

Written Statement of R. Franklin Balotti
Testimony Before the Task Force on Selection of Class Counsel

Given the number of corporations incorporated in Delaware, Delaware courts have over the years seen a large number of shareholder class actions as well as shareholder derivative actions. Despite the large volume of representative actions, Delaware courts rarely have had to deal with selection of lead counsel issues. Historically, the traditional method in Delaware for resolving lead counsel issues in multiple class actions has been for the various counsel to resolve such issues by private negotiation and agreement. These agreements have included the designation of sole lead counsel, several co-lead counsel and/or the formation of an executive committee of various counsel to direct the strategy of class counsel. When a consensus on organizational structure was not readily achieved, plaintiffs' counsel typically held organizational meetings that sought to provide an opportunity for open, frank and full exchange of views and for any particular plaintiffs' counsel to present his or her position to the other plaintiffs' counsel. At the end of the meeting, a vote was typically taken to determine the organization structure. Obviously, there have been many instances when aspirants to the leadership position have been disappointed and hard feelings may have been created. Despite this, Delaware courts have rarely had to involve themselves in the selection of lead counsel process. Moreover, on the few occasions when Delaware courts have had to confront organizational disputes among plaintiffs' counsel, they have repeatedly admonished counsel to organize themselves. E.g., Lewis v. Great W. Fin. Corp., C.A. No. 15549 (Del. Ch. Mar. 21, 1997).

Recently, Delaware courts have confronted selection of class counsel issues and have begun to develop criteria for selecting class counsel.

The Digex Decision

For all practical purposes, Delaware law on the issue of selecting class counsel begins with the recent decision by the Delaware Court of Chancery in TCW Technology Limited Partnership v. Intermedia Communications Inc., et al., C.A. No. 18336 (Del. Ch. Oct. 17, 2000), which was later consolidated under the caption In re Digex Inc. Shareholders Litigation (“Digex”). In Digex, there was a dispute between members of what can be referred to as the traditional shareholder plaintiffs’ bar and counsel for an institutional investor which owned a very large number of shares and, hence, had a very large interest in the outcome of the litigation. In addressing this dispute, the Court first stated that contrary to “myths, fables, or mere urban legends,” there was no basis under Delaware law for a plaintiffs’ counsel to gain any advantage in the selection process by being the first to file a complaint. Id. at 8. The Court’s conclusion was consistent with prior statements by the Delaware Supreme Court. For example, in Rales v. Blasband, 634 A.2d 927 (Del. 1993), the Delaware Supreme Court noted the failure sometimes to investigate completely the allegations in a derivative complaint “may arise in some cases out of an unseemly race to the court house, chiefly generated by the ‘first to file’ custom seemingly permitting the winner of the race to be named lead counsel. The result has been a plethora of superficial complaints that could not be sustained.” Id. at 934 n.10. The Supreme Court stated that nothing requires the Court of Chancery, or any other court having appropriate jurisdiction, to countenance this process by penalizing diligent counsel who file quality complaints after gathering pertinent information. Id.; see Grimes v. Donald, 673 A.2d 1207, 1217 n.11 (Del. 1996) (quoting Rales for the same proposition). In Digex, the Court of Chancery expressly declined to consider the order in which the various complaints were filed as a relevant factor in selecting class counsel.

The Digex Court noted that there was no Delaware "rule, statute or decisional authority" with respect to how class counsel should be selected. Id. at 8. The Court then articulated the following three non-exclusive factors that should be considered: (i) the quality of the pleading; (ii) the financial interest of the plaintiff in the outcome of the litigation; and (iii) the vigor in prosecuting the litigation. Id. at 9-10. Using these factors, the Digex Court selected the institutional plaintiff as the lead plaintiff after concluding that it was preferable with respect to each of three factors. The Court then selected as lead counsel for the class the counsel that had been retained by the lead plaintiff. In other words, having selected the lead plaintiff, the Court then respected the lead plaintiff's selection of counsel as counsel for the class.

Subsequent Cases

Approximately one month after the Digex decision, the Court of Chancery once again was confronted with a dispute with respect to the selection of lead counsel in In re IBP, Inc. Shareholders Litigation, C.A. No. 18373 (Del. Ch. Nov. 21, 2000) (Transcript). In IBP, fifteen class action complaints were filed challenging the same transaction. The various counsel who had filed fourteen of these class actions had agreed upon an organizational structure. The one remaining plaintiffs' counsel, which had not seriously negotiated with the other plaintiffs' counsel because in its opinion it would have been futile to do so, applied to the Court to be selected as lead counsel. The Court, despite having serious concerns with respect to the manner in which the organizational structure was implemented,¹ determined that the negotiated organizational structure should not be disturbed. In

¹The Court seemed particularly troubled by the fact that the initial organizational structure was apparently based on the order in which the complaints were filed by the respective plaintiffs' counsel. The initial organizational structure was voluntarily modified to designate the plaintiffs' counsel who represented the plaintiff with the largest financial interest in the outcome of the litigation as chairman of the executive committee.

addition to applying the three Digex factors in reaching its conclusion, the Court added a fourth factor that should be considered in selecting lead counsel. Noting the importance of encouraging to plaintiffs' counsel to organize themselves without involving the Court, the Court held that it would require "that there be a good faith participation in some group process by everybody who wishes to take a leadership role." Id., tr. at 76. The addition of this fourth factor is not surprising given the distaste often expressed by Delaware courts in having to deal with issues relating to the selection of lead counsel.

