February 2014

New Bully on the Class Action Block -- Analysis of Restrictions on Securities Class Actions Imposed by the Private Securities Litigation Reform Act of 1995

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NEW BULLY ON THE CLASS ACTION BLOCK—
ANALYSIS OF RESTRICTIONS ON SECURITIES
CLASS ACTIONS IMPOSED BY THE
PRIVATE SECURITIES LITIGATION
REFORM ACT OF 1995

I. INTRODUCTION

In 1995 Congress perceived a growing threat to the nation's capital markets from the numerous frivolous lawsuits against corporations under federal securities laws. Congress was especially concerned about collusion between plaintiffs' law firms and the so-called "professional plaintiffs" that often led to settlements favoring the law firms at the expense of the class members.  

To combat the perceived abuses, Congress, on December 22, 1995, over President Clinton's veto, enacted the Private Securities Litigation Reform Act of 1995 ("PSLRA" or "Act"). The innovations found in the Act include a complete overhaul of the securities fraud class actions. On top of the regular requirements of the Federal Rules of Civil Procedure, the PSLRA imposes an additional layer of restrictions applicable exclusively to the federal securities laws violations, completely changing the field of federal securities class actions.

This Note examines the procedural changes that most affect securities class actions and analyzes the difficulties that have already arisen or might arise before the courts interpreting the new rules. It also suggests how experience gathered in the application of the

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1 The term "professional plaintiffs" refers to individuals who owned only small interests in many different companies and were willing to lend their names to the securities class actions in exchange for an extra payment upon settlement. Some of these individuals figured as class representative in a number of cases. See S. Rep. No. 104-98, at 6 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 685.

2 See id.


PSLRA class action provisions can be used to improve the whole of the class action scheme under the Federal Rules.

II. GENERAL BACKGROUND AND ENACTMENT

The PSLRA represents the first substantial reform of the federal securities laws since the sweeping New Deal legislation. It received major support from the lobbying efforts of accountants, securities firms, and the high-tech industry, who were hardest hit by the harassing lawsuits. The Securities and Exchange Commission (SEC) also was very concerned with the voluminous filings of frivolous securities class actions and advocated changes in the procedural rules. Thus, SEC Chairman Arthur Levitt in his congressional testimony spoke in favor of the revision of the rules governing securities class actions "because private litigation imposes substantial unnecessary costs when it is abused by private plaintiffs or their attorneys." The Senate report stated:

Under the current system, the initiative for filing [securities fraud] suits comes almost entirely from lawyers, not from genuine investors. Lawyers typically rely on repeat, or "professional," plaintiffs who, because they own a token number of shares in many companies, regularly lend their names to lawsuits. Even worse, investors in the class usually have great difficulty exercising any meaningful direction over the case brought on their behalf. The lawyers can decide when to sue and when to settle, based largely on their own financial interests, not the interests of their purported clients.

Congress, through the PSLRA, effected a number of reforms designed to prevent frivolous lawsuits from being filed and to discourage attorneys from engaging in the offensive practices. These revisions are both substantive and procedural. Substantive rights changed by the PSLRA include the requirement that plaintiffs plead scienter with particularity, a provision extending the safe harbor for forward-looking statements, a limitation on damages, and the elimination of joint and several liability for violations charged under theories of reckless-

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8 See 15 U.S.C. § 78u-4(b) (Supp. II 1996). Although this change is procedural, it has a disproportionately significant bearing on the substantive rights.
9 See id. §§ 77z-2, 78u-5(c) (1)(A) (i).
10 See id. § 78u-4(e).
ness, negligence, or strict liability in favor of a proportionate liability scheme. As for the procedural changes, the most significant of them involve the already mentioned heightened pleading standards and the complete revision of the rules governing securities class actions. The class action changes include:

(i) A requirement that a class action law firm that is the first to file the complaint carry the burden of providing notice to prospective class members without any assurance of ultimately becoming the lead counsel. (Before the Act, a class action law firm could become class counsel in most cases by being the first to the courthouse.)

