

## NOTE

### SHOULD WE USE A CLASS ACTION'S IMPACT ON STOCK PRICE TO GAUGE THE REASONABLENESS OF CLASS COUNSEL'S FEE?

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*If a deterrence rationale fuels the engine that is class action litigation, then its principles should inform our efforts to cure the imperfections in class counsel compensation schemes. Class action defendants are deterred from wrongdoing when it becomes economically unwise to act as such. For publicly-traded companies, the economic prudence of their conduct depends on shareholder perception. Class actions are bad news for shareholders of the named defendant public company. In response, the market reacts, a company's share price decreases, and a message is sent to the company about the imprudence of its conduct. A question then arises: should we use the magnitude of a class action's impact on stock price as a gauge in measuring the reasonableness of class counsel's fee? In theory, the greater the impact, the worse the market thinks of the defendant company's actions, and the more the company will suffer—thereby deterring it from similar future wrongdoing. Class counsel's efforts in litigating a greater-impact claim merit a more substantial award than those litigating lesser-impact claims. Further, a court could theoretically ferret out non-meritorious claims from worthy claims by looking at their impact on stock price; class counsel bringing bogus claims—a real problem in the world of class actions—warrant little-to-no reward in a deterrence-based framework. However compelling this idea may be in the abstract, does it hold up in our practical world? The answer is not so clear.*

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\* Columbia University, B.A. Mathematics, 2013; Cornell Law School, J.D., 2018. All my success stems from the unconditional love and support of my family—Ken, Grace, Lindsey and Dan. Much gratitude to Professor Shay Lavie for pointing me in the direction of using a class action's impact on stock price as an index. Many thanks to the editors and associates of the *Cornell Journal of Law and Public Policy* for their tireless efforts preparing this Note for publication. And to Sue Pado, the queen of all Cornell Law journals—I will forever treasure our friendship. Lastly, I would not have been able to write this Note without inspiration from each member of the Cornell Law School Class of 2018—you all have me excited for what comes next.

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## INTRODUCTION

Are class action plaintiffs' attorneys paid too much?<sup>1</sup> First impression suggests overcompensation; there *is* a greater than de minimis frequency in the filing and settlement of meritless class action suits.<sup>2</sup> Savvy attorney observers can even earn a living in the "cottage industry" of objecting to the settlement of such cases.<sup>3</sup> But the complete opposite view is likewise tenable: maybe they are paid too little?<sup>4</sup> Indeed, well-

<sup>1</sup> *E.g.*, Daniel Capra, *Third Circuit Task Force Report on Selection of Class Counsel*, 74 TEMP. L. REV. 685, 692 (2002); *Lafitte v. Robert Half International*, 376 P.3d 672, 692 (2016) ("[T]here is a perception among a significant part of the non-lawyer population and even among lawyers and judges . . . that class action plaintiffs' lawyers are overcompensated for the work that they do.").

<sup>2</sup> *See, e.g.*, *In re Subway Footlong Sandwich Marketing and Sales Practices Litig.*, 869 F.3d 551, 556–57 (7th Cir. 2017) (denying a settlement in a class action where members complained that Subway footlong sandwiches are not, in fact, a foot long but instead eleven inches in length).

<sup>3</sup> John E. Lopatka & D. Brooks Smith, *Class Action Professional Objectors: What To Do About Them?*, 39 FLA. ST. L. REV. 865, 865–66 (2012). Ted Frank is perhaps the most famous "professional objector." Daniel Fisher, *A Lawyer Who Tries to Block Settlements*, FORBES (Sept. 21, 2009, 12:00 AM), <https://www.forbes.com/forbes/2009/0921/outfront-tort-consumers-lawyer-tries-to-block-settlements.html#4cb146d25e47>. Professional objectors fashion themselves as Robin Hood-type figures, stealing the proposed award from the rich plaintiff attorney and redistributing it to the class member poor. That many of these objections seem to lack merit only serves to compound the trouble surrounding attorneys' fees in class actions. *Cf. Devlin v. Scardelletti*, 536 U.S. 1, 21–22 (2002) (Scalia, J., dissenting).

<sup>4</sup> Alison Frankel, *In Biggest Cases, Class Action Lawyers Are Low-balling Fee Requests – and That's a Good Thing*, REUTERS (Nov. 1, 2016, 5:56 PM), <https://www.reuters.com/article/us-onthecase-fees/in-biggest-cases-class-action-lawyers-are-low-balling-fee-requests-and-thats-a-good-thing-idUSKCN12W542> (acknowledging lower class ac-

reasoned studies suggest that class action plaintiffs' attorneys make too little.<sup>5</sup> This Goldilocks-esque uncertainty between too-much and too-little should not paralyze the legal community, for those with the ability to effect change are getting restless.<sup>6</sup> Northern District of California Judge Lucy Koh stated in response to one class counsel's recent fee request: "I would never have appointed you . . . had I known."<sup>7</sup> To better understand class counsel's fee, we need to experiment with different measures to gauge its reasonableness.

Accuracy may not be the first characteristic to come to mind when considering a public company's share price. Despite many well-established theories demonstrating the stock market's accuracy, our understanding undeniably has room for improvement.<sup>8</sup> Nevertheless, the stock market regularly influences the legal landscape, both in economic effect<sup>9</sup> and doctrine.<sup>10</sup> For example, defendant share prices suffered losses of \$120 billion in the aggregate annually between 1997 and 2016 in class actions sounding in securities fraud, with 2017 alone finishing with an annual loss of \$131 billion.<sup>11</sup> This inextricable link should be further utilized to inform how we understand attorneys' fees.

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tion attorney fee amounts, while also arguing that this is a preferable result to "super-mega-fund" settlements).

<sup>5</sup> Brian T. Fitzpatrick, *Do Class Action Lawyers Make Too Little?*, 158 U. PA. L. REV. 2043, 2044 (2010) ("[C]lass actions lawyers not only do not make too much, but actually make too little.").

<sup>6</sup> See Alison Frankel, *DOJ Signals New Interest in Policing Class Action Settlements*, REUTERS (Feb. 20, 2018, 2:29 PM), <https://www.reuters.com/article/legal-us-otc-doj/doj-signals-new-interest-in-policing-class-action-settlements-idUSKCN1G42NI>.

<sup>7</sup> Amanda Bronstad, *Judge Hires Special Master to Vet Attorney Bills in Anthem Settlement*, RECORDER (Feb. 1, 2018, 9:42 PM), [https://www.law.com/therecorder/sites/therecorder/2018/02/01/judge-hires-special-master-to-vet-attorney-bills-in-anthem-settlement/?cmp=share\\_twitter](https://www.law.com/therecorder/sites/therecorder/2018/02/01/judge-hires-special-master-to-vet-attorney-bills-in-anthem-settlement/?cmp=share_twitter) ("Koh . . . went over the records one by one, questioning why of the 329 lawyers who submitted bills in the case, more than 100 were partners, and more than two dozen were contract attorneys charging \$300 to \$400 per hour.").

<sup>8</sup> And good reasons to do so. See generally Kevin Haeberle, *Stock-Market Law and the Accuracy of Public Companies' Stock Prices*, 2015 COLUM. BUS. L. REV. 121 (2015).

<sup>9</sup> Between 2008 and 2017, the filing of securities class actions resulted in an average annual loss of \$249 billion for investors. Stefan Boettrich & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2017 Full-Year Review*, NERA Economic Consulting 1, 12 (2018), [http://www.nera.com/content/dam/nera/publications/2017/PUB\\_2016\\_Securities\\_Year-End\\_Trends\\_Report\\_0117.pdf](http://www.nera.com/content/dam/nera/publications/2017/PUB_2016_Securities_Year-End_Trends_Report_0117.pdf).

<sup>10</sup> See, e.g., *Halliburton Co. v. Erica P. John Fund, Inc. (Halliburton II)*, 134 S. Ct. 2398 (2014); see also Victor E. Schwartz & Christopher E. Appel, *Rebutting the Fraud on the Market Presumption in Securities Fraud Class Actions: Halliburton II Opens the Door*, 5 MICH. BUS. & ENTREPRENEURIAL L. REV. 33 (2015).

<sup>11</sup> *Securities Class Action Filings: 2017 Year in Review*, CORNERSTONE RES. 1, 39 (2018), <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2017-YIR> [hereinafter *2017 Year in Review*].

Defendant companies hate class actions.<sup>12</sup> Professor Charles Silver succinctly explains why: “By aggregating hundreds, thousands, or even millions of claims, the class action can make small claims viable and empower claimants in other ways.”<sup>13</sup> Even with aggregation, however, small claims translate to small recoveries for each class member, and many never collect on their winnings.<sup>14</sup> Claimants, despite empowerment, do not generally benefit monetarily to any appreciable extent.<sup>15</sup> A deterrence rationale instead better reflects the driving force behind class actions and their relief.<sup>16</sup> For example, novel methods of class relief, such as *cy pres* and fluid class recovery,<sup>17</sup> have grown in popularity and are primarily deterrence based.<sup>18</sup> Defendant companies are deterred

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<sup>12</sup> Norton Rose Fulbright, *2017 Litigation Trends Annual Survey* 1, 26, 29–30 (2017) (“Regulatory investigations, class actions and environmental disputes lead to far higher degree of concern relative to the volumes affecting organizations.”).

<sup>13</sup> Charles Silver, “*We’re Scared to Death*”: *Class Certification and Blackmail*, 78 N.Y.U. L. REV. 1357, 1360–85, 1429 (2003); see JOHN C. COFFEE, JR., HILLARY A. SALE & M. TODD HENDERSON, *SECURITIES REGULATION: CASES AND MATERIALS* 924–26, 925 n.10 (Robert C. Clark et al. eds., 13th ed. 2015).

<sup>14</sup> See *Sullivan v. DB Investments, Inc.*, 667 F.3d 273 (3rd Cir. 2011) (remarking that, in class actions requiring members to fill out a claims form to obtain their winnings, “filing rates rarely exceed seven percent, even with the most extensive notice campaigns.” (quotation marks omitted)); Mayer Brown LLP, *Do Class Actions Benefit Class Members?* 20–21 (2013), <http://www.instituteforlegalreform.com/uploads/sites/1/Class-Action-Study.pdf> (collecting cases where few payouts to class members were made).

<sup>15</sup> E.g., *Saska v. The Metropolitan Museum of Art*, 975 N.Y.S.2d 605, 617 (N.Y. App. Div., 2013); Jennifer Smith, *Met Makes It Clear, Visitors Don’t Have to Pay*, WALL ST. J., Feb. 27, 2016, at A15 (describing a class action settlement in which the Metropolitan Museum of Art agreed to replace the phrase “recommended price” with “suggested price” at the entrance as a result of the former phrase deceiving visitors into paying \$25 to enter). The Met has since changed its admission policy, imposing a \$25 fee on all nonresidents of New York State. Robin Pogrebin, *Goodbye, Pay-as-You-Wish*, N.Y. TIMES, Mar. 2, 2018, at C13. Explaining why the Met made this change, President and CEO Daniel Weiss said, “[P]eople [now] assume that the Met is free when, in fact, it depends on the support of its visitors to open its doors every day.” *Id.*

<sup>16</sup> See Linda S. Mullenix, *Ending Class Actions as We Know Them: Rethinking the American Class Action*, 64 EMORY L.J. 399, 418–23 (2014); *infra* subpart III.B.

<sup>17</sup> “*Cy pres* has generally referred to an effort to provide unclaimed compensatory funds to a charitable interest that is in some way related to either the subject of the case or the interests of the victims, broadly defined. In contrast, ‘fluid class recovery,’ . . . refers to efforts to fashion relief to those who will be impacted by the defendant in the future, in an effort to roughly approximate the category of those who were injured in the past.” Martin H. Redish, Peter Julian & Samantha Zyontz, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 FLA. L. REV. 617, 620 (2010).

The propriety of such relief is currently before the Supreme Court. *Frank v. Gaos*, No. 17-961 (2018); see also *Marek v. Lane*, 134 S. Ct. 8 (Mem) (2013) (denying certiorari but questioning the use of *cy pres* settlements). At the time of this Note’s publication, the Supreme Court had held oral argument in *Frank v. Gaos* but had not yet issued a written decision.

<sup>18</sup> Rhonda Wasserman, *Cy Pres in Class Action Settlements*, S. CAL. L. REV. 97, 117 & n.90 (2014) (“By ensuring that the defendant pays the full amount of the settlement . . . , *cy pres* distributions advance the deterrence and disgorgement objective of the law underlying class claims.”).

when they are hit hard where it hurts, right in the stock price.<sup>19</sup> It may be possible, in the abstract to “grade” a class counsel’s work by how much her efforts hurt the defendant.<sup>20</sup> Assessing the quality of her work informs the reasonableness of her fee. Putting this all together, we can gauge the reasonableness of a fee by how much the class action impacts the defendant’s stock price.

