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Lead Plaintiff Incentives in Aggregate Litigation

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Lead Plaintiff Incentives in Aggregate Litigation

Charles R. Korsmo* Minor Myers**

The lead plaintiff role holds out considerable promise in promoting the deterrence and compensation goals of aggregate litigation. The prevailing approach to compensating lead plaintiffs, however, provides no real incentive for a lead plaintiff to bring claims on behalf of a broader group. The policy challenge is to induce sophisticated parties to press claims not in their individual capacity but instead in a representative capacity, conferring a positive externality on all class members by identifying attractive claims, financing ongoing litigation, and managing the work of attorneys. We outline what an active and engaged lead plaintiff could add to the civil enforcement regime and propose a set of reforms designed induce that engagement. In particular, we argue that courts should be open to awarding lead plaintiffs amounts that are roughly equal in magnitude to those awarded to lead counsel.

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INTRODUCTION

The traditional model of representative litigation places the plaintiffs' attorney squarely in the center of the universe. They act as "private attorneys general," dedicating their resources and expertise to vindicating claims on behalf of disaggregated plaintiffs. In most cases, the plaintiffs' attorney decides when to bring class claims, how to manage them, and how to settle them—subject to court approval. These efforts generate public benefits, promoting compensation and the deterrence of wrongdoing, and so the law creates an incentive for plaintiffs' attorneys to undertake those efforts in the first place, rewarding them with a substantial percentage of the recovery generated for the class. While this award is often referred to as an "attorneys' fee," it has more in common with a reward or a qui tam payment than with a traditional attorneys' fee negotiated with a paying client. The actual lead or named plaintiff is a peripheral figure, at best. With only a small stake in the litigation, the lead plaintiff is

^{1.} See, e.g., John C. Coffee, Jr., Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working, 42 MD. L. REV. 215, 216 (1983); William B. Rubenstein, On What a "Private Attorney General" Is—and Why It Matters, 57 VAND. L. REV. 2129, 2148 (2004).

^{2.} See, e.g., Charles R. Korsmo & Minor Myers, The Structure of Stockholder Litigation: When Do the Merits Matter?, 75 Ohio St. L.J. 829, 841 (2014) ("As a practical matter, then, it is the plaintiffs' attorneys... who decide when to initiate [class and derivative] claims, how to prosecute them, and on what terms to settle them."); Jonathan R. Macey & Geoffrey P. Miller, The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform, 58 U. Chi. L. Rev. 1, 3 (1991) ("[P]laintiffs' class and derivative attorneys function essentially as entrepreneurs who bear a substantial amount of the litigation risk and exercise nearly plenary control over all important decisions in the lawsuit.").

^{3.} See, e.g., Coffee, supra note 1, at 218 ("The conventional theory of the private attorney general stresses that the role of private litigation is not simply to secure compensation for victims, but is at least equally to generate deterrence, principally by multiplying the total resources committed to the detection and prosecution of the prohibited behavior."); Charles R. Korsmo & Minor Myers, Aggregation by Acquisition: Replacing Class Actions with a Market for Legal Claims, 101 IOWA L. REV. 1323, 1333 (2016) ("By solving the basic collective action problem associated with mass claims, class and derivative claims preserve the deterrent and compensation goals of our civil liability system.").

^{4.} See 4 WILLIAM B. RUBENSTEIN, NEWBERG ON CLASS ACTIONS § 15:73 (5th ed. 2019) ("[F]ee awards in class actions average around one-third of the recovery."); Brian T. Fitzpatrick, An Empirical Study of Class Action Settlements and Their Fee Awards, 7 J. EMPIRICAL LEGAL STUD. 811, 835 tbl.8 (2010) (reporting that the mean and median fee awards were both around 25% over 444 federal class actions suits between 2006 and 2007).

^{5.} For a thoughtful exploration of the relationship between qui tam actions and class claims, see Jill E. Fisch, *Class Action Reform, Qui Tam, and the Role of the Plaintiff,* 60 L. & CONTEMP. PROBS. 167, 170 (1997).

^{6.} See id. at 182 ("In the evolving structure of representative litigation, an article exploring the role of the class action plaintiff would have little utility, except from a historical perspective."); Macey & Miller, supra note 2, at 5 ("The named plaintiff does little—indeed, usually does nothing—to monitor the attorney in order to ensure that representation is competent and zealous, or to align the interests of the attorney with those of the class or the corporation.").

presumed to have little incentive or practical ability to play a significant role in generating benefits for the class.⁷ Even where large, sophisticated lead plaintiffs might exist, such as in stockholder class actions, the traditional model relegates them to playing the purely negative role of "monitoring" the plaintiffs' attorney to prevent abuses.⁸ For this reason, leading commentators expect very little from lead plaintiffs.⁹

In theory, a mechanism exists for giving lead plaintiffs an incentive to lend their efforts to the class. This is the so-called "plaintiff incentive award." But the manner in which courts calculate such awards makes them woefully inadequate as incentives. Courts, mired in the traditional concept of the lead plaintiff as a mere figurehead, typically approach such awards from a restitutional point of view—attempting to compensate the lead plaintiff for out-of-pocket expenses associated with their service. But mere restitution can, at best, only remove *dis*incentives. It cannot, by definition, create a positive incentive. Without the prospect of an actual reward for generating class benefits, a sophisticated lead plaintiff will typically be better off pursuing an individual claim. The same characteristics that would

[A]though the litigation system relies on the client to monitor the lawyer's conduct in initiating and conducting litigation, the class plaintiff lacks both the interest and the ability to monitor.... The plaintiff's expenditure of time in monitoring is costly, and the expected value of this expenditure is limited substantially by the small size of plaintiff's interest. The plaintiff's interest in monitoring is reduced further by the virtual elimination of the traditional downside risks associated with unsuccessful litigation;

Charles Silver & Sam Dinkin, *Incentivizing Institutional Investors to Serve as Lead Plaintiffs in Securities Fraud Class Actions*, 57 DEPAUL L. REV. 471, 479 (2008) (summarizing the few incentives present for class representatives).

^{7.} See, e.g., James D. Cox, Randall S. Thomas & Dana Kiku, Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions, 106 COLUM. L. REV. 1587, 1593 (2006) ("Class members suffered profound collective action problems that prevented close monitoring of the class action attorney."); Macey & Miller, supra note 2, at 5 ("The named plaintiff does little—indeed, usually does nothing—to monitor the attorney in order to ensure that representation is competent and zealous, or to align the interests of the attorney with those of the class or corporation."); Elliot J. Weiss & John S. Beckerman, Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions, 104 YALE L.J. 2053, 2060 (1995) (arguing that lead plaintiffs are often "poorly informed about the theories of their cases, . . . totally ignorant of the facts, or . . . illiterate concerning financial matters").

^{8.} See Weiss & Beckerman, supra note 7, at 2060 (arguing that institutional investors "have the knowledge and sophistication necessary to serve as effective litigation monitors"). See generally Private Securities Litigation Reform Act of 1995 § 101(a), 15 U.S.C. § 77z-1 (2012) (outlining appointment of lead plaintiffs).

^{9.} See Fisch, supra note 5, at 173-74:

^{10.} See infra Section II.C.

^{11.} See infra Section II.B; see also Silver & Dinkin, supra note 9, at 478 (noting that institutional investors may opt to file individual claims to avoid the higher costs and weaker claims that accompany class actions).

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make that sophisticated actor valuable to the class—a large stake, meaningful expertise, and substantial financial resources—also make it perfectly capable of proceeding individually. 12

In this Article, we propose a new model of plaintiff incentive awards in aggregate claims, one that holds special promise in complex corporate and securities actions. Our proposal captures the possibility that the lead plaintiff and the plaintiffs' attorney can function as an effective team, with no necessary qualitative difference between their respective contributions. Because the lead plaintiff can fulfill the same function as the plaintiffs' attorney, they ought to be rewarded for doing so in the same fashion. Instead of calculating a percentage-based award for the attorneys and then calculating a separate award for the lead plaintiff, the court should, in appropriate circumstances, calculate a single award and then allocate it among the "team" in rough proportion to each member's respective contribution. Where the plaintiffs' attorneys and lead plaintiffs have agreed in advance on the allocation, the court should, in most circumstances, defer to this agreement between commercially sophisticated parties.

Typical objections to employing plaintiff incentive awards in such a fashion include that it would lead to excessive or arbitrary awards, that it would distort the lead plaintiff's incentives, and that it would harm the interests of the absent class members. These concerns ring hollow in this context. If taken seriously, they would, in most cases, apply even more forcefully against percentage-based contingency fees for plaintiffs' attorneys. Moreover, because any reward at all must be approved by the presiding judge, trial court judges will be well placed to police potential abuses. Our proposed use of plaintiff incentive awards would work to the benefit of absent class members by inducing strong plaintiffs to proceed on a class basis rather than proceeding individually.

This Article proceeds as follows. Part I provides a brief introduction to plaintiff incentive awards, including their function, how they have been employed, and concerns about their use based on traditional conceptions of the role of lead plaintiff. Part II demonstrates that current approaches to awarding incentive awards, geared toward the traditional figurehead lead plaintiff, hamper the effectiveness of such litigation. It also argues that treating the attorneys and lead plaintiffs as a team for the purpose of incentive awards would be especially beneficial in complex corporate and securities litigation. Part III suggests concrete reforms for the use of incentive awards. Part IV evaluates and rejects potential arguments against more

12. See infra Section II.B.

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aggressive use of plaintiff incentive awards in representative corporate and securities cases.

I. THE PREVAILING APPROACH TO PLAINTIFF INCENTIVE AWARDS

This Part describes the existing evidence on how courts make awards to plaintiffs and shows they are common, but small. Courts regularly gesture toward the importance of providing incentives for plaintiffs to bring aggregate claims, but at the same time, courts and lawmakers have expressed thorough skepticism about the practice and have created a series of limitations on the use of plaintiff awards. The Private Securities Litigation Reform Act of 1995 ("PSLRA")¹³ embraces this skeptical approach in the extreme, and Delaware's approach in the recent *Chen v. Howard-Anderson*¹⁴ case shows that even that state's regime holds out little promise to an active lead plaintiff.

A. The Current Pattern of Incentive Awards to Plaintiffs

Plaintiff incentive awards are common, used by many courts to deliver a special payment to lead or representative plaintiffs in representative actions—typically class actions or derivative actions.¹⁵ At the same time, these awards are very small relative to overall recoveries and, in real terms, the amounts awarded have declined over time. Incentive awards are often paid out of the common fund provided for the recovery of the class.¹⁶ Where there is no common fund, courts may allow defendants to pay a plaintiff incentive award as part of a settlement under the authority of a fee-shifting statute.¹⁷

^{13.} Private Securities Litigation Reform Act of 1995 § 101a, 15 U.S.C. § 77z-1(a)(4) (2012).

^{14.} No. 5878-VCL, 2017 Del. Ch. LEXIS 734 (Del. Ch. June 30, 2017).

^{15.} These awards are also termed "service awards" or "case contribution awards" by courts. See 5 Rubenstein, supra note 4, § 17:2.

^{16.} See id. § 17:5 ("Courts have generally approved incentive awards that are withdrawn from the common fund at the conclusion of the common fund case."); see also Hadix v. Johnson, 322 F.3d 895, 898 (6th Cir. 2003) ("[I]ncentive awards are usually viewed as extensions of the common-fund doctrine, a doctrine that holds that a litigant who recovers a common fund for the benefit of persons other than himself is entitled to recover some of his litigation expenses from the fund as a whole."). But cf. Hadix, 322 F.3d at 898 ("Without a common fund, however, there is no place from which to draw an incentive award. Unsurprisingly, we are unable to find any case where a claim for an incentive award that is not authorized in a settlement agreement has been granted in the absence of a common fund.").

^{17. 5} RUBENSTEIN, *supra* note 4, § 17:5 ("If a case does not create a common fund, the defendant may be required by a fee-shifting statute to pay a prevailing party's legal fees; if such a case settles, the defendant will typically agree to pay class counsel's legal fees as part of the settlement. In such settlements, a defendant will often agree to pay the class representatives an incentive award, subject to court approval.").

A study by the Federal Judicial Center examined class actions in four federal district courts in the early 1990s, and it found that 44 of 126 (34.9%) of settled class actions included awards to class representatives. 18 Professor Ted Eisenberg and Professor Geoffrey Miller's more comprehensive study of 374 class action opinions from 1993 to 2002 found that 104 cases (27.8%) involved plaintiff incentive awards. 19 They broke cases down by type and found significant differences: incentive awards were common in consumer credit and commercial cases (present nearly 60% of the time) and rare in corporate cases (4.2%).20 Professor William Rubenstein and Rajat Krishna assembled a database of nearly 1,200 class actions resolved between 2006 and 2011 and found a dramatic increase in the frequency of plaintiff incentive awards.²¹ Awards were part of 71.3% of the cases in his sample, with the rate increasing over time.²² He also found substantial variance across types of claims—well over 90% of civil rights and consumer class actions utilized incentive awards, while only 38.7% of securities class actions did so.²³

While the incidence of plaintiff incentive awards has increased, the size of the awards has fallen somewhat in real terms. Eisenberg and Miller found a median total award of \$18,291 and mean of \$128,803 in 2002 dollars, and the Rubinstein study found a median of \$8,398 and a mean of \$26,326 in 2002 dollars. More of the earlier cases involved more than one named plaintiff receiving an award, so the drop is not as dramatic on a "per plaintiff" basis. The median "per plaintiff" award dropped from \$4,357 to \$4,199, and the mean from \$15,992 to \$9,355.25 The mean award was highest by far in employment discrimination cases, perhaps due to the recognition that the plaintiffs faced serious risks of retaliation.26

^{18.} THOMAS E. WILLGING ET AL., FED. JUDICIAL CTR., EMPIRICAL STUDY OF CLASS ACTIONS IN FOUR FEDERAL DISTRICT COURTS: FINAL REPORT TO THE ADVISORY COMMITTEE ON CIVIL RULES 120 fig.16 (1996), https://www.uscourts.gov/sites/default/files/rule23_1.pdf [https://perma.cc/EFT8-S3TM]. A report on the study is published in Thomas E. Willging et al., An Empirical Analysis of Rule 23 to Address the Rulemaking Challenges, 71 N.Y.U. L. REV. 74, 101 (1996).

^{19.} See Theodore Eisenberg & Geoffrey P. Miller, Incentive Awards to Class Action Plaintiffs: An Empirical Study, 53 UCLA L. REV. 1303, 1320 (2006).

^{20.} Id. at 1323

^{21.} See William B. Rubenstein & Rajat Krishna, Class Action Incentive Awards: A Comprehensive Study (unpublished manuscript) (on file with author). The study is unpublished, but summarized in 5 RUBENSTEIN, supra note 4, §§ 17:7–8.

^{22.} See 5 RUBENSTEIN, supra note 4, § 17:7 tbl.1.

^{23.} Id.

^{24.} Id. § 17:8; Eisenberg & Miller, supra note 19, at 1334.

^{25. 5} Rubenstein, supra note 4, § 17:8.

^{26.} Id.

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Two points on the size of plaintiff incentive awards stand out. First, the disparity between the medians and means suggests that award amounts are highly skewed—small awards in most cases, with substantially larger awards in a handful of cases. This is in keeping with the typical conception that the lead plaintiff plays a relatively small role in most representative actions. Second, the amounts awarded are small, both in absolute and relative terms. Eisenberg and Miller found that the mean incentive award was only 0.16% of the class recovery, with the median a minuscule 0.02%.²⁷ This stands in contrast to attorneys' fees, where 20% is typical in the corporate context and perhaps an even higher percentage is typical in other settings. This surely reflects a judicial perception about the respective contributions of the lead plaintiff and lead counsel.

B. The Rationale for the Current Pattern of Plaintiff Incentive Awards

The legal basis for a court to make a special award to a lead plaintiff is decidedly murky. Federal Rule of Civil Procedure 23 makes no reference to such awards; Professor Rubenstein notes that "[t]he judiciary has created these awards out of whole cloth" and that "few courts have paused to consider the legal authority for incentive awards." Instead, courts have generally focused on the rationale for an incentive award.

The most common rationale grows out of a judicial recognition that a lead plaintiff is necessary in representative litigation but may be reluctant to step forward.³⁰ In addition to helping establish the common factual predicates for recovery by the class, the lead plaintiff can also, in theory, provide value to the class by monitoring the plaintiffs' attorney.³¹ In fulfilling this role, the lead plaintiff bears costs that are not shared by the rest of the class, including pecuniary outlays and the opportunity cost of time dedicated to the case.³² At a minimum, lead

^{27.} Eisenberg & Miller, supra note 19, at 1308.

^{28. 5} RUBENSTEIN, supra note 4, § 17:4.

^{29.} *Id.* ("There are only a few scattered references in the reported case law to the legal basis for incentive awards, with no court addressing the question head on."); *see also* Greenberg v. Procter & Gamble Co. (*In re* Dry Max Pampers Litig.), 724 F.3d 713, 722 (6th Cir. 2013) ("[T]o the extent that incentive awards are common, they are like dandelions on an unmowed lawn—present more by inattention than by design.").