(ii) A requirement that the court presume that the shareholder with the largest financial interest in the outcome is the most adequate representative of the class and appoint such shareholder the lead plaintiff. The Act also limits the ability of a party to serve as lead plaintiff to five class actions brought within any three year period and provides that the lead plaintiff can collect only his pro-rata share of recovery.

(iii) A limitation of attorneys’ fees to a reasonable percentage of the class recovery.

(iv) A restriction on the filing of settlements under seal. The Act creates a presumption against filing settlements under seal.

(v) A requirement that notice of the settlement must be given to class members, detailing: (1) the average amount of recoverable damages per share; (2) an explanation of the attorneys’ fees and costs sought; (3) the address and telephone number for class counsel; and (4) the reason for the proposed settlement.

The Act also includes a number of other procedural changes designed to discourage filings of harassing lawsuits and to make it impossible to sustain them.

11 See id. § 78u-4(g).
12 Before the Act, dismissal of a complaint in many courts was difficult to achieve because scienter could be alleged generally. The Act requires that the complaint contain allegations “stat[ing] with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.” Id. § 78u-4(b)(2).
13 See id. §§ 77z-1(3)(B), 78u-4(3)(B).
15 See id. §§ 77z-1(a)(4), 78u-4(a)(4).
16 See id. §§ 77z-1(a)(6), 78u-4(a)(6).
17 See id. §§ 77z-1(a)(5), 78u-4(a)(5).
18 See id. §§ 77z-1(a)(7), 78u-4(a)(7).
19 Among these changes are:

(i) A requirement that the court stay all discovery pending a motion to dismiss except where discovery is necessary to preserve evidence or to prevent undue prejudice...
III. Analysis of the PSLRA Provisions Affecting Class Actions

Because Congress sought, in enacting the PSLRA, to address the problem of frivolous class action lawsuits, it devoted significant attention to the means of eliminating the incentives fueling the abuse and of making it extremely hard to bring meritless securities class actions. Whereas prior to the Act securities class actions, as any other class actions, were governed by Rule 23 of the Federal Rules of Civil Procedure, the Act provides for several additional requirements.

The first group of requirements under the Act affects the determination of the most adequate plaintiff and encourages institutional investors to apply for this position, while the second sets out to empower the class members by providing them with better information from the early inception of the litigation so that they can make informed decisions regarding the action. Even before these provisions take effect, however, plaintiffs have to comply with initial notice and certification requirements of the Act.

A. Certification and Early Notice Requirements: Punishing the Initiative?

1. Introduction

Under the Act, each plaintiff seeking to represent the class shall file along with the complaint a sworn certification that states, in effect, that the plaintiff is not acting at the behest of the counsel, is familiar...
with the subject matter of the complaint, and has authorized initiation
of the action. The statement should state plaintiff’s willingness to
serve as a representative party for the class and a promise that plaintiff
will not accept any payment for serving in that capacity. It should
also contain information about plaintiff’s transactions in the security
that is at issue in the litigation and should identify any action in the
preceding three years where plaintiff sought to serve or served as class
representative. By imposing these restrictions Congress sought to
erect impenetrable barriers for the “professional plaintiffs” and to
take control of the litigation away from the unscrupulous attorneys.
As one court put it, “Congress sought to eliminate figurehead plain-
tiffs who exercise no meaningful supervision of litigation.”