In Part I, this Note begins with the amenability of Congress and the federal courts to creative class action solutions. Legal academia has introduced many attractive options, including the *ex ante* and *ex post* auction procedures. These alterations address the attorney fee quandary, though the quandary may not be their primary focus. Part II discusses the traditional attorneys fee schemes in the class action context. It also tracks the court’s inquiry into counsel’s fee as applied to the creative solutions mentioned previously. Part III sets forth the theoretical foundation upon which to pair the impact on a defendant’s stock price to a class counsel’s compensation. It then proceeds to examine the deterrence policy driving such analysis, specifically with regard to the Rules of Professional Conduct. Next, it explores the empirical studies demonstrating a link between class actions and defendant stock prices. Along the way, several unforeseen questions arise and are dispensed with. This Note continues by fleshing out some implications of linking attorneys’ fees to share price impact. Part III ends with a guide as to how the legal com-

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<sup>19</sup> *But see* LYNN STOUT, THE SHAREHOLDER VALUE MYTH 19 (2012) (“[T]he idea that corporate performance could be simply and easily measured through the single metric of share price invited a generation of economist and business school professors to produce countless statistical studies of the relationship between stock price and [other] variables . . . in a grail-like quest to discover the secret of ‘optimal corporate governance.’”). I do not however, read my proposal to conflict in any significant way with the late Professor Lynn Stout’s work. She wrote against “a single-minded focus on [maximizing] share price,” *id.* at 3, which is compatible with the idea that decreases in share price tracing to adverse class actions is something companies want to avoid, *contra id.* at 31, 39 (“[W]hen the value of the shareholders’ interests decreases, this must mean the value of the company has declined. The idea is elegant, appealing—and wrong.”).

But even if I am incorrect with my reading, I interpret the late Professor Stout to admit that while share price should not be the “guiding star,” there is undoubtedly a “common assumption that anything that raises the share price of a particular company at a particular time necessarily serves investor welfare.” *Id.* at 65, 112. It follows logically that the common assumption carries with it a corollary: corporate governance assumes that anything that decreases share price harms investor welfare. That is, regardless of whether they should or should not be, the boards of directors in charge of companies look to share price and are affected by decreases thereof. Hence why corporations tie executive and director pay to stock options. *Id.* at 111. So boards of directors have every incentive to steer clear of events that will result in a stock price decrease. This is all the deterrence rationale requires. *See infra* subpart III.B.

<sup>20</sup> That a class action plaintiff’s attorneys work can be compared and that many themselves think they can do better than each other—i.e., earn a higher settlement amount on the same claim—informs auction proposals found sporadically in class litigation. *Cf.* Jay Tidmarsh, *Auctioning Class Settlements*, 56 WM. & MARY L. REV. 227, 260–62 (2014).

munity could continue to develop the ideas presented here and notes some eyebrow-raising aspects that the data supports. This Note concludes by suggesting that while the practice of indexing defendant stock price hits against the reasonableness of attorneys' fees may not be the best solution, the nuances of the market offer an untapped resource that we can look to when gauging the reasonableness of attorneys' fees.

## I. THE CREATIVE CLASS ACTION

In legal academia, a growing literature proposes fresh solutions to stale problems.<sup>21</sup> Class actions demonstrate the success of this trend. Indeed, Congress and some courts have experimented with class actions by applying novel methods proposed in academic literature.<sup>22</sup>

Some innovations are so successful that they have been implemented via statute. The Private Securities Litigation Reform Act of 1995 (PSLRA)<sup>23</sup> is the gold standard. Professors Elliot J. Weiss and John S. Beckerman's influential 1995 Yale Law Journal article guided Congress in the creation of this statute's "most adequate plaintiff" provision.<sup>24</sup> The PSLRA requires the court to choose, as lead plaintiff in a class, the "member or members . . . most capable of adequately representing the interests of class members," as determined by having the "largest financial interest in the relief sought by the class."<sup>25</sup> This plaintiff then "select[s] and retain[s] counsel to represent the class."<sup>26</sup> The thrust being that large-stake institutional investors will retain counsel they have a relationship with, which makes it less likely an unreasonable fee will be charged.<sup>27</sup> Nevertheless—and perhaps to remind courts and parties of the ultimate goal when examining attorneys' fees—Congress built in the

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<sup>21</sup> "How to determine the exact amount [of an attorney's fee] has often been more art than science." Amanda Bronstad, *Judges Look to Profs in Awarding Lower Percentage Fees in Biggest Class Actions*, 258 N.Y. L.J. (Sept. 12, 2017, 6:02 PM), <https://www.law.com/nationallawjournal/almID/1202797733982/?slreturn=20171113130418>.

<sup>22</sup> *E.g.*, *In re Auction Houses Antitrust Litig.*, 197 F.R.D. 71, 74 n.10 (S.D.N.Y. 2000) (using an auction process to select class counsel in a case serendipitously involving Sotheby's and Christie's auction houses).

<sup>23</sup> 15 U.S.C. § 78u-4(a)(3)(B)(v) (2012) ("The most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class.").

<sup>24</sup> Comm. on Banking, Housing, and Urban Affairs, S. 240, 104th Congress, Report 104-98 (June 19, 1995), at 11 n.32. See generally RICHARD A. NAGAREDA, *THE LAW OF CLASS ACTIONS AND OTHER AGGREGATE LITIGATION* 324–25 (2009) (noting that the PSLRA "adequate plaintiff" innovation "stems from an influential law review article: Elliott 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 (1995)").

<sup>25</sup> 15 U.S.C. § 78u-4(a)(3)(B)(i), (iii)(I)(bb) (2018).

<sup>26</sup> *Id.* § 78u-4(a)(3)(B)(v).

<sup>27</sup> Weiss & Beckerman, *supra* note 24, at 2105–08; see also Comm. on Banking, Housing, and Urban Affairs, S. 240, 104th Congress, Report 104-98 (June 19, 1995), at 11 (citing Weiss and Beckerman).

reasonable fee requirement that tracks the corresponding Rule of Professional Conduct.<sup>28</sup>

Other experiments were not so warmly welcomed. Consider the auctioning off of a class. There are two notable auction processes: *ex ante* and *ex post*, each coming with two variations.

#### A. Ex Ante Auctions

The first auction process is an *ex ante* procedure to select and compensate lead counsel.<sup>29</sup> As if in a reverse-bidding auction, law firms submit proposed bids of fee structures which the court considers alongside the bidder's qualifications to choose lead counsel.<sup>30</sup> In theory the court's analysis of competing fee schemes "help[s] to ensure that the bid selected [is] not unreasonably high."<sup>31</sup> For example, Judge Lewis Kaplan employed an auction in *In re Auction Houses Antitrust Litigation*, relying on the "efficient market"<sup>32</sup> surrounding the auction to ensure just compensation.<sup>33</sup> The number of bidding attorneys, the publicity surrounding the government investigation of the defendants, and the monetary nature of the relief requested gave rise to this efficient market.<sup>34</sup> Shortly after its genesis, this method received a warm reception from several federal

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<sup>28</sup> Compare 15 U.S.C. § 78u-4(a)(6) ("Total attorneys' fees and expenses awarded by the court to counsel for the plaintiff class shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class."), with MODEL RULES OF PROF'L CONDUCT r. 1.5(a) (AM. BAR ASS'N 2018) ("A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses.").

<sup>29</sup> See *In re Oracle Securities Litig.*, 131 F.R.D. 688 (N.D. Cal.), modified 132 F.R.D. 538 (N.D. Cal. 1990), for the first usage of this type of auction process. See generally *In re Auction Houses Litig.*, 197 F.R.D. at 78–80 (detailing the history of this auction method).

<sup>30</sup> *In re Auction Houses Litig.*, 197 F.R.D. at 73.

<sup>31</sup> *Id.* at 85.

<sup>32</sup> *Id.* at 82–83. "When someone refers to efficient . . . markets, they mean that [market] prices fully reflect all available information." EDWIN J. ELTON, MARTIN J. GRUBER, STEPHEN J. BROWN & WILLIAM N. GOETZMANN, MODERN PORTFOLIO THEORY AND INVESTMENT ANALYSIS 398 (2009) (emphasis omitted).

<sup>33</sup> The creation of an auction market helps to provide "some assurance that the class's claims are settled at market value" through "a real-world test of the value of class settlements." Tidmarsh, *supra* note 20, at 262–64. There is no guarantee that the "market value" of a case correlates with the true amount of victim compensation. This concern is not unique to auctions; "coupon settlements" offer next to no compensation to the class yet a monetary loss to defendants. Cf., e.g., Wasserman, *supra* note 18, at 136–38; Anna St. John, *Coupon Settlements: Two Steps Forward, One Step Back*, COMPETITIVE ENTERPRISE INST. (Sept. 27, 2017), <https://cei.org/blog/coupon-settlements-two-steps-forward-one-step-back>; *infra* note 67.

<sup>34</sup> *In re Auction Houses Litig.*, 197 F.R.D. at 82–83.

courts across the nation.<sup>35</sup> However, it has grown disfavored with time.<sup>36</sup>

Other *ex ante* auction methods award the entire case instead of solely the representation rights.<sup>37</sup> That is, the victims of the underlying suit “sell” their claims to the highest bidding law firm. This approach grew out of an attempt to fix the incentive misalignment where percentage-of-the-recovery fee schemes are used in class litigation.<sup>38</sup> In percentage-of-the-fee schemes, attorneys will settle a claim only if the reward is higher than the cost imposed. Yet the class ideally wants as large a recovery as possible. Due to diminishing returns, each additional dollar of cost may not add an additional dollar to the recovery pot, especially as the pot grows larger and larger. Increasing the percentage reward permits a firm to take on more costs—growing the recovery pot—and still make a profit. But note that as the attorney’s percentage increases, the client’s recovery eventually decreases. To ensure clients obtain the highest recovery possible and claims are settled at their true worth, Professors Jonathan Macey and Geoffrey Miller proposed giving attorneys 100% of the recovery.<sup>39</sup> In exchange, bidding attorneys would compete in an auction prior to the litigation beginning in earnest, and the proceeds of the auction would go to the class. This eliminates the class action attorney-client agency problems,<sup>40</sup> as the “client” exits the suit almost immediately.<sup>41</sup> Once the claim belongs to the winning attorney, there is no need to examine the reasonableness of the fee, as there is no longer a distinction between the attorney and the client.<sup>42</sup> However, this type of auction has remained a thought experiment, perhaps in part due to the Model Rules of Professional Conduct.<sup>43</sup>

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<sup>35</sup> *E.g.*, *In re Amino Acid Lysine Antitrust Litig.*, 918 F. Supp. 1190 (N.D. Ill. 1996); *In re Network Assocs., Sec. Litig.*, 76 F. Supp. 2d 1017 (N.D. Cal. 1999); *Sherleigh Assocs. v. Windmere-Durable Holdings, Inc.*, 184 F.R.D. 688 (S.D. Fla. 1999). *But see infra* note 54.

<sup>36</sup> *Cf. In re Cendant Corp. Litig.*, 264 F.3d 201, 273–77 (3d Cir. 2001) (killing off *ex ante* auctions; its ripples felt even in jurisdictions where the opinion is not binding).

<sup>37</sup> 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, 106–08 (1991).

<sup>38</sup> *See infra* Part II.

<sup>39</sup> Macey & Miller, *supra* note 37, at 106–08.

<sup>40</sup> *See generally* James D. Cox & Randall S. Thomas, *Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587 (2006). The open secret is that class plaintiffs are loath to evaluate their lawyer’s efforts. Monitoring costs and lack of sophistication impose significant obstacles. *Id.* at 1607–08.

<sup>41</sup> Macey & Miller, *supra* note 37, at 105–10.

<sup>42</sup> *Id.* at 108–09.

<sup>43</sup> *See id.* 85–86 (noting that such an auction method replaces the fee examination problem with an ethical conundrum with Model Rule of Professional Responsibility 1.8(e)). Rule 1.8(e) bars lawyers from giving financial assistance, with certain exceptions, to their clients. MODEL RULES OF PROF’L CONDUCT r. 1.8(e) (AM. BAR ASS’N 2016). Because the clients would be paid at the outset, before the merits of the claims are tested in court, the proceeds of

### B. Ex Post Auctions

The second type of auction is *ex post*, whereby an attorney—acting through a class member—bids to obtain lead counsel rights after the former lead counsel reaches a settlement agreement.<sup>44</sup> The idea is that the bidding-attorney would consider the settlement inadequate in relation to the strength of the claim and can therefore win a larger settlement for the class.<sup>45</sup> If successful, the court would award the new lead counsel and class members accordingly.<sup>46</sup> This method does not speak to any adjustment to attorney fee reasonability determinations.<sup>47</sup> Instead, in this situation, both the deposed and usurping attorney are to be compensated with either the lodestar or the percentage-of-the-recovery methods.<sup>48</sup>

Alternative *ex post* auction methods do adjust the compensation scheme, at least for one of the attorneys involved. Professor Jay Tidmarsh proposed that the usurping attorney should win the ability to be compensated via normal methods.<sup>49</sup> The difference is that the deposed attorney should instead obtain only the quantum meruit value based on the original settlement amount, which is posted in bond by the winning attorney.<sup>50</sup> It remains to be seen whether the calculation of either attorney's fee under this method alters the reasonableness analysis. For the winning attorney, the approach offers nothing new on this point. And

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this auction may be construed as “financial assistance” over other alternatives. The ABA justifies its rule by saying “to do so would encourage clients to pursue lawsuits that might not otherwise be brought and because such assistance gives lawyers too great a financial stake in the litigation.” *Id.* at r. 1.8 cmt. 10. This justification is lacking. As demonstrated by Professor Michael Dorf, the justification is too formalistic, ignores that clients could still be adequately protected despite their lawyer's financial stake, and would not increase the amount of frivolous litigation. Michael C. Dorf, *Why Shouldn't a Lawyer Be Allowed to Pay a Client's Bills? Reflections on Michael Cohen, Donald Trump, and Stormy Daniels*, DORF ON LAW (Feb. 20, 2018), <http://www.dorfonlaw.org/2018/02/why-shouldnt-lawyer-be-allowed-to-pay.html>.

<sup>44</sup> Geoffrey P. Miller, *Competing Bids in Class Action Settlements*, 31 HOFSTRA L. REV. 633, 639–43 (2003).

