

## THE AGENCY PROBLEM: SOME PROCEDURAL SUGGESTIONS

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A few years ago, I wrote an article about settlements in securities class actions entitled, "Do the Merits Matter?"<sup>1</sup> Ever since then I have wanted to write the sequel, "Making the Merits Matter." That is what I would like to talk about today—procedural reforms for securities and consumer class actions.

In doing law reform, it is important to take a structural and institutional approach, looking at what is actually happening in a particular type of litigation we are focusing on. We must try to figure out what it is that is causing the conduct of that litigation to deviate from what we think of as the normal or ideal way that such litigation should be resolved. Then we should fix that, rather than taking the view that the problem is too much litigation or frivolous litigation or greedy lawyers. I do not think that attitude leads to helpful solutions.

I want to talk about a type of reform that addresses what may be the core issue in representative litigation, and that is the agency problem. When litigation is brought by a representative on behalf of people who are not before the court, the issue is whether the lawyers' interests and the representatives' interests may diverge from those of the class. In securities cases, there is some evidence that cases settle without regard to the strength of the case on the merits. In addition, some of the other speakers have referred to settlements in consumer class actions that appear to provide negligible benefits to the consumer class members, but substantial fees to the lawyers.

I think there are two basic kinds of solutions to the agency problem. One is to have a client present to monitor the lawyers' performance. The other is to take steps to align the lawyers' interests more perfectly with the class's interest. In terms of having a client present, I think there is actually a possibility of doing that more effectively in securities class actions because they do not fit the paradigm of class actions. In that paradigm, class actions are needed because there are many small claims that individually are not worth bringing suit over. The problem is that although class actions empower people to bring such claims, there is nobody with a stake big enough to justify monitoring the lawyers' performance.

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1. Janet C. Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497 (1991).

In securities class actions, however, there are claimants who have a lot at stake. In fact, one study showed that the top ten claimants account for about thirty-five percent of the total claims.<sup>2</sup> Thus, some class members, who for the most part are institutional investors, have sizable claims in this setting.

Institutional investors have received significant attention from academics and legislators recently. If you are interested in solving the agency problem, institutional investors appear to be the answer to your dreams, because they are big enough to perform an effective job of monitoring and their interests seem to be almost perfectly aligned with the public interest in the securities laws. They consume large amounts of information about companies, and thus have a strong interest in maintaining a disclosure environment that is not tainted by securities fraud. On the other hand, they are investors and make their money from their investments, so they have a strong interest in making sure that companies are not paying high costs for suits that have no merit. The lead plaintiff provisions of the Private Securities Litigation Reform Act of 1995 represent an effort to get large investors involved.<sup>3</sup>

I would propose, and this is the most radical thing I would propose today, to have an "opt-in" requirement for securities class actions that would affect the largest investors. The opt-in threshold would be set so as to cover approximately the top ten or twenty claimants in the class. Those investors would have to opt-in if they wanted to participate in the recovery. If they opt-in, they thereby signify their willingness to serve on a plaintiffs' steering committee that would monitor the conduct of the litigation, including the choice of the class counsel.

The opt-in requirement would identify potential members of a plaintiffs' steering committee to monitor the litigation and perform the traditional role of the client. Additionally, it would make the amount of potential damages more certain and more verifiable, because the large claimants would be required to specify the relevant information concerning their trades. Only the small claims would have to be estimated. If large claims opted out, they would be excluded from the damage calculation. This would reduce the uncertainty in damages, and the disparity between the parties' estimates, and would make the calculation of damages more realistic.

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2. See Vincent E. O'Brian & Richard W. Hodges, A Study of Class Action Securities Fraud Cases II-3 (June 1991) (unpublished study, on file with *New York Law School Law Review*) (reporting that the top five claimants accounted for an average of 25% of the claims filed, and the top ten claimants accounted for 34.49% of the claims filed).

3. See 15 U.S.C.A. §§ 77z-1(a)(3)(B), 78u-4(a)(3)(B) (West Supp. 1997).

The second type of reform that I would propose is a "truth in labeling requirement" in consumer and securities cases. The amount of a settlement or judgment would only be permitted to be stated in per-claim or per-unit terms (in securities cases, an amount per share), not as an aggregate lump sum.

The primary reason for this is that when the class members get the notice of settlement and have to decide whether to object to the settlement, to opt-out, to file a claim or to do nothing, the most important information they need to know is how much they are going to get out of the settlement. That is information that the class members in securities cases do not have. All they know is the total amount to be distributed to the class. Usually, they get some idea of what the attorneys' fees might be, but often they have no information about how many shares there are in the class or how many shares will claim. Moreover, if this information were made available before the fairness hearing, it would help the judge evaluate the fairness of the settlement.

