in class actions in which they have large amounts at stake. Moreover, the information available at the Stanford site should make it relatively easy for institutions that elect not to become lead plaintiffs to monitor significant developments in all class actions in which they have interests, which also should make it easier for institutions to move to intervene or to object to proposed settlements if they decide that their interests have not received adequate protection.\textsuperscript{27}

It is too early to tell whether institutional investors with large stakes in class actions will begin to volunteer to serve as lead plaintiffs in class actions in which they have large financial interests. As Professor Fisch notes, there are some promising signs.\textsuperscript{28} In two actions not governed by the Reform Act, courts have relied on the most adequate plaintiff concept to appoint institutional investors to decision-making roles. More significantly, in one case filed after passage of the Reform Act, a major institutional investor has moved successfully to be appointed lead plaintiff and has appointed new lead counsel in place of the well known plaintiffs' firm that filed the initial complaint.

The earliest of these cases is \textit{In re California Micro Devices Securities Litigation}.\textsuperscript{29} There, one of the law firms that filed the initial complaint negotiated a proposed settlement without having been appointed by the court to act as lead counsel for the plaintiff class.\textsuperscript{30} The court reacted by stating that it would disapprove the proposed settlement unless the parties could “make a showing that the proposed settlement and accompanying attorney fee award enjoys affirmative support, as opposed to silent toleration, of a significant portion of the prospective class.”\textsuperscript{31}

In a subsequent hearing, the court rejected the settlement and concluded that

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\item \textsuperscript{26} See Weiss & Beckerman, \textit{supra} note 6, at 2100–01, 2104–05.
\item \textsuperscript{27} It also seems likely that, if this notice system operates successfully in the Northern District of California, many other district courts will adopt similar rules requiring that the required notice be posted on the Internet.
\item \textsuperscript{28} Fisch, \textit{supra} note 2, at 539.
\item \textsuperscript{29} 1995 WL 476625 (N.D. Cal. Aug. 4, 1995).
\item \textsuperscript{30} Id. The court also noted that the complaint had been filed on the day following announcement by California Micro Devices, late the previous afternoon, that it had misreported its financial statements. \textit{Id.} at *1.
\item \textsuperscript{31} \textit{Id.} at *6.
\end{itemize}
the case “should not proceed as a class action with any of the named plaintiffs offered by the plaintiff law firms as class representatives.” Instead, the court said, “a truly independent class representative must be appointed to engage class counsel and to conclude any settlement or direct the litigation.” The court named the Colorado Public Employees Retirement Association (“CoPERA”) and the California Public Teachers Retirement System (“CalSTRS”) as co-lead plaintiffs. The court also accepted those two institutions’ choice of Hogan & Hartson, a large law firm not generally considered part of the “plaintiffs’ bar,” as lead counsel for the plaintiff class.

The second action not covered by the Reform Act involved a derivative lawsuit challenging payment by W.R. Grace & Co. of a multi-million dollar severance payment to its former CEO, whom the Grace board of directors had dismissed for cause. The California Public Employees Retirement System (“CalPERS”) objected to a proposed settlement that included no limitation on the severance payment. A New York State court agreed with CalPERS objection, rejected the proposed settlement, allowed CalPERS to intervene in the action, named CalPERS co-lead plaintiff, and named a law firm CalPERS had retained as co-lead counsel charged with further prosecuting the action.

The most significant development, though, has been the successful effort by the State of Wisconsin Investment Board ("SWIB"), a public pension fund with a reputation for activism, to be named lead plaintiff in Gluck v. CellStar Corp., a class action in which SWIB apparently had the largest financial interest of any member of the putative plaintiff class. SWIB also succeeded in having the law firm it had retained named lead counsel for the class. Even more auspicious may be the fact that counsel for two large commercial institutional investors, BZW Barclays Global Investors and Mellon Bank Corporation (which owns the Dreyfus Corporation), filed a letter brief supporting SWIB’s motion to be named lead plaintiff in which they identified themselves as “institutional investors with large and extensive securities holdings who could easily find themselves in SWIB’s