2. Analysis

Under the Act, once the complaint is filed and a certification by
the original plaintiff attached, other investors moving the court to be
appointed lead plaintiffs do not have to file analogous certifications.
The problem with this provision is that it puts the party that files the
complaint at a disadvantage with respect to those who seek appoint-
ment as lead plaintiffs at a later date, especially in light of the limita-
tion on discovery relating to the adequacy of class representation.
By filing first, the plaintiff seeking to represent the class has to make
disclosures that the parties challenging the movant for the same posi-
tion do not have to make. In addition to the certification, the first

24 See id.
25 See id.
(N.D. Cal. July 16, 1997).
ing that extension of the certification requirement to purported class members mov-
ing to become lead plaintiffs would not serve the congressional purpose of
eliminating the use of professional plaintiffs).
29 The Act provides in relevant part:

iv. Discovery. For purposes of this subparagraph, discovery relating to
whether a member or members of the purported plaintiff class is the most
adequate plaintiff may be conducted by a plaintiff only if a plaintiff first dem-
onstrates a reasonable basis for a finding that the presumptively most adequate
plaintiff is incapable of adequately representing the class.
30 Presumably, class members seeking lead plaintiff appointment would make
certain disclosures in order to persuade the court that they are the most adequate for
plaintiff also has to provide initial notice to the members of the purported class about the pendency of the action. Inadequacy of such notice, either substantive (content) or procedural (form, medium of communication, scope, etc.), also might jeopardize the plaintiff’s bid to be appointed class representative.

Moreover, the Act does not specifically provide for a scheme to compensate the expenses associated with filing the complaint on behalf of the class or providing the initial notice to the class. Although the Act’s provision dealing with the plaintiff’s recovery states that “[n]othing in this paragraph shall be construed to limit the award of reasonable costs and expenses (including lost wages) directly relating to the representation of the class to any representative party serving on behalf of the class,” it is unclear whether the courts will allow the party that first filed the lawsuit on behalf of the class to collect under this provision if that party is not later deemed the class representative. In addition, it is unclear whether the sum of money expended by the initial plaintiff on giving notice, that the court ultimately finds inadequate, is a “reasonable” expense.

The issue of compensating the first plaintiff and his or her counsel for their initial services takes on an added dimension in light of the numerous initial complaints in different jurisdictions advancing different recovery theories or class periods but arising out of the same underlying conduct of the defendant. Given the prohibition on the duplication of attorneys’ fees, the first plaintiff (or plaintiffs) could not recover the money expended on drafting the complaint and providing the initial notice. At the time of the initial filing the plaintiff is unaware about how many claims (if any) against the defendant will be filed by other class members. In the face of the substantial expenditures that might not be compensable, the aggrieved persons are thus discouraged from initiating securities class actions.

the job. As Greebel indicates, however, their disclosures do not have to be as extensive as those required of the “initial” plaintiff.

32 See, e.g., Ravens, supra note 27, at *3-4 (“Notice is a prerequisite to designation of a 'most adequate' or lead plaintiff... [Notice defects bar] designation of a lead plaintiff, at least until further proceedings.”); Lax v. First Merchant Acceptance Corp., No. 97-C-2716, 1997 U.S. Dist. LEXIS 12432 (N.D. Ill. Aug. 6, 1997) (involving one group of investors seeking appointment as lead plaintiff that challenged adequacy of the notice provided by another group of investors seeking the same); see also Richard Walker et al., The New Securities Class Action: Federal Obstacles, State Detours, 39 Ariz. L. Rev. 641, 652-53 (1997) (pointing out that “[t]he limited returns suggest that the notice provision does create an obstacle to securing lead plaintiff status by the first plaintiff to file...”).
3. Conclusion

In light of the hazards and expenses associated with being the first one to file, it seems that, as a matter of strategy, a party that contemplates bringing a securities fraud class action might want to delay filing its complaint until after another class member files first. Then, it should file a motion challenging the adequacy of the initial plaintiff and the initial notice and ask to be appointed lead plaintiff. If this party has a significant financial stake in the outcome of the litigation, it may, subject to the availability of other seekers with a substantial interest, have a better chance (and lesser expense) to be appointed lead plaintiff than if it had been the first to file. If the party does not succeed in its bid, it may be able to opt out of the class at a later date to pursue its own action. At least, it would have saved the expense associated with providing initial notice.