^{30.} See Eisenberg & Miller, supra note 19, at 1305 ("The named plaintiff remains an essential prerequisite in all class cases.").

^{31.} See id.

^{32.} See Richard A. Nagareda, Restitution, Rent Extraction, and Class Representatives: Implications of Incentive Awards, 53 UCLA L. Rev. 1483, 1486, 1488 (2006) ("Discovery aside, the class representative may incur opportunity costs insofar as she must devote her time to

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plaintiffs are likely to face the costs of responding to discovery requests and may even be subjected to a deposition.³³ They may also suffer reputational damage, face retaliation from defendants,³⁴ and, in extreme cases, face sanctions if a case is found to be frivolous.

While all of these costs are borne directly by the lead plaintiff, the fruits of their efforts are shared pro rata with the entire class.³⁵ Where the lead plaintiff's share of the recovery is small, the costs of serving as lead plaintiff can make doing so a negative-value proposition.³⁶ Even where serving as lead plaintiff is not negative-value in absolute terms, it will often be so in relative terms—each individual plaintiff would be better off sitting back and letting someone *else* bear the costs of being lead plaintiff. In many cases, this free-rider dynamic can prevent a suit from being brought in the first place.³⁷

A plaintiff incentive award can serve to counteract this freerider dynamic.³⁸ Courts regularly emphasize the goal of incentivizing a

lawsuit.").

- 33. See Eisenberg & Miller, supra note 19, at 1305; Nagareda, supra note 32, at 1486 ("Litigating a class action as the class representative means subjecting oneself to discovery in the manner of a conventional party. By contrast, class action law generally guards against full-fledged discovery directed toward absent class members.").
- 34. This is a particular concern in employment discrimination or whistleblower actions. See Nagareda, supra note 32, at 1486 ("The clearest illustration comes in the context of employment discrimination class actions, where the class representative might run the risk of becoming a focal point for retaliation ").
- 35. See Eisenberg & Miller, supra note 19, at 1305 (noting that while "[n]amed plaintiffs incur costs in performing their role...the benefit from the recovery is shared with other class members"). Eisenberg and Miller further point out that lead plaintiffs may also "gain benefits from performing their role," including "psychic benefits such as the pleasure of having their name on the 'marquee' [and] participating in an interesting and stimulating activity." Id. While such benefits may be significant in an employment discrimination case or consumer class action, they are unlikely to be significant in the kinds of corporate and securities actions that are the focus of this Article.
- 36. Id. at 1305-06 ("In some cases—consumer class actions, where the typical class-member recovery is low, being an example—a class member may even experience a net loss from acting as class champion because the small recoveries normally gained from the case are not enough to cover the increased costs ").
- 37. Id. at 1306 ("At the limit, free-rider effects can result in litigation failing because no one is willing to act as class champion.").
 - 38. PRINCIPLES OF THE LAW OF AGGREGATE LITIGATION § 1.05 cmt. h (AM. LAW INST. 2019): Judges have encouraged lead parties to invest more heavily in litigation by reimbursing them for expenses incurred and time expended at reasonable hourly rates. This practice has a simple economic justification. Part of the justification is comparable to the practice, common in many states, of providing incentive bonuses for named plaintiffs and other class members whose participation contributes importantly to a successful result, and who must on occasion bear additional responsibilities and face the possibility of the adverse demands and consequences of being a named party to

see Eisenberg & Miller, supra note 19, at 1307 ("In the absence of an effective mechanism for compensating class representatives through class counsel...the interests of the class and the

communication with absent class members concerning the nature, progress, and handling of the

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lead plaintiff to step forward,³⁹ often breaking the justification down into several parts: (1) compensation for expense and work undertaken for the class; (2) compensation for financial and other risks attendant to serving as lead plaintiff; and (3) rewarding the lead plaintiff for serving as a "private attorney general" for the benefit of the class and, perhaps, society.⁴⁰

C. Skepticism About the Use of Incentive Awards

Despite the proliferation of plaintiff incentive awards in recent decades, courts and legislatures continue to express policy concerns about their use. These can be roughly grouped under four headings, though they overlap somewhat. The first and most obvious objection to plaintiff incentive awards is that they drive a wedge between the incentives of the named plaintiff and those of the absent class members—the named plaintiff receives the award, and the absent class members do not.⁴¹ The lead plaintiff may be tempted to enter into a collusive settlement, trading off value for the class in exchange for a larger incentive award.⁴² Where the incentive award is large compared

purposes of class action litigation can be served by allowing the *court* the discretion to pay class representatives.").

^{39.} See, e.g., Cook v. Niedert, 142 F.3d 1004, 1016 (7th Cir. 1998) ("Because a named plaintiff is an essential ingredient of any class action, an incentive award is appropriate if it is necessary to induce an individual to participate in the suit.").

^{40.} See Rodriguez v. W. Publ'g Corp., 563 F.3d 948, 958–59 (9th Cir. 2009) (stating that plaintiff incentive awards "are intended to compensate class representatives for work done on behalf of the class, to make up for financial or reputational risk undertaken in bringing the action, and, sometimes, to recognize their willingness to act as a private attorney general."); 5 RUBENSTEIN, supra note 4, § 17:4.

^{41.} The ALI Principles caution that any plaintiff award "should not be an incentive for securing the acquiescence of either the lead parties or the named class members on a basis adverse to the interests of the aggregated group as a whole." PRINCIPLES OF THE LAW OF AGGREGATE LITIGATION § 1.05 cmt. h (AM. LAW INST. 2019); see also 5 RUBENSTEIN, supra note 4, § 17:3 ("[T]he central cost of incentive awards is the risk that the class representative's interests will diverge from or conflict with those of the class").

^{42.} See, e.g., Greenberg v. Procter & Gamble Co. (In re Dry Max Pampers Litig.), 724 F.3d 713, 722 (6th Cir. 2013) ("[W]e should be most dubious of incentive payments when they make the class representatives whole, or (as here) even more than whole; for in that case the class representatives have no reason to care whether the mechanisms available to unnamed class members can provide adequate relief."); Weseley v. Spear, Leeds & Kellogg, 711 F. Supp. 713, 720 (E.D.N.Y. 1989) ("If class representatives expect routinely to receive special awards in addition to their share of the recovery, they may be tempted to accept suboptimal settlements at the expense of the class members whose interests they are appointed to guard."); Raider v. Sunderland, No. Civ.A. 19357 NC, 2006 WL 75310, at *1 (Del. Ch. Jan. 5, 2006) (expressing concern over a lead plaintiff's incentives where a "bonus" award is available); 5 RUBENSTEIN, supra note 4, § 17:1 ("[W]ith the promise of a significant award upon settlement of a class suit, the representative might prioritize securing that payment over serving the class."); Id. § 17:3 ("Courts fear that a class representative can be induced by a special payment to sell out the class's interests."); Eisenberg & Miller, supra note 19, at 1312 ("Some courts and commentators have criticized

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to the lead plaintiff's share of the actual recovery, some courts have expressed concerns that the award may render the lead plaintiff no longer "similarly situated" to other class members, calling into question its adequacy as a class representative.⁴³

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A second criticism of plaintiff incentive awards is that the lead plaintiff often does little of value for the class, and the diversion of a portion of the recovery is inappropriate and unfair. 44 Congress has been especially scornful of "[p]rofessional plaintiffs who own a nominal number of shares in a wide array of public companies," deriding the fact that "in many cases the 'lead plaintiff' has not even read the complaint." 45 The findings prefacing the Class Action Fairness Act of 2005 characterize as an "abuse" cases where "unjustified awards are made to certain plaintiffs at the expense of other class members." 46

A third concern is that lead plaintiffs will engage in rent-seeking behavior. This can take at least two forms. First, courts and commentators have expressed concern that the availability of incentive awards will give potential lead plaintiffs leverage to threaten a class action in order to instead secure a larger settlement in an individual suit. Fecond, where the lead plaintiff is in a position to choose which plaintiffs' lawyer will have control of the litigation—together with the attendant financial rewards—the plaintiff may use this power to extract rents. This carries both the risk of the rent extraction itself, and the possibility that a lead plaintiff will select counsel based on which plaintiff's lawyer is likely to work to secure a large incentive award rather than which will best represent the class. This is particularly a concern in securities class actions, where the PSLRA

incentive awards on the ground that they undermine the named plaintiff's incentives to monitor suboptimal or collusive settlements.").

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^{43.} See, e.g., Radcliffe v. Experian Info. Sols. Inc., 715 F.3d 1157, 1164 (9th Cir. 2013) (expressing concern that plaintiff incentive awards may "destroy the adequacy of the class representatives"); Chavez v. Lumber Liquidators, Inc., No. CV-09-4812 SC, 2015 WL 2174168, at *3 (N.D. Cal. 2015) ("Among other things, the concern about incentive awards and the class representative's adequacy is that, when presented with a potential settlement, the class representative may be more concerned with maximizing those incentives than with judging the adequacy of the settlement as it applies to class members at large.").

^{44.} See Eisenberg & Miller, supra note 19, at 1312 ("Others have expressed concern about the fairness of the named plaintiff receiving a larger award than the rest of the class.").

 $^{45.\;}$ H.R. Rep. No. 104-369, at 32–33 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 732–33.

^{46.} See Class Action Fairness Act of 2005, Pub. L. No. 109-2, § 2(a)(3)(B), 119 Stat. 4, 4.

^{47.} See Eisenberg & Miller, supra note 19, at 1312 ("Incentive awards have also been seen as providing inappropriate leverage to plaintiffs to threaten class action litigation in order to obtain a larger settlement in their individual lawsuits.").

^{48.} See Nagareda, supra note 32, at 1494 ("When the law itself puts into place a gatekeeper... between class counsel and the considerable financial returns that flow from control of class action litigation, there is a real possibility that the gatekeeper will catch on to what is happening. The gatekeeper soon may become a toll taker.").

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presumptively vests control of the litigation in particular shareholders. 49

Lastly, many courts and commentators express a vague discomfort with the idea of persons actually profiting from litigation, rather than simply being compensated for harm suffered. This sense that litigation for profit is somehow unwholesome is generally inchoate, but quite evidently widely held and deeply felt. The unease frequently surfaces in the form of expressions of concern that plaintiff incentive awards will create "professional plaintiffs"—with little or no examination of why professional plaintiffs are ipso facto undesirable—or in conclusory statements about the undesirability of plaintiffs motivated by a "bounty."⁵⁰ As Professors Eisenberg and Miller note, "Incentive awards have been stigmatized as a means for paying off 'professional plaintiffs.' "⁵¹ In many ways, hostility toward professional plaintiffs mirrors the antipathy often directed toward so-called appraisal arbitrageurs and patent trolls.⁵² In part, this hostility appears rooted in the idea that "professional" plaintiffs must be

^{49.} See id. ("Because control of a given litigation presumptively rests with shareholders who have the 'largest financial interest in the relief sought by the class,' the game for plaintiffs' lawyers now consists of establishing relationships with the sorts of large institutional investors likely to meet the PSLRA criterion.").

^{50.} See, e.g., Sauby v. City of Fargo, No. 3:07-cv-10, 2009 WL 2168942, at *2 (D.N.D. July 16, 2009) ("Requests for incentive awards should be carefully scrutinized to ensure the named plaintiffs did not bring suit expecting a bounty"); H.R. REP. No. 104-369, at 32–33 (expressing concern that "professional plaintiffs . . . often receive compensation in the form of bounty payments"); id. at 33 ("Individuals who are motivated by the payment of a bounty or bonus should not be permitted to serve as lead plaintiffs."); 5 RUBENSTEIN, supra note 4, § 17:16 ("[P]aying the class representatives a portion of the settlement fund is simply unseemly: it gives the appearance that the representative is either a professional plaintiff, or a bounty hunter, not a servant for the class." (footnotes omitted)).

^{51.} Eisenberg & Miller, supra note 19, at 1312–13; see also In re UnumProvident Corp. Derivative Litig., Lead Case No. 1:02-cv-386, 2010 WL 289179, at *8 (E.D. Tenn. Jan. 20, 2010) (expressing concern that "paying plaintiffs [out of attorneys' fees] could lead to professional plaintiffs"); H.R. REP. No. 104-369, at 33 ("Individuals who are motivated by the payment of a bounty or bonus should not be permitted to serve as lead plaintiffs."); 5 RUBENSTEIN, supra note 4, § 17:5 (stating that payments to lead plaintiffs out of attorneys' fees "would also create bad policy," without any further elaboration).

^{52.} See, e.g., Charles Korsmo & Minor Myers, Reforming Modern Appraisal Litigation, 41 DEL. J. CORP. L. 279, 314 ("One basic supposition that undergirds criticism of appraisal is that there is something improper or unseemly about buying a lawsuit in this way."); James F. McDonough III, The Myth of the Patent Troll: An Alternative View of the Function of Patent Dealers in an Idea Economy, 56 EMORY L. J. 189, 196–97 (2006) (discussing accusations that "patent trolls" manipulate the system and engage in "legalized extortion" (quoting Bernard Stamler, Battle of the Patents, Like David v. Goliath, N.Y. TIMES (Feb. 21, 2006), https://www.nytimes.com/2006/02/21/business/businessspecial2/battles-of-the-patents-like-david-v-goliath.html [https://perma.cc/4YYN-NUCX])).

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engaged in rent-seeking behavior, either on behalf of plaintiffs' attorneys⁵³ or on behalf of themselves.⁵⁴

D. Limitations on the Use of Incentive Awards

These concerns have manifested themselves in a number of limitations on the use of plaintiff incentive awards. In the first place, when a case settles—as the vast majority of class actions that survive a motion to dismiss do⁵⁵—plaintiff incentive awards included as part of a settlement agreement are subject to judicial scrutiny, which is occasionally quite vigorous.⁵⁶ In Delaware, this scrutiny has taken on the shape of a general presumption against awarding plaintiff incentive awards.⁵⁷

In addition to this general scrutiny, several award-related practices are strongly disfavored and rarely approved. One such disfavored practice is a settlement that calls for an award to those named plaintiffs who agree to support the settlement but no award for those who oppose it.⁵⁸ The manifest problem with this kind of

^{53.} See, e.g., H.R. REP. No. 104-369, at 32–33 ("Professional plaintiffs who own a nominal number of shares in a wide array of public companies permit lawyers readily to file abusive securities class action lawsuits. . . . These lead plaintiffs often receive compensation in the form of bounty payments or bonuses.").

^{54.} As Professor Nagareda noted, the lead plaintiff, as gatekeeper to control of a representative action, "may become a toll taker." Nagareda, *supra* note 32, at 1494. As he went on to note, criticisms of this dynamic "carry an air of unreality. Like Captain Louis Renault in the classic film Casablanca, we are 'shocked, shocked,' to find that there may be rent extraction going on here!" *Id.* at 1495.

^{55.} See 5 RUBENSTEIN, supra note 4, § 17:4 (noting that "most class suits settle [and] the parties typically agree to pay the class representatives some incentive award").

^{56.} See, e.g., Radcliffe v. Experian Info. Sols., 715 F.3d 1157, 1164 (9th Cir. 2013) (noting that trial courts "must be vigilant in scrutinizing all incentive awards"); Sauby v. City of Fargo, No. 3:07-cv-10, 2009 WL 2168942, at *2 (D.N.D. July 16, 2009) ("Requests for incentive awards should be carefully scrutinized to ensure the named plaintiffs did not bring suit expecting a bounty or otherwise compromised the interest of the class for personal gain." (citing Hadix v. Johnson, 322 F.3d 895, 897 (6th Cir. 2003))); Plummer v. Chem. Bank, 91 F.R.D. 434, 442 (S.D.N.Y. 1981) (writing that the presence of a plaintiff incentive award "must be regarded as prima facie evidence that the settlement is unfair to the class, and a heavy burden falls on those who seek approval of such a settlement" (citation omitted)); 5 RUBENSTEIN, supra note 4, § 17:14 (noting that "courts have been somewhat careful in policing certain incentive award practices").

^{57.} See Chen v. Howard-Anderson, No. 5878-VCL, 2017 Del. Ch. LEXIS 734, at *10 (Del. Ch. June 30, 2017) ("Under Delaware law, there is an expectation that the compensation for creating a common fund goes to counsel, and hence a 'presumption against awarding a separate payment or bonus' to a named plaintiff." (quoting Raider v. Sunderland, No. Civ.A 19357 NC, 2006 Del. Ch. LEXIS, at *8 (Del. Ch. Jan. 4, 2006))).

