RESTITUTION, RENT EXTRACTION, AND CLASS REPRESENTATIVES: IMPLICATIONS OF INCENTIVE AWARDS

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Sometimes, no news is good news. In an important article,[1] Theodore Eisenberg and Geoffrey Miller add to the emerging literature that uses empirical research to shed light on the real-world operation of class action lawsuits.[2] The conclusions that Eisenberg and Miller draw about incentive awards to class representatives are consistent with the conclusions of their previous study of class-counsel fee awards.[3] The major point they make regarding both types of awards is easily stated: The patterns in both class-counsel fee awards and incentive awards to class representatives do not deviate dramatically from the respective justifications for those awards. As Eisenberg and Miller carefully note, this observation remains constrained by the available data from the corpus of reported decisions that serve as the basis for both of their studies.[4] Even with this caveat, the good news is that there is no news. Reported awards are inconsistent with narratives of lawyer demands or judicial discretion run wild.

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1. Theodore Eisenberg & Geoffrey P. Miller, *Incentive Awards to Class Action Plaintiffs: An Empirical Study*, 53 UCLA L. REV. 1303 (2006).

2. Important empirical studies of class actions by other scholars include DEBORAH R. HENSLER ET AL., CLASS ACTION DILEMMAS (2000); Thomas E. Willging et al., *An Empirical Analysis of Rule 23 to Address the Rulemaking Challenges*, 71 N.Y.U. L. REV. 74 (1996).

3. Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees in Class Action Settlements: An Empirical Study*, 1 J. EMPIRICAL LEGAL STUD. 27 (2004). For coverage of this study in the general-interest press, see Jonathan D. Glater, *Study Disputes View of Costly Surge in Class-Action Suits*, N.Y. TIMES, Jan. 14, 2004, at C1.

4. Eisenberg & Miller, *supra* note 1, at 1319–22; Eisenberg & Miller, *Attorney Fees*, *supra* note 3, at 44–46.

This Essay focuses on the implications from the Eisenberg and Miller data on incentive awards. My organizing concept involves a comparison implicit in the two empirical studies that Eisenberg and Miller have completed thus far. My suggestion is that we may organize our thinking about what to make from the data on incentive awards by comparing the observations on that subject with the world of class-counsel fee awards.

Part I highlights the ways in which incentive awards to class representatives parallel fee awards for class counsel. By "parallel," this Essay refers to ways in which incentive awards seek to accomplish objectives with respect to class representatives analogous to those advanced by fee awards to class counsel. These objectives are described broadly as restitutionary in nature. Next, Part I discusses how systematic examination of incentive fees in the manner of Eisenberg and Miller's study potentially can move judicial administration of these awards in the same direction as recent developments regarding class-counsel fee awards.

Part II supplies the natural counterpoint by discussing one dimension of incentive awards that finds no close analog to class-counsel fee awards. In part, awards to class representatives should account for the monitoring function those persons undertake on behalf of absent class members. To encourage high-quality monitoring, the law should provide not only restitution (to restore what the class representative expends, either explicitly or implicitly) but also an additional reward (a bounty based roughly on the quality of the monitoring provided). Attention to the restitution and reward aspects of monitoring highlights an anomaly in one significant aspect of class action litigation. The Private Securities Litigation Reform Act of 1995 (PSLRA)[5] prohibits rewards in securities class actions, even though other features of that legislation proceed upon—indeed, enshrine—the notion of high-quality monitoring by large institutional investors as class representatives. This juxtaposition in the PSLRA is especially odd when one considers the growing body of post-PSLRA research suggesting substantial reluctance by institutional investors to serve as class representatives.

Additionally, Part II addresses a second aspect of the class representative's role that finds no close counterpart to class-counsel fees: the "gatekeeping" function of the class representative. Here, the terms "gatekeeping" and "gatekeeper" carry meanings different from what they usually convey in the

5. Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.).

scholarly literature on corporate law.[6] Prior to the Class Action Fairness Act of 2005[7] (the period of the Eisenberg and Miller data), the class representative in class actions involving state-law claims literally might have served as a gatekeeper with regard to forum selection. She might have enabled the class action to avoid removal to federal court and, thereby, remain in a state court advantageous to the class.