33. Id.
34. See id. at 276. CalSTRS was allowed to intervene and be named co-lead plaintiff in part because it had both purchased Cal Micro stock during the class period and retained that stock. CoPERA had purchased considerably more stock, but had sold it prior to the end of the class period. Id.
35. See id. at 278.
38. In its Brief in Support of Motion to be Named Lead Plaintiff, SWIB alleged that it purchased more than 1,000,000 shares of CellStar stock during the class period and that it owned approximately 1.6 million of the 7.9 million shares of CellStar stock held by public investors. SWIB’s Brief is available online at http://securities.stanford.edu. According to the Associate General Counsel of SWIB, the court appointed SWIB lead plaintiff on October 1, 1996. See Keith Johnson, Institutional Investor Participation in Class Actions After the Private Securities Litigation Reform Act of 1995, in ALI/ABA, CURRENT ISSUES IN CORPORATE GOVERNANCE 381, 389 (1996).
39. Id.
Whether these "pioneer" public pension funds achieve positive results through their involvement in these three actions, and how much it costs them to achieve those results, undoubtedly will have a major influence on whether other major institutions step forward and seek to be named lead plaintiff in other securities class actions. In this regard, the revised settlement proposal negotiated by Hogan & Hartson in Cal Micro Devices strikes me as encouraging. The original settlement proposal called for Cal Micro to pay the plaintiff class one million dollars in cash and twelve million dollars in stock and to assign to the class Cal Micro's rights to sue its accountants, Coopers & Lybrand, subject to the requirement that the class pay Cal Micro twenty percent of the first five million dollars (or less) recovered from Coopers & Lybrand. In its opinion rejecting that settlement, the district court expressed particular concern with the small amount of cash that would be recovered, almost all of which would have gone to pay the fees and expenses of plaintiffs' counsel.

The revised settlement proposal calls for Cal Micro to pay the plaintiff class six million dollars in cash and seven million dollars in stock and secures Cal Micro's guarantee that that stock will trade at a certain minimum value during the next three years with a bankruptcy preference and a two million dollar escrow fund. In addition, the revised settlement calls for Coopers & Lybrand to pay four million dollars in cash to the plaintiff class, no portion of which will be payable to Cal Micro; for Cal Micro's outside directors to assign to the class all of their rights in their D&O insurance policy, which Hogan & Hartson estimates is worth about two million dollars; and for Cal Micro to assign to the class all of its rights against its former CEO, who appears to have been primarily responsible for Cal Micro's false and misleading public statements. Finally, Hogan & Hartson and its local counsel are seeking a fee award equal to their hourly fees and expenses, which to date total far less than the fee (equal to 20.5% of the original settlement) sought by the original plaintiffs' counsel.

41. 1.5 million shares "guaranteed" to trade for at least $8.00 per share over a 20-day trading period within a three-and-one half years period. See Representative Plaintiffs' Memorandum of Points and Authorities in Support of Proposed Settlement, Setting of Final Approval Hearing, Approval of Notice to Class, and Related Matters at 3, In re California Micro Devices Sec. Litig., No. C-94-2817-VRW (N.D. Cal. 1996).
42. Id.
43. 608,696 shares guaranteed to trade at least $11.50 per share for 20 consecutive days during the next three years. See id. at 5–6.
44. Id. at 6, 11. The proposed settlement also notes that Hogan & Hartson has judicially frozen assets of the former CEO worth about $11.5 million to secure payment of the assigned claims against him. Id. at 6.
Also encouraging is the fact that several well-known law firms vied to represent SWIB in CellStar. The firm SWIB selected, Blank, Rome Comisky & McCauley, is not one usually identified as a member of the "plaintiffs' bar." In addition to demonstrating that it had sufficient experience in securities litigation to take on the representation, Blank, Rome proposed a fee arrangement that SWIB determined was the most cost effective because of the manner in which it aligned Blank, Rome's interests with those of SWIB and the plaintiff class. More specifically, Blank, Rome proposed a sliding percentage of recovery fee, with the percentage increasing as the recovery increases and as the case proceeds through various stages of litigation. A representative of SWIB has opined that "this negotiated fee schedule represents a significant reduction from fees that are typically awarded in these cases and could save the class as much as several million dollars in legal fees."