<sup>45</sup> See *Forsythe v. ESC Fund Mgmt. Co. (U.S.)*, No. 1091–VCL, 2012 WL 1655538, at \*6 (Del. Ch. May 9, 2012) (“If objectors believe the claims are worth more, they can act on their belief, put real money on the table, and outbid the defendants,” who, by settling, are effectively purchasing the claims.).

<sup>46</sup> Miller, *supra* note 44, at 640–44 (“[T]he court would distribute the amount between new and old counsel, attempting to make a fair allocation reflecting the respective contributions of both while recognizing that the first counsel did not achieve the best result for the class. . . . [I]t would seem appropriate to cap the compensation of the first counsel at the amount she would have received under the initial settlement.”).

<sup>47</sup> *Id.* at 644 (“The *ex post* bid does not purport to immunize counsel fees from judicial scrutiny for reasonableness, and therefore is at least as good a method for controlling fees as the traditional approach.”).

<sup>48</sup> See *infra* notes 61–65.

<sup>49</sup> Tidmarsh, *supra* note 20, at 265–66.

<sup>50</sup> *Id.* at 241 n.53. In fact, it is even less an amount than you think. Professor Tidmarsh proposed that the replaced firm receive the quantum meruit value of the work, deducted by the “reasonable time that the winning bidder's counsel must spend to come up to speed on the case.” *Id.* at 265–66.

providing compensation in the amount of quantum meruit of the services for the deposed attorney tells us nothing about how said amount should be calculated. As embedded in the term itself, reasonableness controls the quantum meruit analysis.<sup>51</sup> Thus the quantum meruit addition is circular.<sup>52</sup> And, perhaps unsurprisingly, the *ex post* auction methods have yet to be embraced to any real extent.<sup>53</sup>

## II. CALCULATING A CLASS ATTORNEYS' FEE

### A. Tradition & Critique

In the absence of the unique compensation schemes, class attorneys' fees are calculated in a fairly routine manner. The Federal Rules of Civil Procedure provide only that class counsel fee awards must be "reasonable."<sup>54</sup> Originally, this was a factor-based analysis. Courts considered twelve factors in total: 1) the time and labor required; 2) the novelty and difficulty of the questions; 3) the skill requisite to perform the legal service properly; 4) the preclusion of other employment due to the acceptance of the case; 5) the customary fee; 6) whether the fee is fixed or contingent; 7) time limitations imposed by the client or the circumstances; 8) the amount involved and the results obtained; 9) the experience, reputation, and ability of the attorneys; 10) the "undesirability" of the case; 11) the nature and length of the professional relationship with the client; and 12) awards in similar cases.<sup>55</sup> Courts have since moved on from these so-called *Johnson* factors.

"The dominant method used to calculate fees in class actions . . . evolved from considering multiple factors to the dominance of two other

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<sup>51</sup> *Quantum Meruit*, BLACK'S LAW DICTIONARY (10th ed. 2014) ("1. The *reasonable* value of services; damages awarded in an amount considered *reasonable* to compensate a person who has rendered services in a quasi-contractual relationship. 2. A claim or right of action for the *reasonable* value of services rendered." (emphasis added)). Even quantum meruit does not close the door to payment calculation via a contingency award. *Cf.* *Universal Acupuncture Pain Services, P.C. v. Quadriano & Schwartz, P.C.*, 370 F.3d 259, 263–65 (2d Cir. 2004).

<sup>52</sup> Nor does Tidmarsh's discount of "*reasonable* time" from the deposed attorneys' fee free his method from the reasonableness whirlpool. *See* Tidmarsh, *supra* note 20, at 265–66 (emphasis added).

<sup>53</sup> *Ex post* auctions never caught on to the extent *ex ante* auctions ever did—even in *Forsythe*, the court eventually refused the objector's attempts to take over the case. *Forsythe v. ESC Fund Mgmt. Co.* (U.S.), No. 1091–VCL, 2012 WL 1655538, at \*6 (Del. Ch. May 9, 2012); *Forsythe v. ESC Fund Mgmt. Co.* (U.S.), No. 1091–VCL, 2013 WL 458373 (Del. Ch. Feb. 6, 2013). And even *ex ante* auctions all but ceased following *In re Cendant Corp. Litig.*, 264 F.3d 201, 273–77 (3d Cir. 2001).

<sup>54</sup> FED. R. CIV. P. 23(h).

<sup>55</sup> *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714, 717–19 (5th Cir. 1974), *abrogated by* *Blanchard v. Bergeron*, 489 U.S. 87 (1989). These twelve guidelines track those listed in Model Rule 1.5(a). *Compare Johnson*, 488 F.2d at 717–19, with MODEL RULES OF PROF'L CONDUCT r. 1.5(a) (AM. BAR ASS'N 2016).

methods, the lodestar and percentage methods.”<sup>56</sup> The Federal Rules now even go so far as to mention these two methods by name.<sup>57</sup> Among all methods, the percentage-of-the-recovery method is the most common, with the most recent scholarship suggesting its use in over 50% of cases between 2009 and 2013.<sup>58</sup> While the Advisory Committee notes for this provision explicitly discuss these two ordinary calculation methods, they do not necessarily bar courts from considering others.<sup>59</sup> Any proposed fee award methodology should aim to be as administrable and objective as possible.<sup>60</sup>

The lodestar method, developed by the Third Circuit in the 1970s, is a rough calculation based on the number of hours plaintiff’s counsel puts in.<sup>61</sup> The number of hours is then multiplied by an hourly rate,<sup>62</sup> though other multipliers and considerations like “reputation and status” may be factored in.<sup>63</sup> Alternatively, the percentage-of-the-recovery method is a cousin to the traditional contingency award for plaintiff’s attorneys, where attorneys are given a percentage of the total award they win for their client.<sup>64</sup> Sometimes, the percentage award is “cross-checked” against the lodestar to avoid a windfall.<sup>65</sup> In other words, the two are

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<sup>56</sup> Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees and Expenses in Class Action Settlements: 1993–2008*, 7 J. EMPIRICAL LEGAL STUD. 248, 266–67 (2010).

<sup>57</sup> FED. R. CIV. P. 23 advisory committee’s note to 2003 amendment (“In particular, there is some variation among courts about whether in ‘common fund’ cases the court should use the lodestar or a percentage method of determining what fee is reasonable. The rule does not attempt to resolve the question whether the lodestar or percentage approach should be viewed as preferable.”).

<sup>58</sup> Theodore Eisenberg, Geoffrey Miller & Roy Germano, *Attorneys’ Fees in Class Actions: 2009–2013*, 92 N.Y.U. L. REV. 937, 944–45 (2017); see also Eisenberg & Miller, *supra* note 56, at 267 (revealing that percentage-of-the-recovery fee schemes were used in 56.4% of class actions between 1993 and 2002, and 37.8% between 2003 and 2008).

<sup>59</sup> The Advisory Committee warned against reading too much into their notes: “[The notes] have no official sanction, and can have no controlling weight with the courts, when applying the rules in litigated cases.” Catherine T. Struve, *The Paradox of Delegation: Interpreting the Federal Rules of Civil Procedure*, 150 U. PA. L. REV. 1099, 1112 n.40 (2002) (quotation and citations omitted).

<sup>60</sup> *Compare* *Perdue v. Kenny A. ex rel. Winn*, 559 U.S. 542, 550–52 (2010) (analyzing the lodestar method), *with* *Blum v. Stenson*, 465 U.S. 886 (1984) (approving the percentage-of-the-recovery method in dictum), *and* *Camden I Condo. Ass’n v. Dunkle*, 946 F.2d 768, 773–74 (11th Cir. 1991) (analyzing the dictum in *Blum*).

<sup>61</sup> *Lindy Bros Builders, Inc. v. Am. Radiator & Standard Sanitary Corp.*, 540 F.2d 102 (3d Cir. 1976) (*Lindy II*) (outlining the contours of the lodestar calculation, introduced in *Lindy Bros. Builders, Inc. v. Am. Radiator & Standard Sanitary Corp.*, 487 F.2d 161 (3d Cir. 1973) (*Lindy I*)).

<sup>62</sup> Which must be a “reasonable hourly rate,” I kid you not. *Lindy I*, 487 F.2d at 167–68.

<sup>63</sup> *Id.* at 167–69.

<sup>64</sup> ROBERT H. KLONOFF, *CLASS ACTIONS AND OTHER MULTI-PARTY LITIGATION IN A NUTSHELL* 311–12 (4th ed. 2012).

<sup>65</sup> See Vaughn R. Walker & Ben Horwich, *The Ethical Imperative of a Lodestar Cross-Check: Judicial Misgivings About “Reasonable Percentage” Fees in Common Fund Cases*, 18 GEO J. LEGAL ETHICS 1453, 1454–55 (2005), for an argument that courts are, in fact, ethically obliged to cross-check a percentage fee against the lodestar calculation.

measured against each other, and using the chosen methodology, any marked difference in favor of a higher fee indicates that said fee is unreasonable.

Each sounds sensible, but each has its drawbacks. For lodestar, difficulty lies with: how many hours lawyers should spend on a given class action; how their hourly rate should be set; whether and how unnecessary actions by the lawyer should lower the fee; what constitutes unnecessary actions; what multipliers should be considered; and how to set said multipliers.<sup>66</sup> For the percentage-of-the-recovery methods, arbitrariness invades with regard to finding the optimal percentage and, in cases of non-monetary relief,<sup>67</sup> how to calculate the total pie of which the attorney is owed a slice.<sup>68</sup> Given their imperfections,<sup>69</sup> opportunities abound for better indices of the reasonableness behind attorneys' fees.

### B. Auctions (*Redux*)

The auction processes in part attempt to cure impurities in these two approaches.<sup>70</sup> Keeping in mind that the ultimate goal is to select counsel who will “best . . . serve the interests of the class,”<sup>71</sup> the auction process forces bidding law firms to divulge their evaluations of a class action case's worth. Regardless of the type of auction method employed, exposing a firm's bid to a court better allows the court to ensure that the class's interests are served. The court's choice in the winning bidder serves as a first step towards ensuring reasonableness; it crowdsources knowledge from those who know best how to evaluate what a firm

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<sup>66</sup> Court Awarded Attorney Fees: Report of the Third Circuit Task Force, 108 F.R.D. 237, 246–49 (3d Cir. 1985).

<sup>67</sup> Nonmonetary relief includes injunctive relief and “coupon settlements.” The latter is when “class members are sent coupons or vouchers for free or discounted products or services from the defendant.” JOEL M. FINEBERG & ROGER A. COLAIZZI, CLASS ACTIONS: RISK MITIGATION AND SETTLEMENT STRATEGIES FOR CLASS ACTION LAWSUITS 7–8 (2014). For example, a recent class action against Ticketmaster settled; class members (including this Note's author) received a whopping \$2.25 off a future ticket purchase. *Schlesinger v. Ticketmaster Class Action Settlement FAQs*, TICKETMASTER (last visited Feb. 22, 2018), <http://help.ticketmaster.com/schlesinger-v-ticketmaster-class-action-settlement-faqs/>.

<sup>68</sup> See, e.g., *In re HP Inkjet Printer Litigation*, 716 F.3d 1173, 1179–87 (9th Cir. 2013) (“But where class counsel is paid in cash, and the class is paid in some other way . . . comparing the value of the fees with the value of the recovery is substantially more difficult. Unlike a cash settlement, coupon settlements involve variables that make their value difficult to appraise . . . . And perhaps more importantly, the additional complexity also provides class counsel with the opportunity to puff the perceived value of the settlement so as to enhance their own compensation.”).

<sup>69</sup> Not only do these methods carry with them inherent deficiencies as to arbitrariness, they also create “perverse incentives” for the plaintiff attorneys involved. *McDaniel v. Cty. of Schenectady*, 595 F.3d 411, 418–19 (2d Cir. 2010).

<sup>70</sup> See generally *In re Auction Houses Antitrust Litig.*, 197 F.R.D. 71, 75–82 (S.D.N.Y. 2000) (discussing how and why the court decided to auction off the class).

<sup>71</sup> *Id.* at 74.

should expect to make on the particular case. The auction method frees the firms from being locked into either lodestar or percentage-of-the-recovery in their ordinary understandings.

For example, Judge Kaplan required firms to bid based on two unique fee schemes. The first involved law firms picking one benchmark under which they would recover nothing.<sup>72</sup> A second benchmark would set the point both below which the firm would receive 100% of the recovery, and above which the firm would receive 25%.<sup>73</sup> The court scrapped the scheme after noting that, should a settlement offer in the amount of the first benchmark be offered, the firm would be incentivized to decline it and to proceed to trial.<sup>74</sup> Instead, the court went with a fee scheme whereby firms proposed a single benchmark, below which they would recover nothing and above which their marginal earnings increase steadily.<sup>75</sup> Judge Kaplan's second fee methodology is clearly akin to the percentage-of-the-recovery practice, though better tailored to class actions.<sup>76</sup>

Nevertheless, auctions do not survive scrutiny and have fallen out of use. For example, in *ex ante* auctions, there is the potential not just for an unreasonable fee, but also for a vital lawyer's work to go unfairly compensated or ignored. Indeed, the first-firm-to-file may be deprived of an opportunity to develop the case it discovered, despite a substantial investment in the investigation thereof. It would also not share in any spoils. The simple solution is to award them a finder's fee—an "amount charged by one who brings together parties for a business opportunity."<sup>77</sup>

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<sup>72</sup> *Id.* at 83.

<sup>73</sup> *Id.* As a condition, the firm would be on the hook for all litigation expenses.

<sup>74</sup> *Id.*

<sup>75</sup> *Id.* at 83–84.