Another aspect of this gatekeeping function, however, has little to do with anything the class representative might accomplish for the benefit of the class and everything to do with service to class counsel. Once again, the most illustrative example arises in securities class actions. Under the PSLRA, the class representative may serve a gatekeeping role by enabling class counsel to gain control of the litigation vis-à-vis competing lawyers within the plaintiffs' bar. This Essay concludes by discussing how this second gatekeeping function bears upon the current controversy over alleged side payments to class representatives by class counsel, the focus of a widely reported criminal indictment concerning the prominent securities plaintiffs' law firm Milberg Weiss Bershad & Schulman LLP.[8]

I. COMMON FEATURES OF INCENTIVE AWARDS AND CLASS-COUNSEL FEE AWARDS

Several features of the incentive awards documented by Eisenberg and Miller parallel aspects of class-counsel fee awards. One of the core justifications for a fee award to class counsel appeals to restitutionary principles. This restitutionary notion holds that, absent a fee award, members of the class would be unjustly enriched by the efforts of class counsel who produce a class settlement beneficial to the class (or, in the rare instance, a favorable judgment at trial).[9] Analogous notions of restitution explain much of what goes on in the context of incentive awards.

6. *See, e.g.*, John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 302 (2004) (describing "gatekeepers" as "independent professionals who pledge their reputational capital . . . to protect the interests of dispersed investors [in a corporation] who cannot easily take collective action"—for example, "auditors and securities analysts . . . who verify or assess corporate disclosures in order to advise investors in different ways").

7. Class Action Fairness Act of 2005 (CAFA), Pub. L. No. 109-2, 119 Stat. 4 (to be codified in scattered sections of 28 U.S.C.).

8. *See* First Superseding Indictment, United States v. Milberg Weiss Bershad & Schulman LLP, No. CR 05-587(A)-DDP (C.D. Cal. May 18, 2006), *available at* http://www.law.com/pdf/ca/milberg_indictment.pdf.

9. *See* Charles Silver, *A Restitutionary Theory of Attorneys' Fees in Class Actions*, 76 CORNELL L. REV. 656, 663–66 (1991).

As Eisenberg and Miller note, many justifications for incentive awards relate to costs or risks borne by the class representative over and above those shared by absent class members.[10] Some costs stem simply from the nature of lawsuits in the adversarial Anglo-American civil justice system. Litigating a class action as the class representative means subjecting oneself to discovery in the manner of a conventional party.[11] By contrast, class action law generally guards against full-fledged discovery directed toward absent class members,[12] a stance consistent with their passive role in the litigation.[13] Discovery aside, the class representative may incur opportunity costs insofar as she must devote her time to communication with absent class members concerning the nature, progress, and handling of the lawsuit.[14] These costs are analogous to out-of-pocket and opportunity costs incurred by class counsel for the benefit of the class.

The risks to the class representative vary depending upon the nature of the underlying litigation. The clearest illustration comes in the context of employment discrimination class actions, where the class representative might run the risk of becoming a focal point for retaliation—overt or subtle—from the defendant employer or prospective employers in the same industry.[15] Although Title VII of the Civil Rights Act of 1964 prohibits employer retaliation,[16] the availability of after-the-fact protection may be only a modest comfort to a class representative concerned about being labeled a "troublemaker." Likewise, fee awards to class counsel rest, in part, on the notion that they bear risks not shared by class members. If anything, one oft-voiced concern is that class counsel face the risk of garnering no return on their investment to develop the litigation absent a settlement and, as a result, might choose a smaller settlement to hedge that risk.[17]

In short, both incentive and fee awards seek to account for costs and risks uniquely borne by the award recipient for the benefit of absent class members. One interesting implication of Eisenberg and Miller's study lies in a possibility