^{58.} See Radcliffe, 715 F.3d at 1166 (referencing Professor Rubenstein's testimony that his research found "not one" judicially approved settlement agreement containing a conditional plaintiff incentive award); 5 RUBENSTEIN, supra note 4, § 17:15 (noting that "[a]t least two circuits—the Seventh and Ninth—have [categorically] prohibited such" conditional plaintiff incentive awards).

conditional award is that it can be used to coerce named plaintiffs into accepting an otherwise deficient settlement, in direct conflict with such plaintiffs' monitoring role.⁵⁹

A second disfavored practice is an "ex ante agreement between putative class counsel and putative class representatives containing certain assurances with regard to incentive awards." ⁶⁰ The leading case involved an agreement by counsel to seek an award that would increase on a sliding scale with the amount of the monetary recovery. ⁶¹ The court identified a number of concerns with enforcing such agreements, including that (1) it could lead to "excessive" awards, divorced from the actual costs and risks incurred by named plaintiffs; ⁶² (2) it could distort named plaintiffs' incentives, causing them to favor monetary recovery over injunctive relief that might be more advantageous to the class; ⁶³ and (3) it would be an unseemly end run around rules against sharing attorneys' fees with clients. ⁶⁴

A third disfavored practice is seeking a percentage of the group recovery as a plaintiff incentive award. While courts may cross-check a proposed award by examining the percentage of the recovery it would represent, "there are very, very few cases in which class counsel have sought, and courts have approved, incentive awards that are actually measured as a percentage of the common fund recovery." The objections to percentage-based awards are similar to those canvassed

The court found it particularly problematic that the incentive agreements correlated the incentive request solely to the settlement or litigated recovery, as the effect was to make the contracting class representatives' interests actually different from the class's interests in settling a case instead of trying it to verdict, seeking injunctive relief, and insisting on compensation greater than \$10 million.

^{59.} See 5 RUBENSTEIN, supra note 4, § 17:15 ("A structural provision in a settlement agreement that has the effect of squelching class representatives' ability to adequately represent the class by voicing their concerns is, simply, not in the class's best interests.").

^{60.} *Id.* § 17:17; *see also Chen*, 2017 Del. Ch. LEXIS 734, at *21 ("This court has held that an *ex ante* agreement in which counsel agrees to pay an incentive award to a representative plaintiff violates public policy." (citing *In re* Fuqua Indus., Inc. S'holder Litig., No. Civ.A 11974, 2006 WL 2640967 (Del. Ch. Sept. 7, 2006)).

^{61.} Rodriguez v. W. Publ'g Corp., 563 F.3d 948, 957 (9th Cir. 2009).

^{62.} See id. at 959 ("[T]hey obligate class counsel to request an arbitrary award not reflective of the amount of work done, or the risks undertaken, or the time spent on the litigation").

^{63.} See id.:

^{64.} See id. ("[T]hey create at least the appearance of impropriety; they violate the California Rules of Professional Conduct prohibiting fee-sharing with clients and among lawyers; and they encourage figurehead cases and bounty payments by potential class counsel.").

^{65.~~5} RUBENSTEIN, supra note $4, \S$ 17:16. Rubenstein goes on to conclude that "[p]ercentage-based incentive awards are disfavored, if not altogether forbidden." Id.

above: (1) they could be excessive, ⁶⁶ (2) they could skew the plaintiffs' incentives, ⁶⁷ and (3) they feel icky. ⁶⁸

E. The PSLRA

The PSLRA was especially attentive to the role of the lead plaintiff but at the same time imposed strictures on what lead plaintiffs could receive.⁶⁹ On the one hand, the PSLRA embraced the idea that the lead plaintiff should monitor the lead counsel, creating a statutory presumption that the investor with the largest stake should be appointed lead plaintiff.⁷⁰ The aspiration in particular was that a large stakeholder would constrain the lawyers acting on behalf of the class.⁷¹

However, the PSLRA envisions nothing more than a monitoring role for the lead plaintiff. The statute limits lead plaintiff awards to "reasonable costs and expenses (including lost wages) directly relating to the representation of the class." Thus, it is not surprising that empirical work has found that lead plaintiffs are least likely to receive remuneration in securities class actions. In this way, the PSLRA rejects any notion that awards to lead plaintiffs should serve as any kind of *reward* for their efforts. The PSLRA may empower particular class members to monitor the lawyers serving as lead counsel, but in its embrace of a purely restitutional approach, where the lead plaintiff can

^{66.} See id. ("[P]aying the class representatives a portion of the settlement amount untethers the award from the services that the representatives provided to the class and the risks they took in doing so.... [It also] threaten[s] to be excessive.").

^{67.} *Id.* ("[S]uch awards may skew the class representatives' incentives by encouraging them to hold out for greater recovery . . . [and] privilege monetary recoveries over other remedies, such as injunctive relief").

^{68.} See id. ("[P]aying the class representatives a portion of the settlement fund is simply unseemly: it gives the appearance that the representative is either a professional plaintiff, or a bounty hunter, not a servant for the class.").

^{69.} See Private Securities Litigation Reform Act of 1995, 15 U.S.C. §§ 77-78 (2012).

^{70.} See 15 U.S.C. § 78u-4(a)(3)(B)(iii)(bb) (2012).

^{71.} Representative litigation spawns a serious and well-known agency problem between the class members who technically "own" the claims and the class attorneys who, in practice, typically control the litigation. See Eisenberg & Miller, supra note 19, at 1304 ("As has long been recognized, these cases tend to be dominated by entrepreneurial attorneys who effectively control all phases of the litigation."); see, e.g., John C. Coffee, Jr., Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions, 86 Colum. L. Rev. 669 (1986); Korsmo & Myers, supra note 3, 1325; Macey & Miller, supra note 2. A plaintiffs' attorney pursuing a contingency fee will often have a more concentrated economic stake than any individual plaintiff and may also have incentives that diverge from those of the plaintiffs. See Korsmo & Myers, supra note 3, at 1326.

^{72. 15} U.S.C. § 78u-4(a)(4).

^{73.} See discussion supra notes 21-23 and accompanying text.

be made whole but can receive no more,⁷⁴ the statute limits any incentive for a class member to bring the claim in the first place.

F. Delaware and the Example of Chen v. Howard-Anderson

Given its importance in corporate and commercial disputes, Delaware looms especially large, and its approach to plaintiff incentive awards deserves special attention. The Court of Chancery may give an award to the lead plaintiff where the plaintiff has (1) dedicated substantial time and effort to the case, 75 (2) provided meaningful expertise on behalf of the class, 76 (3) generated benefit for the class, 77 and (4) faced risks in serving as lead plaintiff. 8 But even in Delaware, a jurisdiction unmatched in its sophistication and attentiveness to the realities of litigation, the regime holds out minimal incentives to a sophisticated lead plaintiff. A recent case—Chen v. Howard-Anderson 19—illustrates the point.

At first glance, *Chen* is a strange choice for demonstrating the shortcomings of the prevailing practice on plaintiff incentive awards, given that it involved the largest award ever granted by the Delaware Court of Chancery.⁸⁰ Yet it nevertheless shows the inadequacy of current incentive awards when it comes to motivating sophisticated would-be lead plaintiffs in any real way. It also demonstrates the gross disparity in the treatment of awards to attorneys and to lead plaintiffs.

^{74.} See H.R. REP. No. 104-369, at 33 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 733 ("Lead plaintiffs are not entitled to a bounty for their services."); Nagareda, supra note 32, at 1489 (concluding that the PSLRA's "language embrace[s] restitution but reject[s] reward beyond the class representative's 'pro rata share of any recovery'" (quoting 15 U.S.C. § 78u-4(a)(2)(A)(vii))).

^{75.} See, e.g., Chen v. Howard-Anderson, No. 5878-VCL, 2017 Del. Ch. LEXIS 734, at *7–8 (Del. Ch. June 30, 2017); Brinckerhoff v. Tex. E. Prods. Pipeline Co., 986 A.2d 370, 396 (Del. Ch. 2010); Raider v. Sunderland, No. Civ.A. 19357 NC, 2006 WL 75310, at *2 (Del. Ch. Jan. 4, 2006).

^{76.} See, e.g., Chen, 2017 Del. Ch. LEXIS 734, at *11; Raider, 2006 WL 75310, at *2.

^{77.} See Chen, 2017 Del. Ch. LEXIS 734, at *11; Raider, 2006 WL 75310, at *2.

^{78.} See Chen, 2017 Del. Ch. LEXIS 734, at *17; Fox v. CDx Holdings, Inc., No. 8031-VCL, 2015 WL 5163790, at *1 (Del. Ch. Sept. 2, 2015). These factors overlap substantially with the inquiries in determining plaintiffs' attorneys' fees. Ams. Mining Corp. v. Theriault, 51 A.3d 1213, 1254 (Del. 2012) (noting that a trial court making an award to plaintiffs' attorneys out of a common fund must consider "1) the results achieved; 2) the time and effort of counsel; 3) the relative complexities of the litigation; 4) any contingency factor; and 5) the standing and ability of counsel involved" (quoting Sugarland Indus., Inc. v. Thomas, 420 A.2d 142, 149 (Del. 1980))). The major difference is that for attorneys' fees, the "result achieved" is explicitly considered and, where a percentage award is granted, is paramount. See id. at 1255 ("But the most important factor, the cases suggest, is the benefit." (quoting the chancery court's hearing approving the attorneys' fee award)). For a lead plaintiff, the result is only formally relevant to the extent the plaintiff can show they "generated" it.

^{79. 2017} Del. Ch. LEXIS 734.

^{80.} See id. at *20 ("[T]his appears to be the largest incentive award that this court has ever approved.").

The case arose out of a 2011 merger transaction between Occam Networks, Inc. and Calix, Inc.⁸¹ Plaintiffs holding approximately 19% of Occam's stock filed suit, alleging various breaches of duty by Occam's officers and directors, as well as disclosure deficiencies.⁸² Serving as lead counsel for the plaintiffs were the Delaware firm of Smith, Katzenstein & Jenkins LLP and Levi & Korsinsky, LLP, a New York firm.⁸³ The court appointed two experienced investors and substantial stockholders, Herbert Chen and Derek Sheeler, as class representatives.⁸⁴

One defendant settled on the eve of trial, and the remaining defendants followed suit after three days of trial. 85 The total settlement amount was \$35 million in cash. 86 The plaintiffs' firms involved in the case financed the litigation by working on contingency, with Levi & Korsinsky paying the lion's share of the out-of-pocket expenses—\$1.7 million out of a total of approximately \$2 million—and the bulk of the expenses (approximately \$1.4 million) going toward paying expert witnesses. 87

Herbert Chen, one of the lead plaintiffs, was the driving force behind the litigation and played a vital role in seeing it to a successful conclusion. As Vice Chancellor Laster concluded after trial, "Chen's involvement was critical." Levi & Korsinsky had assigned a "more junior" attorney to work on the case. And as the court pointed out, "[T]he vast majority of Levi & Korsinsky's litigation efforts involve[d] early disclosure-only or therapeutic settlements," and the firm "had never before taken a case to trial or even deep into the litigation process." Additionally, the \$1.7 million that the firm ultimately invested in the case was "an amount far greater than what Levi & Korsinsky had [ever before] invested in its M&A litigation efforts." The court concluded that without Chen—and his constant threat to

^{81.} See Chen v. Howard-Anderson, 87 A.3d 648, 653 (Del. Ch. 2014).

^{82.} Id. at 664.

^{83.} Id. at 652.

^{84.} Id. at 664.

^{85.} See Chen, 2017 Del. Ch. LEXIS 734, at *4.

^{86.} Id. at *1.

^{87.} Id. at *4, *22.

^{88.} Id. at *16.

^{89.} See id. at *12, *22.

^{90.} Id. at *22.

^{91.} Id.

^{92.} *Id*.

attempt to replace class counsel—the case may never have progressed past a quick, low-value settlement.⁹³

Chen—an experienced investor and research analyst—personally worked more than four thousand hours on the litigation. He wrote memoranda and personally reviewed discovery materials. He prepared drafts of litigation documents; Generated some of the litigation team's key legal strategies"; Frought to bear" his "significant expertise in negotiations" during settlement talks; and "brought valuation expertise to the litigation team," which he used to select and critique the expert witnesses. Lead Delaware counsel recognized that "Chen had provided invaluable services to the class and had been at least ten times more valuable than any other named plaintiff" he had ever known. The services are supported to the class and had been at least ten times more valuable than any other named plaintiff" he had ever known.

Chen also faced risks by serving as class representative. He was deposed and subjected to discovery. The defendants used this discovery to accuse Chen of trading on confidential information. Described While Chen was cleared of wrongdoing by both the court and the Securities and Exchange Commission ("SEC"), he was forced to bear substantial expense in defending against the charges. The accusations also ensnared another investor whom Chen had regarded as his mentor, and they also led to articles in the media that destroyed [Chen's] reputation and effectively prevented him from finding a job on Wall Street.

Chen requested an award of \$4,863,880—accompanied by "meticulous evidentiary support to document his involvement." Lead Delaware counsel, while acknowledging Chen's "invaluable services to

^{93.} *Id.* at *15 ("Without Chen's commitment to the case, there was a substantial risk that the attorneys would not have pressed forward during the initial post-closing phase"); *id.* at *16 ("But for Chen, my sense is that Levi would have limited" resources dedicated to the case); *id.* at *22 (noting that "[w]hen the defendants came forward with a [low-value] settlement, the three Levi & Korsinsky attorneys jumped at it. Joseph Levi saw a chance to cover his costs, avoid the risk of a loss, and secure a fee").

^{94.} Id. at *12-14.

^{95.} Id. at *13.

^{96.} *Id.* at *15.

^{97.} Id. at *14.

^{98.} Id. at *13.

^{99.} *Id*. at *16.

^{100.} Id. at *12.

^{101.} *Id*. at *17.

^{102.} See id. at *18.

 $^{103.\} Id.$ at *19–20 (noting that "Chen had to hire counsel, produce extensive discovery . . . and sit for a ten-hour deposition" in the SEC investigation).

^{104.} Id. at *19.

^{105.} *Id.* at *11–12.

the class," recommended he receive only \$1 million. ¹⁰⁶ The court ultimately adopted Delaware counsel's recommendation and awarded Chen \$1 million. ¹⁰⁷ The court acknowledged that "[i]f anything, the award is low given Chen's contributions, "¹⁰⁸ but it nonetheless felt constrained by Delaware law's general presumption against incentive awards, together with the lack of precedent for a larger award. ¹⁰⁹

Class counsel, by contrast, applied for and was awarded 30% of the recovery, or \$8.65 million. In a case where the lead plaintiff's efforts were extraordinary and arguably as or even more valuable to the class, the disparity in sheer size between the amount awarded to the attorneys and the amount awarded to the lead counsel is remarkable. Lead counsel took home more than eight times what the court was able to award to the lead plaintiff.

The level of scrutiny applied to the plaintiff award likewise stands in sharp contrast to the relatively routine approval of 30% for the lead counsel. The examination of the lead plaintiff's application spanned nearly seven pages of analysis and included a detailed and exhaustive summary of Chen's role. By contrast, the court needed only a single paragraph to approve lead counsel's fee request, noting that the litigation was complex, risky, and required significant investment, with no attempt at quantification. 112

Delaware continues to express skepticism about incentive awards to plaintiffs. In the 2018 Saba Software case, the Court of Chancery approved a \$100,000 incentive award to a plaintiff who had prepared a five-hundred-page SEC whistleblower complaint that was, according to the attorneys, "the blueprint for our understanding of the accounting issues that were at play here." Later in 2018, however, the Delaware Supreme Court observed that "incentive fee awards may be problematic" and "encourage[d] a careful review of the factors to be

^{106.} Id. at *12.

^{107.} Id. at *20.

^{108.} Id.

 $^{109.\} Id.$ at *10, *20 ("Chen has advanced sound arguments as to why the award could be much higher. An award of \$1 million, however, is already unprecedented.").

^{110.} *Id.* at *8–9, *23. The award represented a baseline of \$9,906,318.89, minus the \$1.25 million awarded to the lead plaintiffs. *Id.* at *23. In addition to Chen's \$1 million, the other lead plaintiff, Sheeler, was awarded \$250,000. *Id.* at *20. The split between Levi & Korsinsky and lead Delaware counsel, Smith, Katzenstein & Jenkins, was not disclosed.

¹¹¹. Though, after subtracting the share awarded to the class representatives, the percentage kept by counsel is closer to 26%.

^{112.} Chen, 2017 Del. Ch. LEXIS 734, at *22.

 $^{113. \} See \ Jeff \ Montgomery, \ Chancery \ OKs \ \$19.5M \ Deal \ Ending \ Saba \ Software \ Merger \ Suit, \\ LAW360 \ \ (Sept. 24, 2018, 8:15 PM), \ https://www.law360.com/articles/1085786 \\ [https://perma.cc/29B9-N3V5].$

considered before making incentive fee awards."¹¹⁴ In light of that guidance, the Court of Chancery noted in early 2019 that "this has become an issue that we are increasingly being asked to scrutinize."¹¹⁵ In a derivative suit involving Zynga, the parties reached a settlement that recovered \$11.25 million. The court awarded the plaintiff attorneys' fees and expenses of \$2.25 million, and the lead plaintiff had requested an incentive award of \$5,000. The court noted that it was "sympathetic that he put in, although he doesn't have an exact quantification of it, a meaningful amount of time in the case," but was ultimately "uncomfortable awarding" him \$5,000. Instead, it awarded him \$2,000.