This strategy, of course, would benefit only the parties with relatively significant interests. As for the shareholders with small stakes in the outcome that have traditionally supplied professional plaintiffs, the small size of their interest effectively precludes them from utilizing this strategy of filing first, given the costs of drafting the complaint and providing the initial notice and the near-certainty that they will not become lead plaintiffs.

Even though strategic considerations might encourage a party with a substantial interest to delay its filing, the very fact that the party’s interest is significant guarantees that the securities fraud will not go unpunished and that the party will come forward and sue the offender in the absence of other plaintiffs. Since the statute of limitations in securities fraud actions is relatively short, the risk of “losing” important evidence is not very high. Moreover, the party will have

34 See Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350 (1991) (declaring that the statute of limitations for a private securities fraud cause of action is one year from the time of discovery of the fraud and at most three years from the date of the alleged violation).

35 It should be remembered, of course, that the notice provision, 15 U.S.C. §§ 77z-1(a)(3)(A), 78u-4(a)(3)(A) (Supp. II 1996) and the choice of the most adequate plaintiff provision, 15 U.S.C. §§ 77z-1(a)(3)(B), 78u-4(a)(3)(B) (Supp. II 1996), coupled with the delay necessary to dispose of the motion to dismiss, push back the beginning of discovery even further. See, e.g., Sherrie R. Savett, The Merits Matter Most And Observations On A Changing Landscape Under the Private Securities Litigation Reform Act of 1995, 39 Ariz. L. Rev. 525, 531 (1997) (“The court’s decision time on a motion to dismiss is uncertain, but even if a judge decides in one month, it will be a minimum of nine months from the filing of the complaint before discovery can even start.”). Yet, once a lawsuit is filed, “any party to the action with actual notice of the allegations contained in the complaint” has an affirmative duty to preserve evidence “as if [it] were the subject of continuing request for production of documents from
more time to conduct an independent investigation into the merits of the case and to make a better judgment on whether to bring it or not. Additional time also means a better drafted complaint.

Overall, certification and initial notice provisions of the Act serve well the congressional intent of discouraging the race to the courthouse, even though they have a tendency to "punish the initiative." Along with other provisions of the Act, they have played a significant role in curbing the filing of frivolous securities class actions. They may also serve as a valuable base for any future Rule 23 reform.

B. Most Adequate Plaintiff Provisions

1. Introduction

The lead plaintiff provisions of the PSLRA were specifically crafted to address the problems caused by the attorneys initiating and conducting the litigation without much control from the class members. To deal with such abuses, Congress, relying on the proposals expressed by Professors Weiss and Beckerman in a law journal article, provided a scheme designed to give the lead plaintiff, preferably an institutional investor, more incentive to supervise the class counsel's behavior. Weiss and Beckerman believed, and Congress agreed, that institutional investors with large stakes in the outcome of the litiga...
gation would be likely to monitor the attorneys more effectively and would be more articulate in defending the interests of the class vis-à-vis class counsel.\footnote{\textsuperscript{41}}

Insofar as the most adequate plaintiff provisions go beyond the pre-existing lead plaintiff requirements of the Federal Rules of Civil Procedure,\footnote{\textsuperscript{42}} they appear to come in conflict with the established rules and undermine the uniformity of the federal judicial system.\footnote{\textsuperscript{43}} These provisions also have had an unexpected consequence of generating satellite litigation between different plaintiffs vying to become lead plaintiffs.\footnote{\textsuperscript{44}} Judicial interpretation of these provisions has already proven to lack uniformity.