10. *See* Eisenberg & Miller, *supra* note 1, at 1315–16.
11. *See id.* at 1305.
12. *See* 5 ALBA CONTE & HERBERT B. NEWBERG, NEWBERG ON CLASS ACTIONS § 16:3, at 133 (4th ed. 2002).
13. The notion of passivity on the part of absent class members underlies the U.S. Supreme Court's disinclination to apply to such persons the usual "minimum contacts" standard for personal jurisdiction. *See* Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 809–10 (1985).
14. *See* Eisenberg & Miller, *supra* note 1, at 1315.
15. *See id.* at 1315–16.
16. *See* Civil Rights Act of 1964 § 704, 42 U.S.C. § 2000e-3(a) (2000).
17. *See* Charles Silver, *Class Actions—Representative Proceedings*, *in* 5 ENCYCLOPEDIA OF LAW AND ECONOMICS 194, 218 (Boudewijn Bouckaert & Gerrit DeGeest eds., 2000) (summarizing findings in the class action literature).

that their data raise simply by their nature as aggregate data—namely, that judicial decisions on incentive awards might gravitate in the same direction as judicial decisions on class-counsel fee awards. Some courts have set class-counsel fee awards through a process involving the crosschecking of the award sought in the case at hand with awards in other, broadly comparable class actions. The Third Circuit Court of Appeals' 2001 opinion on the fee award from a multimillion-dollar class settlement in the Cendant PRIDES securities litigation provides a good illustration of this technique in operation.[18] The Eisenberg and Miller data have the beneficial effect of encouraging courts to take a similar approach with regard to incentive awards—in essence, to ask whether the award sought in a given case bears a reasonable relationship to incentive awards in similar cases.

To be sure, there remains a limitation to this kind of crosschecking in the incentive-fee context. As Eisenberg and Miller note, reported decisions involving either incentive awards or class-counsel fee awards represent only a portion of the "full universe" of cases on those subjects.[19] One long-term outgrowth of this observation might consist of more systematized reporting of both kinds of awards.[20] Even in a world of limited empirical data, however, some imperfect crosschecking would be better than none at all. The compiling of the Eisenberg and Miller data, in itself, advances this objective by providing a body of information for courts to use.

II. DIVERGENCE IN THE ROLES OF CLASS REPRESENTATIVES AND CLASS COUNSEL

Two additional features of what class representatives do have no counterpart to class-counsel functions. The first feature consists of the role that class representatives, in theory, undertake by monitoring the conduct of the litigation by class counsel on behalf of absent class members. The second concerns

18. *See In re* Cendant Corp. PRIDES Litig., 243 F.3d 722, 737 (3d Cir. 2001) (setting forth a table of fee awards in comparable reported cases). A more recent decision from the Third Circuit Court of Appeals points approvingly to the district court's reliance on expert testimony concerning published empirical research on class-counsel fee awards in other cases. *See In re* Rite Aid Corp. Sec. Litig., 396 F.3d 294, 303 (3d Cir. 2005).

19. Eisenberg & Miller, *supra* note 3, at 46; *see also* Eisenberg & Miller, *supra* note 1, at 1345–46.

20. Systematic reporting of awards would carry forward to the post-settlement-approval phase the goal of enhancing information as a way to check class settlement practices. The same notion animates the concise information labels that William Rubenstein suggests in his symposium article as a way to convey the basics of a proposed class settlement to absent class members. *See* William B. Rubenstein, *The Fairness Hearing: Adversarial and Regulatory Approaches*, 53 UCLA L. REV. 1435 (2006).

the role of class representatives as gatekeepers, either for the class as a whole or for class counsel in the competitive market for litigation control.

A. Monitoring and the PSLRA

Meaningful monitoring does not necessarily occur across the broad range of class action litigation. A familiar insight in the literature—one voiced vividly by Miller and other scholars—holds that the class representative is often a mere figurehead, such that class counsel frequently operate free from conventional client monitoring.[21] The subject of monitoring, moreover, is not wholly distinct from cost. Any monitoring done by class representatives gives rise to part of their opportunity costs. The initial point here is that these particular opportunity costs find no counterpart to the costs incurred by class counsel.