II. GETTING THE INCENTIVES RIGHT FOR POTENTIAL LEAD PLAINTIFFS

The basic policy objective of lead plaintiff awards is to induce plaintiffs to bring claims in a representative capacity instead of bringing them solely on their own behalf. The problem is that the restitutionary approach taken by most courts makes serving as lead plaintiff unappealing, and that is especially so when the potential lead plaintiff is a financial institution. This Part outlines the policy challenge and explains why the prevailing practice of awards to lead plaintiffs is inadequate.

A. The Limited Appeal of a Representative Claim

Many potential plaintiffs are likely to approach litigation as an investment, evaluating at each step the course of action offering the most attractive mix of risk and reward. This will surely be so for potential plaintiffs in corporate and securities claims. The decision to put time and money into litigation will be weighed like any other investment—in terms of its expected return. This approach has two major consequences. First, many potential plaintiffs generally cannot be expected to serve as active lead plaintiffs for nonfinancial reasons. Second, in order for serving as an active lead plaintiff to be worth their while, investors (especially institutional investors) would need to

^{114.} Isaacson v. Niedermayer, 200 A.3d 1205, 1205 n.1 (Del. 2018).

^{115.} Transcript of Continued Hearing on the Special Litigation, Committee's Motion for Approval of the Proposed Settlement, Plaintiff's Application for Award of Attorneys' Fees, Expenses, and an Incentive Award, and Rulings of the Court at 61, Sandys v. Pincus, No. 9512-CB (Del. Ch. Jan. 18, 2019).

^{116.} Id. at 6, 36 (calling the \$11.25 million the "settlement fund").

^{117.} Id. at 56, 60.

^{118.} Id. at 61.

^{119.} *Id*.

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receive an adequate return on their investment in the litigation, over and above merely recovering their costs.

In many class action contexts, lead plaintiffs may be motivated to take an active role by nonpecuniary considerations. Most obviously, plaintiffs in civil rights or employment discrimination actions may be strongly motivated by a desire to pursue justice. This may even be a motivation in consumer class actions or mass torts. As Eisenberg and Miller point out, "Named plaintiffs also gain benefits from performing their role." Among these are "psychic benefits such as the pleasure of having their name on the 'marquee,' being catered to by counsel, or participating in an interesting and stimulating activity." These benefits will likely ring hollow to an institutional stockholder, who is likely to be focused exclusively on financial considerations. Indeed, even if the managers of such an institution were personally inclined to serve as lead plaintiffs, they may be compelled by fiduciary obligations to their investors to focus exclusively on financial considerations.

The focus on financial considerations means that litigation in general—and serving as lead plaintiff in particular—must offer an adequate return on investment in order to be worthwhile. Unless lead plaintiffs are permitted to earn an adequate return on their costs—above and beyond mere restitution—the litigation-related costs portion of the institutional investor's investment must be regarded as having zero return, thus lowering the overall return from litigation. As a result, positive-value claims would not be brought, resulting in underdeterrence and undercompensation.

^{120.} Eisenberg & Miller, supra note 19, at 1305.

^{121.} Id.

^{122.} Consider, for example, an institutional investor with a \$100 million investment in a company's stock, and whose investment targets require an expected return of 15% in order to pursue an investment. Imagine the investor has a claim that could be expected to return \$15 million. If it were cost-free, the claim would meet the investor's investment criteria and be worth litigation (\$15m/\$100m = 15%). But suppose that it would cost \$10 million (in time, money, and opportunity costs) to litigate the claim. The overall investment in the litigation would now be \$110 million. Even if the plaintiff could recover these additional costs via a plaintiff incentive award, the investment would no longer meet the required return threshold, and would not be brought (\$15m/\$110m = 13.6%).

^{123.} See Silver & Dinkin, supra note 9, at 472 ("The PSLRA thus makes it economically irrational for class members to volunteer as lead plaintiffs, absent special motivations. Because private institutional investors care only about their bottom lines, they prefer to sit on the sidelines.").

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B. The Appeal of Proceeding Individually

When a potential plaintiff considers pressing a claim, that plaintiff will often be better off proceeding on an individual basis. 124 This is especially so in strong corporate and securities cases.¹²⁵ Where a plaintiff has a large enough stake—either held as an ordinary investment or acquired after the fact by a specialist fund with the intention of pursuing litigation—a suit will have positive value even on an individual basis, thus negating the need for a representative action in the first place, at least from the plaintiff's perspective. 126 In such cases, the institutional plaintiff would have little or nothing to gain from pursuing aggregate relief. Doing so would cause the plaintiff to lose control of the litigation and also lose control over the terms of the settlement. While a class claim might spread the costs of litigation across a wider group, those costs could be substantially higher, as the institutional investor would lose the ability to negotiate fees directly with the attorneys. 127 The institutional investor may be better off paying all of the fees directly, on a negotiated hourly basis, rather than paying only a share of a contingency fee as part of a class.

By proceeding individually, an institutional investor can also preserve the potential for bringing a class action as a threat against the defendant in order to extract a larger settlement individually. Defendants might be eager to pay off this threat, in the hopes that in the absence of the strong institutional plaintiff, a class action will either not be brought at all or will be litigated half-heartedly to a cheap settlement.

While proceeding individually may be optimal for a strong plaintiff, it is suboptimal from a public policy perspective, leading to underdeterrence, undercompensation, and wealth transfers from small

^{124.} Cox, Thomas & Kiku, *supra* note 7, at 1604 ("Institutional investors with large potential claims have sometimes found it more advantageous to act for themselves rather than on behalf of all other investors."): Silver & Dinkin, *supra* note 9, at 478:

Individual lawsuits are cheaper than class actions, which entail expensive procedures like . . . judicial approval of settlements and fees. Class actions can also water down institutional investors' claims by mixing them with individual investors' weaker claims. For this reason, large investors sometimes opt out of class actions and sue on their own.

^{125.} See, e.g., John C. Coffee, Jr., Litigation Governance: Taking Accountability Seriously, 110 COLUM. L. REV. 288, 309–14 (2010).

^{126.} See id. at 312, 314 (noting that institutional investors in the AOL Time Warner settlement who opted-out "did significantly better than if they had stayed in the class" and suggesting that the "securities class action could become the vehicle of last resort for only those smaller claimants who cannot economically afford to opt out").

^{127.} See PRINCIPLES OF THE LAW OF AGGREGATE LITIGATION \S 1.05 cmt. h (Am. LAW INST. 2019) (noting that "[w]ithout these payments, potential lead plaintiffs often find it economically advantageous . . . to file conventional lawsuits of benefit to themselves alone").

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to large investors. Indeed, where large investors opt out, there are even fewer potentially effective monitors of class counsel among those remaining in the class. Consider, for example, an institutional stockholder bringing—and settling for cash—a meritorious case while holding 20% of the stock of the issuer. In such a case, the defendants will bear only a fraction of the cost of their wrongdoing, leading to underdeterrence. Moreover, the absent 80% of stockholders will receive no compensation. Where the institutional plaintiff is able to use the threat of a class action to extract a larger settlement, the problem of underdeterrence is somewhat reduced, but it is accompanied by a transfer of wealth from the absent stockholders to the institutional stockholder.

Both deterrence and compensation goals—as well as equality of treatment—would be furthered by the institutional plaintiff forgoing individual litigation in favor of spearheading a representative action. The availability of an adequate incentive award is likely to be crucial in convincing a sophisticated potential lead plaintiff to do so.

C. Restitution Is Not an Incentive

Courts and lawmakers have been right to note that an award to a lead plaintiff must provide compensation, at a minimum, for costs incurred. But awards that do nothing more, awards that are purely restitutionary in nature, cannot provide an incentive to serve as lead plaintiff. At best, such an award can leave a potential lead plaintiff indifferent to serving or not serving. To actually encourage a lead plaintiff to step forward, and to encourage the lead plaintiff to make the right level of investment in the job on behalf of the class, an incentive award must also provide a reward—above and beyond compensation—for good service. 131

^{128.} See Keith N. Hylton, Deterrence and Aggregate Litigation 21 (Bos. Univ. Sch. of Law, Working Paper No. 17-45, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3059583 [https://perma.cc/3QME-P5NA] ("The negative claim class left behind by opt-out litigants is vulnerable to the monitoring problem: no victim has an incentive to serve as a genuine monitor so the lawyer is likely to enter into a collusive settlement.").

^{129.} Cox, Thomas & Kiku, *supra* note 7, at 1602 ("Having an independent, engaged plaintiff is socially useful. Despite these benefits, few financial institutions seek to so involve themselves, presumably because they do not see that the rewards of doing so are sufficient to offset the cost of becoming involved.").

^{130.} Silver & Dinkin, supra note 9, at 481 ("Getting institutions to step from the sidelines onto the playing field requires larger bonuses than individual investors historically received.").

^{131.} Eisenberg & Miller, *supra* note 19, at 1306 (emphasizing "the potential social value of compensating named plaintiffs for the full costs of their contributions to the litigation, and also rewarding them for good performance"); Nagareda, *supra* note 32, at 1488:

Although courts have paid lip-service to the desirability of plaintiff incentive awards serving as a reward, the actual pattern of such awards has been largely restitutional in nature. Awards reimburse the lead plaintiff's reasonable costs but hold out no meaningful reward for good performance. This means that the vast bulk of incentive awards are small in absolute terms, and miniscule as a percentage of the recovery. Are related worry is over "excessive" incentive awards—that an award above the direct costs faced by the lead plaintiff may unacceptably skew the plaintiff's incentives. Are reputation. Financial risks are retaliation or loss of reputation. Financial risks are generally ignored—financial expenditures are compensated, but not rewarded with a risk-related return on capital.

Delaware is highly attentive to the incentive effects its rulings have on the behavior of plaintiffs' attorneys, but, as the *Chen* case illustrates, the doctrine in Delaware fails to consider the incentives that bear on potential lead plaintiffs. The award to class counsel in that case was in addition to the nearly \$2 million in out-of-pocket expenses for which they had already been reimbursed out of the class recovery. By contrast, Chen's award was an all-in figure that appears unlikely even to reimburse him for the opportunity costs of his time, let alone the reputational and career damage he suffered as a result of being the public face of the litigation. It is highly unlikely that any potential lead plaintiff would observe Chen's experience and feel an urge to replicate it.

An "incentive" for someone to do something for the benefit of others encompasses both the prospect of recompense for effort expended (restitution) and the prospect of benefit beyond what that person might gain simply by sitting back and remaining within the undifferentiated group (reward). . . . Ideally, incentive awards should reward high-quality monitoring but not low-quality monitoring.

132. See Silver & Dinkin, supra note 9, at 481:

Dollar-for-dollar reimbursement provides no incentive to bear these costs [of serving as lead plaintiff]. This is especially true in light of the risk of losing the opportunity cost of diverting employees from more profitable business activities to monitoring litigation, 'the potential for disclosure of proprietary nonpublic information,' the danger of losing access to inside information going forward, and the possibility of being sued by disgruntled plaintiffs.

(quoting Cox, Thomas & Kiku, supra note 7, at 1602).

- 133. See supra Part I.
- 134. See supra Part I.
- 135. See supra Part I.
- 136. See supra Section I.F.

D. The Backwards Policy Behind the PSLRA

The PSLRA likewise adopts a wholly restitutional approach that offers no real incentive to lead plaintiffs. In the first place, a would-be institutional lead plaintiff may fear that the focus on costs "directly relating to the representation" may mean that its less-tangible costs, such as opportunity costs, will not be compensated.¹³⁷ But even if all costs are fully compensated, that would merely mean that the lead plaintiff received a 0% return on its investment in serving as lead plaintiff—not exactly an attractive prospect to an institutional investor. It is hardly surprising that, as many scholars have pointed out, the PSLRA has had disappointing results in terms of attracting institutional lead plaintiffs. 138 Indeed, more than a decade ago, Professor Nagareda identified the restitutional approach of the PSLRA as working "at cross-purposes with the ideal of high-quality monitoring by class representatives,"139 highlighting the incongruity of the limits on incentive awards "when the law consciously seeks to induce highquality monitoring from persons who devote their professional lives to seeking big financial rewards, not just restitution for the costs and expenses of their efforts."140

E. Artificial Constraints on Financing the Prosecution of Aggregate Claims

Were a lead plaintiff to supply financing under current rules, however, it would put an amount at risk that could easily run into the millions of dollars, constituting a significant drag on returns if that risk is uncompensated, as well as a major downside risk if the litigation is unsuccessful. Even a sophisticated and well-capitalized lead plaintiff would be reluctant to finance litigation in a securities case because the PSLRA prohibits any financial return on expenditures. This is an especially sharp deterrent against an institutional stockholder opting

^{137.} See 15 U.S.C. § 78u-4(a)(4); Nagareda, supra note 32, at 1489–90 ("Burdens on institutional investors include the prospect of disruptive discovery into their internal business practices and trading activities.").

^{138.} See Stephen J. Choi et al., Do Institutions Matter? The Impact of the Lead Plaintiff Provision of the Private Securities Litigation Reform Act, 83 WASH. U. L.Q. 869, 877 (2005) (concluding that institutional investor involvement remained "quite small" following passage of the PSLRA); Cox, Thomas & Kiku, supra note 7, at 1590–91 (discussing the findings of their study, which demonstrates that institutions post-PSLRA are reluctant to act as lead plaintiffs).

^{139.} Nagareda, *supra* note 32, at 1489, 1491 ("When it comes to service as a PSLRA lead plaintiff, one substantial sticking point for many institutional investors appears to be precisely the prospect of merely gaining restitution for their efforts, without the possibility of reward beyond their pro rata share of any class-wide recovery.").

^{140.} Id. at 1491.

to finance the litigation itself, rather than have the plaintiffs' lawyers finance it by working on contingency.

Most representative litigation is financed by the plaintiffs' attorneys, who then hope to recoup their investment through a contingency award at the conclusion of the case. This may sometimes be necessary because no individual plaintiff has the financial resources or the incentive to finance a case that proceeds all the way through trial. Furthermore, collective action problems prevent plaintiffs from pooling their resources even where paying by the hour would be preferable. Lawyer-provided financing, however, comes with significant downsides. First, it means "that plaintiffs' attorneys are generally providing a bundled set of undifferentiated services, including legal services and financing of the litigation itself." ¹⁴¹ As a result, it is extremely difficult for plaintiffs to determine how much they are paying for financing, let alone engage in any real price shopping-indeed, plaintiffs' attorneys rarely compete on price at all, and instead "compete largely on quality."142 Second, there is little reason to think that plaintiffs' firms are the lowest-cost providers of financing. By their nature, law firms lack the capital resources of large financial institutions, and they also face difficulty achieving adequate diversification due to the human capital constraints on the number of cases they can take on at any one time.¹⁴³

The result is that lawyer-provided financing does not come cheap. Plaintiffs' attorneys are routinely awarded between one-fifth and one-third of any recovery in representative litigation. ¹⁴⁴ In successful cases, such an award can vastly exceed the amount the attorneys would have earned had they been paid by the hour. Courts justify such awards as necessary for rewarding the attorneys for financing the litigation—working on contingency and running the risk of getting nothing if the litigation was unsuccessful. While this practice is sensible, the reward often goes far beyond what a financial investor would demand for bearing a similar risk.

^{141.} Korsmo & Myers, supra note 3, at 1345.

^{142.} Id. at 1344; see also Lester Brickman, The Market for Contingent Fee-Financed Tort Litigation: Is It Price Competitive?, 25 CARDOZO L. REV. 65, 93–97 (2003) (answering the title question: no).

^{143.} See Peter Charles Choharis, A Comprehensive Market Strategy for Tort Reform, 12 YALE J. ON REG. 435, 476 (1995) (noting that "in order to invest [labor] in many lawsuits, plaintiffs' law firms would have to be huge"); Korsmo & Myers, supra note 3, at 1345 (stating that law firms "are limited in the number of cases they can effectively take on at any given time"); Richard W. Painter, Litigating on a Contingency: A Monopoly on Champions or a Market for Champerty?, 71 CHI.-KENT. L. REV. 625, 678–80 (1995) (noting the difficulties faced by law firms in achieving adequate diversification).

^{144.} See, e.g., Fitzpatrick, supra note 4, at 833 (noting that fee awards range from 3% of the settlement to 47%, with a mean award of 25.4% and a median of 25%).

For reasons that are never clearly stated, however, it appears that courts are only willing to compensate the *lawyers* for bearing this financial risk. Other parties who finance litigation are not awarded multiples of their expenses to compensate them for the risk they bear. Courts have indicated an unwillingness to award contingency fees to plaintiffs' attorneys who have already been paid by the hour, as they might if they'd obtained funds provided by litigation financiers. This refusal is based on the fact that the attorneys have already been paid a negotiated rate and have not borne the kind of risk that usually justifies such awards. At the same time, however, no court seems inclined to award any reward beyond mere reimbursement to the parties that paid the attorneys, despite the fact that these parties have borne precisely the kind of risk usually used to justify a contingency fee that exceeds a typical hourly rate. 146

The practice of rewarding law firms that finance litigation—while refusing to similarly reward other parties who finance litigation—creates a strong bias in favor of law firms financing litigation, even where other parties may be able to do so at lower cost. In most class action contexts, this bias is unlikely to do much harm because the law firm really is likely to be the most plausible source of financing. ¹⁴⁷ In the corporate and securities context, however, an institutional stockholder plaintiff may be much better suited to bear the financial burden, yet still be frozen out.