2. Analysis

a. Presumed Adequate Until Proven Guilty

After the complaint accompanied by the certification is filed and the preliminary notice is disseminated to the class members, the Act allows any interested class member to file a motion to be appointed lead plaintiff.\footnote{\textsuperscript{45}} In most of the securities class actions brought after the Act, several plaintiffs have squared off against each other to obtain this sought-after position. Therefore, the first challenge class members have to face comes from within their own midst rather than from the opposing party.\footnote{\textsuperscript{46}} Interestingly enough, the appointment by the court of the most adequate plaintiff does not prejudice defendant’s ability to challenge this appointment during the class certification hearing,\footnote{\textsuperscript{47}} even though the court would have already made a determin-

\footnote{\textsuperscript{42}} See FED. R. CIV. P. 23(a).
\footnote{\textsuperscript{44}} See \textit{SEC, Report to President and Congress on the First Year of Practice Under the Private Securities Litigation Reform Act of 1995}, at 43 (1997).
\footnote{\textsuperscript{46}} Although the defendant is not usually involved in challenging the adequacy or typicality of a potential lead plaintiff at this stage, at least one court has granted a defendant standing to challenge the adequacy of the initial notice to the class, given the importance of such notice to the very maintenance of the class action. See Greebel v. FTP Software, Inc., 939 F. Supp. 57, 60 (D. Mass. 1996).
\footnote{\textsuperscript{47}} See Greebel, 939 F. Supp. at 60 (citing legislative history); see also Gluck v. Cellstar Corp., 976 F. Supp. 542, 545 (N.D. Tex. 1997); Lax v. First Merchants Acceptance Corp., \textit{supra} note 32. Nevertheless a case may be made that because the statute is not dispositive on its face, defensive collateral estoppel should apply on the issue of adequacy of representation.
nation whether the plaintiff satisfies Rule 23(a) requirements.\textsuperscript{48} Potentially, this provision subjects the class representative to the expense of litigating the issue of its adequacy twice—first against other class members vying for the same position, and then against the defendant at the class certification stage. Although this result might be in line with the congressional intent of discouraging frivolous lawsuits by making it less attractive for a person to sue for securities fraud, this double-expense seems inherently unfair and may potentially discourage a number of meritorious claims.

b. Selecting the Most Adequate Plaintiff

The Act mandates that the court considering the appointment of the lead plaintiff presume that the most adequate plaintiff is the person or a group of persons that:

(1) either filed a complaint or filed a motion to be appointed lead plaintiff;
(2) in determination of the court, has the largest financial interest in the outcome of the litigation; and
(3) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure.\textsuperscript{49}

Traditionally, the courts sitting in class actions allow a defendant standing to challenge the adequacy of the lead plaintiff as best available surrogates. See Greebel, 939 F. Supp. at 60 (citing Weiss & Beckerman, supra note 40, at 2101). With other members of the plaintiff's class mounting the challenge, however, the defendant's "services" should no longer be required in this matter. Insofar as a defendant purports to represent the interests of the absent class members when it challenges the lead plaintiff's adequacy, it is in privity of interest with the class members who had already unsuccessfully challenged the lead plaintiff on the same grounds. It is doubtful that the defendant will have better information about the lead plaintiff's adequacy than the other class members who challenged the lead plaintiff's adequacy at an earlier stage. Just like the defendant, the class members challenging the lead plaintiff's adequacy would be able to obtain discovery of the plaintiff relating to the plaintiff's adequacy, pursuant to 15 U.S.C. §§ 77z-1(a)(3)(B)(iv), 78u-4(a)(3)(B)(iv) (Supp. II 1996).

If the lead plaintiff's compliance with Rule 23(a) requirements had been unsuccessfully challenged by other class members, allowing the defendant to challenge the same would only result in judicial waste and would subject the lead plaintiff to additional unnecessary expense. The defendant should be allowed to challenge the lead plaintiff's adequacy only if the issue had not been previously adversely litigated and resolved, or if the discovery reveals new information that puts the plaintiff's adequacy in doubt.


Members of the plaintiff class may attempt to refute the presumption in favor of the plaintiff with the largest financial interest by establishing that such plaintiff "will not fairly and adequately represent the class" or "is subject to unique defenses." If the challenger demonstrates a "reasonable basis" for a finding of the plaintiff's inadequacy, the challenger may obtain discovery of that plaintiff. It is unclear what the threshold for the "reasonable basis" is and whether it will be possible for a party to pass this muster without any discovery at all. The courts will have a lot of leeway in interpreting this provision.