<sup>76</sup> Indeed, most class action auctions to select class counsel use some sort of species of the percentage-of-the-recovery method. This is likely because no firm can accurately anticipate how many hours they will put into the case. Nevertheless, clever auction fee schemes tailor themselves to the class action context. For example, consider the district court's bidding process in *In re Cendant Corp. Litig.*, 264 F.3d 201, 225 n.5 (3d Cir. 2001), as explained by the Third Circuit:

The grid for the main Cendant action required that counsel submit a fee in terms of a percentage of the total class recovery. Movants were directed to propose fees depending on the phase at which the litigation was resolved (the horizontal axis) and the size of the eventual recovery (the vertical axis). The phases of litigation listed on the grid were: from pleadings through adjudication of any motion to dismiss; during discovery through adjudication of a summary judgment motion; after adjudication through a trial verdict; and post-trial. The sizes of recovery listed on the grid were: first 100 million; second 100 million; third 100 million; next 50 million; next 50 million; next 50 million; and over 500 million.

For an analysis of why the third traditional compensation scheme, the fixed fee—which incorporates the stages of class litigation highlighted in the block quote—has not been embraced in class actions, see *infra* note 161.

<sup>77</sup> *Finder's Fee*, BLACK'S LAW DICTIONARY (10th ed. 2014).

Yet, as class actions currently stand, finder's fees are rare, and there is no set practice for their determination. Nor is there a requirement that the winning bidder even pay a finder's fee, were there to be an auction, as implicitly noted by the Southern District of New York:

The routine selection of lead counsel by auction . . . may discourage attorneys from searching out and identifying illegal activity, as the attorney who takes this initiative is not necessarily compensated for his or her effort. This casts doubt on the desirability of holding any auction at all, at least in cases in which attorney initiative played an important role in uncovering the alleged wrong.<sup>78</sup>

But all that means is that the auction process is ripe for improvement. Improvements previously contemplated include granting a "right of first refusal" to match the winning bid to the investigating counsel.<sup>79</sup> But the Southern District dismissed this idea as wresting control from the court, thereby "undermining the court's ability to ensure that the class receives the highest quality representation."<sup>80</sup> Altogether, the silver bullet is yet to be forged; there is no tried-and-true method for calculating the reasonableness of attorneys' fees.<sup>81</sup> Thus, it makes sense to examine

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<sup>78</sup> *In re Auction Houses Antitrust Litig.*, 197 F.R.D. at 81–82. Undergirding this idea is the suggestion that, at least where a class action follows a government investigation, an auction process does not step on the first-to-file's toes:

[T]he alleged wrong came to light only after it was announced that the Department of Justice had begun to investigate defendants and that Christie's had sought conditional amnesty from criminal prosecution. The attorney who filed the first complaint in this case therefore is not necessarily any more deserving of the lead counsel position than is any other attorney involved, and selection as lead counsel of someone other than the first-to-file did not deprive an investigating attorney of his or her just reward or dissuade attorneys in other cases from searching out a wrong.

*Id.* at 82.

For analysis of simultaneous government and class action litigations originating from the same conduct, see *Miss. ex rel. Hood v. AU Optronics Corp.*, 571 U.S. 161 (2014), as well as Zachary D. Clopton, *Redundant Public-Private Enforcement*, 69 VAND. L. REV. 285, 287–88 (2016) (quoting and discussing 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, 228 (1983) ("[W]e see today a very different spectacle, one resembling the Oklahoma land rush, in which the filing of the public agency's action serves as the starting gun for a race between private attorneys, all seeking to claim the prize of lucrative class action settlements, which public law enforcement has gratuitously presented them.")).

<sup>79</sup> *In re Auction Houses Antitrust Litig.*, 197 F.R.D. at 81–82.

<sup>80</sup> *Id.*

<sup>81</sup> Practitioners and courts alike should be mindful that the type of compensation scheme may depend on the type of and particular class action being brought. *Cf.* Seyfarth Shaw LLP, *Plaintiffs' Counsel Garner \$15 Million Attorneys' Fee Award for Largest TCPA Settlement In History*, WORKPLACE CLASS ACTION BLOG (Apr. 13, 2017), <https://www.workplaceclassaction.com/2017/04/plaintiffs-counsel-garner-15-million-attorneys-fee-award-for-largest-tcpa-settlement-in-history/> (analyzing *Aranda v. Caribbean Cruise Line, Inc.*, No. 12-04069, 2017 WL 1369741 (N.D. Ill. Apr. 10, 2017), a TCPA class action in which the court employed a

new reasonableness indices, keeping in mind that one solution may result in unforeseen problems appearing.

### III. A CLASS ACTION'S IMPACT ON A DEFENDANT'S STOCK PRICE AS A REASONABLENESS INDEX

#### A. *Impetus*

As set forth since the outset of this Note, courts should not necessarily satisfy themselves with the usual suspects for attorney fee calculation—lodestar and percentage-of-the-recovery—or the heretofore suggested alternatives like auctions. The analysis of a fee calculation method in this context should begin with first principles: what purposes do class actions serve? There are three: compensation for victims, deterrence of wrongdoing, and judicial efficiency.<sup>82</sup> If an alternative compensation mechanism can balance these three competing rationales, it is far more likely to identify a reasonable fee and to find usage in court. Granted, there is unlikely to be a one-size-fits-all solution concurrently satisfying all these competing interests.<sup>83</sup> So long as an attorney-fee-calculation method stays mindful of them, an acceptable solution may reveal itself.

Class actions hurt.<sup>84</sup> A lot.<sup>85</sup> Perhaps, then, it makes sense to focus on deterrence and to correlate the worth of a class action with how much it hurts a defendant. Because a “stock price can often be a barometer of [a company’s] health,”<sup>86</sup> we can thus measure the damage a defendant suffers by looking at the magnitude of a class action’s impact on a company’s stock price.<sup>87</sup> It is fair to say that most class actions are filed

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“sliding scale” percentage rather than a “flat-percentage” approach, though noting that the plaintiff’s counsel “face[d] materially greater risks in this case than those faced in other recent TCPA class actions”).

<sup>82</sup> Mullenix, *supra* note 16, at 418–23. Securities class actions specifically provide an additional benefit by “promoting investor confidence in the market.” Mark Klock, *Do Class Action Filings Affect Stock Prices? The Stock Market Reaction to Securities Class Actions Post PSLRA*, 15 J. BUS. & SEC. L. 109, 155 (2016) (citing Lynn A. Stout, *Type I Error, Type II Error, and the Private Securities Litigation Reform Act*, 38 ARIZ. L. REV. 711, 714–15 (1996)).

<sup>83</sup> See Mullenix, *supra* note 16, at 431–36.

<sup>84</sup> E.g., Ken Belson, *Debilitated Players Accuse N.F.L. of Stalling on Settlement Payments*, N.Y. TIMES (Nov. 13, 2017), <https://www.nytimes.com/2017/11/13/sports/football/nfl-convulsion-lawsuit.html>.

<sup>85</sup> E.g., Paul Kiernan, *Petrobras to Pay \$2.95 Billion to Settle U.S. Suit Over Corruption*, WALL ST. J. (Jan. 3, 2018, 10:46 AM), <https://www.wsj.com/articles/petrobras-to-pay-2-95-billion-to-settle-u-s-suit-over-corruption-1514983108?mod=searchresults&page=1&pos=19>.

<sup>86</sup> *Why Do Companies Care About Their Stock Prices?*, INVESTOPEDIA (Dec. 19, 2017, 4:43 AM), <https://www.investopedia.com/articles/basics/03/020703.asp>. But see *supra* note 19.

<sup>87</sup> This is not to be confused with “stock-drop lawsuits,” which are class actions brought after a company’s announcement of news resulting in a drop in stock price. Matt Levine, *There Will Always Be Stock-Drop Lawsuits*, BLOOMBERG (June 23, 2014, 2:19 PM), <https://>

against public companies<sup>88</sup>—companies whose shares are traded on a stock exchange.<sup>89</sup> In theory, then, a large amount of class action filings, adverse orders and judgments, and settlements<sup>90</sup> will result in a drop in the defendant’s stock price.<sup>91</sup> It stands to reason that the degree to which this drop occurs therefore correlates to the degree of harm felt by the defendant.

The empirical evidence backs this up: bad news for a company results in a decrease in the company’s stock price, and the effect is felt

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www.bloomberg.com/view/articles/2014-06-23/there-will-always-be-stock-drop-lawsuits. The difference lies in the source of the stock price drop. In stock-drop lawsuits, the drop traces to bad news, the content of which could serve as the basis for a future class action filing. The amount of that drop correlates to the plaintiff’s damages. Attorneys’ fees in stock-drop lawsuits are also a thorny issue, but what else is new? Cf. COFFEE, SALE & HENDERSON, *supra* note 13, at 923.

My proposal can be conceived as an offshoot of stock-drop lawsuits. To shareholders, news of their company’s status as a defendant in a class action is bad news. The corresponding drop that follows this particular bad news, this Note suggests, should be correlated with the plaintiff class attorney’s compensation and should not serve as a basis for a second stock-drop lawsuit. If it did serve as the basis, we could find ourselves in an inescapable litigatory black hole.

<sup>88</sup> Cf. Kevin LaCroix, *Though a Private Company, Uber Hit With Securities Class Action Lawsuit*, D&O DIARY (Sept. 26, 2017), <https://www.dandodiary.com/2017/09/articles/securities-litigation/though-private-company-uber-hit-securities-class-action-lawsuit/> (“It is . . . not news that a private company has been sued by investors on the basis of alleged misrepresentations. It is not even news that a private company has been sued for securities fraud. What *is* news is that the lawsuit was filed in the form of a securities *class action*.” (emphasis added)).

<sup>89</sup> *Public Company*, NASDAQ, <http://www.nasdaq.com/investing/glossary/p/public-company> (last visited Mar. 1, 2018).

<sup>90</sup> The need to examine the defendant stock price at news of class certification is obviated by the fact that approval of a class settlement almost always requires a judge to determine that the class is certifiable. See *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997); KLONOFF, *supra* note 64, at 287–91; see also Howard M. Erichson, *The Problem of Settlement Class Actions*, 82 GEO. WASH. L. REV. 951 (2014) (arguing “that class actions should never be certified solely for purposes of settlement”). Whether settlement news occurs a) at the same time as, or b) after news of certification is therefore immaterial as class action trials are exceedingly rare. See, e.g., Daniel Fisher, *Study Shows Consumer Class-Action Lawyers Earn Millions, Clients Little*, FORBES (Dec. 11, 2013, 8:46 AM), <https://www.forbes.com/sites/danielfisher/2013/12/11/with-consumer-class-actions-lawyers-are-mostly-paid-to-do-nothing/> (noting that of 148 Class Action Fairness Act class actions in 2009, not a single one went to trial). What this means is that news of certification is the functional equivalent of news of settlement. See also *infra* note 157 and accompanying text.

<sup>91</sup> My proposal is not without its imperfections. Like the difficulties with measuring investor losses, “[i]t is simple to measure the total decline in a stock’s price over a specified period, but the decline attributable to [a specific event] may be only a small fraction of the total decline that the stock experienced. . . . [S]ome of this decline may be attributable to external developments in the world, in the financial markets, or in the general industry.” COFFEE, SALE & HENDERSON, *supra* note 13, at 923. At the very least then, we can adopt a rebuttable presumption like that of *Basic v. Levinson*. See *infra* notes 92–96.

once the news is made public.<sup>92</sup> Our legal system, specifically in securities actions, recognizes this phenomenon. This idea underlies the *Basic Inc. v. Levinson* “fraud-on-the-market” presumption.<sup>93</sup> The *Basic* presumption follows from an efficient market’s contemporaneous incorporation of all publicly-available information into a corporation’s share price.<sup>94</sup> The stock market is one such efficient market.<sup>95</sup> Any of a defendant’s publicly-made material misstatements that fraudulently inflate a stock price will therefore inevitably result in a stock price decline once the truth is made public through a corrective disclosure. Investors trading at the inflated-price are thereby harmed by the decline: they operated on a false set of facts, and thus can be presumed to have relied on the material misstatements.<sup>96</sup> The necessary link to the proposal herein, then, is whether adverse class action news is a type of bad news. It is.<sup>97</sup>

The data supports this link. Class action filings have been observed to negatively impact a defendant’s stock price.<sup>98</sup> The filing of a class actions cause share prices to drop.<sup>99</sup> One hypothesis is to extend that principle to judgment and settlement news.<sup>100</sup> Another is to say that the magnitude of a stock price drop reflects the weight of the information entering the market, and given that—in legal terms—an adverse judgment or settlement sets forth a future, likely unforeseen-with-appreciable-specificity expense that the company will have to pay out, the stock price drop at that time would reflect the merits of the claim.<sup>101</sup> The

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<sup>92</sup> See generally, ADVANCES IN INVESTMENT ANALYSIS AND PORTFOLIO MANAGEMENT 147 (Cheng-Few Lee ed., 2000) (“[N]egative shocks (bad news) introduce more volatility than positive shocks (good news). . . . [W]hen bad news hits the market, stock prices tumble.”).

<sup>93</sup> 485 U.S. 224 (1988).

<sup>94</sup> See ELTON et al., *supra* note 32, at 398–429.

<sup>95</sup> Burton G. Malkiel, *Is the Stock Market Efficient?*, SCIENCE, Mar. 10, 1989, at 1313 (“[O]ne has to be impressed with the substantial volume of evidence suggesting that stock prices display a remarkable degree of efficiency.”).

<sup>96</sup> *Basic Inc. v. Levinson*, 485 U.S. 224, 248 n.27 (1988).