In stockholder litigation, large institutional investors are likely to have sufficient financial resources to serve as an alternative source of financing, paying plaintiffs' attorneys by the hour where doing so would be preferable. Due in part to the fact that these institutional investors have far greater capital resources at their disposal than even the largest law firms, such investors will frequently be much better placed to offer financing at substantially lower cost. Moreover, specialist litigation funds would be able to lower their risk (and thus

^{145.} See, e.g., Sciabacucchi v. Salzberg, No. CV 2017-0931-JTL, 2019 WL 2913272, at *7 (Del. Ch. July 8, 2019) (EP) ("Some degree of contingency risk is a prerequisite for a risk-based award: If counsel were paid by the hour, then they can at most receive reimbursement of their fees and expenses.").

^{146.} The PSLRA of course forbids doing so. See supra notes 75–76.

^{147.} With the increasing prevalence of litigation finance firms—who seek to profit by financing litigation—this may not always be the case. See Korsmo & Myers, supra note 3, at 1346–52 (describing the operation of such firms). See generally Austin T. Popp, Note, Federal Regulation of Third-Party Litigation Finance, 72 VAND. L. REV. 727, 731–40 (2019) (providing an overview of historical and modern forms of third-party litigation finance),

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costs) by investing in multiple cases, achieving diversification on a greater scale than is practicable for a law firm.¹⁴⁸

F. Prior Proposals to Empower Lead Plaintiffs

This inadequacy of existing incentives to serve as lead plaintiff has led other commentators to propose a variety of reforms to aggregate litigation. Professors Cox and Thomas, for example, have argued that courts should be more willing to compensate lead plaintiffs "for *all* expenses related to an institution's participation as a lead plaintiff." This enhanced form of restitution would cover not only direct costs but also the costs of time devoted by internal investment and professional staff to monitoring the case. They also suggested that a lead plaintiff might receive an award exceeding the costs, similar to an attorney's lodestar award, which would encourage service as a lead plaintiff. The same content of the costs of the costs of the costs of the case.

Others have offered proposals designed to import market dynamics through an auction process. Professors Macey and Miller, for example, proposed that the named plaintiff simply be eliminated in large claims and also that claims be auctioned in judicial sale. Professor Silver and economist Sam Dinkin offered three related but alternative reform proposals. First, they proposed that a lead plaintiff could receive a multiple of its holdings, increasing its economic exposure to the claims and thus the appeal of the role. Second, a court could sell off a standardized share of the gross class recovery to the highest bidder. The auction winner would serve as lead plaintiff, and the proceeds of the auction sale would be distributed among class members along with any other recoveries. Their third proposal was their preferred one: conducting an auction for 30% of any funds recovered, but requiring the winner to bear all costs and expenses associated with prosecuting the suit.

^{148.} See Korsmo & Myers, supra note 3, at 1345 ("Dedicated purchasers of legal claims would be able to employ greater capital resources and engage in more thorough diversification than is generally possible for law firms."). Financial engineering could generate even greater diversification. See, e.g., Michael Abramowicz, On the Alienability of Legal Claims, 114 YALE L.J. 697, 739–40 (2005) ("A corporation could easily be established to prosecute a single large claim, and its shares could even be publicly traded, to further facilitate diversification of risk.").

^{149.} Cox, Thomas & Kiku, supra note 7, at 1637 (emphasis added).

^{150.} Id.

^{151.} *Id.* at 1637–38.

^{152.} Macey & Miller, supra note 2, at 6.

^{153.} Silver & Dinkin, *supra* note 9, at 489–91.

^{154.} Id. at 492-500.

^{155.} Id. at 500-05.

These types of proposals have many advantages over the prevailing regime, including better incentives to serve as lead plaintiff and to monitor the cost and performance of class counsel. ¹⁵⁶ But as others have observed, the auction regime falls short in a critical way: it can "undercut the incentive to commit resources investigating possible corporate wrongdoing" in the first place. ¹⁵⁷ A creative plaintiff might commit considerable resources to investigate a potential claim and even acquire assignments only to have the aggregate litigation rights purchased away entirely (as under Macey and Miller's proposal) or diluted (as under Silver and Dinkin's proposal). ¹⁵⁸ This reduces the incentive to invest in developing claims, especially for complex and obscure types of claims.

The approach we develop here builds on the suggestion of Cox and Thomas by decoupling the award a lead plaintiff can expect from both the damages it suffered as a class member and its out-of-pocket costs. ¹⁵⁹ We go further, however, in suggesting that the lead plaintiff might be put on equal footing with class counsel in fee awards. Our proposal also is similar in concept to the third proposal of Silver and Dinkin ¹⁶⁰ in that our proposal would potentially give the lead plaintiff and class counsel a similar share of the gross recovery, to be divided as they see fit. But our proposal would require that the lead plaintiff earn that share through service to the class by identifying and prosecuting the claim, not simply by paying for it at the commencement of the suit. Our proposal thus preserves the incentive for potential lead plaintiffs to invest in claim development. This approach may not be superior in all cases, but where investigating and pursuing the claim requires some initial risk, it may prove superior.

In general, our proposed solution can be distinguished from these important earlier contributions in three ways. First, unlike auction proposals, which would create a new and potentially complicated procedure, our proposal works within the existing framework of attorney and plaintiff incentive awards. Second, as noted above, our proposal would not undercut the incentive to develop claims by allowing them to be scooped up by an outsider in an auction. Third, earlier proposals involve decisions being made at an early stage of the proceedings, when uncertainty is typically high. In contrast, our proposal features a judicial decision made with the benefit of hindsight

^{156.} See Fisch, supra note 5, at 176–83 (discussing the benefits and drawbacks of various proposals).

^{157.} Id. at 182.

^{158.} Macey & Miller, supra note 2; Silver & Dinkin, supra note 9.

^{159.} Cox, Thomas & Kiku, supra note 7.

^{160.} Silver & Dinkin, supra note 9.

at the end of the proceeding, either after trial or when approving a settlement.

Postponing the decision on the plaintiff's reward has two benefits. First, once a plaintiff secures control of a claim via an auction, she may be tempted to use that control to favor her own interests at the expense of the class. This temptation would be lessened under our proposal. The plaintiff's award would be determined with the benefit of hindsight, with the court unlikely to reward self-serving behavior. Second, auction-style proposals would require the would-be lead plaintiff to make the crucial investment decision at the outset, when information about the value of the claim may not be fully developed. At best, bidders will have to discount what they are willing to pay to account for this uncertainty and lack of information, reducing the amount of proceeds going to the class. At worst, the need for an upfront decision will prevent bidders from emerging at all. 161 Our proposal would allow lead plaintiffs to "stage" their investments, a crucial method for dealing with risk and lack of information when investing in hard-to-value assets. 162 Lead plaintiffs would be able to recalibrate their investment as new information emerged—deciding at key stages of the litigation what resources to dedicate to motion practice, discovery, trial preparation, and so on—just as plaintiffs' attorneys do.

III. A BETTER APPROACH TO PLAINTIFF INCENTIVE AWARDS

Current legal doctrine reflects a strongly ingrained notion that the plaintiffs' attorney is the only relevant player in representative litigation, while the lead plaintiff is at best secondary, and more often wholly inconsequential. In many contexts, no doubt, this notion is largely accurate. But in other contexts, particularly in corporate and securities claims, this is not so. An active lead plaintiff can be as important, or even more important, than the plaintiffs' attorney in obtaining benefits for the class. The lead plaintiff and counsel could function more as a team than they would in the typical conception of a class action, which has a leader (the lawyer) and a monitor (the lead plaintiff). Where this is the case, courts should approach calculating an

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^{161.} See Korsmo & Myers, supra note 3, at 1369 ("An auction . . . unavoidably entails a onetime valuation at a relatively early stage, with all the attendant risk of getting it wrong. To the extent that claims are difficult to value and the risk of error is high, the resulting market is likely to be thin.").

^{162.} See generally id. ("If during the course of litigation the acquirer finds the claims to be more valuable than originally estimated, it may purchase additional claims to supplement the original position.").

appropriate plaintiff incentive award in much the same way as calculating an appropriate attorneys' fee.

Indeed, in cases driven by lead plaintiffs, the judicial task should reduce to apportioning what would normally be the attorneys' fee award between the lawyers and the lead plaintiffs, based on their respective contributions. In doing so, the court will essentially be policing a team production problem, where the efforts of multiple parties are required to produce an undifferentiated group benefit—here, the common fund. The judicial task, then, has two steps. First, determining an appropriate overall award, in much the same way as is currently done in determining an appropriate plaintiffs' attorney fee. And then second, deciding how to apportion that award among the attorneys and the lead plaintiffs. We present the details of our proposal in this Part.

A. Incentive Awards Should Reward Expertise and Financial Risk

Traditional formulations for evaluating plaintiff incentive awards consider, in theory, the expertise brought to bear by the lead plaintiff, ¹⁶⁴ together with the risks the plaintiff has borne. ¹⁶⁵ These considerations mirror those used in calculating the award to be granted to plaintiffs' attorneys out of a common fund. In practice, however, lead plaintiffs are not rewarded for their expertise in identifying and pressing claims to anything like the extent plaintiffs' attorneys are rewarded.

In appropriate cases, plaintiffs' attorneys are rewarded richly indeed. Just in the corporate and securities context, Delaware courts, for example, have not hesitated to award very large attorneys' fees where the litigation resulted in real monetary recovery and this result could be attributed to the efforts and expertise of counsel. ¹⁶⁶ In one

^{163.} See, e.g., Margaret M. Blair & Lynn A. Stout, A Team Production Theory of Corporate Law, 85 VA. L. Rev. 247, 249 (1999) ("In the economic literature, team production problems are said to arise in situations where a productive activity requires the combined investment and coordinated effort of two or more individuals or groups."). See generally Armen A. Alchian & Harold Demsetz, Production, Information Costs, and Economic Organization, 62 AM. ECON. Rev. 777, 779–81 (1972) (describing the team production problem); Bengt Holmstrom, Moral Hazard in Teams, 13 Bell J. Econ. 324, 326–30 (1982) (discussing the role of group incentives during the team production process).

^{164.} See, e.g., Raider v. Sunderland, No. Civ.A. 19357 NC, 2006 WL 75310, at *2 (Del. Ch. Jan. 5, 2006) (using three factors to provide a "bonus payment" to the lead plaintiffs, one of which was that the "time and expertise provided by Raider were well beyond that provided by a typical plaintiff").

^{165.} See Fox v. CDX Holdings, Inc., No. 8031-VCL, 2015 WL 4571398, at *26 (Del. Ch. July 28, 2015) (finding a breach of duty because the board members knew of the risk in placing a value on the company which did not comport with their subjective belief); 5 RUBENSTEIN, supra note 4, § 17:3 & nn.15–17 (collecting cases).

^{166.} See, e.g., Ams. Mining Corp. v. Theriault, 51 A.3d 1213, 1257-59 (Del. 2012).

extreme instance, the Delaware Court of Chancery awarded plaintiffs' counsel \$304 million in fees—15% of the recovery—where it was convinced the benefit was due to the efforts of counsel, where the case was complex, and where the attorneys had taken the risk of litigating on contingency, spending \$1 million on out-of-pocket costs in the process. The award came to approximately \$35,000 per hour worked. Then-Chancellor Strine defended such awards as "creat[ing] a healthy incentive for plaintiff's lawyers to actually seek real achievement for the companies that they represent in derivative actions and the classes that they represent in class actions. The short, such awards are essential in attracting the efforts of would-be private attorneys general in the first place.

The lack of similar awards to lead plaintiffs is no doubt due, at least in part, to the scarcity of cases where the lead plaintiff plays a meaningful role. But even in a case like *Chen*, where the lead plaintiff's valuable contribution of expertise and effort has indisputably been vital in securing a significant benefit for the class, the calculation of Chen's reward looks nothing like the calculation of the reward for the attorney.¹⁷⁰ Even more problematically, while courts recognize the risk of litigating on contingency and experiencing out-of-pocket costs as justification for awards that are multiples of those costs and risks, lead plaintiffs are granted only restitution for their financial costs.¹⁷¹

In such cases, courts should recognize that the lead plaintiff and the plaintiffs' attorneys are functioning as a team in producing the class benefits. Courts should acknowledge situations where lead plaintiffs are fulfilling at least some of the functions traditionally performed by plaintiffs' attorneys, and then reward them accordingly. Lead plaintiffs who provide meaningful expertise and undertake meaningful financial risk—by, for example, paying class counsel by the hour—should be rewarded for doing so in the same fashion as plaintiffs' attorneys would. Failing to treat them similarly results in inadequate incentives for institutional investors to serve as private attorneys general in corporate and securities cases where plaintiffs' law firms are ill-equipped to do so, resulting in a suboptimal team.

^{167.} Id. at 1218, 1255–56.

^{168.} Id. at 1252.

^{169.} Id. (quoting the chancery court's decision).

^{170.} See discussion supra notes 81-109 and accompanying text.

^{171.} See supra Section II.D.

B. Percentage-Based Awards Should Be Favored

The first step of the two-stage analysis we envision—determining an appropriate overall fee for the team responsible for the class benefit—need not change. In a typical class action, where the class benefits are entirely attributable to the efforts of the plaintiffs' attorneys, or nearly so, fee awards in cases resulting in a quantifiable benefit typically take the form of a percentage of the benefit. 172 As the Delaware Supreme Court has suggested, a percentage fee recognizes that the most important consideration should be the overall benefit to the class. 173 At times, percentage fees have been criticized as providing windfalls disproportionate to the efforts actually made by the plaintiffs' attorneys. 174 This led to a movement in the 1970s and 1980s away from percentage-based awards and toward first calculating a reasonable hourly fee—the so-called "lodestar"—and then applying a "multiplier" based on the risk involved and the quality of the attorneys' work. 175

By the mid-1980s, however, many observers had become disenchanted with the lodestar method. In 1985, a task force of the U.S. Court of Appeals for the Third Circuit issued an influential report criticizing the lodestar method and recommending a return to percentage-based fees in common fund cases. In making this recommendation, the task force identified a number of deficiencies with the lodestar method, including its false sense of precision and determinacy, the incentive it creates to prolong the number of hours worked, and the burden it places on judges. Perhaps the most salient advantage of a percentage-based fee, however, is that it rewards

^{172.} See, e.g., Ams. Mining Corp., 51 A.3d at 1253 ("Beginning in 1881, [plaintiffs' attorneys] fees were calculated and awarded from a common fund based on a percentage of that fund."); id. at 1259 ("When the benefit is quantifiable . . . Sugarland calls for an award of attorneys' fees based upon a percentage of the benefit.").

^{173.} See id. ("In determining the amount of a reasonable fee award, our holding in Sugarland assigns the greatest weight to the benefit achieved in the litigation.").

^{174.} See Report of the Third Circuit Task Force, Court Awarded Attorney Fees, 108 F.R.D. 237, 242 (3d. Cir. 1986) ("However, the percentage-of-recovery system sometimes resulted in strikingly large fee awards in a number of cases. Press reaction to these awards, and criticism from within the profession that the fees were disproportionate to the actual efforts expended by the attorneys, generated pressure to shift away from the percentage-of-recovery approach.").

^{175.} See Id. at 243 (describing the factors considered when calculating the "lodestar" and the factors for determining the "multiplier"); Lindy Bros. Builders v. Am. Radiator & Standard Sanitary Corp., 487 F.2d 161, 167–69 (3d Cir. 1973) (outlining the determination of a reasonable hourly rate and the other considerations for determining reasonable compensation).

^{176.} See Report of the Third Circuit Task Force, 108 F.R.D. at 246 (noting that the lodestar approach "has come under increased criticism, with some observers asserting that its technique causes more problems than it solves").

^{177.} Id. at 246-49, 260-65.

^{178.} Id. at 246-49.

attorneys in direct proportion to the consideration that matters most—the recovery for the class.¹⁷⁹ In essence, percentage-based awards make the recipient an equity holder in the claims, giving them an incentive to maximize the value of that equity.

Where a lead plaintiff is nothing more than a necessary figurehead, the type of compensation provided by the lodestar method and by traditional approaches to incentive awards—is all that is necessary, perhaps with a small "kicker" reward to overcome any collective action problems that would prevent anyone from being willing to serve. Where, however, the lead plaintiff is a sophisticated party, vital to the initiation and success of the litigation, the situation changes. From the perspective of the absent class members who benefit from their efforts, the lead plaintiff's role becomes indistinguishable from that of the attorneys, with the two functioning as a team. The same considerations that make a percentage-based fee superior for attorneys also apply for a sophisticated lead plaintiff. Courts have decades of experience selecting appropriate percentage-based fees to reward attorneys for securing class benefits. If, however, institutional investors are able, by diversification or otherwise, to reduce the risks they face as compared to law firms, we expect that somewhat lower percentage awards would be sufficient. 180

The basic approach to calculating an appropriate percentage need not change as applied to active lead plaintiffs. All that must change is the strong presumption that allowing the lead plaintiff to share in a percentage fee is improper.