The possibility of achieving comparable savings in legal fees, standing alone, may make it financially attractive for other institutions to seek to be named lead plaintiffs in class actions in which they have potential multi-million dollar claims. In addition, the fee arrangements negotiated by SWIB and by the institutional lead plaintiffs in Cal Micro may have a significant impact on future securities class actions, regardless of whether institutional investors seek to become lead plaintiffs in many such actions. Heretofore, courts have not had access to marketplace data concerning the contingent fees that sophisticated members of the plaintiff class would be prepared to pay and that competent and experienced securities lawyers would be prepared to accept. Thus, they have made fee awards in a partial vacuum, looking only at the fees that plaintiffs' attorneys have requested and courts have awarded in other, more or less comparable cases.

In the future, courts will have the option of using the fee arrangements negotiated by institutional lead plaintiffs as benchmarks when deciding what fees to award in other class actions. These fee arrangements undoubtedly constitute useful benchmarks. Nonetheless, courts should exercise some caution in relying on them.

Institutional investors are much more likely to apply to be named lead plaintiffs in class actions in which they believe it will be relatively easy to prove that defendants engaged in disclosure fraud than in actions where they have strong doubts about the validity of plaintiffs' claims. Consequently, the fee arrangements

46. See Johnson, supra note 38, at 388. See also Weiss & Beckerman, supra note 6, at 2106 (suggesting that both traditional plaintiffs' firms and other firms were likely to compete to represent institutional investors in class actions).

47. Courts generally reduce the percentage of recovery awarded once the size of the recovery exceeds certain thresholds—a practice that gives plaintiffs' attorneys a strong incentive to settle even strong cases—rather than take them to trial and risk recovering nothing at all. See Weiss & Beckerman, supra note 6, at 2107.

48. See Johnson, supra note 38, at 389. He also noted that SWIB has agreed to support a request for a bonus of up to 1.5% if Blank, Rome handles the case expeditiously. Id.

49. Professor Fisch and others have expressed concern that institutional investors may seek to become lead plaintiffs in class actions for the purpose of seeking dismissal of claims
institutional investors negotiate, while suitable for such strong cases, may not include an adequate allowance for the risks plaintiffs' attorneys assume in securities class actions in which success is less certain. Courts should be sensitive to this difference in risk. If they are not, plaintiffs' attorneys may become less willing to pursue potentially meritorious claims in situations where success is less certain.

The developments just noted provide some basis for optimism that institutional investors will volunteer to serve as lead plaintiffs in many additional class actions. However, the most important determinant of whether institutions will do so probably will be how courts deal with an issue that, to my knowledge, no court has yet addressed: the extent to which defendants in class actions are allowed to pursue discovery relating to whether the institutions that have been named lead plaintiffs are adequate and typical class representatives. As noted above, the Reform Act limits other class members' right to conduct discovery concerning whether a presumptively most adequate plaintiff should be appointed lead plaintiff to cases in which another class member "first demonstrates a reasonable basis for finding that the presumptively most adequate plaintiff is incapable of adequately representing the class." The Act, however, does not speak to the question of whether a defendant should be required to make a similar showing before being allowed to conduct discovery as to whether an institutional investor meets Rule 23's requirements as to adequacy and typicality.

that they believe lack merit. These commentators cite an incident in 1995 in which several institutions wrote a letter to lawyers who had filed a class action against Intel Corp. suggesting that the claims against Intel lacked merit. See Joseph A. Grundfest & Michael A. Perino, The Pentium Papers: A Case Study of Collective Institutional Investor Activism in Litigation, 38 Ariz. L. Rev. 559 (1996). Prior to the delivery of the institutions' letter, the lawyers voluntarily dismissed their suit against Intel. Id.

At the conference at which this Comment was presented, William Lerach, a leading plaintiffs' attorney, suggested that passage of the lead plaintiff provisions was motivated by the Intel precedent—that Congress hoped institutions would become lead plaintiffs and then dismiss many of the "frivolous" suits many members of Congress believed were being filed. However, that seems unlikely. It is hard to imagine that many institutional investors will seek to be named lead plaintiffs for the purpose of moving to dismiss class action claims with which they disagree. As Mr. Lerach made clear in his remarks, members of the plaintiffs' bar will be monitoring how institutions conduct the class actions over which they gain control. Before moving to have a securities fraud claim dismissed, an institution acting as lead plaintiff surely would recognize that it needed to investigate the original plaintiffs' claim exhaustively, if only to be able to defend itself against charges that it had not met its obligations to the plaintiff class.