The Eisenberg and Miller data suggest that incentive awards for class representatives are doing a plausible job of capturing the opportunity-cost dimension.[22] Opportunity costs, nonetheless, are not all that one should take into account with regard to monitoring. If anything, the term "incentive award" itself encompasses notions of both restitution and reward. Consider how the word "incentive" is used in ordinary parlance. An "incentive" for someone to do something for the benefit of others encompasses both the prospect of recompense for effort expended (restitution) and the prospect of benefit beyond what that person might gain simply by sitting back and remaining within the undifferentiated group (reward).

The distinction between restitution and reward helps to clarify the monitoring function that a class representative serves. With regard to monitoring, the challenge for the law lies in determining not merely the out-of-pocket costs, opportunity costs, and risks for the class representative but also the quality of the monitoring she provides. Ideally, incentive awards should reward high-quality monitoring but not low-quality monitoring. This qualitative dimension is more amorphous than notions of cost, however. An inquiry into monitoring quality would call for the court to grapple either explicitly or implicitly with a hard counterfactual comparison. The court would have to ask whether the monitoring done by a given class representative improved the

21. *See* 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, 93–94 (1991) (suggesting that class action law should dispense with the fiction of a class representative and, instead, permit the filing of class complaints in the name of a fictive "Jane Doe"); *see also* Jean Wegman Burns, *Decorative Figureheads: Eliminating Class Representatives in Class Actions*, 42 HASTINGS L.J. 165 (1991).

22. *See* Eisenberg & Miller, *supra* note 1, at 1308.

conduct of the litigation on behalf of absent class members beyond some implicit baseline. Incentive awards might capture this qualitative dimension of monitoring only impressionistically.

The revealing point here speaks to one significant setting for class action litigation in which the legal framework for incentive awards works at cross-purposes with the ideal of high-quality monitoring by class representatives. As Eisenberg and Miller observe, the PSLRA permits court-ordered awards to class representatives but limits such awards to "reasonable costs and expenses (including lost wages) directly relating to the representation of the class."[23] The PSLRA otherwise requires class representatives to swear that they "will not accept any payment" beyond their "pro rata share of any recovery" for the class—for instance, any side payments from class counsel apart from court-ordered awards.[24]

Side payments are explored later.[25] For now, the focus remains on the PSLRA language limiting awards to the "reasonable costs and expenses . . . directly relating to the representation of the class"—language embracing restitution but rejecting reward beyond the class representative's "pro rata share of any recovery."[26] The Conference Committee Report on the PSLRA flatly states that "[l]ead plaintiffs are not entitled to a bounty for their services."[27] For the Committee, "bounty payments or bonuses" prior to the PSLRA "encouraged the filing of abusive cases."[28]

In making awards under the strictures of the PSLRA, some courts look to the "burdens sustained" by the class representatives, both in terms of the "time and effort expended" and the "personal risks incurred."[29] Even this view is not uniformly held, however. One reported decision finds "nothing in the statute" to "allow class representatives to make fee applications based upon their time charges."[30] The important point is that even courts amenable to incentive awards seek to account for various costs and risks of monitoring and eschew notions of rewarding high-quality monitoring. This is not a knock on those courts. The inattention to monitoring quality makes for a faithful interpretation of the PSLRA language. But that language itself stands in odd

23. 15 U.S.C. § 78u-4(a)(4) (2000).
24. *Id.* § 78u-4(a)(2)(A)(vi).
25. *See infra* Part II.B.2.
26. 15 U.S.C. § 78u-4(a)(2)(A)(vii).
27. H.R. REP. NO. 104-369, at 33 (1995) (Conf. Rep.), *as reprinted in* 1995 U.S.C.C.A.N. 730, 732.
28. *Id.*
29. *In re* Xcel Energy, Inc., Sec., Derivative & "ERISA" Litig., 364 F. Supp. 2d 980, 1000 (D. Minn. 2005); *see also, e.g.*, Hicks v. Stanley, No. 01 Civ. 10071(RJH), 2005 WL 2757792, *10 (S.D.N.Y. Oct. 24, 2005); *In re* Heritage Bond Litig., No. 02-ML-1475 DT, 2005 WL 1594403, *13–*18 (C.D. Cal. June 10, 2005).
30. *In re* AMF Bowling Sec. Litig., 334 F. Supp. 2d 462, 470 (S.D.N.Y. 2004).

juxtaposition with the rest of the statute. Of all the settings for class action lawsuits, securities classes after the PSLRA represent the one context in which the law celebrates and seeks to invigorate high-quality monitoring by the class representative.