<sup>97</sup> Zhiyan Cao & Ganapathi S. Narayanamoorthy, *The Effect of Litigation Risks on Management Earnings Forecasts*, 28 CONTEMP. ACCT. RESOL. 125, 125–26 (2011) (“[O]n the date a lawsuit is filed, corporate defendants lose nearly 1 percent of their value. For any filing pertaining to violation of securities laws, the losses are much higher with companies on average losing about 2.73 percent of their value at the filing date.”).

<sup>98</sup> Klock, *supra* note 82, at 110; Stephen P. Ferris & A.C. Pritchard, *Stock Price Reactions to Securities Fraud Class Actions Under the Private Securities Litigation Reform Act* 6–8 (John M. Olin Ctr. for Law & Econ., Research Paper No. 01-009, 2001).

<sup>99</sup> See Cao & Narayanamoorthy, *supra* note 97, at 125–26; Klock, *supra* note 82, at 133–54; Ferris & Pritchard, *supra* note 98, at 18–33.

<sup>100</sup> *But cf.* Klock, *supra* note 82, at 155 (noting that the market can anticipate the filing of securities class actions and that the full drop in value over the life of a class action is completed one day after filing).

<sup>101</sup> It would have to be a relative drop, not an absolute drop. A \$1 drop for Apple (trading at \$172.50 per share as of February 22, 2018) is not equivalent to a \$1 drop for Orange SA (trading at \$17.04 per share as of February 22, 2018). But we already knew this: one simply

greater the drop, the better the plaintiff attorney did.<sup>102</sup> The better the plaintiff attorney did, the more the attorney deserves to be paid, and the more reasonable his or her higher fee looks.

### B. Policy, Professional Responsibility, and Deterrence

Of a class action's three purposes (deterrence, victim compensation, and judicial efficiency), compensating plaintiff's attorneys based on how much they cause a drop in the defendant's stock price ties best to the deterrence rationale. Courts already analyze a fee's reasonableness with deterrence in mind. "Judges and plaintiffs often rely on estimates of maximum value [of damages] when assessing the fairness of . . . the requested attorneys' fees."<sup>103</sup> This amount is "somewhat illusory, because the parties never [expect] that [defendants] . . . [will] actually pay anything close to that amount."<sup>104</sup> Actual victim compensation, while the lifeblood of civil litigation, is irrelevant at the class-attorney-fee inquiry stage; the terms of settlement have been decided and left for the members to claim—the attorney's work, outside of effecting notice, is done.<sup>105</sup> Defendants and intermeddling objectors bemoan this disregard as rendering the attorney fee calculation unrealistic.<sup>106</sup> Surely, measuring the proposed fee against historically-verifiable events—the impact of the class litigation on stock price—is better than the current practice of

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cannot compare apples to oranges. Thus, we should look at how much the stock price dropped relative to what the price was before the market's adjustment.

<sup>102</sup> That a) courts need to approve settlement of class actions and that b) objectors can object to settlement backstops this hypothesis from being influenced by collusion between the two sides to the detriment of the class. *Cf., e.g., In re Subway Footlong Sandwich Marketing and Sales Prac. Litig.*, 869 F.3d 551, 555 (7th Cir. 2017) (noting that the ability of the attorney will matter, and, although any settlement requires a degree of cooperation, that should not be enough to throw off the general premise that better attorneys obtain better results).

<sup>103</sup> Jacob Gershman, *Value of Beck's Beer Settlement a Case Study in Class Action Math*, WALL ST. J. (Oct. 22, 2015, 10:00 AM), <https://blogs.wsj.com/law/2015/10/22/value-of-becks-beer-settlement-a-case-study-in-class-action-math/1/>.

<sup>104</sup> *Poertner v. Gillette Co.*, No. 6:12-cv-803-Orl-31DAB, 2014 WL 4162771, at \*4–5 (M.D. Fla. Aug. 21, 2014), *aff'd* 618 Fed. App'x 624 (11th Cir. 2015). To receive their piece of the class action settlement pie, plaintiffs often have to fill out and file forms. Already passive during the class litigation's development, *see Cox & Thomas, supra* note 40, at 107–08, plaintiff apathy continues to the case's conclusion, even to the point of sacrificing any reward, *see Sullivan v. DB Inv., Inc.*, 667 F.3d 273, 329 n.60 (3d Cir. 2011) (en banc) ("Filing rates rarely exceed seven percent, even with the most extensive notice campaigns." (internal quotation marks omitted)).

<sup>105</sup> Class counsel is likely ambivalent as to how many class members wind up receiving notice and collecting on their earnings. They care only if the presiding judge cares. *Cf. Gershman, supra* note 103.

<sup>106</sup> *Id.* (mentioning Judge Richard Posner's characterization of the practice as "scandalous").

measuring it against purely speculative, idealistic events—the entirety of the class collecting on their prize.<sup>107</sup>

Preliminary fears, marshalled forth in response to any changes to class actions, concern increasing the amount of frivolous class action litigation<sup>108</sup> and violations of Model Rule of Professional Conduct Rule 3.1.<sup>109</sup> The parade of horrors would look something like the following: 1) filing any class action complaint hurts a defendant company's share price; 2) the harm is sufficient such that any compensation scheme based on it makes it worthwhile for a class plaintiff's lawyer to file frivolous complaints;<sup>110</sup> 3) an increase in the amount of frivolous class actions complaints will lead to a corresponding increase in either a) the number of and total value disgorged by settlements, or b) if packaged among other meritorious claims, an increase in the value disgorged by—but not necessarily the number of—settlements. There are three intertwined answers to the supposed concerns here. First, defendants still have every incentive to defend frivolous claims; this, coupled with the courts' large role in overseeing the life of a class action,<sup>111</sup> serves as an adequate safeguard against frivolity.<sup>112</sup> Second, frivolous class actions deter future wrongdoing in that they increase the cost of doing business for defendant companies, who already are undeterred when compared to their level of wrongdoing in fact.<sup>113</sup> Finally and facetiously, it is hard to im-

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<sup>107</sup> Perhaps, then, if we tied attorney's fees to the amount of notice or claims actually filed—as a proxy for measuring how many class members truly cared about the suit, a utilitarian approach to class actions—we could better gauge the reasonableness of the fee. An in-depth examination as to this idea is outside the scope of this Note.

<sup>108</sup> S. Rep. No. 104-98, 104th Cong. (1st. Sess. 1995); H.R. Rep. No. 104-50, 104th Cong. (1st. Sess. 1995).

<sup>109</sup> MODEL RULES OF PROF'L CONDUCT R. 3.1 (AM. BAR ASS'N 2017) ("A lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis in law and fact for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law."). The Restatement of the Law Governing Lawyers defines a frivolous claim as "one that a lawyer of ordinary competence would recognize as so lacking in merit that there is no substantial possibility that the tribunal would accept it." RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 110.

<sup>110</sup> Indeed, the share price decrease for "frivolous" class action complaint filings is statistically significant. Klock, *supra* note 82, at 138–39 ("frivolous" understood as any case ultimately dismissed).

<sup>111</sup> *E.g.*, FED. R. CIV. P. 11; *id.* 12(b)(6); *id.* 23(e); *id.* 23(g). The PSLRA goes further by imposing mandatory, harsher penalties against frivolity in the securities context. *See* 15 U.S.C. § 78u-4(c) (2018).

<sup>112</sup> If it doesn't, Congress could step in and provide another mechanism for the punishment of frivolous-filers. *See* Tim Ryan, *Frivolous Lawsuit, Class Action Bills Up for Debate*, COURTHOUSE NEWS SERV. (Mar. 8, 2017), <https://www.courthousenews.com/frivolous-lawsuit-class-action-bills-debate/>.

<sup>113</sup> Francis E. McGovern, *Punitive Damages and Class Actions*, 70 LA. L. REV. 435, 454 (2010) ("[T]he economic perspective looks at the welfare of society as a whole and is correspondingly much more in tune with the more pragmatic jurisprudence of supporters of punitive damages class actions. A single award of damages to achieve an optimal level of investment in safety for a defendant could be achieved if all plaintiffs in a mass tort brought suit and were

agine that there could be *more* frivolous class action litigation than there already is.<sup>114</sup>

Does the deterrence rationale applied to the compensation scheme proposed here go so far as to incentivize class attorneys to scorch the earth of defendants in an attempt to harm them as much as possible?<sup>115</sup> Will this lead to over-deterrence? Judges, defense practitioners, defendants themselves, and professional responsibility professors may cry foul against this method for creating a perverse incentive to harm the defendant.<sup>116</sup> But Comment 1 to Model Rule of Professional Conduct Rule 1.3 does not expressly prohibit “press[ing] for every advantage that may be realized for a client,” or “the use of offensive tactics.”<sup>117</sup> Rule 4.4(a) prohibits actions “that have no substantial purpose other than to embarrass, delay or burden” defendants,<sup>118</sup> but this language grants shrewd lawyers a number of exits.<sup>119</sup> Alas, there seems to be no hard line against an attorney’s motivation being to “harm” the defendant, though courts have inherent authority to punish lawyers acting “in bad faith, vexatiously, wantonly, or for oppressive reasons.”<sup>120</sup> But even so, do not all actions on behalf of the class “harm” the defendant to varying degrees? The usage “harm” should not handcuff the methodology, were it adopted, to a retributivist or sadist rationale.<sup>121</sup> The realities of the class litigation process protect against this motivation spinning out of control.<sup>122</sup> Settlement requires cooperation, and virtually all successful class

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compensated; there would be no need for an overall damages assessment. The reality is, however, that underdeterrence is the norm . . . .” (footnote omitted).

<sup>114</sup> *E.g.*, *Dennis v. Kellogg Co.*, 697 F.3d 858, 862 (9th Cir. 2012) (throwing out a settlement where class plaintiffs claimed Kellogg’s assertion that eating “Frosted Mini-Wheats® helps improve children’s attentiveness” better than no breakfast at all was false advertising).

<sup>115</sup> Truly cunning plaintiff attorneys planning on suing a public company could invest heavily in that company’s stock, intending to immediately divest upon filing their complaint. Such conduct would contribute to the stock price drop on that day—plaintiffs hoping that the drop crosses the statistically significant threshold. Without an indication that plaintiff attorneys would actually do so (or have access to funds sufficient to contribute in fact), any more discussion on this is outside the scope of this Note.

<sup>116</sup> Any potential over-deterrence as a result, however, may not be as perverse as it seems. Professor Frances McGovern argues in favor of an increase in punitive damages awards in class actions, as they are “instrumental [to the] goal of achieving optimal investment in safety from the perspective of society in general.” McGovern, *supra* note 113, at 454.

<sup>117</sup> MODEL RULES OF PROF’L CONDUCT r. 1.3 cmt. 1 (AM. BAR ASS’N 2018).

<sup>118</sup> MODEL RULES OF PROF’L CONDUCT r. 4.4(a) (AM. BAR ASS’N 2018).

<sup>119</sup> See Geoffrey C. Hazard, Jr., Susan P. Koniak, Roger C. Cramton, George M. Cohen & W. Bradley Wendel, *THE LAW AND ETHICS OF LAWYERING* 791–92 (Robert C. Clark et al. eds., 6th ed. 2017) (“Can a clever advocate always articulate such a purpose? It is not surprising that [4.4(a)] leads to few disciplinary actions.”).

<sup>120</sup> *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 766 (1980).

<sup>121</sup> *But see* Lia Peng & Ailsa Röell, *Executive Pay and Shareholder Litigation*, 12 REV. FIN. 141, 144 (2008) (“Private class action litigation is an important disciplinary mechanism that distinguishes the U.S. capital markets from most others.”).

<sup>122</sup> See *infra* note 172 and accompanying text.

actions settle.<sup>123</sup> Further, given the collective action problems class members face, attorneys often lead the litigation charge themselves anyway.<sup>124</sup> Finally, there are practical reasons to avoid such ruthless tactics.<sup>125</sup> Professor John C. Coffee Jr. explains why:

[C]lass counsel is aware that if they press defendants “too hard,” defendants may actually solicit a rival team of plaintiffs’ attorneys to file an action elsewhere and then may enter an immediate settlement with these new entrants. So long as this rival action is filed in a different state court, the court hearing the original class action—whether a state court or a federal court—will be essentially powerless to stop this potential reverse auction.<sup>126</sup>

Is there a misalignment of objectives?<sup>127</sup> Plaintiff attorneys may be more inclined to act in ways more likely to result in a dramatic stock price decrease, which may not be actions preferred by the class. However, there are two aspects inherent to all class actions that solve this theoretical conundrum. One, we could conceive of the attorneys’ actions being means-based<sup>128</sup> and actually in their client’s best interest.<sup>129</sup> Two,

<sup>123</sup> See Fisher, *supra* note 90. The takeaway being, if the action is not dismissed, it will settle.

<sup>124</sup> Christopher R. Leslie, *The Significance of Silence: Collective Action Problems and Class Action Settlements*, 59 FLA. L. REV. 71, 80 (2007).

<sup>125</sup> Practical reasons counsel in favor of avoiding such conduct outside the class action context as well. Roger N. Saylor, *Rambo Litigation: Why Hardball Tactics Don’t Work*, A.B.A. J., Mar. 1, 1988, at 79.