C. Ex Ante Fee Agreements Should Be Favored

Where a sophisticated lead plaintiff and the plaintiffs' lawyers operate as a team, the second step of the process we envision—allocating the fee award among the attorneys and lead plaintiffs—is potentially more difficult. The key feature of the team production problem is the difficulty of figuring out how to allocate the benefits generated by team production.¹⁸¹ Even if a court wanted to split a

^{179.} See, e.g., Ams. Mining Corp. v. Theriault, 51 A.3d 1213, 1254 (Del. 2012) (noting that Delaware rejects the lodestar method of "award[ing] fees based on hourly rates that may not be commensurate with the value of the common fund created by the attorneys' efforts").

^{180.} See infra Section III.F.

^{181.} See Blair & Stout, supra note 163, at 249:

If the team members' investments are firm-specific . . . and if output from the enterprise is nonseparable (meaning that it is difficult to attribute any particular portion of the joint output to any particular member's contribution), serious problems can arise in determining how any economic surpluses generated by team production—any 'rents'—should be divided.

percentage-based fee among the lead plaintiffs and plaintiffs' attorneys, it may be difficult for that court to determine, after the fact, the relative contributions of the various parties.

This problem is hardly unique to the lead plaintiff context. The problem arises on a routine basis any time two or more law firms team up to litigate a case together. The typical judicial approach in such cases is to avoid the question altogether, leaving it to the firms themselves to work out. Often firms will decide how any incentive fee will be divided upfront, and only when the firms are entirely at loggerheads will the court step in to muddle through the allocation as best it can.

The same considerations favor an ex ante agreement in the context of corporate and securities litigation with an institutional investor lead plaintiff. In many cases, the allocation would likely be simple. Institutional lead plaintiffs, with their greater financial resources and monitoring capability, would simply pay by the hour—just like most defendants—and the parties would agree that the lead plaintiffs would receive the entire incentive award. In other cases, the interested parties might decide on a different division of risk and reward. The more vital the plaintiffs' attorneys to the prospective success of the case, the more lead plaintiffs will be willing to give up, and vice versa. In most cases, the resulting split—the product of bargaining by sophisticated parties in a competitive market—will be a better measure of the parties' relative contribution than anything a court could craft after the fact. 182

While not directly analogous, a fee dispute in the recent case *In re Appraisal of Dell, Inc.* is instructive. ¹⁸³ The case involved multiple appraisal petitioners, the largest group of which entered into a contingency fee agreement with lead counsel. The agreement provided that counsel would "advance[] the expenses necessary to litigate the case... and receive an attorneys' fee equal to the amount [of the benefit] with the percentage depending on the magnitude of the recovery and how far the litigation progressed." ¹⁸⁴ Following a successful trial, several of the other petitioners who had not signed the fee agreement objected to being required to pay the same fees. The court

^{182.} The ALI Principles endorse this general idea, though not exactly in this context. See PRINCIPLES OF THE LAW OF AGGREGATE LITIGATION § 1.05 cmt. h (AM. LAW INST. 2019) (suggesting that judges "should attempt to employ the same fee and cost arrangements represented persons would use if they could hire lawyers directly").

^{183.} See In re Appraisal of Dell, Inc., No. 9322-VCL, 2016 WL 6069017, at $^*1-6$ (Del. Ch. Oct. 17, 2016) (providing factual background on the case, which concerned the payment of contingency fees when multiple appraisal petitioners, some of which did not sign the fee agreement at issue, are involved), rev'd sub nom. Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd, 177 A.3d 1 (Del. 2016).

^{184.} *Id*. at *1.

ultimately imposed the same fee on all petitioners—not because they were bound by the fee arrangement, but because "an arm's-length agreement, particularly with a sophisticated client, as in this instance, can provide an initial 'rough cut' of a commercially reasonable fee." ¹⁸⁵ Ultimately, the trial result was overturned on appeal, including the allocation of fees, which the Delaware Supreme Court ordered adjusted to reflect the unique benefits obtained by the lead plaintiff. ¹⁸⁶ The case for deference to an ex ante agreement, however, is stronger here, where the agreement is not as to the total *amount* of the award—which is still to be determined by the court—but simply governs the *allocation* of the award, a matter as to which the absent members of the class are likely to be indifferent.

As a result, ex ante agreements as to how the ultimate incentive award will be divided ought to be welcomed by courts, rather than invalidated or ignored.

D. Embracing Specialist Litigation Investors as Lead Plaintiffs

Dedicated investment funds that specialize in litigation can potentially make extremely effective lead plaintiffs, promising greater expertise and lower cost than one-time players. As noted earlier, concerns regarding anything beyond purely restitutionary plaintiff incentive awards are often outgrowths of opposition to "professional plaintiffs" seeking a "bounty." We have argued elsewhere that this revulsion toward litigation for profit is seldom well founded. 189 Others

We fail to see how the Court of Chancery could refuse to reduce the amount of expenses owed by . . . other stockholders entitled to appraisal to account in some balanced and fair way for the benefits that Lead Counsel obtained through its representation of [the lead plaintiff] and that [the lead plaintiff] obtained thanks to the fair value award and settlement leverage it gained by delaying resolution of its entitlement to appraisal until after trial.

Ultimately, the Delaware Supreme Court concluded that, on remand, the Court of Chancery "must make a reasoned and sizable reduction in those [expenses] awarded against the shares entitled to appraisal to account for the fair share [the lead plaintiff] should have borne, but the Lead Counsel chose not to seek from it." Id.

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^{185.} Id. at *14, 19 (quoting Wis. Inv. Bd. v. Bartlett, No. Civ.A. 17727, 2002 WL 568417, at *6 (Del. Ch. Apr. 9, 2002)).

^{186.} See Dell, Inc., 177 A.3d at 46:

^{187.} See Korsmo & Myers, supra note 3, at 1343 ("Financiers can pay attorneys by the hour and have the kind of concentrated economic stake and repeat player expertise that will give them the incentive and wherewithal to effectively monitor the course of the litigation.").

^{188.} See discussion supra note 53-54 and accompanying text.

^{189.} See Korsmo & Myers, supra note 3, at 1372–80 (arguing that the traditional concerns that such litigation might inappropriately commodify personhood, encourage predatory behavior, lead to meritless litigation, inadequately deter offenders, or simply prove impractical, are largely unfounded); Korsmo & Myers, supra note 52, at 315 ("Unless the appraisal right itself is

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have likewise recognized the potential benefits of a cadre of specialist lead plaintiffs. 190 For example, consider the hedge funds who purchased distressed mortgage-backed securities in the wake of the financial crisis. Many of these funds intended to enforce legal rights against the sellers who made false representations about the quality of the loans included in the securities. Although sometimes termed "vulture funds,"191 these entities sought out situations where the sellers had thus far gotten away with fraud totaling in the tens of billions of dollars due to the lack of an adequate plaintiff. In seeking to remedy this wrongdoing, the after-acquiring funds were benefiting other holders of the securities. Perhaps more importantly, they were also furthering the public policy goal of deterring fraud. 192 Viewed in this light, they might be characterized as "white knight" funds, rather than "vulture funds." They were motivated by a desire to benefit themselves, to be sure, but we should expect no more of lead plaintiffs than we do of butchers, brewers, or bakers. 193

In any event, the revulsion against "speculating in litigation" is of ancient vintage¹⁹⁴ and is still widely felt by people with Stone Age moral sensibilities. It forms at least some of the basis for restrictions on champerty. ¹⁹⁵ It also serves as a prominent aspect of opposition to

substantively undesirable, the mere fact that it has been transferred to someone better able to vindicate the right does not constitute an argument against its vindication.").

190. See Cox, Thomas & Kiku, supra note 7, at 1638:

[A] demonstrated record as a diligent monitor of the present suit, when coupled with a good track record of being such a monitor in other cases, should be more than enough to persuade the court that the petitioning institution has only the positive characteristics associated with being a professional plaintiff;

Silver & Dinkin, *supra* note 9, at 495 (raising the possibility that "litigation specialists" might emerge to buy into class action claims).

191. See, e.g., Brief for Amicus Curiae the Securities Industry & Financial Markets Ass'n in Support of Defendant-Appellant at 12, ACE Sec. Corp. v. DB Structured Prods., Inc., 977 N.Y.S.2d 229 (N.Y. Sup. Ct. 2013) (discussing "[t]he financial crisis and the vulture-fund [residential mortgage backed security] wave").

192. See James D. Cox, Response, Securities Class Actions as Public Law, 160 U. PA. L. REV. PENNUMBRA 73, 74 (2011) ("The securities laws carry out several public objectives in addition to protecting the individual investor.").

193. See ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 9–10 (Harriman House Ltd. 2007) (1776) ("It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.").

194. See Korsmo & Myers, supra note 52, at 314 (describing restrictions on buying and selling claims as having "deep common law roots").

195. See, e.g., 4 WILLIAM BLACKSTONE, COMMENTARIES *134–36 (explaining that both barratry, or excessive filings, and champerty, or the process of financing a lawsuit in which one has no interest other than the potential proceeds, were punished significantly by English common law); Choharis, supra note 143, at 461 (defining champerty as supporting a lawsuit "in hopes of profiting" and explaining that this practice was particularly disincentivized in early Rome, thirteenth and fourteenth century England, and during the reign of Henry VIII); Max Radin, Maintenance by Champerty, 24 CALIF. L. REV. 48, 60–63 (1935) ("It was clear that a purchaser in

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specialized patent litigation firms—commonly referred to as "patent trolls"—and the more recent emergence of appraisal arbitrage. 196

Hostility toward such plaintiffs serves as a deterrent against serving as lead plaintiff, and drives at least some of the general limitations on plaintiff incentive awards. It would hardly be irrational to worry that courts would look unkindly upon specialist, repeat-player, litigation-focused investment funds. To the extent distaste for professional plaintiffs leads courts to be unwilling to reward such funds via adequate plaintiff incentive awards, it creates a disincentive to create a specialist fund in the first place.

Courts should not hesitate to reward an effective lead plaintiff that has produced benefits for the class simply because it is a repeat player. Moreover, courts should hesitate to apply archaic doctrines like champerty, maintenance, and barratry¹⁹⁷ to security holders who buy the security after a cause of action has arisen, with the intent to pursue litigation.¹⁹⁸ Abolishing such doctrines would be in keeping with the "general trend...away from restrictions on claim alienation, beginning with the legalization of contingency fees, which were themselves once regarded as champertous."¹⁹⁹

In addition, the contemporaneous ownership requirement should be abandoned. In Delaware, this rule requires derivative plaintiffs to have been a stockholder at the time of the original alleged wrongdoing²⁰⁰ and casts doubt on whether an after-acquiring

all likelihood paid far below the price which would have been demanded if the land were in possession, and the whole transaction in medieval eyes was tainted with that speculation which was the essence of the abhorred sin of usury.").

^{196.} See Merion Capital LP v. BMC Software, Inc., No. 8900-VCG, 2015 WL 67586, at *7 (Del. Ch. Jan. 5, 2015) (acknowledging concerns "that appraisal arbitrage itself leads to unwholesome litigation"); Letter from Cravath, Swaine & Moore LLP, Davis Polk & Wardwell LLP, Latham & Watkins LLP, Skadden, Arps, Slate, Meagher & Flom LLP, Simpson Thacher & Bartlett LLP, Sullivan & Cromwell LLP, and Wachtell, Lipton, Rosen & Katz, to the Council of the Corp. Law Section of the Del. State Bar Ass'n and Lawrence A. Hamermesh, Professor, Widener's Inst. of Del. (Apr. 1, 2015) (on file with author) (decrying "unseemly claims-buying that is rampant and serves no legitimate . . . purpose"). Appraisal arbitrage refers to the practice of buying shares of a merger target following announcement of a merger, with the intention of bringing a statutory-appraisal action seeking the fair value of those shares. See Charles R. Korsmo & Minor Myers, Appraisal Arbitrage and the Future of Public Company M&A, 92 WASH. U. L. REV. 1551, 1552–56 (2015).

^{197.} Blackstone defined barratry as "frequently exciting and stirring up suits and quarrels." 4 BLACKSTONE, *supra* note 195, at *134; *see also* Korsmo & Myers, *supra* note 3, at 1343 ("Roughly speaking, barratry' refers to a third party stirring up a lawsuit among others....").

^{198.} We have argued elsewhere that these ancient laws "serve no useful purpose in modern society." Korsmo & Myers, *supra* note 3, at 1382.

^{199.} Id. at 1344.

^{200.} See DEL. CODE. ANN. tit. 8, § 327 (2019) (requiring that a derivative stockholder allege that it held the stock "at the time of the transaction of which such stockholder complains or that such stockholder's stock thereafter devolved upon such stockholder by operation of law").

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stockholder can serve as lead plaintiff in a class action.²⁰¹ Other have similar rules. The policy behind iurisdictions contemporaneous ownership requirement is somewhat murky,²⁰² but it appears to be designed to suppress nuisance litigation. If this is the goal, however, the contemporaneous ownership requirement is likely to be counterproductive. By limiting the universe of potential lead plaintiffs to those who happened to own stock at the time of the alleged wrongdoing, the rule freezes out specialized institutional investors with expertise in identifying and managing claims. The rule thus stands as a barrier to the entrance of the most promising type of highly qualified and effective lead plaintiffs, who could prevent collusive settlements of meritorious suits and generate benefits for all stockholders.²⁰³

Finally, while it is reasonably clear that for stock, any underlying legal claims transfer along with the shares, most states have a general rule that legal claims do not transfer along with property unless the assignor "manifest[s] an intention to transfer the right."²⁰⁴ This rule has been applied to, for example, corporate bonds and assetbacked securities.²⁰⁵ While this rule is not an absolute bar on an after-acquirer bringing claims—they can overcome it by having the seller manifest intent to transfer claims—it is an unnecessary obstacle to the creation of a specialized, high-quality lead plaintiff.²⁰⁶ Where the assets

^{201.} See, e.g., Dieter v. Prime Comput., Inc., 681 A.2d 1068, 1072–73 (Del. Ch. 1996) (holding that an after-acquiring stockholder should not serve as lead plaintiff due to concerns as to whether they can be considered "typical of the class"); see also Korsmo & Myers, supra note 3, at 1357–58 ("Delaware law has not squarely confronted the question of whether after-acquiring stockholders are members of a merger class action Given this uncertainty . . . such stockholders have been precluded from serving as lead plaintiff in a merger class action.").

^{202.} Other, more influential, commentators have examined the rationales behind the contemporaneous ownership requirement and found them wanting. See, e.g., J. Travis Laster, Goodbye to the Contemporaneous Ownership Requirement, 33 Del. J. Corp. L. 673, 673 (2008) (arguing that the requirement "is fundamentally incoherent" and that it "operates largely at random, and it arbitrarily mandates the dismissal of potentially meritorious claims"); Macey & Miller, supra note 2, at 77 ("The rationale for the contemporaneous ownership rule . . . appears questionable at best.").

^{203.} See Korsmo & Myers, supra note 3, at 1383 (criticizing the contemporaneous ownership requirement for generating an "artificial scarcity" of suitable lead plaintiffs); id. ("The ironic result is that a policy purportedly instituted to avoid strike suits may, in fact, be blocking pursuit of meritorious claims while doing little to prevent strike suits.").

^{204.} See, e.g., DNAML Pty, Ltd. v. Apple Inc., No. 13cv6516 (DLC), 2015 WL 9077075, at *4 (S.D.N.Y. Dec. 16, 2015) (quoting RESTATEMENT (SECOND) OF CONTRACTS § 324 (2019)).

²⁰⁵. See Royal Park Invs. SA/NV v. HSBC Bank USA, N.A., No. 14 Civ. 8175, 14 Civ. 9366, 2018 WL 679495, at *4–5 (S.D.N.Y. Feb. 1, 2018) ("A certificateholder has standing to sue only if every prior transaction in the chain included an assignment of the right to sue along with the underlying certificate.").

^{206.} *Cf.* Palazzolo v. Rhode Island, 533 U.S. 606, 628 (2001) ("It would be illogical, and unfair, to bar a regulatory takings claim because of the post-enactment transfer of ownership where the steps necessary to make the claim ripe were not taken, or could not have been taken, by a previous owner."), *abrogated on other grounds by* Lingle v. Chevron U.S.A., 544 U.S. 528 (2005).

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have changed hands multiple times, it can be difficult or impossible to determine who owns any appurtenant claims.²⁰⁷ States should adopt rules like New York's default rule that all preexisting claims transfer along with the underlying bonds.²⁰⁸

E. The Judicial Backstop

In all events, plaintiff incentive awards have a built-in gatekeeper—the trial court judge. The trial court judge already must approve any settlement in representative litigation, as well as any awards to the lead plaintiff and the plaintiffs' attorneys. As is discussed more fully below, the conflicts of interest that must be policed in the context of plaintiff incentive awards are broadly similar to those that arise with attorneys' fees. If anything, the agency problem is less acute for the lead plaintiff.