Such an investigation is likely to be an expensive proposition. The institution commissioning such an investigation presumably would have to reach into its own pocket to pay the law firm it retained to debunk the original plaintiffs' claim, since that firm would have no expectation of being awarded a contingent fee. The costs of such an enterprise almost surely would exceed any benefits that an institutional shareholder could hope to realize from having a non-meritorious class action dismissed, especially because, if the original plaintiffs' claims lacks merit, defendants surely will be prepared to incur all costs reasonably necessary to have that claim dismissed.

In *Greebel v. FTP Software, Inc.*, the court held that defendant FTP had standing to challenge the plaintiffs' compliance with the Reform Act's plaintiff certification and early notice requirements, but not to conduct discovery relating to appointment of a lead plaintiff. The court reasoned that appointment of a lead plaintiff would not prejudice FTP's ability to later question whether the lead plaintiff was an adequate class representative because the court would be open to revisiting that issue in considering the lead plaintiff's motion for class certification. However, the court did not address whether the constraints that apply to other class members' efforts to conduct discovery concerning adequacy and typicality also would apply to FTP.

The adequacy and typicality requirements of Rule 23 are designed to safeguard the interests of absent class members. Prior to enactment of the Reform Act, absent members of the putative plaintiff class generally had no way of knowing that a class action had been filed and, as a consequence, virtually never appeared to question the adequacy or typicality of the person seeking to be named lead plaintiff. Courts got into the habit of allowing defendants, as the best available surrogates, to raise such questions. Defendants, however, generally are interested in defeating class certification, not in protecting the interests of absent class members. Moreover, at least in open market fraud cases in which class members have had an opportunity to contest the appointment of a lead plaintiff, defendants' legitimate interest in challenging the typicality or adequacy of a lead plaintiff relates primarily to the possibility that a court will subsequently determine that the plaintiff class should not have been certified because the lead plaintiff was not adequate or typical.

However, it is hard to imagine a court reaching such a conclusion in a case in which a substantial institutional investor has been named lead plaintiff. A court presumably will not allow other class members, who will have had an opportunity to contest whether an institutional investor is an adequate and typical class representative at the hearing at which that institution was named lead plaintiff, to raise issues relating to the adequacy or typicality of that lead plaintiff in any subsequent proceeding. Thus, there is no realistic possibility that defendants will be forced to defend a putative class action only to learn that the result therein is not binding on other members of the putative plaintiff class because the class was improperly certified.

Defendants' only other plausible concern relates to typicality—that an institutional investor cannot maintain a class action because it is subject to unique

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52. Id. at 62.
53. Id. at 62 n.4.
54. See generally id. at 57.
55. See Weiss & Beckerman, *supra* note 6, at 2101. Charles Wright et al., 7B *Federal Practice & Procedure, Civil* § 1806 (2d ed. 1986), points out that the court is responsible for deciding whether a given plaintiff satisfies the adequacy and typicality requirements of Rule 23(a).
56. See Macey & Miller, *supra* note 8, at 63–66.
defenses and thus its claims are not typical of those of the plaintiff class. In an open
market fraud case, though, the claims of a substantial institutional investor seeking
to be named lead plaintiff almost always will be identical in nature to those of other
class members. More specifically, determinations as to the materiality of
defendants' statements and omissions never turn on the conduct of the lead
plaintiff. Neither do determinations as to whether defendants acted with scienter.

Once plaintiffs have established those elements of their case, they are entitled
to a presumption of reliance, which a defendant can rebut in three ways: (1) by
proving that the lead plaintiff was privy to the truth; (2) by showing that corrective
or omitted information had entered the market; or (3) by proving that the lead
plaintiff would have purchased or sold securities at the same price even had it
known of defendants' deception. The second defense relates more to materiality
than to reliance. The third is applicable only to an investor who is irrational or who
buys or sells securities for the purpose of becoming a plaintiff in a securities class
action. No substantial institutional investor is likely to fall into either of these
categories.