The PSLRA consciously moves away from the preexisting regime for securities class actions in which leadership of a given litigation on the plaintiffs' side stemmed from winning a race to the courthouse to file a class complaint.[31] Drawing on the proposal in an influential law review article by Elliott Weiss and John Beckerman,[32] the PSLRA establishes a rebuttable presumption that the court shall appoint as the "lead plaintiff" in a securities class action the class member or members with the "largest financial interest in the relief sought by the class."[33] To put the point in the parlance of Weiss and Beckerman, the PSLRA seeks to "let the money do the monitoring" by empowering large institutional investors to take the lead as class representatives specifically on the premise that they have both the financial incentive and the expertise to engage in high-quality monitoring.

Research on the real-world operation of the PSLRA, however, sheds a rather different light on institutional investors as monitors. Such investors can be reluctant to take on the burdens associated with service as lead plaintiff,[34] not just because of the costs associated with that role but also for other reasons. Burdens on institutional investors include the prospect of disruptive discovery into their internal business practices and trading activities, a prospect that is all the more daunting given the possibility that those investors might obtain a greater recovery simply by litigating on their own.[35] Furthermore, even apart from their willingness to serve as lead plaintiff, institutional investors often

31. *See* H.R. REP. NO. 104-369 (CONF. REP.), at 33; S. REP. NO. 104-98, at 10 (1995), *as reprinted in* 1995 U.S.C.C.A.N. 679, 689.

32. 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).

33. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I)(bb) (2000).

34. For an overview of the literature on participation by institutional investors as lead plaintiffs under the PSLRA, see Stephen J. Choi et al., *Do Institutions Matter? The Impact of the Lead Plaintiff Provision of the Private Securities Litigation Reform Act*, 83 WASH. U. L.Q. 869 (2005). These commentators observe that the participation of institutional investors is "increasing" relative to the "quite small" rates of participation in the years following the adoption of the PSLRA. *Id.* at 877. Even in more-recent years, institutional investors served as lead plaintiffs in only one-half or less of the securities class actions filed. *See* PRICEWATERHOUSECOOPERS LLP, 2004 SECURITIES LITIGATION STUDY 15 (2005), *available at* http://www.securitieslitigation.com/2004_study.pdf (finding that institutional investors constituted 51 percent of the lead plaintiffs in securities class actions filed in 2002 and 41 percent of those filed in 2003).

35. *See* James D. Cox & Randall S. Thomas, *Empirically Reassessing the Lead Plaintiff Provision: Is the Experiment Paying Off?*, 106 COLUM. L. REV. (forthcoming 2006) (manuscript at 20–24), *available at* http://ssrn.com/abstract=783948.

do not bother to file claims for available funds from securities class action settlements. As James Cox and Randall Thomas show in an important article, institutional investors let billions of settlement dollars "slip through their fingers."[36]

Whatever the reality of monitoring in other settings, one point about securities class actions emerges: The embrace of high-quality monitoring as a public policy goal and the experience with institutional investors in the post-PSLRA period, together, highlight the anomaly of awards confined to "reasonable costs and expenses." In this context, the law wants high-quality monitoring to occur but has encountered obstacles in achieving that goal. If anything, the logic behind installing institutional investors as lead plaintiffs supports a more—not less—wide-ranging inquiry for incentive awards in securities litigation.[37]

The PSLRA hinders the practical achievement of its own ideals for class representatives by confining incentive awards to restitution and rejecting complementary notions of reward. By limiting awards to "reasonable costs and expenses," the PSLRA seeks to fight the proverbial last war—to respond to perceived abuses in the pre-PSLRA era rather than to design a legal framework for awards under the changed arrangements for lead plaintiffs promoted by the PSLRA itself. When it comes to service as a PSLRA lead plaintiff, one substantial sticking point for many institutional investors appears to be precisely the prospect of merely gaining restitution for their efforts, without the possibility of reward beyond their pro rata share of any class-wide recovery. This result is ironic, to say the least, when the law consciously seeks to induce high-quality monitoring from persons who devote their professional lives to seeking big financial rewards, not just restitution for the costs and expenses of their efforts.

