SHUTTERSTOCK

JUDGES WHO SETTLE

THIS ARTICLE develops a construct of judges as gatekeepers in corporate and securities litigation, focusing on the last period—or settlement stage—of the cases. Many accounts of corporate scandals have focused on gatekeepers and the roles they played or, in some cases, abdicated.

Corporate gatekeepers, like investment bankers, accountants, and lawyers, function as enablers and monitors. They facilitate transactions and enable corporate actors to access the financial and securities markets. Without them, the transactions would not happen. In class actions and derivative litigation, judges are the monitors and enablers. They are required to oversee the litigation arising from bad transactions and corporate scandals. Unlike other types of private law litigation, where the parties settle and have the case dismissed, judges must approve settlements of class actions and derivative litigation. They are actually charged with fiduciary responsibilities and control the exit stage, or settlement, of the litigation. As a result, the judges' job is to be a gatekeeper.

THE JUDGES ARE NOT, however, doing their jobs. "Doing their jobs" requires actual scrutiny of the role of defense counsel and insurers, both of whom amplify agency costs. It also requires scrutiny of the settlement collusion between defendants and plaintiffs. Yet, traditionally both academics and the courts have failed to analyze those issues in the context of the costs of aggregate and derivative litigation. This article provides a real cut at those issues. It then develops and explores principles for gatekeeping judges, which, if implemented, will decrease the agency costs of this type of litigation and ensure that the judges are actually functioning as the fiduciaries they are required to be.

Securities and corporate laws and regulations rely on gatekeepers to provide merits reviews of corporate disclosures and transactions. Accountants, lawyers, and investment bankers control access to financing and the securities markets. They certify documents and financials and ensure that corporate actors adhere to their fiduciary, disclosure, and other duties. Independent directors also combat agency costs, monitor their fellow corporate actors, and, in some cases, hire the other gatekeepers and ensure they do their jobs well. Thus, gatekeepers control market access directly—certified accountant reports are required for certain public filings—and indirectly through advice to clients or their companies.

Many accounts of corporate scandals have focused on gatekeepers and the roles they played or, in some cases, abdicated. Corporate gatekeepers function as monitors and enablers. Judges oversee the private enforcement that arises from financial gatekeeping failures and scandals. They control access to settlements and therefore are also monitors and enablers. Although no one has previously identified them as gatekeepers, judges are assigned that role for certain types of litigation. They are not, however, doing the job well.

By Hillary A. Sale


STEPHEN KENNEDY

> **"This article develops a construct of judges as gatekeepers and a set of principles to guide them in policing aggregate and derivative litigation."**

THIS ARTICLE DEVELOPS a construct of judges as gatekeepers and a set of principles to guide them in policing aggregate and derivative litigation. Part I provides an introduction to this type of litigation and the role of judges as agency cost monitors. Part II contrasts the "solutions" of this type of litigation with its costs, and explores an area not developed in the legal literature—the agency issues on the defendants' side of the cases. The development of the role of defense counsel and their collusion with plaintiffs' counsel illuminates the need for judges to perform their gatekeeping role.

Part III explores the role of judges in aggregate litigation, including their fiduciary responsibilities as monitors of the agency costs inherent in these cases. The judicial role maps to the role of gatekeepers more generally. The focus of this article is on gatekeeping for the "exit mechanism," or settlement stage of these cases. To develop this gatekeeping role, this article examines a set of cases in which judges engaged in some gatekeeping, as well as incentives for gatekeeping and for shirking.

THE PRINCIPLES DEVELOPED and explored in Part IV reveal that judges both have the power and incentives to control the agency costs by refusing to grant settlement approval in cases that do not meet the standards of Rule 23. Moreover, the decision to grant, or refuse, approval is contingent on fulfilling their gatekeeping/fiduciary responsibilities. Adherence to the principles developed in this article will help to ensure that judges are in fact functioning as the fiduciaries the law requires them to be.

Active engagement and careful review are the basic hallmarks of judicial settlement gatekeeping. Without judicial approval, litigants cannot exit. There is no remedy. There are no fees. There is no preclusion. The power to grant all of these things is significant. The power to refuse it is as well. Fulfilling this role will create not only a better settlement process, but also will result in better substance and outcomes.

Of course, judicial gatekeeping is not a complete solution to the agency problems in aggregate litigation. No single solution is. It is important to recall, however, that aggregate litigation itself provides a solution to gaps in the administrative state and the resulting agency issues. Gatekeeping judges can help to decrease collusion on all sides of the cases. The judicial gatekeeping construct in this article provides a partial solution to the agency cost issues. It establishes the role and duties of the courts and reveals how they can protect the authority of the system, the nature of the settlements, and the deterrence effects of the cases. In short, gatekeeping judges have an important role to play, and this article constructs and explicates that role. Now it is up to the judges.

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