More recently, the Court of Chancery was faced with another dispute among plaintiffs' counsel in In re Siliconix Inc. Shareholders Litigation, C.A. No. 18700 (Del. Ch. May 16, 2001) (Transcript). Although the competing plaintiffs and their counsel eventually reached an agreement, thereby obviating the need for the Court to resolve the merits of this dispute, the Court's decisions with respect to certain preliminary issues do provide some guidance. For example, the Court once again expressed its extreme distaste with having to become involved in disputes over class counsel issues. Second, the Court demonstrated a willingness to consider various options for selecting lead counsel including the possibility of auctions.² Lastly, the Court noted that the Digex factors are not exclusive and that, "[b]ased on the context of a given action, other factors may become significant and the weight accorded to the several factors may vary." In re Siliconix Incorporated Shareholders

²Although the merits of an auction procedure were not fully presented to or addressed by the Court, all competing plaintiffs' counsel agreed that an auction procedure would be particularly inappropriate given the transactional nature of the litigation that is characteristic of most Delaware stockholder class actions. Specifically, transactional litigation (i) deals with events in flux, (ii) is often influenced significantly by non-litigation factors such as the emergence of another bidder or the formation of a special committee, and (iii) is often the subject of expedited proceedings. These factors make it difficult for a court to conduct a formal auction procedure and for the various plaintiffs' counsel to make an intelligent bid.

Litigation, C.A. No. 18700, slip op. at 4 (Del. Ch. May 23, 2001). Although the Court did not have an opportunity to identify what these additional factors might be, the Court's ruling that certain discovery had to be produced in connection with the lead counsel dispute indicates that such additional factors could possibly include: (i) the plaintiff's experience in class action litigation; (ii) the experience of counsel in representing plaintiffs in class actions; and (iii) the experience of counsel in representing defendants in class actions. While permitting discovery on these topics, the Court was careful to state that it was not determining that these additional factors were pertinent but rather was merely providing the competing plaintiffs' counsel with the opportunity to develop the factual context for arguments that apparently would be advanced. Id. at 6 n.5.

Continuing Development of Delaware Law

The recent instances in which Delaware courts have had to deal with selection of class counsel likely has been caused by many factors and may be caused in small part by the emergence of institutional or other large investors in the shareholder litigation process. Prior to the recent emergence of large investors, disputes with respect to lead counsel were rarely presented to the Courts. Rather, any and all disputes were generally determined among plaintiffs' counsel themselves. Since there is old Delaware precedent indicating that the order in which various complaints were filed should have some basis in selecting lead counsel, the fact is that plaintiffs' counsel traditionally have used the time of filing a complaint as a factor in their private negotiations with respect to the organizational structure of plaintiffs' counsel in class action litigation in Delaware. Irrespective of the underlying merits of using this as a significant factor, it did provide significant clarity upon which plaintiffs' counsel privately could negotiate and resolve class counsel

issues.³

The emergence of large investors in shareholder litigation introduced a new variable that has been difficult to incorporate into the equation that typically had been utilized by plaintiffs' counsel in organizing themselves. Drawing by analogy to the federal model, the institutional investors sought to assume exclusive leadership positions in the class litigation. This demand for exclusive control of the class litigation was often resisted by the traditional plaintiffs' bar. The lack of any Delaware precedent addressing the significance, if any, of the amount of financial interest at stake for each of the respective plaintiffs made it difficult for private resolutions of these disputes to be achieved on a consistent basis.⁴ The Digex decision began the process of filling in the vacuum that had been created in Delaware decisional authority by the emergence of large, institutional shareholder plaintiffs.

The Digex decision is significant because it sets forth, for the first time under Delaware law, a set of objective, non-exclusive factors that should be considered in selecting class counsel. Subsequent decisions have provided additional guidance with respect to other relevant factors that

³In view of the recent Delaware decisions, however, the significance of this factor has been substantially reduced, if not eliminated, even in private negotiations among plaintiffs' counsel. As the Court of Chancery stated in IBP, "the plaintiffs' bar is going to have to rethink the emphasis it places on speed. I think it's going to have to figure out how it addresses the fact that sometimes the lawyers and the clients in the best position to represent the class well may act more deliberately, and the mere fact that people have been designated as lead counsel because they got themselves together early may also not be a particularly good reason to exclude somebody who [files] later" Id., tr. at 79.

⁴In an earlier decision, the Court of Chancery dealt with the competing interests of plaintiffs' counsel by (i) consolidating all the actions filed by the traditional plaintiffs' bar (ii) permitting the action filed by the institutional shareholder to proceed separately and (iii) requiring that the consolidated action and the institutional investor action be coordinated to eliminate duplication and inefficiency. See In re SFX Entertainment, Inc. Shareholders Litig., Consol. C.A. No. 17818 (Del. Ch. Apr. 25, 2000) (ORDER).

should be considered. The factors articulated in Digex and in subsequent decisions set up a framework that likely will be conducive to enabling plaintiffs' counsel to once again achieve a private resolution of lead counsel disputes without Court involvement. That being said, however, given that the Digex decision was rendered less than eight months ago and the necessarily fact intensive nature of inquiries regarding the selection of lead counsel, it is likely that this area of the law will undergo further development.