B. Gatekeeping, Rent Extraction, and Transparency

A second feature of what class representatives actually do in litigation finds no counterpart in the functions of class counsel. Class representatives may serve as gatekeepers in two ways. One aspect of this gatekeeping function concerns forum selection; another pertains to the desire of class counsel to

36. James D. Cox & Randall S. Thomas, *Letting Billions Slip through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements*, 58 STAN. L. REV. 411, 450 (2005).

37. For a similar policy recommendation based upon empirical research suggesting that certain types of institutional investors may serve a beneficial role as monitors of class-counsel fees, see Michael A. Perino, *Markets and Monitors: The Impact of Competition and Experience on Attorneys' Fees in Securities Class Actions* 31 (St. John's Legal Studies Research Paper No. 06-0034, 2006), *available at* http://ssrn.com/abstract=870577.

secure control of the litigation vis-à-vis competing firms within the plaintiffs' bar. This is not to suggest that the appropriate place to account for gatekeeping, if at all, is necessarily through incentive awards. Nevertheless, recognition of the gatekeeping role served by class representatives frames an important, antecedent question: whether the law should acknowledge and regulate gatekeeping in a manner that subjects it to external scrutiny instead of leaving it largely to other devices, as it does now.

1. Gatekeeping and Forum Selection

Prior to the Class Action Fairness Act of 2005 (CAFA),[38] the identity of the class representative had the potential to affect dramatically the choice of forum for class action lawsuits involving state-law claims. Interpreting the then-existing diversity jurisdiction statute in *Supreme Tribe of Ben-Hur v. Cauble*,[39] the U.S. Supreme Court held that only the citizenship of the class representative counted when determining whether complete diversity of citizenship existed between opposing sides in a class action.[40] The strategic implication of *Ben-Hur* was not lost upon plaintiffs' lawyers. Class counsel could prevent removal of a class action originally filed in state court by selecting a class representative whose citizenship would destroy diversity. Concern over this strategy formed part of the impetus for Congress to amend—through CAFA—the diversity jurisdiction statute to move from the usual standard of complete diversity to one of minimal diversity for class actions.[41] Today, diversity of citizenship exists in a class action as long as "any member of a class of plaintiffs is a citizen of a State different from any defendant."[42]

When the class representative effectively served as the gatekeeper to state court, the class representative did something beneficial for the class as a whole. That benefit might be far from trivial in particular instances. One of the broadly shared premises of CAFA was that some courts within state judicial systems were more inclined to certify nationwide classes involving state-law

38. Class Action Fairness Act of 2005 (CAFA), Pub. L. No. 109-2, 119 Stat. 4 (to be codified in scattered sections of 28 U.S.C.).

39. 255 U.S. 356 (1921).

40. *Id.* at 366.

41. *See* S. REP. NO. 109-14, at 10 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 3, 11.

42. Class Action Fairness Act of 2005 (CAFA), Pub. L. No. 109-2, § 4, 119 Stat. 4, 9 (amending 28 U.S.C. § 1332 (2000)). By the time of CAFA, the U.S. Supreme Court had already stated that Article III of the Constitution "poses no obstacle to the legislative extension of federal jurisdiction, founded on diversity, so long as any two adverse parties are not co-citizens." State Farm Fire & Casualty Co. v. Tashire, 386 U.S. 523, 531 (1967). For criticism of this view, see C. Douglas Floyd, *The Limits of Minimal Diversity*, 55 HASTINGS L.J. 613 (2004).

claims than federal courts.[43] Keeping a class action in state court thus, on this view, had the potential to make a decisive difference in class certification.