The most adequate plaintiff selected by the court chooses, subject to court's approval, the counsel for the class. So long as there is no duplication of attorneys' services and no increase of the cost to the class, the most adequate plaintiff may select more than one law firm to

52 See id. §§ 77z-1(a)(3)(B)(v), 78u-4(a)(3)(B)(v). At least one court has required the submission of bids from the law firms representing the investors seeking lead plaintiff positions prior to the ruling on who the most adequate plaintiff is. See Raftery v. Mercury Fin. Co. (In re Mercury Fin. Co. Litigation), No. 97-C-624, 1997 U.S. Dist. LEXIS 12439 (N.D. Ill. Aug. 7, 1997). The court indicated that the proposed class counsel's compensation should figure as one of the variables in the formula for determining most adequate plaintiff and may be an important enough factor to rebut the statutory presumption of adequacy. See id. at *10.

Although the court's concern with the class's well-being is highly commendable, its ruling is in conflict with the plain language of the statute. The Act presupposes that court's appointment of lead plaintiff precedes the choice of the law firm to represent the class. To allow the court to consider potential compensation of the counsel as a factor in determining who the most adequate plaintiff is would leave the provision of the Act that allows the most adequate plaintiff to select class counsel, subject to court's approval, a mere surplusage. The court would have already given the approval to class counsel at the time of selecting most adequate plaintiff.

The goal of the Raftery court may be served, however, at a later date when the most adequate plaintiff presents its choice of class counsel to the court. When a class member submits a motion for appointment of class counsel contemporaneously with the motion to be appointed lead plaintiff, there is nothing in the Act to prevent the court from appointing that investor most adequate plaintiff while at the same time denying its motion for appointment of the counsel. Moreover, attorneys' fees and expenses are subject to the court's approval anyway pursuant to 15 U.S.C. §§ 77z-1(a)(6), 78u-4(a)(6) (Supp. II 1996).
serve as co-lead counsel. Most courts also allow several investors or groups of investors to be appointed co-lead plaintiffs.

The PSLRA does not specify how the court should determine who has the largest financial interest in the outcome of the litigation. The four factors suggested by the Northern District of Illinois in Lax v. First Merchant Acceptance Corp. are definitely relevant. They include: (1) the number of shares purchased; (2) the number of net shares purchased; (3) the total net funds expended by the plaintiffs during the class period; and (4) the approximate losses suffered by the plaintiff. Other factors might include: (1) the volume of plaintiff's trade in defendant's securities during the class period; (2) current level of plaintiff's interest in the company; and (3) percentage of plaintiff's investment in the security relative to the plaintiff's overall wealth.

c. Five Strikes and You're Out: Bar on Professional Plaintiffs

The Act also creates a bar for any person to serve as the lead plaintiff in more than five securities class actions within any three-year period, except as the court may otherwise permit. It is unclear whether this provision of the Act can be applied retroactively to pre-

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This approach seems to be in conflict with the text of the Act, though, as PSLRA clearly contemplates appointment of a person or a group of persons as the most adequate plaintiff. 15 U.S.C. §§ 77z-1(a)(3)(B)(iii)(I), 78u-4(a)(3)(B)(iii) (Supp. II 1996).


56 See id. at *17.

57 This factor is subjective and concentrates on the projected loss an investor stands to suffer as a result of the fraud in relation to the investor's (individual or institution) overall net worth. After all, the party that stands to lose the most as a result of the fraud will represent the interests of the class (and itself) more vigorously than a plaintiff that stands to lose only a negligible portion of its overall investments.

Act conduct. If not, pre-December 22, 1995 involvement in securities class actions as lead plaintiff should not jeopardize one’s chances under the Act and the information regarding the pre-Act conduct need not appear on the certification filed contemporaneously with the complaint due to its irrelevance.