That leaves the first defense, which really is tantamount to a claim that a lead
plaintiff purchased stock on the basis of material non-public (i.e., inside)
information. As a practical matter, it seems implausible that any institutional
investor that purchases or sells securities on the basis of inside information would
seek to become lead plaintiff in a securities class action relating to those securities.
Moreover, if such information had been made available to an institutional investor,
the defendant corporation, as the source of the information, presumably would be
aware of that fact.

Consequently, in order to advance Congress' purpose of encouraging
institutional investors to become lead plaintiff in securities class actions, a court
should impose a requirement similar to that which Congress has imposed on
members of the plaintiff class. That is, a court should require a defendant to
demonstrate it has some reasonable basis to believe that an institutional investor is
incapable of adequately representing the class or is subject to unique defenses. If a
defendant cannot make such a showing, discovery should not be allowed.

58. Id. at 249.
59. In no reported post-Basic case has a defendant succeeded in rebutting the
presumption of reliance, nor has any court allowed a defendant to use any defense other
than the three listed by the Court to rebut that presumption. See Fine v. American Solar
King Corp., 919 F.2d 290, 299 (5th Cir. 1990), cert. dismissed, 502 U.S. 976 (1991); Rand
62. As Beckerman and I have explained elsewhere, if courts do not adopt such an
approach and instead allow defendants to conduct "boxcar discovery," few institutions are
likely to incur the costs that serving as lead plaintiff would entail. See Weiss & Beckerman,
supra note 6, at 2101–03. An alternative approach would be to bifurcate the trial and deal
In addition to developments relating directly to the likelihood that institutional investors will serve as lead plaintiffs in securities class actions, there has been one other development, also involving the appointment of lead plaintiffs, that strikes me as a possible cause for concern. When John Beckerman and I developed the lead plaintiff concept, we had in mind two paradigmatic cases: (1) the typical securities class action, in which a figurehead plaintiff serves as the key to the courthouse for an established plaintiffs' lawyer and (2) an alternative situation in which an institutional investor with a loss of several million dollars, which represents some meaningful fraction of the losses incurred by all members of the plaintiff class, volunteers to serve as lead plaintiff. We did not think about a third class of cases: those in which institutional investors, especially public pension funds with relatively modest stakes in class actions, move to be appointed lead plaintiffs."

Professor Fisch notes that the Reform Act creates a potentially new and lucrative position—class action counsel for an institutional investor. "The potential problem I now see is that some attorneys will nurture relationships with the elected officials who control public pension funds and that those officials, as a sort of political pay-off, will have their funds move to be named lead plaintiff in class actions in which they have modest, but not insubstantial, stakes and will designate those attorneys as lead counsel if and when they are found to be the "most adequate plaintiff."

If the attorneys involved are highly competent and committed to representing class members' interests, such arrangements should present few problems. But if the attorneys do not have such competence or such a commitment, and if the public officials involved do not actively monitor their attorneys' efforts, what could result is a dynamic even more problematic than that which preceded congressional passage of the Reform Act. "How more substantial institutional investors would react, were such a situation to develop, remains to be seen."

with issues relating to a lead plaintiff's reliance only after issues relating to materiality and scienter have been resolved.

63. Richard H. Walker et al., The New Securities Class Action: Federal Obstacles, State Detours, 39 ARIZ. L. REV. 641, 661 (1997), suggest that such institutions have moved to be named lead plaintiff in a number of cases. The failure of my co-author and I to anticipate such a development illustrates what economic theorists call "bounded rationality."

64. See Fisch, supra note 2, at 550.


66. Institutions might realize that their interests are receiving even less effective representation than was the case prior to passage of the Reform Act and react by moving to
The court in *Greebel* noted that the “inspiration” for the Reform Act’s lead plaintiff provisions was the article I wrote with John Beckerman. Having Congress enact our proposal into law has been both thrilling and a bit disconcerting. Along with other interested persons, we’re watching with interest to see how well our ideas work in practice.

Alternatively, they might remain content to “free ride” on the efforts of class counsel, no matter how ineffective, and on the limited protection provided by judicial oversight of class action settlements.