To recognize the gatekeeping function that class representatives serve in forum selection, nonetheless, is not to say that the incentive-award calculus is remiss in not accounting for that function. Unlike incurring costs or performing high-quality monitoring, the mere naming of the class representative in the complaint does not in itself call for that person to do anything different from absent class members as a functional matter. The class representative benefits the class not by doing but simply by being. And the incentive-fee calculus already accounts for any consequent burdens uniquely borne by the class representative—say, in discovery—as a result of being named in the complaint.

In addition, precisely because of its broad nature, a prospective nationwide class pre-CAFA likely would have encompassed any number of persons whose citizenship would suffice to defeat a removal motion in the manner sketched here. All that was needed was a class member with citizenship different from all the named defendants. As a result, there was little potential for any given person who fit that description to engage in what economists describe as rent extraction vis-à-vis class counsel—to demand a side payment simply for the use of her name on the class complaint. A second aspect of gatekeeping, however, is more likely to lead to rent extraction: litigation control.

2. Gatekeeping and Litigation Control

The class representative might serve as a gatekeeper not by enabling the class to sue in a desired forum but rather, by enabling class counsel to secure control of the litigation vis-à-vis competing law firms. Here, too, securities class actions provide an apt illustration. In the pre-PSLRA period, when control of a given litigation turned on winning the race to the courthouse,[44] the class representative advanced the interest of class counsel in gaining litigation control simply by being a shareholder with a broadly diversified portfolio. To put the point less formally: The world in which control turned upon getting a class complaint on file quickly was one in which the game for would-be class counsel depended upon their ongoing relationships with people likely to own shares in any firm that one might later suspect of securities fraud. The practice of awarding control to the winner of the race to the courthouse—a practice generated and enforced by the law itself—effectively empowered broadly diversified individual investors as gatekeepers for class counsel.

43. *See* S. REP. NO. 109-14, at 14, *as reprinted in* 2005 U.S.C.C.A.N. 3, 14.

44. *See supra* note 31.

Enactment of the PSLRA did not end gatekeeping, but it did alter the identity of the gatekeepers. Because control of a given litigation presumptively rests with shareholders who have the "largest financial interest in the relief sought by the class,"[45] the game for plaintiffs' lawyers now consists of establishing relationships with the sorts of large institutional investors likely to meet the PSLRA criterion. This empowerment of institutional investors as gatekeepers for class counsel in the competition for litigation control is an empowerment created by the law itself.

The key difference between gatekeeping for purposes of litigation control by class counsel and gatekeeping as forum selection is this: Gatekeeping as control creates circumstances ripe for rent extraction. It comes as little surprise that the sorts of individual investors likely to enable class counsel to get a class complaint on file quickly in the pre-PSLRA period were also sophisticated enough to realize the gatekeeping role that they served for class counsel. These, after all, were not financial neophytes. Nor should it come as a surprise that the large institutional investors preferred as lead plaintiffs by the PSLRA might come to a similar recognition. When the law itself puts into place a gatekeeper to stand between class counsel and the considerable financial returns that flow from control of class action litigation, there is a real possibility that the gatekeeper will catch on to what is happening. The gatekeeper soon may become a toll taker.

And so it is that the world of practice—at least, reportedly—caught up with the predictions from underlying economics. In April 2006, federal prosecutors announced a plea agreement whereby an individual investor (Howard Vogel) acknowledges receipt of side payments from a law firm (Milberg Weiss) for service as the class representative in securities class actions filed by the firm.[46] Milberg Weiss itself was indicted in May 2006.[47] Other media reports point to suspicions of so-called pay-to-play arrangements, whereby public officials associated with some of the larger institutional investment funds—say, pension funds for the employees of populous states—purportedly garner payments through campaign contributions and otherwise from plaintiffs' lawyers involved in securities litigation.[48] In the PSLRA era, the

45. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I)(bb) (2000).