<sup>126</sup> John C. Coffee, Jr., *Class Action Accountability: Reconciling Exit, Voice, and Loyalty in Representative Litigation*, 100 COLUM. L. REV. 370, 392 (2000). That is, in instances of class actions stemming from the same set of facts filed in courts around the country, the first to reach settlement will moot the other ongoing actions. Defendants do this by having the settlement include “a release covering all possible claims that the class members then hold against the defendants. . . . Such a release . . . can bar all claims that the plaintiff could have asserted against the defendants in any forum,” subject to Due Process constraints. John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 COLUM. L. REV. 1343, 1371 (1995). This includes state court orders approving class action settlements, even if the state court lack subject matter jurisdiction. *Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367, 374 (1996); see Coffee, *Class Action Accountability*, *supra* note 126, at 392 n.52.

<sup>127</sup> See Richard Posner, *ECONOMIC ANALYSIS OF LAW* 803 (14th ed. 2014) (“But with no “real” client—no claimant with a significant interest in the outcome—the lawyer for the class is under little pressure to exert himself to maximize the recovery for the class. His earnings from the suit are determined by the legal fee he receives rather than by the size of the judgment.”); see also Susan P. Koniak, *Feasting While the Widow Weeps: Georgine v. Amchem Products, Inc.*, 80 CORNELL L. REV. 1045, 1048 (1995).

<sup>128</sup> See MODEL RULES OF PROF’L CONDUCT r. 1.2 (AM. BAR ASS’N 2018) (saying that clients control the ends while their attorneys control the means).

<sup>129</sup> Defendants feeling the hurt through drops in their stock price will be more inclined to exit the litigation as soon as possible than they would be in the absence of the drops. See Klock *supra*, note 82, at 139 (“[E]ven frivolous lawsuits result in a statistically significant drop in the value of the firm.”). A pressing desire to exit the litigation means 1) quicker settlement, and 2) higher settlement.

it is extremely hard to conceive of a) the “client” when an attorney represents potentially hundreds of class members, each with their own views concerning the litigation, and b) how they, as a sufficient whole, could assert a true preference against such tactics.<sup>130</sup> The Federal Rules of Civil Procedure do not help on this point: “Class counsel must fairly and adequately represent the interests of the class.”<sup>131</sup> The Restatement Third of the Law Governing Lawyers, section 14 comment (f) acknowledges these troubles and advises, “[a] class-action lawyer may therefore be privileged or obliged to oppose the views of the class representatives after having consulted with them . . . . The lawyer should act for the benefit of the class as its members would reasonably define that benefit.”<sup>132</sup>

Nevertheless, differing objectives are not necessarily the result of misaligned incentives. Both plaintiff and plaintiff counsel would want to obtain the highest recovery as possible, given the theory that the greater a defendant is hurt, the more likely they are to agree to a higher settlement amount.<sup>133</sup> There is no incentive similar to auctions where counsel wants to go to trial and the class prefers to settle, because it is no more likely that trial will hurt the defendant any more than certification did.<sup>134</sup> Indeed, it stands to reason that the hurt is at its zenith when the class is certified, given that class actions invariably end in dispositive motion dismissal or settlement.<sup>135</sup>

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<sup>130</sup> See Leslie, *supra* note 124, at 80–81.

<sup>131</sup> FED. R. CIV. P. 23(g)(4).

<sup>132</sup> RESTATEMENT THIRD, THE LAW GOVERNING LAWYERS § 14, cmt (f).

<sup>133</sup> See Posner, *supra* note 127, at 803–04.

<sup>134</sup> See *In re Auction Houses Antitrust Litig.*, 197 F.R.D. 71, 83 (S.D.N.Y. 2000) (rejecting the first auction scheme on this basis). Unless, of course, class counsel thinks that raking the defense through the coals during trial will damage their stock price even further. This is quite a gamble, and an unwise one at that, as even the path from certification to trial is not easy to navigate. See Joseph M. McLaughlin, 2 McLAUGHLIN ON CLASS ACTIONS § 8:1 (14th ed. 2017) (noting that courts demand a plaintiff’s produce a trial plan as a condition to certification, and in the event of an appeal after verdict, examine whether that trial plan was adequate to protect the court’s and defendant’s interests); cf. *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 367 (2011) (rejecting “Trial by Formula” where only a small sample of class members have their claims tried, with the outcomes then extrapolated to rest of the class, because the method worked to the detriment of defendants). *But see*, Robert H. Klonoff, *Class Actions in the Year 2026*, 65 EMORY L.J. 1569, 1572 (2016) (predicting “a significantly larger number of class actions cases will go to trial . . .”). For an examination as to present difficulties faced by plaintiffs, defendants, and courts taking class actions to trial, see Michael K. Grimaldi, *Trying Class Actions: The Complex Task of Managing and Resolving Individual Issues in Class Trial*, 36 REV. LITIG. 90, 90–112 (2017).

<sup>135</sup> E.g., Thomas E. Willging, Laural L. Hooper & Robert J. Niemic, *An Empirical Analysis of Rule 23 to Address the Rulemaking Challenges*, 71 N.Y.U. L. REV. 74, 143–45 (1996). An interesting aspect of settlement, with implications for how much the terms hurt the defendant company, is that many have an express denial of wrongdoing. Samuel Issacharoff & Robert H. Klonoff, *The Public Value of Settlement*, 78 FORDHAM L. REV. 1177, 1195–99 (2009). This is often true as well in the public enforcement that precedes class actions, partic-

Deterrence fits the scheme better than judicial efficiency or victim compensation, but this is not to say those rationales are ignored. Judicial efficiency is not sacrificed, as the defendant's stock price reaction to a class action is readily observable.<sup>136</sup> Further, much ink has been spilled alleging that cost-benefit analyses push toward quickly settling a class action, regardless of the merits, to avoid having the class's life hang in the balance while the court decides a dispositive motion.<sup>137</sup> If the preceding allegation is true, then all rationales but judicial efficiency drop out; the quicker the claim is disposed, the less a court has to do. In that case, the deterrent effect, which is often cast in terms of public utility, would be small, if non-existent.<sup>138</sup>

Victim compensation follows only if the share price decrease is construed as an accurate valuation of the plaintiff's harm suffered. The greater the victim's compensation, the greater the decrease in stock price. Any fee compensation scheme premised on this thinking would necessarily require flexibility, as the injuries suffered in class actions vary widely.<sup>139</sup> That is, the hit to a defendant's stock price would vary according to the disparity in type and weight of a class's injury. The greatest flaw with basing the scheme in victim compensation, however, is that it discounts the ability of the plaintiff lawyer, which is the underlying foundation upon which attorneys' fees should rest. Thus, deterrence seems a better fit.

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ularly in the securities fraud setting. *E.g.*, *KPMG to Pay \$6.2 Million Neither Admit nor Deny SEC Charges*, CORP. CRIME REP. (Aug. 15, 2017, 11:20 AM), <https://www.corporatecrimereporter.com/news/200/kpmg-pay-6-2-million-neither-admit-deny-sec-charges/>. More research needs to be done to determine whether or not a denial of wrongdoing provision has an effect on the market's reaction to the settlement news.

<sup>136</sup> Life could, however, get more difficult if the defendant challenges the presumption that the share price decline traces to the class action. *See supra* note 91.

<sup>137</sup> *But see generally* Silver, *supra* note 13, at 1385–1429 (offering an explanation as to why defendants in class actions settle, in refutation of the idea that they are coerced into “blackmail settlements”).

<sup>138</sup> *See, e.g.*, Brian T. Fitzpatrick, *Do Class Actions Deter Wrongdoing?* 8–13 (Vand. Univ. Law Sch. Legal Studies Research Paper Series, Working Paper No. 17–40, 2017), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3020282](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3020282) [hereinafter Fitzpatrick, *Deter Wrongdoing?*] (deterrence exists); *cf.*, *e.g.*, *U.S. S.E.C. v. Citigroup Global Markets Inc.*, 827 F. Supp. 2d 328, 333–335 (S.D.N.Y. 2011), *vacated* 753 F.3d 285 (2d Cir. 2014) (finding that previous deterrence efforts to deter defendant's conduct did not factor into its recidivist tendencies).

Doubts as to the legitimacy of settlement as an indicator of wrongdoing—hence the questions about the effectiveness of deterrence—are not unique to the class action context. For example, American courts forbid the use of settlement negotiations as evidence of wrongdoing. FED. R. EVID. 408. But others disagree about deterrence in the class action context. *See* Fitzpatrick, *Deter Wrongdoing?*, *supra* note 138, at 14–20; Issacharoff & Klonoff, *supra* note 135, at 1195–99.

<sup>139</sup> *Compare In re NFL Players Concussion Injury Litig.*, 821 F.3d 410 (3d Cir. 2016) (brain injury), *with* Complaint, *Baker-Rhett v. S. Carter Enters.*, No. 1:16-cv-05801 (S.D.N.Y. Apr. 18, 2017) (promised exclusive access to the new Kanye West album).

### C. *Empirical Considerations*

All these theoretical underpinnings mean nothing without an investigation as to the actual effect class actions have on defendant stock prices. The studies reflect a few obstacles.<sup>140</sup> The first hurdle is that the market may incorporate class action events into share price before those events occur.<sup>141</sup> In particular, a defendant's stock price may fall before the filing of a class action. Scholarship has demonstrated that a statistically significant decline in share price occurs before the filing of a class action complaint.<sup>142</sup> Given the close proximity in time between the fall and the filing, this phenomenon poses a few problems to any potential reasonability metric of the type suggested here. For one, there are causation problems: how can we fairly attribute a stock drop to an uncertain future event?<sup>143</sup> Similarly, if we accept this idea broadly—that the market anticipates (i.e., feels the effect of) litigation events before they occur—by the time the case settles or comes to judgment, the stock price impact of a settlement or judgment may have already occurred.<sup>144</sup> This hurts the connection between the efforts of the class action plaintiffs' attorney and her impact on defendant share price, and potentially severs the utility of basing her compensation on the change in share price. This is the causation problem.

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<sup>140</sup> See Rob Bauer & Robin Braun, *Misdeeds Matter: Long-Term Stock Price Performance After the Filing of Class-Action Lawsuits*, 66 FIN. ANALYSIS J. 74 (2010); Ferris & Pritchard, *supra* note 98; Amar Gande & Craid M. Lewis, *Shareholder-Initiated Class Action Lawsuits: Shareholder Wealth Effects and Industry Spillovers*, 44 J. FIN. & QUANTITATIVE ANALYSIS 823 (2009); Klock, *supra* note 82; Patrick Lieser & Sascha Kolaric, *Securities Class Action Litigation, Defendant Stock Price Revaluation, and Industry Spillover Effects*, DEP'T OF BUS. ADMIN., ECON. & LAW, TECHNISCHE UNIVERSITÄT (2016), [http://www.efmaefm.org/0EFMAMEETINGS/EFMA%20ANNUAL%20MEETINGS/2016-Switzerland/papers/EFMA2016\\_0388\\_fullpaper.pdf](http://www.efmaefm.org/0EFMAMEETINGS/EFMA%20ANNUAL%20MEETINGS/2016-Switzerland/papers/EFMA2016_0388_fullpaper.pdf); Markus Niemeier, *Class Action Lawsuits and Stock Prices*, FIDERES (Apr. 21, 2016), <http://fideres.com/publications/class-action-lawsuits-and-stock-prices>.

<sup>141</sup> Bauer & Braun, *supra* note 140, at 78–80; Klock, *supra* note 82, at 154–55; Niemeier, *supra* note 140.

<sup>142</sup> Klock, *supra* note 82, at 133–35; Ferris & Pritchard, *supra* note 98, at 32. At first glance, attributing the decline to future unknowable events (e.g. filing a class action following a private investigation) raises causation, insider trading, and/or time-travel problems. *But see infra* section III.C.1.

<sup>143</sup> STEPHEN A. ROSS, RANDOLPH W. WESTERFIELD & JEFFREY F. JAFFE, CORPORATE FINANCE 351 & n.9 (6th ed. 2003) (“Because a stock’s return today cannot depend on what the market does not yet know, the information that will be known only in the future cannot influence the stock’s return either.”).

<sup>144</sup> This is especially palpable in class actions following a public investigation. When there was an antecedent public investigation, private class counsel has less work to do because she only has to follow the government’s lead. Further, because of market efficiency, the details from an antecedent public investigation would likely be already incorporated into the stock price before a class action develops based on the same underlying facts. *Contra* Bauer & Braun, *supra* note 140, at 90 (“If the company has already been facing problems before the filing date in terms of self-disclosure or legal investigations by third parties, it suffers additionally from the filing of the lawsuit by its shareholders.”).

Second, if the market truly reacts before the event, then whether the event is good or bad for the company should not matter. Neither news of settlement and adverse judgment—understood here as bad news, as it is confirmation that the defendant will have to “pay up”—nor news of dismissal—the corollary good news, confirmation that the defendant is not liable for any payment—would make a difference. Simply put, the type of news would not matter, as there is no way the market could know the content of the news before its publication. Either share price would increase in all cases, decrease in all cases, or randomly shift irrespective of the nature of the news. This is the good-news-bad-news problem.

### 1. Solving the Causation Problem

Problems created by the market anticipatorily incorporating events turn out to be paper tigers. While it is fair to say that we can never argue that the anticipatory decline is due solely to the coming class action filing,<sup>145</sup> a few responses suffice. First, this fear has not dissuaded academics in their event studies—even those not localized to the class action context—from attributing an abnormal drop in share price to a future event.<sup>146</sup> Stephen A. Ross, Randolph W. Westerfield, and Jeffrey F. Jaffe explain why:

An astute reader may wonder why the abnormal return is negative on day 1, as well as on day 0. To see why, first note that the announcement date is generally taken in academic studies to be the publication date of the story in *The Wall Street Journal (WSJ)*. Then consider a company announcing a dividend omission via a press release at noon on Tuesday. The stock should fall on Tuesday. The announcement will be reported in the *WSJ* on Wednesday, because the Tuesday edition of the *WSJ* has already been printed. For this firm, the stock price falls on the day *before* the announcement in the *WSJ*.

