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SECURITIES LITIGATION 101:

THE ROLE OF THE LEAD PLAINTIFF

In previous articles, we wrote about factors a fund may consider when deciding whether to file a motion for lead plaintiff in a securities class action and the criteria a judge uses to select among competing movants. In this installment, we discuss what is required and expected of the court-appointed lead plaintiff during the litigation, with institutional investors in mind.

In general, the lead plaintiff selects and retains lead counsel, negotiates attorneys' fees, oversees the litigation, participates in settlement negotiations, and makes major decisions on advice of counsel—such as whether to participate in mediation, accept a settlement offer, proceed with trial, or appeal. The lead plaintiff must act in the best interests of the class members throughout the litigation.

Federal securities litigation is largely brought under two laws enacted after the Wall Street Crash of 1929: the Securities Act of 1933, which covers newly issued securities, and the Securities Exchange Act of 1934, which covers existing securities traded on exchanges. Six decades later, the Private Securities Litigation Reform Act of 1995 (PSLRA) added lead plaintiff provisions to both laws.

The PSLRA directs judges to “appoint as lead plaintiff the member or members of the purported plaintiff class who the court determines to be most capable of adequately representing the interests of class members” and who “in the determination of the court, has the largest

NOTICE OF FIRST COMPLAINT

- Under the PSLRA, anyone filing a federal securities class action must issue a public notice about the lawsuit, opening a 60-day window for any investor or group interested in overseeing the litigation to file a lead plaintiff motion with the presiding judge

LEAD PLAINTIFF DEADLINE

- Investors interested in controlling the litigation file lead plaintiff motions
- Investors who don't step forward at this time retain their rights to participate in or opt out of any eventual monetary recovery

LEAD PLAINTIFF SELECTION

- The judge selects one or more lead plaintiffs based largely on the size of their potential loss
- The judge approves lead plaintiff's selection of counsel

THE LEAD PLAINTIFF SELECTS AND RETAINS LEAD COUNSEL, NEGOTIATES ATTORNEYS' FEES, OVERSEES THE LITIGATION, PARTICIPATES IN SETTLEMENT NEGOTIATIONS, AND MAKES MAJOR DECISIONS ON ADVICE OF COUNSEL.

financial interest in the relief sought by the class," unless someone can show they are not "typical" and "adequate" under Rule 23 of the Federal Rules of Civil Procedure. A "typical" plaintiff is one whose legal claim arises from the same events and is based on the same legal theory as those of the class; an "adequate" one does not have interests that are opposed to the class and has sufficient resources and experience to represent the class and oversee counsel.

Selecting Counsel and Negotiating Fees

Under the law, the lead plaintiff selects and retains counsel to represent the class, subject to court approval. Because the courts typically evaluate a proposed lead counsel's experience in shareholder class actions and its ability to litigate the case at hand, the lead plaintiff is advised to choose a firm that has a history of successful representations and is free of conflicts of interest.

Negotiating a reasonable fee with a proposed counsel is an important duty for lead plaintiff, since attorneys' fees and expenses are normally subtracted from any monetary recovery before it is distributed to the class members. An unreasonably high fee, therefore, reduces the portion of the settlement that goes to shareholders. At the same time, lead counsel typically litigates securities class action on contingency, only recouping the cost of attorney time and expenses if the case succeeds, so its fee agreements price in that risk. Because shareholder lawsuits are complex and often take years to resolve, lead counsel may spend hundreds of thousands and even millions of dollars on out-of-pocket expenses such as outside damage experts, massive document reviews, and mediators; that doesn't count the salaries lead counsel must pay, win or lose, to the lawyers, paralegals and staff who work on the case.