46. *See* Exhibit A, Statement of Facts in Support of Plea Agreement and Information for Defendant Howard J. Vogel, United States v. Vogel, No. CR-06-00320 (C.D. Cal. Apr. 27, 2006), *available at* http://lawprofessors.typepad.com/whitecollarcrime_blog/files/vogel_plea_documents.pdf.

47. *See supra* note 8.

48. *See, e.g.*, Neil Weinberg & Daniel Fisher, *The Class Action Industrial Complex*, FORBES, Sept. 20, 2004, at 150, 151–52. For scholarly commentary on the pay-to-play phenomenon, see Cox & Thomas, *supra* note 35 (manuscript at 31–36); Samantha M. Cohen, Note, *"Paying-to-Play" is the New Rule of the Game: A Practical Implication of the Private Securities Litigation Reform Act of 1995*, 1999 U. ILL. L. REV. 1331, 1341–43.

fund officials then are in a position to select the donor lawyers as counsel for securities class actions in which the fund serves as lead plaintiff.

Time will tell if these allegations will be proven. The point is that these allegations carry an air of unreality. Like Captain Louis Renault in the classic film *Casablanca*, we are "shocked, shocked," to find that there may be rent extraction going on here![49]

Seen in the foregoing light, incentive awards by courts represent the most above-board mechanism to regulate the financial dimensions of service as a class representative. Here, as Justice Brandeis reminded us elsewhere, sunlight is "the best of disinfectants."[50] Not surprisingly, the Eisenberg and Miller data show that this above-board mechanism is operating more or less as we would like. The difficult challenge for the law—and not necessarily just the law of class actions—lies in determining what to do about the potential for rent extraction that does not show up in motions for incentive awards from a court.

The PSLRA takes one possible stance by calling for class representatives to foreswear the receipt of side payments for their services.[51] This stance sounds in longstanding ethical strictures against barretry and champerty.[52] The issue here, however, is more than one of payment to induce or to maintain litigation. Current law calls for a dissonant mix of behavior when the law itself installs particular persons as gatekeepers and, at the same time, admonishes them and the lawyers whose business interests they serve not to act upon the reality of that gatekeeping function. Understood from this perspective, prosecutions

49. I am not the first commentator to appropriate these words to question the surprise expressed by some observers when the underlying realities of complex civil litigation suddenly come to light. *See* Samuel Issacharoff, *"Shocked": Mass Torts and Aggregate Asbestos Litigation after* Amchem *and* Ortiz, 80 TEX. L. REV. 1925, 1927–30 (2002) (criticizing U.S. Supreme Court class settlement decisions for casting aggregation in asbestos litigation as a deviation from the norm of individual lawsuits, rather than as an above-board refinement of preexisting practices involving the settlement of cases on an aggregate basis).

50. LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY 92 (Frederick A. Stokes Co. 1914) (1913).

51. *See* 15 U.S.C. § 78u-4(a)(2)(A)(iv) (2000).

52. William Blackstone describes "barretry" as "the offence of frequently exciting and stirring up suits and quarrels between his majesty's subjects, either at law or otherwise." WILLIAM BLACKSTONE, 4 COMMENTARIES *133. The same source describes "champerty" as a "species of maintenance," which in turn consists of "an officious intermeddling in a suit that no way belongs to one, by maintaining or assisting either party with money or otherwise, to prosecute or defend it." *Id.* at *134. "Champerty" specifically involves the champertor making a "bargain" with a party "to divide the land or other matter sued for between them, if they prevail at law; whereupon the champertor is to carry on the party's suit at his own expense." *Id.* at *134–*35.

Similar concerns underlie the legal framework that governs the advancement of costs and expenses by class counsel in securities litigation. *See* Geoffrey P. Miller, *Payment of Expenses in Securities Class Actions: Ethical Dilemmas, Class Counsel, and Congressional Intent*, 22 REV. LITIG. 557, 560–63 (2003).

like the one brought against Milberg Weiss may have a beneficial effect. They can bring a recognition that the time is at hand for the law to move beyond Captain Renault's feigned shock and toward a more delicate job: that of grappling overtly with the on-the-ground financial implications of the litigation machine that the law itself has created.