Alternatively, imagine another firm announcing a dividend omission via a press release on Tuesday at 8 P.M. Since the stock market is closed at that late hour, the stock price will fall on Wednesday. Because the *WSJ* will report the announcement on Wednesday, the stock price falls on the day of the announcement in the *WSJ*.

Since firms may either make announcements during trading hours or after trading hours, stocks should fall on

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<sup>145</sup> See *supra* note 91.

<sup>146</sup> See, e.g., ROSS, WESTERFIELD & JAFFE, *supra* note 143, at 352 n.11.

both day 1 and day 0 relative to publication in the *WSJ*.<sup>147</sup>

The idea holds true even in time windows beginning before day negative one and ending at day zero: “[T]he lawsuit *per se* and not any pre-filing event drives the long-term post-event [share price decrease].”<sup>148</sup>

Second, if there is still any doubt, then we can, at the very least, presume that the earlier drop is due to the class action filing. The data shows that the drop is “abnormal,” so we know that it is not due to ordinary market forces.<sup>149</sup> The close proximity in time between the drop and the filing supports the presumption, absent of other explanations, that the filing is the cause. Professor Rob Bauer and Robin Braun credit “rumors hitting the market or repercussions from triggering events.”<sup>150</sup>

## 2. Solving the Good-News-Bad-News Problem

A 2016 study suggests there is no difference between good and bad news, at least at the end of a class action.<sup>151</sup> Empirical research shows a striking “similarity in the magnitude of the stock price reaction for dismissed and settled cases.”<sup>152</sup> “Defendant firms experience a slight positive price reaction during the three day period surrounding the conclusion day.”<sup>153</sup> This is not true at the outset of a class action: “[E]ven frivolous lawsuits result in a statistically significant drop in the value of the firm, but the magnitude of the drop is substantially larger for the filings that are not frivolous.”<sup>154</sup> We would expect a difference, considering a defendant company’s (and likely its shareholders’) preference for dismissal over settlement.<sup>155</sup> But would we expect that difference to be felt at

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<sup>147</sup> *Id.*; see Klock, *supra* note 82, at 132–33.

<sup>148</sup> Bauer & Braun, *supra* note 140, at 88–90 (“The official filing of a [class action] lawsuit . . . appears to be the cause of an erosion of confidence. On the basis of this finding, we conclude that a ‘true filing effect’ does exist.”).

<sup>149</sup> ROSS, WESTERFIELD & JAFFE, *supra* note 143, at 351–52, 352 n.11 (“The *abnormal return* (AR) on a given stock for a particular day can be calculated by subtracting the market’s return on the same day ( $R_m$ )—as measured by a broad-based index such as the S&P composite index—from the actual return ( $R$ ) on the stock for that day.”); Klock, *supra* note 82, at 133–54 (collecting data sets demonstrating abnormal returns on stock price close-in-time to class action filings).

<sup>150</sup> Bauer & Braun, *supra* note 140, at 78–83, 86–90.

<sup>151</sup> Lieser & Kolaric, *supra* note 140.

<sup>152</sup> *Id.* at 19–20.

<sup>153</sup> *Id.* at 35.

<sup>154</sup> Klock, *supra* note 82, at 138–39 (using the ultimate dismissal “as a proxy for frivolous behavior”).

<sup>155</sup> See MICHAEL R. McDONALD & CAROLINE E. OKS, 18TH ANNUAL NAT’L INST. ON CLASS ACTIONS, BEST PRACTICES FOR DEFENDING A CLASS ACTION COMPLAINT BEFORE EVEN FILING A RESPONSE, at E-19 to E-20 (2014), <https://www.gibbonslaw.com/Files/Publication/ca664190-9d00-45a7-8bda-dffe808d1003/Presentation/PublicationAttachment/27dd8eb4-31e3-41ca-95a2-2e78dc4d546c/Best%20Practices%20for%20Defending%20a%20Class%20Action>

filing before any real investigation of the claim outside of the complaint? Not likely.

The above phenomenon does not mean there is no effect on share price over the life of the class action suit. Further research “offers limited evidence that the market does take . . . litigation development into account.”<sup>156</sup> But, in line with the above findings regarding the conclusion of a class action, the only relevant information for shareholders, in terms of stock price, is that there is *development*, not the actual nature (good vs. bad) of the development. The greatest influence on the share price at this point is the presence of litigation, not the merits thereof.<sup>157</sup> So when researchers talk of the market’s anticipation of litigation events, one would best understand it as an inability to evaluate the case’s development.<sup>158</sup> As above, the market can actually anticipate the filing of class action complaints, and even differentiate among them according to merit.<sup>159</sup> Other explanations for the “difference in kind,” but not “difference in effect” (i.e., good news and bad news each having an effect—and that effect is the same between the two) result should not be ruled out: consider the reputational damage<sup>160</sup> or the sunk cost embedded in any litigation.<sup>161</sup>

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.pdf; see also, Note, *Risk-Preference Asymmetries in Class Action Litigation*, 119 HARV. L. REV. 587, 598–601 (2005) (rejecting the idea that blackmail settlements incentivize a defendant to “part with their money” rather than “proceed to a trial”).

<sup>156</sup> Ferris & Pritchard, *supra* note 98, at 31–33.

<sup>157</sup> *Id.* at 33 (“[The research] suggest[s] that the content of the complaint is not material information to market participants.”). This, in hindsight, further supports the treatment of news of class certification as the same as news of settlement. See *supra* note 90.

<sup>158</sup> Perhaps a different outcome would be obtained if there were greater media scrutiny or public interest. Cf. Stephanie Dube Dwilson, *How Do Lawsuits Affect Stock Prices?*, ZACKS, <https://finance.zacks.com/lawsuits-affect-stock-prices-10130.html> (last visited Dec. 14, 2017) (“In 2010, the Walt Disney Co. lost a lawsuit filed by Celador International . . . After the decision, shares in Disney stock actually went up by 4 percent. The public really wasn’t interested in the lawsuit, so no negative media buzz surfaced to spook investors and hurt the stock.”).

<sup>159</sup> See *supra* notes 155–56 and accompanying text.

<sup>160</sup> Jonathan M. Karpoff, D. Scott Lee & Gerald S. Martin, *The Cost to Firms of Cooking the Books*, 43 J. FIN. & QUANTITATIVE ANALYSIS 581, 598–606 (2008) (“[C]lass-action settlements explain a small portion . . . of firms’ loss in market value . . . . The remaining [amount] reflects . . . the average reputation loss.”); Eric Helland, *Reputation Penalties and the Merits of Class-Action Securities Litigation*, 49 J.L. & ECON. 365, 365 (2006) (“Only in shareholder class actions in the top quartile of settlements or in which the Securities and Exchange Commission has initiated a case do directors appear to suffer reputational penalty when a board they serve on is accused of fraud.”). But see Helland, *supra*, at 366 (“[F]or the average case, there is no evidence of a negative effect on reputation associated with allegations of fraud. In fact, directors accused of fraud increase their net number of board positions for almost all measures of new board positions.”).

<sup>161</sup> Randy J. Kozel & David Rosenberg, *Solving the Nuisance-Value Settlement Problem: Mandatory Summary Judgment*, 90 VA. L. REV. 1849, 1855–60 (2004) (examining the strategy behind getting a defendant to settle for an amount less than their expected sunk litigation costs). But see Klock, *supra* note 82, at 139 (“We lack data on the average cost of defending a

A return to assumptions proves useful. Data indicates that news of settlement, though expected to be “bad news,” does not necessarily carry with it a cloud of negative thoughts around a company’s outlook. Instead, “the observed positive price reaction to settlement news is consistent with investors being relieved that such settlement will end costly litigation and reduce ‘litigation overhang.’”<sup>162</sup> This is not to suggest that

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class action that is ultimately dismissed, so we cannot ascertain whether the drop is merely due to expected litigation costs or something more than that, which might include damage to the corporate reputation.”).

If these sunk costs are truly incorporated into the share price at the outset of a class action litigation, then there is good reason why the third compensation scheme in the non-class action context has not been adopted in class actions. This third type is the “flat fee[.] . . . intended to compensate a lawyer for all work to be done on a matter or a discrete aspect thereof, regardless of the time required or complexity of the assignment.” Douglas R. Richmond, *Understanding Retainers and Flat Fees*, 34 J. LEGAL PROF 113, 131–35 (2009). For example, attorneys can charge a flat fee based on litigation benchmarks—pre-discovery, discovery, post-note of issue, etc. *E.g.*, *Litigation Phase Breakdown and Cost/Flat Fee Projection*, STEVEN J. LODGE, PLLC, <http://www.stevelodgelawonline.com/files/38350965.pdf> (last visited Dec. 14, 2017). These benchmarks are common to most if not all lawsuits. Because class actions all but end at around the certification stage, *see* Willging et al., *supra* note 135, different-but-analogous benchmarks would have to be established for this type of suit. To offer a few: pre-discovery investigation, survival of a motion to dismiss, class-related discovery, merits-related discovery, certification, and victory in 23(f) appellate review. *E.g.*, *In re Cendant Corp. Litig.*, 264 F.3d 201, 225 n.5 (3d Cir. 2001).

There are some conceivable benefits to this type of scheme if it was to be used by a class plaintiff attorney. It would be in the attorney’s best interests to complete each stage as quick as possible, eliminating any time-wasting efforts. This serves the judicial economy rationale of class actions. It also is unlikely to lead to a plaintiff attorney’s coaxing a class defendant into filing a motion to dismiss, for summary judgment, or a 23(f) appeal. *See* Kozel & Rosenberg, *supra*, at 1873, 1873 n.41. It’s just too risky and time-intensive.

But the method has fatal flaws. There is an irremovable arbitrariness in setting a value for the work done at the various stages. Further, the time-spent aspect can work against the idea that lawyers bringing more meritorious cases should be compensated better—class actions can serve their deterrence and compensation rationales while being settled at the outset of a litigation. If a claim is so strong such that the defendant quickly agrees to a huge settlement, fully compensating victims and sufficiently deterring future conduct, it is unfair to reward this plaintiff attorney less than those who drag out less-meritorious claims. In fact, it may lead to a plaintiff attorney declining to settle quickly in the hopes of obtaining a larger fee. Finally, this method of compensation does nothing to influence a class plaintiff attorney’s efforts to obtain the largest possible award for his clients, outside of good business practice.

However, the stages of litigation distinction infrequently appears in some class action plaintiff attorney fee schemes. *See, e.g.*, *In re Wells Fargo Securities Litig.*, 157 F.R.D. 467 (N.D. Cal. Jan. 12, 1995); *Wenderhold v. Cylink*, 191 F.R.D. 600 (N.D. Cal. Feb. 4, 2000); *In re Lucent Technologies, Inc. Securities Litig.*, 194 F.R.D. 137 (D.N.J. Apr. 26, 2000). Judge Vaughn Walker, the first implementer of an auction process, recognized utility in setting fees with litigation stages in mind: the “notion of a fee discount for early settlement . . . adjust[ment of] the fee based on the stage of the litigation at which the case is resolved, ranging from pleading to motions to dismiss, to summary judgment, to verdict after trial, to appeal.” *In re Auction Houses Antitrust Litig.*, 197 F.R.D. 71, 80 (S.D.N.Y. Sept. 22, 2000).

<sup>162</sup> U.S. CHAMBER INST. FOR LEGAL REFORM, ECONOMIC CONSEQUENCES: THE REAL COSTS OF U.S. SECURITIES CLASS ACTION LITIGATION 18 (2014). Litigation overhang includes “[not only] direct costs of litigation . . . but also indirect costs such as curtailment of corporate investments.” *Id.*

there are not negative effects a class action settlement may have on the defendant company. Settlement has been linked with liquidity problems and worsening Altman Z-scores for a defendant firm.<sup>163</sup> Liquidity and Altman Z-scores are proxies for a company's health, just as we have understood share price here.<sup>164</sup> These may or may not be better indices upon which to lay an attorney-fee-reasonableness analysis.<sup>165</sup>

Final considerations should include a brief mention of the data's fascinating quirks. First, the degree to which the stock price drops varies depending on where the class action was filed. "[F]ilings in the Ninth Circuit lead to valuation drops that are more than double those for filings in the Second Circuit."<sup>166</sup> Second, rival firms in the industry's share prices are also affected.<sup>167</sup> Third, defendants of different economic sectors experience share price impacts of differing amounts.<sup>168</sup> Fourth, the types and number of allegations in a complaint affect defendant share prices differently.<sup>169</sup> The details do not jeopardize our inquiry; studies have yet to demonstrate a causal link between these quirks and the effect on share prices.<sup>170</sup>

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<sup>163</sup> Lynn Bai, James D. Cox & Randall S. Thomas, *Lying and Getting Caught: An Empirical Study of the Effect of Securities Class Action Settlements on Targeted Firms*, 158 U. PA. L. REV. 1877, 1912 (2010).

<sup>164</sup> Alan D. Holtz, *Liquidity is Lord: Evaluating Imminent Financial Distress*, 18 AM. BANKR. INST. J. 12, 12–13 (1999). See generally Larry Cao, *The Altman Z-Score in Edward Altman's Own Words*, CFA INSTITUTE (Feb. 2, 2016), <https://blogs.cfainstitute.org/investor/2016/02/02/the-altman-z-score-in-edward-altmans-own-words/> (Altman Z-score predict the likelihood of a company going bankrupt based on "a number of financial indicators [combined] with a technique for statistical classification known as discriminant analysis"); Roger Wohlner, *Liquidity Measurement Ratios*, INVESTOPEDIA (May 4, 2017, 2:51 PM), <https://www.investopedia.com/university/ratios/liquidity-measurement/> ("[A] company with insufficient liquidity might be forced to make tough choices to meet their obligations. These . . . could prove detrimental to both the company's short-term viability and their long-term financial health.").