Moreover, prohibition to serve as the most adequate plaintiff does not necessarily preclude one from initiating a lawsuit. Although Congress intended the exception to the “five times in three years” rule to apply only to institutional investors, this intention is not sufficiently “anchored” in the statutory text and thus it is possible that courts might apply it to individual plaintiffs under certain limited circumstances. For example, where the only person to file the complaint is someone who has already served as lead plaintiff in five securities class actions over the period of three years and nobody else moves the court to be appointed lead plaintiff, the court’s refusal to award lead plaintiff position to the only filer would raise serious due process questions. However, such a situation is not very likely to arise in practice.

3. Conclusion

Although the PSLRA has been successful in eliminating the race to the courthouse, it is unclear whether its lead plaintiff provisions can claim much credit for this result. Other PSLRA clauses, particularly the early certification, bar on discovery, and limitation attorney’s fees provisions might be equally responsible for such an outcome. On the other hand, the lead plaintiff provisions contain too many uncertainties and interpretive challenges, and have already caused unnecessary delays. Moreover, considering the specifics of the securities


61 See John C. Coffee, Jr., The Future of the Private Securities Litigation Reform Act: Or, Why The Fat Lady Has Not Yet Sung, 51 Bus. Law. 975, 975–76 (1996) (“The Supreme Court has shown . . . that it will pay little attention to statements in legislative history that are not ‘anchored’ to some provision in the statutory text.”) (citing Shannon v. United States, 512 U.S. 573, 583 (1994)).

62 See Savett, supra note 35; see also supra note 37 and accompanying text.

63 See SECURITIES AND EXCHANGE COMMISSION, supra note 44.
class actions, the value of the PSLRA lead plaintiff provisions to the reform of the national class action scheme is limited. Under such circumstances, these provisions should not be used as a model for future reform.

C. Knowledge Is Power: Disclosure of the Settlement to Class Members

1. Introduction

Prior to the Act, the terms of the settlement reached by the class counsel often did not reach class members at all or reached them in a very curtailed form. Consequently, the class members lacked meaningful information to evaluate the settlement and to decide whether to approve it, oppose it, or opt out of it altogether. Without sufficient information to form a judgment about the merits of the settlement, few members of the class objected to the settlement terms. This system ensured that class counsel had a free hand in deciding when and under what conditions to settle. The courts routinely approved such settlements on the principle that "a bad settlement is almost always better than a good trial." To redress this problem, Congress has imposed a number of limitations, including a restriction on filing the settlements under seal, a requirement that a detailed settlement notice be provided to the class, and a provision encouraging the courts to exercise stricter scrutiny in evaluating the award of attorney's fees under the settlement terms.

2. Analysis

a. Limiting Parties' Ability to File Settlements Under Seal

Under the Act, a sealed settlement may be filed only if the court allows it pursuant to a motion by a party. The movant has the burden of demonstrating good cause for non-disclosure. Under the PSLRA, in order to establish "good cause" a party has to prove that it would suffer "direct and substantial harm" if the settlement terms or certain provisions thereof are published. As the language of the Act indicates, the sitting judge will have broad discretion in deciding whether

64 See Phillips & Miller, supra note 60, at 1050; Walker et al., supra note 32, at 645.
65 See Phillips & Miller, supra note 60, at 1050.
68 See id. §§ 77z-1(a)(7), 78u-4(a)(7).
69 See id. §§ 77z-1(a)(6), 78u-4(a)(6).
70 See id. §§ 77z-1(a)(5), 78u-4(a)(5).
to grant the motion, grant it in part while denying the rest, or deny it altogether. The Act does not specify how the court is to measure whether the potential harm is "direct" or "substantial." It is also unclear whether the court can balance potential harm to a party against the potential harm to the class that would inevitably result from the lack of information about the settlement, or whether the inquiry should stop at the showing of harm to a party.