In addition, this proposal would help promote settlement (at least initially). Typically the plaintiffs say there are many shares in the class and the defendants deny this and say there are very few. If the parties really believed their numbers, and if settlement offers had to be stated in per-share terms, there would be a greatly expanded zone of agreement. The parties could say, "Let's settle for two dollars a share," which would seem like a small amount to the defendants and a large amount to the plaintiffs. Now obviously, at the end of the day somebody is going to be surprised, but over time people ought to learn to estimate more accurately.

Finally, I propose reforms that would better align the interests of the plaintiffs, the lawyers, and the class. These reforms relate to fee awards. I propose that there be no negotiation or discussion of the fee award until after the final approval of the settlement. Further, rather than having one lump sum settlement amount from which the attorney fees are deducted, there should first be an agreement or a judgment on the amount that will go to the class. After final approval of the settlement, there should be an adjudication of the amount of the attorneys' fees, which would be paid directly by the defendant.

What these two reforms would accomplish is to ensure that the defendant has an interest in presenting an adversary presentation on the fee issue. Currently, there is an acute conflict of interest between the class and the lawyers on the fee request, because every dollar that goes to the lawyers comes directly from the class recovery. Yet that is the very point where there is no longer an adversary presentation. There are some quixotic folks who go around filing objections, but I think it is unwise to rely on Larry Shoenbrun to do everything.

Next, I would tie the amount of the fee more directly to the benefit conferred on the class by holding the hearing on the fee award only after the close of the period for filing claims. If the recovery is stated on a per-

share basis, then once all the claims are filed you know exactly what the benefit is that has been conferred on the class, and the fee can be determined in that light. In determining a reasonable fee, the judge should be required to make an explicit reference to the proportionality of the fee to the benefit conferred on the class.

This reform would not add much to current securities settlements, where the total amount of the class recovery is known, at least in all-cash settlements without give-back provisions.<sup>4</sup> It would have real bite, however, in consumer class actions where non-cash—"coupon" or "in-kind"—settlements are common and frequently criticized.<sup>5</sup> Examples come readily to mind: the Cuisinart food processor price-fixing settlement, where purchasers received half-off coupons for future purchases of non-food-processor Cuisinart products;<sup>6</sup> the airline coupon price-fixing settlement, where class members got coupons with a face value of \$408 million toward future purchases and \$50 million in cash, and class counsel received \$14 million cash;<sup>7</sup> the proposed GM pick-up truck product liability settlement, which would have given class members a coupon good for \$1000 off on the purchase of another GM truck, plus \$9.5 million in attorneys' fees;<sup>8</sup> and the proposed settlement of the Ford Bronco II litigation, which would have given class members a free inspection, an educational video, an owner's manual supplement, a safety sticker for their sun visors (much of which was already required by government regulation), and \$6 million in fees.<sup>9</sup>

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4. A "give-back" provision directs that unclaimed funds revert to the defendant.

5. See Note, *In-Kind Class Action Settlements*, 109 HARV. L. REV. 810 (1996).

6. See *In re Cuisinart Food Processor Antitrust Litig.*, MDL 447, 1983 WL 153, \*2-3 (D. Conn. Oct. 24, 1983).

7. See *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297 (N.D. Ga. 1993).

8. See *In re General Motors Corp. Pick-Up Truck Fuel Tank Prod. Liab. Litig.*, 55 F.3d 768 (3d Cir. 1995) (reversing the settlement approved by the district court, in part on the issue of the adequacy of the settlement), *cert. denied*, 116 S. Ct. 88 (1995).

9. See *In re Ford Motor Co., Bronco II Prod. Liab. Litig.*, CIV.A.MDL 991, 1997 WL 104971, at \*4 (E.D. La. Mar. 7, 1997) (finding that there was no consideration because consumers only received information to which they were already entitled, and that fee request was "so far out of the range of what I consider reasonable as to suggest . . . collusion"); see also Emily Barker, *Class Members Claim Duplicity in Photocopier Suit*, AM. LAW., May 1994, at 29 (discussing proposed settlement of antitrust suit against Xerox by customers and copier repair companies; the proposed settlement consisted of discount coupons to end-users with a face value of \$223 million, \$2 million in coupons to 4000 copier repair class members, \$5 million cash to five named plaintiffs, and a clear sailing clause for \$35 million in fees).

Such nonpecuniary settlements have been criticized for delivering little if any benefit to the class, while generating large attorneys' fees.<sup>10</sup> One problem for courts in evaluating such settlements is the difficulty in valuing the non-cash component. By deferring the attorney fee award until the class has actually filed claims, my proposal would take much of the uncertainty out of this endeavor. Similarly, it would eliminate uncertainty as to how many members of the class would actually file claims.<sup>11</sup>

These reforms would be superior to many of the reforms that have been proposed legislatively, and except for the opt-in requirement, these reforms could be adopted by judges without congressional action.

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10. See, e.g., John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877 (1987); Note, *supra* note 5.

11. See Janet Cooper Alexander, *The Value of Bad News in Securities Class Actions*, 41 UCLA L. REV. 1421, 1448-49 (1994).