In the presence of this natural gatekeeper, the need for bright-line rules—against after-acquiring lead plaintiffs, against percentage-based incentive awards, against ex ante agreements with class counsel, and so on—is highly attenuated. The trial judge simply needs discretion to bar such practices on a case-by-case basis, if and when they threaten to have deleterious effects on the class.

F. The Promise of Specialized Lead Plaintiffs in Corporate and Securities Claims

Any sophisticated institutional lead plaintiff would likely be a boon to the class, as compared to an unsophisticated figurehead. But a lead plaintiff that specializes in serving in that role holds out unique benefits. Such funds can offer economies of scale, the risk-reducing benefits of diversification across many claims, and can develop greater expertise in identifying and resolving claims (as well as monitoring the plaintiffs' attorneys).²⁰⁹ Specialists can "vindicate the underlying legal rights more effectively and thus make the claims more valuable."²¹⁰

^{207.} See id. at 626–30 (discussing the potential effects of applying different property rights to different owners after property has been transferred).

^{208.} See N.Y. GEN. OBLIG. LAW § 13-107(1) (McKinney 2019) ("Unless expressly reserved in writing, a transfer of any bond shall vest in the transferee all claims or demands of the transferrer, whether or not such claims or demands are known to exist... for damages against the trustee or depositary under any indenture under which such bond was issued.").

^{209.} Jill Fisch identified similar benefits arising from the work of relators in qui tam suits. Fisch, *supra* note 5, at 195 ("Three components of the plaintiff's role add value: initiating litigation, providing information and investigative assistance, and providing litigation resources and support.").

^{210.} Korsmo & Myers, supra note 52, at 315.

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Doing so would not only benefit the specialist and other class members, but also the original (selling) holder of the claims and the deterrent function of class actions more generally.²¹¹

Any investment security is highly likely to have at least one substantial institutional holder, given that the proportion of S&P 500 stocks held by institutional investors now exceeds 80%. The PSLRA's unique limitations on corporate and securities claims are thus especially striking because it is precisely in those claims where one might otherwise expect to see a sophisticated potential lead plaintiff. These institutional investors—with large resources at their command, and usually substantial financial and legal sophistication—hold out promise as something other than the usual figurehead plaintiff.

Even where a promising lead plaintiff does not exist at the time a claim arises, one can come into existence after the fact relatively easily in the corporate and securities context. Where a valuable claim exists, a specialized investor can increase its exposure by acquiring assignments of the claims from class members. Indeed, litigation-focused funds can specialize in buying and bringing such claims. This further sets apart corporate and securities actions from other aggregate litigation contexts. While, in theory, after-acquiring specialists could buy up other types of claims as well, the ability to do so by simply buying securities on established markets or by taking assignments from claim holders dramatically reduces the transaction costs associated with doing so in the corporate and securities context.

The potential utility of an institutional lead plaintiff stems in part from their financial and legal sophistication, and in part from the financial resources likely to be at their disposal. This offers straightforward benefits in identifying claims, prosecuting them, and monitoring counsel.

^{211.} Id.

^{212.} See Einer Elhauge, Horizontal Shareholding, 129 HARV. L. REV. 1267, 1268 (2016) ("[I]nstitutional investors like BlackRock, Vanguard, Fidelity, and State Street now own around 80% of all stock in S&P 500 corporations.").

^{213.} See Weiss & Beckerman, supra note 7, at 2121–23 (positing that institutional investors' involvement as lead plaintiff in class action suits may aid in the advancement of the disclosure policies of the federal securities laws).

^{214.} See Korsmo & Myers, supra note 3, at 1353 ("Would-be class members could sell their claims to buyers who specialize in evaluating and pressing claims. Having accumulated a large number of similar claims, the buyer could then press them on its own behalf.").

^{215.} See id. at 1382-83 (explaining the superiority of after-the-fact acquisition in the stockholder context relative to other types of class actions).

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1. Identifying Meritorious Claims

Unlike in many class action scenarios, the lead plaintiff in a complex corporate or securities case may be vital in identifying and crafting the claim in the first place. For many class actions, whatever their factual complexity, the underlying claims are relatively straightforward and do not require much sophistication on the part of the plaintiffs' lawyers in order to craft a complaint. This tends to lead to the scenario described in much of the literature on class actions and decried in the legislative history of the PSLRA—plaintiffs' attorneys who select lead plaintiffs, rather than the other way around, and lead plaintiffs who play little or no role in the actual litigation.²¹⁶ This can be the case even in corporate and securities litigation.²¹⁷

Some strong cases, however, may lie buried in the proverbial haystack. They might hinge on difficult questions of valuation or complex webs of contractual arrangements that defy explication on the front page of the *Wall Street Journal*. Some set of claims may thus lie beyond the practical ability of generalists to identify on their own. To be sure, other types of claims like employment discrimination or products liability may also remain undetected but for the efforts of a particularly active plaintiff. But the complexities of many corporate and securities claims make it especially likely in that context. A few examples will make the point clear.

^{216.} See H.R. CONF. REP. 104-369, at 32–33 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 732–33 (describing "[p]rofessional plaintiffs who own a nominal number of shares in a wide array of public companies" and noting that "in many cases the 'lead plaintiff' has not even read the complaint"); see, e.g., Korsmo & Myers, supra note 2, at 841 ("As a practical matter, then, it is the plaintiffs' attorneys . . . who decide when to initiate [class and derivative] claims, how to prosecute them, and on what terms to settle them."); Macey & Miller, supra note 2, at 3 ("[P]laintiffs' class and derivative attorneys . . . exercise nearly plenary control over all important decisions in the lawsuit")

^{217.} See, e.g., Janet Cooper Alexander, Do the Merits Matter? A Study of Settlements in Securities Class Actions, 43 STAN. L. REV. 497, 565 (1991) ("Many plaintiffs' firms have longterm relationships with certain investors with broad-spectrum portfolios who are regularly plaintiffs in class actions."); Matthew D. Cain & Steven Davidoff Solomon, A Great Game: The Dynamics of State Competition and Litigation, 100 IOWA L. REV. 465, 480 (2015) (noting that "[t]he drivers of merger litigation are shareholder plaintiffs' attorneys' firms" and that "shareholder litigation is a lawyer-driven process rather than one that is operated for the benefit of shareholders"); Roberta Romano, The Shareholder Suit: Litigation Without Foundation?, 7 J.L. ECON. & ORG. 55, 55–56 (1991) ("Critics of the shareholder suit assert that most of the suits are frivolous and that the plaintiff's bar is the true beneficiary of the litigation.").

^{218.} See, e.g., MBS 'Putback' Investors Target Big Issuers, CERTIFIED FORENSIC LOAN AUDITORS (Feb. 24, 2012), https://certifiedforensicloanauditors.com/articles/02.12/MBS-putback-investors-target-big-issuers.html [https://perma.cc/5VUC-ABDK] (noting, in the context of mortgage-backed security putback litigation, that it is "far from easy money" and that "it requires considerable manpower to pore over detailed loan files in search of flaws").

The asset-backed securities that were especially popular prior to the financial crisis are legendary in their complexity. The details of the underlying assets can be, realistically, only partially disclosed in publicly available prospectuses, and the underlying contractual arrangements are bewilderingly complex, running to hundreds or thousands of pages. In the wake of the financial crisis, when many such securities became distressed, potential claims against issuers, trustees, and other parties abounded. Without dedicated assistance from the sophisticated institutional investors who held the securities, however, the chances of nonspecialist litigators getting their arms around the economic and contractual realities involved would have been slim to none. Indeed, many of the more sophisticated contractual claims brought in the wake of the crisis have been by specialist funds that have accumulated the securities specifically in order to assert legal rights.

Even more standard corporate bonds will be governed by indentures that typically run into the hundreds of pages and may be largely impenetrable to the nonspecialist. Unless an issuer or trustee breaches the indenture in a particularly flamboyant fashion, its actions are unlikely to feature in the financial press to get on the radar of a plaintiffs' attorney, and perhaps might not be noticed by anyone at all except a particularly vigilant bondholder. Unless such bondholders are willing to spearhead litigation themselves, many potentially meritorious claims will never be identified in the first place, and many unspectacular breaches of contract are likely to go undetected and undeterred.

2. Assisting in Complex Litigation

Just as it may be difficult for a nonspecialist litigator to discover claims and craft a compelling complaint without assistance from an expert lead plaintiff, an expert lead plaintiff may also be vital to actually prosecuting the resulting litigation. Tasks ranging from formulating discovery requests, interpreting documents produced

^{219.} See, e.g., Henry T. C. Hu, Too Complex to Depict? Innovation, "Pure Information," and the SEC Disclosure Paradigm, 90 Tex. L. Rev. 1601, 1628–29 (2012) (demonstrating that modern-day financial practices, including those involving asset-backed securities, are becoming increasingly complex); Charles R. Korsmo, The Audience for Corporate Disclosure, 102 IOWA L. Rev. 1581, 1618 (2017) (describing asset-backed securities as "emblematic of the new complexity of structured finance").

^{220.} See Hu, supra note 219, at 1634–36 (describing the information problems in offering asset-backed securities); id. at 1640 (explaining the partial and sometimes inaccurate descriptions of complex underlying contracts in asset-backed securities prospectuses).

^{221.} See, e.g., MBS 'Putback' Investors Target Big Issuers, supra note 218 ("A growing number of hedge funds are scouring the files of securitized home loans, in hopes of reaping rich profits by forcing mortgage-bond issuers to buy back faulty credits.").

during discovery, preparing for depositions, selecting and preparing expert witnesses, valuing the potential recovery, and even writing briefs and preparing trial strategy may be difficult or impossible for counsel to perform without the assistance of a lead plaintiff knowledgeable in the context of the litigation. The *Chen* case described earlier illustrates this point dramatically.

3. Monitoring Class Counsel

Agency problems are endemic in all types of representative litigation and need to be monitored, either by courts or by the plaintiffs themselves.²²² The evidence suggests, however, that the agency problem is especially acute in corporate and securities litigation and that such cases offer a better prospect of effective monitoring by an effective lead plaintiff.

The prevalence of collusive settlements in stockholder litigation is well documented in the literature.²²³ The most salient recent example involves merger class actions, where transactions were awash in so-called "disclosure only" settlements, where the only "recovery" was additional disclosures by the defendant—and a substantial payment to the plaintiffs' attorneys.²²⁴ These disclosure-only settlements are especially likely to be collusive in nature.²²⁵ The plaintiffs' lawyers get a tidy payout for little effort, and the defendants secure broad releases of claims at low cost—less than the cost of litigating even a frivolous claim.²²⁶ As a result, frivolous claims abound, and potentially meritorious claims are settled on the cheap.²²⁷

These collusive settlements have been particularly difficult for courts to police, given the ease with which the parties can put together an impressive-looking package of additional disclosures and—in some types of stockholder suits—various governance reforms (additional

^{222.} See Korsmo & Myers, supra note 3, at 1333 ("The unavoidable problem created by both the class action and the derivative suit is one of agency costs.").

²²³. An early study by Roberta Romano found that only half of settlements led to any monetary recovery for stockholders, while more than 90% provided for cash attorneys' fees. Romano, supra note 217, at 61.

^{224.} Cain & Solomon, *supra* note 217, at 479–81.

^{225.} See Joel Edan Friedlander, How Rural/Metro Exposed the Systemic Problem of Disclosure Settlements, 40 DEL. J. CORP. L. 877, 881–83 (2016) (proposing that the routine use of disclosure settlements "undermined in various respects the proper functioning of a system for the judicial enforcement of fiduciary duties").

^{226.} See Sean J. Griffith & Alexandra D. Lahav, The Market for Preclusion in Merger Litigation, 66 VAND. L. REV. 1053, 1057–58 (2013).

²²⁷. Our own recent empirical study suggested that merger claims were being brought over the past decade with no regard for the underlying merits of the claims. Korsmo & Myers, supra note 2, at 847.

independent directors, a new audit committee, and so on). While academic research has suggested that these nonmonetary settlements are generally of little or no value,²²⁸ it can be difficult for a judge to determine whether a complicated package of disclosures and governance reforms is truly valuable or mere window dressing.²²⁹

It is also particularly easy for plaintiffs' attorneys to evade monitoring by maintaining a stable of pliant "professional" plaintiffs for stockholder litigation, in a way that would seldom be possible in other contexts. To have standing, a plaintiff must simply be a stockholder. In the extreme, an individual could, at relatively low cost, own a single share of every publicly traded company and thus have standing in every stockholder suit involving a public company. And, indeed, prominent plaintiffs' firms have been accused of keeping such clients essentially on retainer, offering them side payments to serve as plaintiffs in stockholder suits filed by the firm.²³⁰ Such a plaintiff is unlikely to be willing or able to perform any real monitoring.

Large institutions with sufficient legal and financial sophistication, by contrast, could be effective monitors, ²³¹ keeping a sharp eye on the litigation and the choices made by counsel. This dynamic is on display in stockholder appraisal, where most claims are brought by specialist funds who buy stock after the challenged merger has been announced. ²³²

IV. POTENTIAL OBJECTIONS

At this point, it may seem unlikely to the reader that any fairminded, educated person could raise objections to our proposals. But this is a fallen world. In this Part, we consider—and reject—potential objections to a more robust use of plaintiff incentive awards in pursuit of high-quality lead plaintiffs. In general, the various objections ring

^{228.} See Jill E. Fisch et al., Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform, 93 Tex. L. Rev. 557, 559 (2015) ("Although deal litigation is pervasive, these lawsuits rarely result in a monetary recovery for the plaintiff class.").

^{229.} Given this difficulty, and the mounting evidence of abusive merger litigation, Delaware courts have recently decided to err on the side of rejecting disclosure-only settlements in merger litigation. See In re Trulia, Inc. Stockholder Litig., 129 A.3d 884, 898 (Del. Ch. 2016) (holding that, going forward, disclosure-only settlements are disfavored and will be approved only where additional disclosures are "plainly material" and releases of liability are "narrowly circumscribed").

^{230.} See Press Release, Debra Wong Yang, U.S. Attorney, Cent. Dist. of Cal., Milberg Weiss Law Firm, Two Senior Partners Indicted in Secret Kickback Scheme Involving Named Plaintiffs in Class-Action Lawsuits (May 16, 2006), https://online.wsj.com/public/resources/documents/milbergpress05182006.pdf [https://perma.cc/RSA7-P86G].

^{231.} See Weiss & Beckerman, supra note 7, at 2109–25 (analyzing the factors that may determine whether an institutional investor will choose to serve as lead plaintiff in litigation).

^{232.} See Korsmo & Myers, supra note 196, at 1552–56.

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hollow for two reasons. First, they prove too much. If they were taken seriously, they would in most cases apply even more forcefully against contingency fees for plaintiffs' attorneys. Second, they are overwrought in a context where trial court judges are well situated to provide oversight against abuses.

A. Plaintiff Incentive Awards Misalign Incentives

The most basic objection to providing an economically meaningful incentive award to lead plaintiffs is that doing so would distort the lead plaintiffs' incentives and risk causing them to sell out the class to enter into collusive settlements.²³³ If anything, however, this risk is far less acute for an institutional lead plaintiff than for a plaintiffs' attorney.²³⁴ Absent a percentage-based fee, a plaintiffs' attorney has no economic stake in the actual recovery at all. As a result, the temptation is especially strong to strike a collusive settlement that provides only symbolic relief for the plaintiffs but a cash payment for the attorneys. Indeed, such "coupon settlements" and "disclosure-only" settlements have plagued representative litigation.²³⁵ The attorneys' incentive for a quick settlement is heightened by the fact that the upfront costs of filing a suit are small—often no more than the cost of filing a quick complaint—with major costs only being incurred if the case is actually litigated.

By contrast, an institutional lead plaintiff, by definition, will have a large stake in the actual recovery. The desire to maximize the value of this stake will tend to counteract the incentive to reach a low-value settlement in hopes of an award, unless the prospective award is extremely large. Moreover, unlike a plaintiffs' attorney, an institutional lead plaintiff must make a substantial upfront investment in amassing a position in the first place—in appraisal litigation it is not uncommon for specialist funds to spend tens or even hundreds of millions of dollars establishing their stock holdings. This upfront investment reduces the incentive to either bring a meritless suit for nuisance value or to reach a quick, low-value settlement of a meritorious claim.²³⁶ The skewing of

 $^{233.\} See\ {\rm discussion}\ supra$ notes 41--42 and accompanying text.

^{234.} See Cox, Thomas & Kiku, supra note 7, at 1593 ("[A] settlement offer that provided recovery of the attorney's tangible and opportunity costs could loom larger than the prospect of aggressively pursuing the action to a more lucrative prospective judgment or settlement."); Fisch et al., supra note 228, at 568–622 (discussing the problem in the context of stockholder class actions challenging mergers); James Tharin & Brian Blockovich, Coupons and the Class Action Fairness Act, 18 GEO. J. LEGAL ETHICS 1443, 1445–47 (2005) (discussing the problem in the context of consumer and antitrust class actions).

^{235.} See Tharin & Blockovich, supra note 234, at 1445-47.

^{236.} See Korsmo & Myers, supra note 3, at 1335–37.