CASE IS ARGUED

- Dispositive Motions
- Discovery
- Class Certification
- Summary Judgment



SETTLEMENT IS ANNOUNCED

- After the judge grants preliminary approval, a claims administrator identifies and notifies class members about the settlement
- Class members can opt out and file individual actions
- Class members can object to settlement or attorneys' fees



SETTLEMENT RECEIVES FINAL APPROVAL

- The judge approves the settlement and "reasonable" attorneys' fees
- Proofs of claim must be filed by a deadline set by the judge
- The claims administrator reviews and approves claims
- The settlement fund is distributed to approved claimants on a pro-rata basis according to the plan of allocation

Happily, there are plenty of blueprints available for would-be lead plaintiffs looking to structure a retention agreement. Organizations such as the National Association of Public Pension Attorneys and the Council of Institutional Investors have published primers on securities litigation that offer sample agreements, including fee percentages.

In addition, like the selection of lead counsel itself, attorneys' fees and expenses are subject to court approval in federal securities litigation. The PSLRA requires attorney fees and expenses to be a "reasonable percentage" of the damages paid to the class, leaving it up to the judge to determine what that means. Federal courts conduct a review of attorney time sheets and expense reports to measure the proposed fee against the work performed. Federal courts also consider the fee percentages to other settlements of a comparable size or in the corresponding circuit to maintain consistency in fee awards.

Overseeing the Litigation

The PSLRA's requirement that the court appoint as the lead plaintiff the party or parties most capable of adequately representing the class, combined with subsequent decades of jurisprudence, establish clear expectations that the lead plaintiff oversee the litigation and monitor counsel.

While the law and the courts do not require intimate knowledge with the day-to-day details of the litigation, the lead plaintiff should understand the basics, including the important allegations in the complaint and the case's procedural status. It should be familiar with its responsibilities and understand its duties, especially the need to respond to defendants' discovery requests by providing relevant documents and deposition testimony related to its investment in the company. The lead plaintiff must be willing and able to perform these duties since defendants may challenge its adequacy of oversight during depositions or at the class certification stage. Within these broad parameters, however, institutional investors have considerable leeway to seek a level of involvement that is appropriate for their staffing resources while maintaining a hand in major strategic decisions that affect the outcome of the case.

The lead plaintiff should require the lead counsel to provide regular updates about the litigation, give them an opportunity to review key pleadings, and advise them of upcoming deadlines and decision points. The lead counsel should provide clear analysis, guidance, and recommendations on any decisions required of the lead plaintiff. During the discovery phase, the lead plaintiff should expect the lead counsel to help produce required documents and, after proper preparation, represent the lead plaintiff in depositions.

WHILE THE LAW DOES NOT REQUIRE INTIMATE KNOWLEDGE WITH LITIGATION DETAILS, THE LEAD PLAINTIFF SHOULD UNDERSTAND THE BASICS, INCLUDING THE IMPORTANT ALLEGATIONS IN THE COMPLAINT.

Participating in Settlement Talks

One of the most important responsibilities of the lead plaintiff is to participate in any settlement discussions or mediations. An active lead plaintiff can greatly impact the size of the settlement, the makeup of the settlement considerations (e.g., cash only or cash and stock) and the decision to include corporate governance elements in the settlement agreement. In addition, the lead plaintiff is required to approve any settlement prior to court review. If no settlement is reached, the lead plaintiff will need to attend the trial. If the case is lost at trial, lead plaintiff must evaluate with lead counsel and decide whether to appeal.

Conclusion

Understanding the expectations and responsibilities of the lead plaintiff before facing a decision to file a lead plaintiff motion creates clear expectations about the time and staff resources an institutional investor needs to commit to the process. It also highlights the importance of establishing relationships with experienced plaintiffs' counsel. Perhaps most importantly, it illustrates why sophisticated institutional investors are better able to adequately represent class members than small individual investors, especially in large-scale litigation. ■

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UNDERSTANDING THE EXPECTATIONS AND RESPONSIBILITIES OF THE LEAD PLAINTIFF CREATES CLEAR EXPECTATIONS ABOUT THE TIME AND STAFF RESOURCES AN INSTITUTIONAL INVESTOR NEEDS TO COMMIT TO THE PROCESS.