<sup>165</sup> Bai, Cox & Thomas, *supra* note 163, at 1912 (noting that the research does not rise to the level of causation instead of mere correlation). A thorough investigation on this point is outside the scope of this Note.

<sup>166</sup> Klock, *supra* note 82, at 142–46. Even worse, in the Second Circuit "the actual filing event has no statistically discernible effect." *Id.* This could be especially problematic since the Second Circuit saw more than 1.5x the amount of securities class actions filings than the next highest circuit in 2017. 2017 YEAR IN REVIEW, *supra* note 11, at 34 (seventy-five in the Second Circuit; forty-five in the Ninth Circuit). Resist the temptation to find this flaw fatal; this is only correlation and certainly not causation. We cannot say that class actions filings in the Second Circuit will, as a rule, have no effect on defendant share price. See Klock, *supra* note 82, at 143 ("[W]e have to be extremely careful not to draw causal inferences from these results. There are too many factors at play that cannot be adequately controlled for." (footnote omitted)).

<sup>167</sup> Lieser & Kolaric, *supra* note 140, at 24.

<sup>168</sup> Klock, *supra* note 82, at 147–54.

<sup>169</sup> Bauer & Braun, *supra* note 140, at 83.

<sup>170</sup> See, e.g., Klock, *supra* note 82, at 142; *infra* notes 178–183.

#### D. Implications

Because the impact on a defendant's stock price is most felt at the outset of a class action—at filing—the reasonableness of an attorney's fee could be assessed immediately. This hurts the fitness of a reasonableness analysis based on stock price reaction. Part of the motivation behind such a method is that it measures the quality of the representation and the work the attorney put in.<sup>171</sup> If the filing is the only time when a class action's negative impact on a defendant's share price can differentiate between meritorious and non-meritorious cases, then the attorney's work and effort does not factor into the impact on share price.<sup>172</sup> Or if the attorney's work does factor in, only the strength of the pre-filing investigation or the complaint's plausibility impact share price.<sup>173</sup> Perhaps the impact could also relate to the reputation of the firm as zealous litigators, but, if so, this does not rescue the basis upon which the impact index rests. A court should not deem attorneys' fees reasonable solely as a result of a firm's reputation walking in the door.

The different effects on stock price upon filing rest on whether the claim is meritorious or not.<sup>174</sup> One could argue, then, that the lead counsel should be compensated for effort and work put into bringing and presenting the claims.<sup>175</sup> After all, even if there are several class plaintiff attorneys attempting to bring suit on the same set of facts, lead counsel did fend off those competitors. Further, lead counsel saw the case to completion. However weak a foundation this would be for determining reasonableness, it nevertheless proves useful to examine its implementation.

#### E. Method, Application, and Final Considerations

Despite the noted obstacles above, there is room to use the class action's impact on a defendant's stock price to gauge the reasonableness of attorneys' fees. Developments past filing should be ignored because

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<sup>171</sup> See *supra* note 102 and accompanying text.

<sup>172</sup> Effort during the life of the class action being impactless on a defendant's share price consequently counsels against the "scorched earth," "take no prisoner," "Godzilla" or "Rambo litigation" tactics that some may fear arise should a court adopt the share price impact method I am proposing. See generally Gideon Kanner, *Welcome Home Rambo: High-Minded Ethics and Low-Down Tactics in the Courts*, 25 *LOU. L.A. L. REV.* 81, 81 n.2 (1991); *supra* notes 116–126 and accompanying text.

<sup>173</sup> Bauer & Braun, *supra* note 140, at 86–90 ("[T]he lawsuit *per se* and not any pre-filing event drives the long-term post-event [share price decrease]."). Whether this impact on stock price speaks to plausibility in the *Twombly-Iqbal* sense is outside the scope of this Note. If it does, however, defendants and courts alike may have another "tool" to use at the motion to dismiss stage. Far more research needs to be done before any such application can occur.

<sup>174</sup> Klock, *supra* note 82, at 138–39.

<sup>175</sup> This strengthens the need for awarding finder's fees, see *supra* notes 77–80 and accompanying text, but does not require that finder's fees be analyzed in this manner.

the stock price does not feel an effect, differentiable between good and bad outcomes, when the class action terminates.<sup>176</sup> But the impact on shares at the filing stage should be incorporated into a court's analysis, as there is statistically significant difference in how much the stock declines in price depending on whether or not the complaint is subsequently dismissed.<sup>177</sup> This method would assess the quality of class counsel's work at the front end, in that meritorious claims will hit the defendant company harder than non-meritorious claims.

Readers are cautioned against applying the findings of the previously-cited studies to a particular, recently-sued company's share price. Professor Klock refrained from analyzing "[a]bnormal returns for individual securities . . . because they are too volatile."<sup>178</sup> On the whole, event studies do offer a percentage to which these stock prices suffer.<sup>179</sup> But this is not a benchmark of merit. Should a defendant share price decrease in the days surrounding a class action filing to a lesser extent than these benchmarks, the class action would not necessarily lack merit. Event studies are retrospective, not prospective.

Distilled, the question is: "[S]hould an event date abnormal return that is significantly large relative to abnormal returns in the pre-event control period . . . be accepted as prima facie statistical evidence?"<sup>180</sup> The answer, unfortunately, is no:

The statistics of an event study apply only if the statistical test is made *after* the hypothesis is created, so that there is a chance that the price movement is statistically significant and a chance that it is not. If one first identifies days that have statistically significant movements, then the only error can occur in properly identifying material [events]. However, this is not the function of an event study, and certainly the error rates from the event study do not apply to the probability of making accurate [event] determinations.

Thus, any process that first looks at price movements and then searches for [events] is not a proper

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<sup>176</sup> See Lieser & Kolaric, *supra* note 140, at 19–20, 35; *supra* section III.C.2.

<sup>177</sup> Klock, *supra* note 82, at 138–39.

<sup>178</sup> Klock, *supra* note 82, at 132.

<sup>179</sup> Over the (-1,0) interval, meritorious filings lead to -2.56% loss; frivolous filings - 0.87%. Klock, *supra* note 82, at 140–41. Without accounting for merit, share prices suffered - 3.86% loss over the (-1,0) interval. Bauer & Braun, *supra* note 140, at 75, 83. Over the (-1,1) interval, -3.25% losses. Lieser & Kolaric, *supra* note 140, at 20, 34.

<sup>180</sup> Charles J. Corrado, *Event Studies: A Methodology Review*, 51 ACCT. & FIN. 207, 217 (2011).

event study, at least not if [event] determinations involve any element of subjectivity.<sup>181</sup>

What this means is that in any litigation, even if it is identified that a defendant's share price suffered an abnormal loss greater than or equal to the average abnormal loss that the studies have shown in the timeframe surrounding a class action event, this does not necessarily mean that we can say, *prima facie*, that the class action event caused this decrease. Such a determination would require different statistical studies.<sup>182</sup> No study to date has focused on predicting a class action's impact on a defendant's share price.<sup>183</sup>

Given the law's supposed allergy to math and statistics, one may wonder: first, should a study fill this gap? And second, whether its findings would be administrable.<sup>184</sup> Or, one may posit that the data is not helpful for calculating attorneys' fees, as dismissed cases avoid the calculation entirely. But with the right tools, this idea could be administrable and useful, say in the certification-only-for-the-purposes-of-settlement context.<sup>185</sup> For example, the Seventh Circuit reversed a class-action-settlement approval—and specifically lambasted the attorney's fee—holding that: “Because the settlement yields fees for class counsel and zero benefits for the class, . . . [the case] should have been dismissed out of hand.”<sup>186</sup> That is, an objection<sup>187</sup> to class counsel's fee and settle-

<sup>181</sup> David Tabak, Use and Misuse of Event Studies to Examine Market Efficiency 4–5 (April 30, 2010) (Working Paper) (on file with NERA Econ. Consulting) (footnote omitted).

<sup>182</sup> E.g., Sumanta Singha, Steve Hillmer & Prakash P. Shenoy, *On Computing Probabilities of Dismissal of 10b-5 Securities Class-Action Cases*, 94 DECISION SUPPORT SYSTEMS 29, 40 (2017) (“Further, we also observe that the short-term-drop (STD) in share price within a period of 1–5 days is an important attribute. This agrees with our belief that STD measures the immediate impact of the security fraud and is a proxy of the financial loss suffered by investors. Hence, we expect the likelihood of dismissal to be lower when share price drop is > 42.2%. In our case, the likelihood ratio for dismissal is 0.6465 when STD > 42.2% and 1.097 when STD < 42.2%, which includes no allegation of short term drop in the consolidated complaint . . . Thus, an allegation of STD > 42.2% favors non-dismissal, which is consistent with our belief.”).

<sup>183</sup> See *id.* (“[W]e present a model that can be used to predict probability of dismissal in response to motion to dismiss.”); Blakeley B. McShane et al., *Predicting Securities Fraud Settlements and Amounts: A Hierarchical Bayesian Model of Federal Securities Class Action Lawsuits*, 9 J. EMPIRICAL LEGAL STUD. 482, 507–08 (2012) (“Our model is predictive of settlement incidence (i.e., likelihood of dismissal) and outcome (i.e., expected settlement amount) at the time a case is filed.”).

<sup>184</sup> See *supra* note 60 and accompanying text.

<sup>185</sup> See generally Coffee, *Class Action Accountability*, *supra* note 126, at 372 n.9 (describing the practice leading up to Supreme Court's decision in *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997)).

<sup>186</sup> *In re Subway Footlong Sandwich Marketing and Sales Practices Litig.*, 869 F.3d 551, 557 (7th Cir. 2017) (internal quotation marks omitted).

<sup>187</sup> Theodore H. Frank's Objection to Proposed Settlement, *In re Subway Footlong Sandwich Marketing and Sales Practices Litig.*, No. 2:13-md-2439-LA, (E.D. Wis. Dec. 15, 2015). Note the objector: Ted Frank. See *supra* note 3.

ment was the vehicle by which the court ultimately found the claim frivolous and ultimately dismissed it.<sup>188</sup> In all fairness, the complaint's frivolousness was obvious on its face—but this won't be true of all cases.<sup>189</sup>

### CONCLUSION

Are class action fee calculation an untapped legal hot-spot where my proposed method is needed to cure abuse?<sup>190</sup> Unlikely. The method is imperfect. But the status quo itself is not perfect, hence the need for creative solutions. A fundamental truth upon which we can rely to create new solutions is: lawsuits, especially class actions, hurt defendants.<sup>191</sup> The hit to defendants' stock price as an index for the reasonableness of an attorney's fee combats some of the nefarious aspects pervading class actions. And the data evidences statistical significance thereof.<sup>192</sup> Though the weight of its flaws counsel against its application, there is unexplored territory relating to stock price and class litigation's impact on it. Further research could lead to unforeseen, positive results. Stranger things have happened, especially in the world of class actions.<sup>193</sup>

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<sup>188</sup> Stipulation of Dismissal Without Prejudice, *In re Subway Footlong Sandwich Marketing and Sales Practices Litig.*, No. 2:13-md-2439, (E.D. Wis. Oct. 24, 2017).

<sup>189</sup> Granted, my proposal would have had no effect on Subway footlong litigation because Subway is a privately-held company. *General FAQ*, SUBWAY, <http://www.subway.com/en-us/contactus/subwayfaqs> (last visited Mar. 3, 2018). Nonetheless, the way in which the Seventh Circuit handled the case was not the first time a court acted as such and likely won't be the last. See *In re Walgreen Co. Stockholder Litig.*, 832 F.3d 718 (7th Cir. 2016); Notification of Docket Entry, *Hays v. Walgreen Co.*, No. 1:14-cv-09786 (N.D. Ill. Dec. 13, 2016).

<sup>190</sup> Kathianne Boniello, *Ridiculous Class-action Lawsuits Are Costing You Tons of Money*, N.Y. POST (Jan. 6, 2018, 7:48 PM), <https://nypost.com/2018/01/06/ridiculous-class-action-lawsuits-are-costing-you-tons-of-money/> (discussing recent class action filings and highlighting one such suit alleging "CVS brand candy boxes [had] too much air inside").

<sup>191</sup> "After now some dozen years of experience I must say that as a litigant I should dread a lawsuit beyond almost anything else short of sickness and death." Learned Hand, *The Deficiencies of Trials to Reach the Heart of the Matter*, reprinted in 3 LECTURES ON LEGAL TOPICS 1921–22, at 87, 105 (1926).

<sup>192</sup> Thus making it more than a coincidence. *E.g.* David Gaffen, *Patriots Lose—Markets Win?*, WALL ST. J (Feb. 4, 2008, 1:37 PM), <https://blogs.wsj.com/marketbeat/2008/02/04/patriots-lose-markets-win/>.

<sup>193</sup> *E.g.*, Complaint, *Careathers v. Red Bull GmbH* at 5–7, No. 1:13-cv-00369-KPF (S.D.N.Y. Jan. 15, 2013) (filing a class action against Red Bull because the energy drink did not, in fact, "give you wings"); Final Judgment and Order of Dismissal with Prejudice at 5, *Careathers v. Red Bull GmbH*, No. 1:13-cv-00369-KPF (S.D.N.Y. May 12, 2015) (approving settlement which included an injunction against "making any future claims about the functional benefits of Red Bull Products without medical and/or scientific support.").