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incentives is much less with respect to an institutional lead plaintiff than for a plaintiffs' attorney or for a traditional lead plaintiff with a small stake in the underlying claim and the prospect of a lump-sum incentive award.

If—as we propose above—plaintiff incentive awards for institutional investor lead plaintiffs are typically calculated as a percentage of the recovery, the misalignment of incentives is reduced even further. The lead plaintiffs' award will simply scale with the recovery to the class. Furthermore, a percentage-based award puts the amount of the award entirely in the hands of the supervising judge who must approve the settlement and determine an appropriate percentage award. In the presence of an ex ante agreement among the lead plaintiffs and attorneys on the splitting of a prospective award, the judge can simply determine the percentage award in the same fashion as would be done normally. In all cases, the presiding judge can police the settlement²³⁷ just as they would in other circumstances where a risk of collusion is present.²³⁸ Only in extraordinary circumstances would an award be justified in the absence of a monetary recovery.

B. Lead Plaintiffs Seldom Merit a Significant Award

The drafters of the PSLRA were particularly perturbed by the prevalence of figurehead lead plaintiffs,²³⁹ forbidding lead plaintiffs in securities class actions from receiving any incentive award beyond pure restitution. The PSLRA is at least half right: where the lead plaintiff has served no more than a nominal role, they should receive no more than a nominal award, if any. But the fact that *most* lead plaintiffs do little to benefit the class is no reason to swear off rewarding the rare lead plaintiffs who do a great deal to benefit the class. By definition, the institutional lead plaintiffs we have in mind will be anything but figureheads. If, however, they can expect no reward for benefitting the class, they will have no reason to do so rather than proceeding individually. Ironically, the resolve to treat all lead plaintiffs as nothing

^{237.} See, e.g., Ann K. Wooster, Annotation, *Propriety of Incentive Awards or Incentive Agreements in Class Actions*, 60 A.L.R. 6th 295, § 4 (2010) ("The decision of whether to grant an incentive award to a named plaintiff in a class action following conclusion of the litigation is within a court's discretion.").

^{238.} See, e.g., In re Trulia, Inc. Stockholder Litig., 129 A.3d 884, 898 (Del. Ch. 2016) (discussing the problem of collusive settlements in merger class actions, and implementing increased scrutiny of such settlements).

^{239.} See H.R. REP. No. 104-369, at 32–33 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 732–33 (noting, in support of the limitations on incentive awards, that "in many cases the lead plaintiff' has not even read the complaint").

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more than figureheads makes it more likely that only figureheads will be willing to serve as lead plaintiffs.²⁴⁰

C. Large Incentive Awards Will Encourage Rent Seeking

A third concern is that lead plaintiffs will engage in rent-seeking behavior, either in the form of threatening a class action to secure a larger settlement in an individual suit or in the form of selecting as class counsel the firm who will agree to give them the biggest slice of the award rather than the firm that will best represent the class.²⁴¹ Neither of these concerns hits the mark.

As to the first type of "rent seeking," the value of the threat to bring a class action does not depend on whether there is a potential incentive award in the class action. Indeed, the prospect of a substantial incentive award should help to induce large plaintiffs to actually proceed on a class basis, rather than simply use the threat of a class action as leverage in an individual action. If that threat is credible—indeed, if the plaintiff even contemplates proceeding individually—it proves the insufficiency of the plaintiff incentive award regime.

As to the second type of "rent seeking," it is subject to powerful countervailing incentives in this context. The type of institutional lead plaintiff we envision will have a large stake in the underlying claims, giving them an incentive to select class counsel who will maximize the value of those claims, after factoring in costs. In addition, if the lead plaintiff has negotiated for a portion of a percentage-based award, maximizing the award will also depend on maximizing the recovery.²⁴²

^{240.} We are not the first to note this irony, which is especially rich in the context of the PSLRA, which itself creates a legal framework to prevent figurehead lead plaintiffs. *See* Nagareda, *supra* note 32, at 1491:

The PSLRA hinders the practical achievement of its own ideals for class representatives by confining incentive awards to restitution and rejecting complementary notions of reward. By limiting awards to "reasonable costs and expenses," the PSLRA seeks to fight the proverbial last war—to respond to perceived abuses in the pre-PSLRA era rather than to design a legal framework for awards under the changed arrangements for lead plaintiffs promoted by the PSLRA itself.

^{241.} See Cox, Thomas & Kiku, supra note 7, at 1593.

^{242.} This stands in contrast to the situation where, being unable to secure benefits within the litigation via an incentive award, lead plaintiffs instead seek to extract benefits from prospective lead counsel outside the litigation. See Stephen J. Choi et al., The Price of Pay to Play in Securities Class Actions, 8 J. EMPIRICAL LEGAL STUD. 650 (2011) (describing evidence that public pension funds use their power to select lead counsel under the PSLRA to solicit campaign contributions). But see David H. Webber, Is "Pay-to-Play" Driving Public Pension Fund Activism in Securities Class Actions?: An Empirical Study, 90 B.U. L. REV. 2031, 2032 (2010) (finding that "evidence suggests that beneficiary board members (not politicians) drive [such] cases for reasons having to do with the financial soundness of the fund"). As Silver and Dinkin note, the irony of the pay-to-play allegations is that they prove that stronger incentives can be effective in inducing class members to serve as lead plaintiff. Silver & Dinkin, supra note 9, at 488 ("Although widely

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Again, the incentive will be to hire counsel best able to assist in doing so. The lead plaintiff's position will be little different from an individual litigant seeking to choose a lawyer that provides an optimal mix of cost and quality. This is especially so for lead plaintiffs who choose to simply pay by the hour in exchange for the entire incentive award.

Viewed more broadly, the concern with "rent-seeking" behavior is wrongheaded in general. Control of a successful class action confers substantial financial returns.²⁴³ But these returns are created by the law, and they exist for a reason. They provide an incentive for bringing representative litigation in the first place, which is thought to generate public benefits, including improved deterrence of wrongdoing and compensation for the wronged.²⁴⁴ One may call these financial returns "rents," but if private actors are to be expected to generate positive externalities, they must be entitled to internalize at least some of the benefits they generate. The patent system, for example, is based on this simple idea, and indeed so is the American system of private property more generally. This has long been recognized as applied to plaintiffs' attorneys, who are typically assumed to be vital to generating the benefits of aggregate litigation. We merely propose extending the same treatment to lead plaintiffs when they are vital to achieving the desired public benefits. Current practice allows plaintiffs' attorneys to monopolize the "rents" from aggregate litigation, despite the fact that their incentives may diverge considerably from those of the class. Our proposal would merely allow particularly useful lead plaintiffs—whose incentives are otherwise aligned with those of the class—to get a cut of the action.

D. Awarding a Share of the Contingency Fee Will Generate Disputes

Some courts, particularly in Delaware, have expressed concern that incentive awards to lead plaintiffs will necessarily involve judges in disputes between lead plaintiffs' and plaintiffs' attorneys.²⁴⁵ This

despised, political contributions have an important upside: they provide selective incentives for trustees to volunteer public sector and union funds as lead plaintiffs.").

^{243.} See, e.g., Nagareda, supra note 32, at 1494 (noting the "considerable financial returns that flow from control of class action litigation").

^{244.} See, e.g., Coffee, supra note 1, at 218 ("The conventional theory of the private attorney general stresses that the role of private litigation is not simply to secure compensation for victims, but is at least equally to generate deterrence, principally by multiplying the total resources committed to the detection and prosecution of the prohibited behavior.").

^{245.} See Chen v. Howard-Anderson, 2017 Del. Ch. LEXIS 734, at *11 (Del. Ch. June 30, 2017) (citing Transcript of Record at *33–34, In re Commercial Assets, Inc. S'holders Litig., No. 17402 (Del. Ch. Aug. 3, 2000) (Strine, V.C.) ("I don't think we ought to start individually compensating named plaintiffs in every sort of litigation. . . . [W]e don't want them to become sort of a rival or a coordinated kind of fee application on behalf of named plaintiffs.")).

concern is unconvincing. Courts deal on a routine basis with cases involving more than one plaintiffs' firm litigating in pursuit of a percentage-based contingency award. In many, perhaps most, of those cases, the firms—as sophisticated economic actors—negotiate among themselves how the eventual award (determined by the court) will be divided. Where they cannot agree, the judge determines the allocation, based on a rough appraisal of the firms' relative contributions. ²⁴⁷

There is thus no reason to expect rival award applications on a routine basis. When a sophisticated institutional investor serves as lead plaintiff, it is, as we argue above, also likely they will negotiate ahead of time with counsel regarding how any percentage-based award will be split. If anything, rival applications from a lead plaintiff are less likely than from a rival firm, given that the lead plaintiff will have chosen the lead counsel in the first place. Where no such agreement exists, though, the court is perfectly able to determine an appropriate split, just as when two rival firms have a dispute. This may, in fact, be an easier proposition than attempting to calculate a precise dollar amount for an incentive award. In the *Chen* case, for example, 248 rather than just cataloguing Chen's contributions and trying to value them in a vacuum, the Vice Chancellor could have compared Chen's contributions to those of the plaintiffs' firms and arrived at a rough proportion, dividing the award accordingly.

E. Ex Ante Agreements Allocating Incentive Fees Will Lead to Abuse

Many of the rebuttals offered thus far depend, at least in part, on sophisticated lead plaintiffs being able to bargain ex ante with plaintiffs' firms over how any percentage-based award will be divided. Such agreements would represent the outcome of bargaining between sophisticated parties, based on their appraisal of the relative contribution of the lead plaintiffs and the plaintiffs' attorneys to the case. As such, they would free courts from having to make difficult allocative decisions themselves when determining awards.

Professor Rubenstein, however, highlights a number of objections to ex ante agreements, drawing from a case out of the U.S.

^{246.} See 5 RUBENSTEIN, supra note 4, § 15:23 (discussing the process by which attorneys' fees are negotiated among class counsel).

^{247.} See id. (stating three situations when a judge will oversee the award allocation, the first of which is a lack of agreement among attorneys within the class).

^{248.} See supra Section I.F.

Court of Appeals for the Ninth Circuit.²⁴⁹ Several of the objections are ill-founded on their face. The district court, for example, worried that such agreements "encourage figurehead cases and bounty payments by potential class counsel."²⁵⁰ This is exactly backwards—it is the prospect of sharing in the reward that gives a lead plaintiff an incentive to be an active monitor and participant, rather than sitting back and remaining a figurehead. Similarly, the Ninth Circuit worried that "[i]f allowed, ex ante incentive agreements could tempt potential plaintiffs to sell their lawsuits to attorneys who are the highest bidders."²⁵¹ Left unexplained is why a plaintiff should not sell its lawsuit to the highest bidder, just as it sells its house to the highest bidder.

Other criticisms of ex ante agreements are tautological. The district court, for example, concluded that such agreements are improper because "they create at least the appearance of impropriety."²⁵² Relatedly, both the district and circuit courts expressed concern that such agreements violated ethical rules on fee sharing with clients.²⁵³ While the courts, of course, are bound to enforce such rules, the rules themselves are not self-justifying. That is, it is no good to say that ex ante agreements should be against the rules because they are against the rules. The real question is whether ex ante agreements should be against the rules.

Still other criticisms are rooted in the specifics of the case. The ex ante agreement in question envisioned an award that rose with the recovery but was subject to a cap.²⁵⁴ Both courts pointed out that this structure distorted the plaintiff's incentives, giving them no incentive to seek injunctive relief or a recovery above the cap.²⁵⁵ Similarly, both courts faulted the parties for not disclosing the agreement to either the class or the court.²⁵⁶ These are valid criticisms, and good reasons for disfavoring the agreement at issue in the case, but they are not good reasons for disfavoring ex ante agreements generally. The type of agreements we have in mind would simply allocate the percentage-based award the court would grant anyway. As such, the lead plaintiff would simply have the same incentives a plaintiffs' attorney already has—to achieve an outcome that the court believes beneficial enough to

^{249.} See 5 RUBENSTEIN, supra note 4, \S 17:17 (discussing Rodriguez v. West Publishing Corp., 563 F.3d 948 (9th Cir. 2009)).

^{250.} Rodriguez v. W. Publ'g Corp., No. CV05-3222 R (MCx), 2007 U.S. Dist. LEXIS 74767, at *70 (C.D. Cal. Sept. 10, 2007), rev'd in part, Rodriguez, 563 F.3d 948.

^{251.} Rodriguez, 563 F.3d at 960.

^{252.} Id. at 959.

^{253.} Id.

^{254.} Id. at 957.

^{255.} Id. at 959-60.

^{256.} Id. at 959.

justify as large an award as possible. Courts could also require agreements to be disclosed at the outset and could invalidate problematic provisions if necessary.

A final criticism of ex ante agreements—and of percentage-based awards generally—is that they can result in "an arbitrary award not reflective of the amount of work done, or the risks undertaken, or the time spent on the litigation."²⁵⁷ Again, this criticism is inapplicable to the type of allocation agreement we envision. Such an agreement simply specifies how the award is to be split, not how it is calculated. The court would still determine the total amount to award the lead plaintiff—attorney team and could consider whatever factors are appropriate in the case. In general, however, we expect it will be most appropriate to place the greatest weight on the benefit achieved for the class, as doing so creates the best incentives for the lead plaintiff—attorney team to maximize that benefit.²⁵⁸

F. Claims-Buying and Bounty Hunting Is Super Yucky

The argument—if it can be called that—that large incentive awards to sophisticated professional lead plaintiffs would be unseemly has at least two components. First, incentive award practices of the type we suggest would lead to awards that are "too large," diverting compensation that rightfully belongs to the class. And second, claims buying and litigation for profit are themselves unwholesome.

As to the first component, it is true that our proposals would result in lead plaintiffs receiving awards much larger than those now commonly given. It is not the case, however, that our proposals would result in diversion of compensation from the class. Rather, they would result in diversion of resources away from defendants, and perhaps as a second order effect a diversion of compensation from plaintiffs' attorneys for providing financing. The gross award would be calculated in the same old way. But rather than going entirely (or almost entirely) to the plaintiffs' attorneys—on the assumption that they were predominantly responsible for the benefit to the class—it would also be allocated to the lead plaintiff when the lead plaintiff also played a substantial role.

We have addressed the arguments about the supposed unseemliness of claims buying and litigation for profit at length elsewhere.²⁵⁹ These arguments are increasingly divorced from

258. See discussion supra note 173 and accompanying text.

^{257.} Id.

^{259.} See Korsmo & Myers, supra note 3 (discussing settlement and contingency fees).

reality.²⁶⁰ The buying and selling of legal claims is entirely commonplace. Examples include assignment of contract claims, companies acquiring legal claims by merger, effective transfer of claims to insurance companies via subrogation, purchasing claims out of bankruptcy, transfer of claims appurtenant to property (including intellectual property), and effective "sale" of a large portion of claims to attorneys in the form of a contingency fee.²⁶¹ As we have noted:

In many, if not most of these everyday scenarios, the driving economic logic is the same: the transfer of claims to parties who—via greater expertise, economies of scale, ability to diversify away risk, etc.—can vindicate the underlying legal rights more effectively and thus make the claims more valuable, benefiting the claim seller and purchaser alike. ²⁶²

To that, we might add that where effective litigation furthers public policy purposes like improved deterrence and compensation—as it does in representative litigation—profit-motivated claim transfer also works to better further those purposes.

CONCLUSION

The traditional model of representative litigation is one where the plaintiffs' attorney is the indispensable party and the lead plaintiff is a mere cog, largely interchangeable with the rest of the class. In many contexts, no doubt, this model is largely accurate, and unavoidably so. In some settings, however, it is possible—indeed, likely—that a strong lead plaintiff could play a vital role in successfully identifying and litigating class claims. In particular, many corporate or securities claims will involve difficult questions of valuation or extremely complex webs of contractual arrangements that will be beyond the practical ability of nonspecialist plaintiffs' attorneys to comprehend on their own. As a result, an expert lead plaintiff may be vital in identifying a claim and crafting a complaint in the first place, and vital in managing the ongoing litigation to enforce the claim.

We argue that lead plaintiffs who provide meaningful expertise or shoulder financial risks on behalf of the class should be rewarded for doing so in the same way attorneys are, rather than simply being

^{260.} See Nagareda, supra note 32, at 1496 (evaluating distaste for profit-driven litigation and concluding "that the time is at hand for the law to move beyond . . . feigned shock and toward a more delicate job: that of grappling overtly with the on-the-ground financial implications of the litigation machine that the law itself has created").

^{261.} Korsmo & Myers, supra note 52, at 314.

 $^{262.\} Id.$ at 315.

^{263.} See, e.g., MBS 'Putback' Investors Target Big Issuers, supra note 218 (noting, in the context of mortgage-backed security putback litigation, that it is "far from easy money" and that "it requires considerable manpower to pore over detailed loan files in search of flaws").

^{264.} See supra Section III.F.

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reimbursed. In addition, limitations on awarding lead plaintiffs a percentage of the class recovery should be eliminated. And we argue that specialist litigation investors should be embraced rather than stigmatized. This approach would better promote the deterrence and compensation goals of aggregate litigation.