b. Detailed Settlement Notice to the Class

Under the Act, members of the class have to be provided with the settlement terms, including the amount of the settlement recovery in the aggregate and on a per share basis, the statement of the potential outcome of the case, the amount of fees and costs sought by class counsel, identification of the lawyers' representatives who can answer any questions related to the settlement terms, a brief statement explaining why the parties are proposing the settlement, and such other information as may be required by the court. When empowered by the information contained in the settlement notice, class members will be in a much better position to make an informed decision as to whether to oppose the settlement or a certain provision thereof.

c. Approving the Settlement

Absent any objection from the class members, the court is very likely to approve the settlement on the same considerations as before the Act. Probably even more so now since the settlement notice disclosures ensure the class members' awareness and reduce the pressure on the judge to act as a watchdog for the interests of the absent class members. The court, of course, still has the discretion to reject or modify the settlement.

At least some of the provisions of the settlement agreement, those dealing with the payment of attorneys' fees and costs, are likely to receive even more judicial scrutiny under the Act than before. The Act limits attorneys' fees and costs to "a reasonable percentage of any

71 Id.
72 See id. §§ 77z-1(a)(7)(A), 78u-4(a)(7)(A).
73 See id. §§ 77z-1(a)(7)(B), 78u-4(a)(7)(B).
74 See id. §§ 77z-1(a)(7)(C), 78u-4(a)(7)(C).
75 See id. §§ 77z-1(a)(7)(D), 78u-4(a)(7)(D).
76 See id. §§ 77z-1(a)(7)(E), 78u-4(a)(7)(E).
77 See id. §§ 77z-1(a)(7)(F), 78u-4(a)(7)(F).
78 See supra note 64 and accompanying text.
damages and prejudgement interest actually paid to the class." It is conceivable, then, that during a fairness hearing a judge, even in the absence of any objection from the class members, may modify attorneys' fees provisions of the settlement.

The PSLRA provides no guidance as to what constitutes a "reasonable percentage" of the damages and what is meant under the phrase "actually paid" to the class. For example, how should a court deal with the settlements that bestow non-pecuniary benefits on the class members? Would the court have to deny any compensation to the plaintiff's law firm where the class members recover very small or no monetary damages? This interpretation appears manifestly unfair and puts pressure on the attorneys to press for monetary damages in the settlement negotiations at the expense of other alternatives potentially beneficial to the class. If so construed, this provision invites violations of the ethical rules governing our profession.

3. Conclusion

Overall, the settlement provisions of the PSLRA are well designed to serve the goal of providing more information to class members and to terminate abuses by the plaintiff's law firms. They constitute a significant improvement over the rules presently governing other kinds of class actions. If the practical experience justifies the high expectations of Congress regarding these provisions, legislators should seriously consider expanding their application to all other class actions brought under the Federal Rules of Civil Procedure.

IV. Conclusion

The Private Securities Litigation Reform Act of 1995 has brought significant changes to securities class actions. It has already succeeded in terminating the race to the courthouse and in encouraging sophisticated investors to volunteer to serve as lead plaintiffs. At the...
same time, it has brought new interpretive and practical challenges to the courts, not the least of which is finding the balance between the presumption in favor of uniformity in the federal judicial system and the unique procedural rules applicable exclusively to the class actions brought under the federal securities laws. How the courts deal with these challenges remains to be seen.

Legislators should keep an eye on the judicial interpretations of the Act and on the impact the Act's procedural changes have upon the development of the securities class actions. Congress (or the Supreme Court) should move with all deliberate speed to incorporate provisions of the Act that prove useful and beneficial into the Federal Rules in order to ensure "just, speedy, and inexpensive" resolution of controversies\(^\text{85}\) and to bring all federal class actions back into uniformity. Hopefully, the PSLRA is only a pilot program that will help to make the whole of the class action scheme of the Federal Rules more efficient. While far from being perfect, it is a bold and innovative attempt at reform and should be applauded as such. Currently, the ball is in the courts' hands, and they will have a decisive voice in determining whether the PSLRA proves to be a success or a failure.

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\(^{85}\) See Fed. R. CIV. P. 1.

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